



EnergyAustralia

LIGHT THE WAY

22 September 2022

Australian Energy Market Commission
Lodged electronically

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National Gas Amendment (DWGM interim LNG storage measures) Rule 2022

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. EnergyAustralia owns, contracts, and operates a diversified energy generation portfolio that includes coal, gas, battery storage, demand response, solar, and wind assets. Combined, these assets comprise 4,500MW of generation capacity.

EnergyAustralia welcomes the opportunity to respond to the AEMC's consultation paper on the DWGM interim LNG storage measures (the paper).

We recognise the challenges the Victorian gas markets and other east coast markets are experiencing. Victorian gas production is in decline, demand for gas to firm electricity supply is increasing, international demand for gas has increased due to scarcity arising from the conflict between Russia and Ukraine, and the Port Kembla Energy Terminal to import gas to the east coast market is now forecast by AEMO to not be available until 2024. Seasonal adequacy risks are therefore forecast to emerge as soon as 2023.¹ In this context, it is important to note that this rule proposal does little to address seasonal adequacy risks, it can only help to address peak day reliability issues that may emerge in reasonably exceptional circumstances. Other policy measures are needed to resolve the broader seasonal adequacy problem.

EnergyAustralia questions whether there has been sufficient analysis to establish that there is a problem around the levels of Dandenong LNG storage utilisation. To the extent that there is a problem, we also question whether there is an adequate understanding of the root cause of that problem, and therefore have some doubt over whether the rule proposal will effectively solve the cause of the problem.

That said, we also recognise the challenges that the Minister and AEMO face. AEMO forecasts that given various assumptions, winter 2023 peak day supply capacity is just above the forecast 1-in-20-year peak day system demand.² At first glance, Dandenong LNG has uncontracted capacity and would seem to provide a possible solution. In this context, while we would prefer a deeper analysis

¹ AEMO, Victorian Gas Planning Update, March 2022, p.3.

² AEMO, Victorian Gas Planning Update, March 2022, p.3.

to support the adoption of the rule proposal, we acknowledge that this might be traded off in favour of providing a timely response.

Our submission below discusses the problem statement and potential unintended consequences, which supports that the rule change should only be an interim measure with short duration, until work on longer term measures can be completed. We also discuss key design details and comment on the drafting of the proposed rule (in the attachment).

The problem statement

It is important to understand the fundamental market or regulatory failure that the rule proposal aims to address. The Minister has identified the declining contracted storage levels in the Dandenong LNG facility as a problem because it may impact reliability, system security and safety of supply in the DWGM.

Within this statement, a material distinction is whether the rule proposal aims to respond to a system security or safety issue versus a reliability issue. We support AEMO using Dandenong LNG for system security and safety purposes. However, AEMO has clear existing powers to trade in natural gas today, and so the rule proposal seems unnecessary on this basis alone (although we recognise that Dandenong might not have the gas available to trade).

An alternative rule would be to make a rule change with a clear objective that it is to be used for system security/safety purposes only and impose a limit on the amount of LNG/gas that can be stored/used by AEMO, capped at AEMO's forecast needs for system security/safety. However many of the aspects of the rule proposal (e.g. AEMO's bidding to the DWGM) are arguably only relevant for reliability purposes.

As the rule proposal has many elements that are only relevant for reliability, we infer that the main purpose of the rule proposal is to improve reliability and therefore we focus on this issue for the rest of this submission.

It is not clear that there is a reliability problem to solve. Market participants already have strong incentives to provide reliability for their customer load. The reduction in the use of Dandenong LNG could therefore merely reflect that market participants have switched to lower cost ways to maintain reliability or hedge price risk e.g. switching to other storage facilities. This is a compelling view given that APA's prices have increased 44-46% (as reported by the ACCC)³, and warrants further investigation. Further, where market participants have not used Dandenong LNG to hedge, this might be because the facility is only useful for certain purposes. E.g. it does not provide good supply for gas generators.

With regard to APA's recent price increases, we note ACCC reports that APA might be exercising market power. The ACCC noted that "APA's ability to change its contracting model and reject shippers' requests to negotiate more favourable terms underscores the significant market power that they have in respect of the Dandenong LNG facility".⁴ If the price increases reflect market power, then the proposed rule will not specifically address the market power issue and could exacerbate it resulting in further inefficiencies, and result in unintended consequences, as discussed more below.

Conversely, it is also possible that APA is pricing Dandenong LNG efficiently and market participants are rationally deciding not to contract the efficient levels of storage, in which case the proposed rule

³ ACCC, Gas inquiry interim report, July 2022, p. 89.

⁴ ACCC, Gas inquiry interim report, July 2022, p. 91.

is again misdirected and alternative solutions to increase reliability to efficient levels should be considered.

In view of the lack of clarity around whether there is a problem, and what that problem is or its root cause, we strongly recommend that the rule proposal only be used as an interim measure until the problem can be fully assessed to minimise any unintended consequences.

Unintended consequences

If the cause of the problem is APA exercising market power, then the proposed solution to compel AEMO to utilise any unutilised capacity has significant drawbacks.

Even if APA has market power, its current pricing power is somewhat constrained by market participants' response to prices. At some point, the effect of the increase in price on APA's profits is more than offset by a reduction in quantity.

The proposed rule is to make demand for APA's storage service completely inelastic to price as AEMO will be obliged to purchase any unutilised capacity. APA could respond by increasing its prices to market participants further. Any reduction in demand by market participants in response to these high prices will be automatically offset by an equal and opposite increase in demand by AEMO. The rule proposal requires that APA negotiate in good faith with AEMO and on broadly the same terms as the 2022 agreement between APA and AEMO, but this does not stop APA from increasing its prices for other market participants which lack a good faith protection. Nor is it clear that the change in law provisions within the 2022 agreement between APA and AEMO will be sufficient to stop APA exercising its market power in its dealings with AEMO, given that APA may already have had market power at the time that contract was entered into, and there are "Regulatory Change" provisions in the contract that may allow APA to renegotiate terms in the agreement affected by this rule change.

In turn this can be expected to increase prices for consumers directly, given that APA is now selling its services at higher prices and there are additional costs in AEMO contracting storage, which must be borne by consumers. It will also increase prices for consumers indirectly, as AEMO will be playing an increasingly prominent role as a "quasi market participant", with further possible unintended consequences.

AEMO's role as a "quasi market participant" could also result in other inefficiencies. AEMO may have non-financial incentives which means that it does not make an efficient trade-off between the cost of reliability and the cost of less reliability (customer curtailment), and consumers bear these costs of inefficient decisions.

Moreover, AEMO's decisions – and the expectation of their decisions – may also distort the behaviour of market participants throughout the supply chain. Indeed, for example in the 2010 rule change which removed similar powers from AEMO, AEMO argued that "the LNG storage provisions in the NGR were limiting the ability of the LNG storage provider to offer efficient and innovative LNG storage services".⁵

The rule proposal could also have an effect on how storage is contracted at Dandenong LNG. The AEMC should aim to provide some indication of the key details of the arrangement as soon as possible. In particular, the proposed rule does not make clear the basis AEMO would trade out of its positions if a market participant wanted its gas/storage and at what prices. If, for example, AEMO would relinquish storage back to APA, APA might then be able to trade this to market participants at elevated rates.

⁵ AEMO, rule change request, 8 June 2010.

While the AEMC can minimise any distortions by requiring AEMO to trade directly with market participants and requiring pricing at prevailing market rates, it is likely and reasonable for market participants to wait to understand what the rule change arrangements are so that they know the context they are contracting in. Waiting for the details around the rule proposal could in itself disadvantage market participants or exacerbate problems with filling the LNG facility, where they will have reduced time to negotiate new terms. *[Confidential information has been omitted for the purposes of section 24 of the Australian Energy Market Commission Establishment Act 2004 (SA) and sections 71 and 319 of the National Gas Law.]*

Alternative solutions

If APA's market power is the problem, then the suitable alternative solution is to economically regulate the services provided by the LNG facility. This in turn could be expected to reduce prices for those services, and hence efficiently increase market participants' use of the facility without the need for AEMO's intervention. We note that Energy Ministers have recently announced that a regulatory impact statement will be prepared to consider whether a third-party access regime for storage facilities should be implemented, as recommended by the ACCC. We strongly recommend that this should be expedited.

If the problem is not one of market power, and the storage service is efficiently priced, and yet market participants are deciding not to contract for storage, but the level of reliability is inefficient, then a more appropriate solution may be to increase the market price cap or other market settings. This would increase the incentives for market participants to take actions to improve reliability (including, but not limited to, increasing utilisation of the Dandenong LNG facility), avoiding possible unintended consequences from AEMO acting as a "quasi market participant".

Lastly, as noted above, our submission has focussed on the rule proposal in the context of aiming to deliver greater reliability. We would be less concerned with the rule proposal if it were limited to system security/safety objectives.

Key design considerations

Setting aside our concerns on the rule proposal above, we have also assessed the design of the proposed rule as specified in the proposed drafting of the rule and AEMC's paper. Overall, we agree with:

- purchasing storage capacity as late as reasonably possible to provide as much time as possible for a market response. 15 March each year is appropriate, *however details of AEMO's arrangements should be made clear as soon as possible, so that market participants understand the context that they are contracting in.*
- AEMO only delivering gas to the market at the market price cap (or even slightly above) (analogous to the RERT). This should avoid AEMO's participation in the market affecting prices or incentives of retailers to hedge to manage price risk via forward contracts.
- AEMO being able to trade out of its gas and storage capacity positions if market participants want the storage capacity. *There should be no time restrictions around this ability to allow the broadest market response.*
- requirements for AEMO to be transparent and accountable in its decision making.

We agree that the rule should be an interim measure with short duration. We suggest the AEMC consider whether the end date should be specified as 2025, or whether instead it might be specified as 2025 at the latest, and ended earlier if another more enduring solution is implemented before then (such as economically regulating the LNG facility).

As above, further detail is required on the following and should be the subject of future consultation on the relevant procedures:

- the basis AEMO would trade out of its positions if a market participant wanted its gas/storage, or at the end of winter, and
- at what prices. *Prices should be at market rates with AEMO selling to the highest bidder to avoid "free option" issues.*

In the attachment, we provide other detailed comments on the design, and comment on the drafting of the proposed rule.

If you have any questions in relation to this submission, please contact me (Selena.liu@energyaustralia.com.au or 03 9060 0761).

Yours sincerely,
Selena Liu
Regulatory Affairs Lead

Detailed comments

1. Filling the facility

AEMO is required to hit the target storage levels by the start of winter (and maintain over winter). This means that it has approximately 6 weeks between 15 March and 1 May to fill the facility, so it can choose when in that period to procure the gas and fill the storage facility. How it makes this choice should be detailed in the rule change or relevant procedure.

2. Definition of LNG storage providers

The proposed rule does not explicitly limit it to the Dandenong facility, but instead it applies to "LNG storage providers" which links back to "a person who owns, controls or operates a facility for storing liquefied natural gas in Victoria declared by Order under section 41 to be a declared LNG storage provider, or any successor in law or assignee of that LNG storage provider." (National Gas (Victoria) Act 2008).

The AEMC should ensure that Dandenong is the only declared LNG facility, to ensure that the rule does not inadvertently cover other storage facilities either now or in the future.

3. 285(3)(c): "the gas scheduling procedures.. may allow AEMO to: (i) impose conditions in relation to the scheduling of gas from the LNG reserve; and (ii) provide a demand forecast;"

The purpose of this subclause is unclear.

- It should be clarified to narrow it to imposing conditions on AEMO's LNG, as opposed to any LNG within the facility.
- We are not sure what the demand forecast relates to and why it is required, e.g. a demand forecast for gas from the facility.

4. Rule 286 Disposing of the LNG reserve and 286A LNG reserve procedures

Much of the detail of how LNG reserve (stock of gas, and capacity) is to be disposed is delegated to the Procedures. This may be appropriate, but it does leave open many unanswered questions:

- AEMO "may" relinquish. Under what conditions/criteria can it decide to/not to?
 - At what price? *As above, we consider this should be at market rates, and problems associated with transferring back to APA (who may then increase the prices) should be avoided*
 - At what time? How much in advance of the actual transfer do market participants need to agree with AEMO for a transfer to occur? What is the process for this?
 - What happens if there are multiple market participants seeking the gas/capacity?
 - What happens at the end of winter?

The opposite of the above (i.e., the cost of purchasing LNG reserve and stock) is recovered via participant fees under the Rules. To be consistent, any proceeds should offset such fees, and that this should be determined in the Rules (not the procedures).

5. Bidding at \$800.01/GJ

To give effect to AEMO being supplier of last resort, AEMO's gas should be bid at above VoLL, providing this can be readily accommodated by AEMO's systems. Alternatively, other market participants could be capped at \$799.99/GJ. Although this would only be an issue if a \$800.00/GJ bid would result in dispatch to be allocated on a pro-rata basis, which would be inconsistent with AEMO being the supplier of last resort.