



**EnergyAustralia**

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Australian Energy Market Commission

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Dear Commissioners

Lodged electronically: [www.aemc.gov.au](http://www.aemc.gov.au) (GPR0003)

### **East Coast Wholesale Gas Market and Pipeline Frameworks Review, Stage 2 Draft Report, 4 December 2015**

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.

EnergyAustralia supports the development of a liquid and transparent gas market. The Australian Energy Market Commission (the Commission) has recommended a package of reforms which has the potential to deliver this which we generally support. At this stage, further development of operational and procedural details to allow a more informed assessment of the net benefits is required. In the interests of delivering a successful reform, we outline our concerns with some aspects of the recommendations and suggest possible alternatives.

Once the details of the high-level designs are developed, it is important to ensure that the reforms will deliver on the identified benefits and COAG Gas Market Vision. Where aspects of the recommendations are independent, they should be assessed separately on their own merits after the detailed implications are understood. This will ensure that all elements of the reform package are effective.

If you would like to discuss this submission, please contact me on (03) 8628 4518.

Regards

**Ben Hayward**

Industry Regulation Analyst

## Pipeline Access

### Pipeline capacity auction

The Commission has recommended that an auction is held for contracted but un-nominated capacity after the nomination cut-off time. This will allow for fully variable and reduced costs for the short-term opportunistic use of pipeline capacity. Undoubtedly this will result in higher utilisation of gas pipelines and allocative efficiency. This measure would be a positive change but there are some issues that warrant further investigation which are outlined below. If the issues are found to be insurmountable in the detailed design, we recommend a voluntary day-ahead trading mechanism be considered.

The Commission has stated that both economic withholding and high search and transaction costs contribute to the lack of liquidity in capacity trading, and that the pipeline capacity auction will provide additional incentives for shippers to trade capacity in advance. The Commission aims to address search and transaction costs through improved information and capacity trading platforms. Economic withholding is not an issue in the short-term and this mechanism has little bearing on long-term rights. Furthermore, the capacity auction will act to reduce incentives for shippers to transact on the trading platforms.

On pipelines where *as available* gas is being sold currently (allowing third-party access), incumbent shippers have limited ability to prevent access by other shippers. This strongly suggests that it is search and transaction costs that are the main impediment to secondary transactions between shippers for capacity in the short-term, as in these cases both shippers would benefit from a trade.

In a physically uncongested pipeline, offers at *as available* prices would no longer be attractive to a prospective shipper when the alternative is a potentially low priced auction result. Therefore the day-ahead capacity auction will reduce incentives for holders of firm rights to trade as they will receive a lower price than they can currently. Likewise, purchasers will be highly likely to rely on the capacity auction where the reserve price could be set close to short-run marginal cost.

An auction could result in firm shipper's renomination rights being eroded. This is covered in more detail in the next section on intra-day flexibility. A market for day-ahead capacity, as suggested below, would solve these issues but may be operationally difficult. Holding the auction later, closer to the start of the gas day, will give firm shippers more time to make a decision regarding utilisation of their capacity before it is sold.

Where shippers have signed firm contracts with a large variable component, they may find they are being charged a higher marginal rate than shippers utilising the auction. We are also unsure how *as available* contracts will be treated.

### **Alternative to the day-ahead auction: day-ahead market**

We support the day-ahead auction but suggest that an alternative is also considered. It offers an intermediate step before the suggested day-ahead use-it-or-lose-it (UIOLI) auction where holders of firm capacity are able to offer unused capacity at a price. Any short-term hoarding issues will be clear to policy makers due to the transparency of the market. This option should remain on the table in case issues with the auction become apparent during detailed design, or to allow for a staged implementation of the day-ahead UIOLI auction.

This would also allow for a simpler implementation. As it would be voluntary, changes to contracts and processes would not be required unless participants chose to adapt contracts themselves to better utilise the market.

Shippers would be able to value and hold capacity for intra-day flexibility. This is important for managing fuel for Gas-Powered Generation (GPG) and intra-day demand forecast changes.

This mechanism would provide improved incentives to transact in advance on the trading platforms. Purchasers would be more inclined to procure capacity before the day-ahead market as there is no longer the potential for a low auction clearing price.

Under the auction, holders of firm capacity will utilise their rights for any net benefit action. Higher value uses may be available to other participants who are denied the chance to purchase the capacity at short notice. This could increase the amount of capacity available for purchase in the short term.

### **Intra-day flexibility**

The day-ahead capacity auction may reduce participants' ability to utilise renominations to manage intra-day positions. Where the proposed auction results in higher utilisation, firm shippers may find they have reduced access to their capacity and must make operational decisions earlier.

There is interaction between the gas and electricity markets and participants have the ability to access capacity throughout the day to meet the fuel demands of GPG facilities. As the generation mix transitions to intermittent renewable supply, flexibility will become more important in responding effectively. Intra-day demand forecast changes must also be managed.

The Commission has stated that contracts which provide renomination flexibility beyond the nomination cut-off times are rare. This is not the case in practice. Pipelines do generally have discretion whether to accept renominations, but this is done in good faith and we have not had a renomination rejected in recent history.

Shippers' firm capacity will generally be available throughout the day although this may not be technically reflected in contracts. Ideally, more certainty should be placed in contracts. As renominations are particularly useful in managing a gas portfolio and are frequently able to be accommodated by the pipeline owner with minimal impact, there is a net benefit to formalising this facility.

### **Potential improvements to producer and pipeline inflexibility**

Both producers and pipelines have significant inflexibilities which impede the efficient allocation of gas in the short term. We would like to see improvements in this area being addressed as a high priority for regulators. The recommendations have been tailored to fit with existing contract structures, but these should not be assumed to be fixed. This review should include an investigation into the timing and alignment of producer and pipeline nominations, and how flexibility for shippers can be improved.

Producers can require nominations from shippers before schedules are released for the markets. This will result in pipelines being either over- or under-supplied on a day. Shippers rely on park/loan and other pipeline services to manage these imbalances. These services can be expensive and do not add value beyond managing a somewhat arbitrary requirement from producers. Assisting producers to provide a more efficient level of flexibility will ensure a greater ability for shippers to balance their positions in the markets and improve liquidity in the Southern Hub day-ahead and intra-day products.

Pipeline contracts may contain charges applying to intra-day nominations. Where these reflect real costs to the pipeline operator, the potential for reduction in these costs should be investigated. These charges will diminish the ability of shippers to react to intra-day market changes.

### **Information regarding primary capacity trades made transparent**

The Commission recommends the publication of the actual (not advertised) price of all primary capacity sales, and terms and conditions of those sales which might impact the price. This is to address the perceived discriminatory access to pipeline capacity. We note the Commission is still weighing up anonymity requirements and benefits from information disclosure.

EnergyAustralia is an on-going supporter of gas market transparency. However, we oppose this recommendation on the basis that it provides little value and has potentially damaging consequences (see the discussion in the box below).

The ACCC's East Coast gas inquiry is currently investigating the competitiveness of the wholesale gas industry and the competitiveness of access to gas transportation is specifically in scope. We consider that any discriminatory behaviour will be addressed through this inquiry and will also provide comfort to new-entrant shippers of equitable terms.

The decision of the Federal Energy Regulatory Commission (FERC) on US primary pipeline sales information is referred to in the report and notes there is very little contract information which is not required to be released. However this cannot be applied directly in the Eastern Australian gas market without consideration of the effects on downstream markets.

Discriminatory access, if and where it exists in the East Coast gas market, should be addressed by more direct means such as auctioning the last tranche of capacity or by open seasons for market expansions. This could avoid the problems of caused by release of commercially sensitive information. Another alternative way is to increase market transparency in a different way. To this end, we believe that increasing the detail, accuracy and ease of access to daily participant flows by pipeline will provide additional insight into the state of the market. We explore this further in the section on Information Provision on page 7.

### **The effect of information transparency on downstream markets**

Information regarding primary sales of capacity has the potential to allow some aspects of participants' operations in downstream markets to be inferred. In the electricity market, some gas-powered generation (GPG) may be disadvantaged compared with other fuel sources, as well as GPG located on different pipelines or embedded in distribution networks.

Anonymity will be difficult to obtain in practice. Various terms and conditions will be valued differently for supply to GPG or a retail load. Coupled with publicly announced projects and contracts, detailed information on a generator's strategy can be understood. This could include energy and capacity constraints, hedging requirements, and a component of the cost structure. This will disadvantage a subset of electricity generators and create a distortion in the market.

Therefore, we believe that too great a degree of information transparency is commercially detrimental, it is very difficult to properly anonymise the data and that if steps can be taken to fully anonymise the data then that data is of limited use.

## **Trading at the Southern Hub**

Trading at the Victorian Declared Transmission System (DTS) will move from a gross to a net balancing market. Participants will trade imbalances on the exchange before, and throughout the day. There will be a single price for imbalances and deviations as most trading will occur on the exchange.

EnergyAustralia supports the changes at this stage, but cannot give a full assessment until the details are worked through. Many issues have arisen in the gas markets that were not foreseen during their initial design. The recommendations are at a high-level and the gas markets are somewhat complicated. It is inevitable that issues will arise during the detailed design, and they may possibly require significant alterations of the design. We note that there is further consultation planned by the Commission and have welcomed the thorough engagement with industry to date.

The Declared Wholesale Gas Market (DWGM) and Short-Term Trading Markets (STTM) are constantly evolving as various trade-offs made during previous design decisions become less appropriate and begin to negatively affect trading. The new design must be effective under current conditions but also robust under conceivable scenarios for up to twenty years in the future.

We support the inclusion of the exchange for trading of gas for forward physical delivery. This will provide price signals and better enable participants to manage their position. However, we are not yet convinced that development of financial products is certain to follow. Financial contracts can be risky to sell while primary producers themselves lack exposure in the spot market.

## **Balancing at the Southern Hub**

Under the Commission's proposal, market participants will be incentivised to balance their positions by trading intra-day products on the exchange. *Residual balancing* will be undertaken by the hub operator when market participants are not collectively balancing their positions. A separate balancing platform could be set up (similar to Market Operator Service (MOS) gas) until the exchange develops the liquidity to be reliable.

We do not believe it is necessary for a transitional balancing mechanism as it would add significant costs for both AEMO and participants for a measure that is only temporary. Gas that is offered in the DWGM's intra-day schedules has been sufficient to manage the system and we see no barriers for this gas to be offered on the proposed exchange.

The balancing period duration could be daily, intra-day, or as needed. If the market is sufficiently balanced it may be unnecessary to cash out imbalances at regular intervals. We note that the Commission has recommended investigation into an indeterminate balancing period and believe this to be a worthwhile exercise.

Longer periods allow for the system to become further imbalanced and require operator interventions without attributing the costs to the causer (as a participant's earlier imbalance can be corrected by the end of the period). Shorter periods may impose potentially unnecessary balancing actions when there is no risk to the system. The appropriate period could vary substantially between winter and summer making a fixed period inefficient at times. No specific balancing period, where the operator can take action only when needed, appears to solve these issues. We encourage the Commission to consider this in the detailed design steps.

### **Balancing charges**

The commission has outlined that out-of-balance participants could be charged either the average, or marginal cost of residual balancing action undertaken. If an interim balancing platform is introduced, this could be pay-as-bid as MOS is currently, or a single cleared price.

Residual balancing on the exchange will be similar to a pay-as-bid auction. This causes bid shadowing (offering gas at the same price as other participants and at a higher price than it would have been offered otherwise) to provide a partial hedge if high priced gas is scheduled. This effect would be increased under marginal cost based recovery.

However due to the net market, gas can be used to offset a negative position by injecting (or purchasing) it before balancing action is required by the operator. In this sense a participant can hedge effectively under either pricing methodology.

The average price will differ from the marginal price only when offers of different prices are scheduled, yet the difference will not be significant. Participants with negative positions are incentivised to purchase cheaper balancing gas before operator intervention regardless of their offers.

Average price is a better option as it represents the actual cost of balancing the system and does not over-recover from participants. Under marginal cost recovery, participants may be less likely to offer balancing gas to the market, as they will hold it to mitigate exposure to high balancing charges.

### **Balancing Platform**

The Commission has proposed a balancing platform be provided while liquidity in the intra-day products develops. This would be similar to MOS in the STTM. We do not believe it is necessary for a transitional mechanism which would add significant costs for only a temporary measure. Gas that is offered in the DWGM's intra-day schedules has been sufficient to manage the system and we see no barriers for this gas to be offered on the proposed exchange.

## **Access to transportation capacity at the Southern Hub**

An entry-exit system allows for independent rights to inject and withdraw gas from the DTS. These capacity rights are comparable to forms of AMDQ as they exist in the DWGM currently. The system appears to offer some advantages but will also bring challenges. The current market carriage model allows for high utilisation of the system which should continue. At this stage of the design we support the adoption of the entry-exit model.

### **Congestion Management**

Congestion is proposed to be managed by an oversell-buyback mechanism. Additional to the initial allocation, the hub operator can release more capacity to auction at short-term as an understanding of likely congestion develops. The auctioned capacity could either be firm or interruptible. Where the system is unlikely to be able to support users' nominated flows, the hub operator can buy back firm capacity potentially through a reverse auction.

The hub operator could safely release more capacity when congestion is unlikely to occur. This will enable opportunistic utilisation of spare capacity. However this may not be an effective process when the chances of congestion are high. We expect that the operator will be conservative as the costs to buy back the capacity are potentially high.

Participants, rather than the pipeline operator, will have the best understanding of their own requirements. Allocation of spare capacity among participants on a market is therefore a preferable solution to obtaining high utilisation and efficient allocation of capacity.

Continuity with the contract carriage market can be attained by utilising the same mechanisms for trading capacity. The trading platforms would provide long-term trading options with the suggested day-ahead capacity trading mechanism allowing for short-term trades. These arrangements have the potential to more effectively manage congestion in the Southern Hub.

### **Information provision**

We support the improved transparency in the gas market. The recommendations in the Information Provision Stage 2 Draft Report will provide additional information to support informed decision making. Data quality and completeness is a high priority and we fully support the improvements to the reporting framework and information coverage.

Gas flows and supply/demand conditions on a day are not presented in an intuitive way. We strongly support the removal of the zonal model and the development of more effective aggregation methods.

Improvements to the range of information are welcome but will be of limited value unless the data can be interpreted in a meaningful way. The Bulletin Board should aim to provide a comprehensive view of the physical flows of gas. Sophisticated users of gas market data will rely on raw data which allows for ad hoc analysis and customisation of how it is presented allowing Bulletin Board costs to be minimised.

Currently, previous-day market data can be used to deduce information on shippers which is not currently published directly. This includes daily individual shipper pipeline flows to and from the DWGM and STTMs. This data is available, but incomplete (particularly in regional areas), approximate, and requires resource intensive analysis. We see no reason for this data not to be made available across the market. Previous-day, disaggregated flow data will not damage any shipper's competitive position as GPG and market data is already available. This addition would bring gas market transparency closer to that of the National Electricity Market and is important to identify trading opportunities.