26 March 2015

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Sir/Madam,

Re: East Coast Gas Wholesale Gas Market and Pipeline Frameworks Review

Lumo Energy welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) East Coast Wholesale Gas Market and Pipeline Framework Review (the Review).

Lumo Energy is 100% owned by Snowy Hydro Limited. We sell gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland and we are currently one of the largest second tier retailers.

The Commission will assess the role and objectives of the facilitated gas markets on the east coast and support their continued development as part of the Review. It will make changes to the market structure to improve the liquidity, transparency and to improve the ability of market participants to manage risk.

To deliver appropriate incentives and signals to facilitate efficient and timely investment in gas transportation infrastructure, the Review will also focus on the gas transmission regulatory arrangements.

The COAG Energy Council (the Energy Council) expects the Commission to take the relevant action required to strengthen the structure and competitiveness of the east coast wholesale gas market.

While the Commission has just begun the Review it appears it has prematurely assumed the facilitated gas markets are inefficient because they were developed ad-hoc without a clear strategic plan.

Yet the Commission has not made a case that proves the existing market and regulatory arrangements that make up the facilitated markets,[1] including the transmission arrangements, are inefficient.

For this reason it is important for the Commission to act prudently before initiating and progressing major policy reforms.

[1] Throughout this submission Lumo Energy will use term facilitated markets in a consistent way with the Commission's Public Forum Paper. We understand that the term facilitated markets encompasses the Declared Wholesale Gas Market in Victoria, the Short Term Trading Market with hubs at Adelaide, Sydney and Brisbane and the Wallumbilla Gas Supply Hub.

Major policy reforms to the facilitated markets and their accompanying transmission arrangements should only be introduced when a case has been made to demonstrate the existing arrangements are inefficient based on the facts.

At a time when market participants are exposed to higher market risk as a result of more LNG exports there is a danger that introducing major policy changes to the facilitated markets and their accompanying transmission arrangements could inadvertently lead to other unexpected risks.

Therefore, we prefer that the Commission implement changes incrementally and targeted in response to identifiable, evidenced policy problems. In addition, any change implemented should be proportionate to the size of any problem identified.

If the Commission makes recommendations for major change, we would expect it to:

- make any changes based on facts; and
- develop, test and assess the impact of these changes before enacting them.

Lumo Energy supports the scope of this Review being broadened in these circumstances.

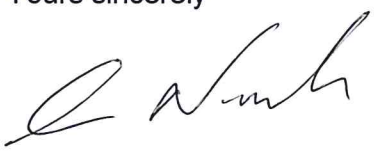
For example if the Commission recommends the compulsory winding back of the bilateral contracts in the wholesale supply of gas, it is our expectation that the Commission will apply greater rigour and analysis to assess the impact of these changes before enacting them.

Lumo Energy has full confidence that the Commission will make responsible, incremental, and targeted changes to the market and regulatory arrangements to the facilitated markets in response to any evidenced based problems they identify.

Lumo Energy proposes a number of incremental changes in our responses to the questions in the Review. This should provide the Commission with some solutions regarding the nature of any incremental changes that are required in the facilitated markets and their accompanying transmission arrangements.

We thank the Commission for the opportunity to respond to this Review. Should you wish to discuss any matters contained within this submission, please contact me on 03 9976 5701.

Yours sincerely



Con Noutso
Wholesale Regulatory Manager
Lumo Energy Australia Pty Ltd

Lumo Energy Submission to East Coast Gas Wholesale Gas Market and Pipeline Frameworks Review

A: Facilitated Markets

1. Given their performance to date, are the existing markets able to facilitate transactions required to manage current conditions?

The performance of the facilitated markets to date has been reasonable.

The facilitated markets were originally established to enable market participants to trade gas imbalances on gas days. In addition they were designed to operate as balancing markets overlaid on long term bilateral contracts rather than just commodity markets.

The facilitated markets have been operating in a satisfactory manner since they were developed and provide market participants additional flexibility required to manage their gas portfolios.

Whilst incremental improvements to the way in which these markets operate would be welcomed they are currently able to facilitate the transactions that are required to manage current conditions.

In terms of the performance of the facilitated markets, we have yet to see any evidence that suggests these markets won't be able to facilitate the transactions required in the market to manage the current conditions.

Market participants in the Declared Wholesale Gas Market (DWGM), Short Term Trading Market (STTM) and the Wallumbilla Gas Supply Hub (GSH) will continue to be able to:

- trade their imbalances;
- purchase gas on a short term basis;
- efficiently allocate gas during system constraints;
- support the efficient trade and movement of gas between regions;
- support the development of financial products that help manage risk; and
- buy transmission capacity through efficient contracting arrangements.

2. Will the current market framework be able to facilitate transactions that may be required to meet future transactions?

The current market framework will be able to facilitate transactions that may be required to meet future transactions.

We have no doubt that incremental adjustments aimed at improving the operational efficiency of these markets will be necessary as the facilitated markets continue to evolve and mature.

Nevertheless a major overhaul of the facilitated markets will not be necessary. Such a move would be counter-productive in an environment where market participants face higher risk as a result of higher LNG exports.

We prefer incremental changes to each of the facilitated markets is made in response to identifiable, evidenced problems and proportionate policy responses to the problems identified.

3. Are there any barriers to using the wholesale markets, for instance for new entrant retailers or for large users wishing to participate directly in markets?

There are no real barriers to using the wholesale markets.

Retailers and large users are free to enter the markets where they meet the eligibility and registration requirements in each of the specific facilitated markets.

Entry to these markets can take many forms.

For example it could be that a market participant enters the Declared Wholesale Gas Market (DWGM) backed by long term wholesale supply and transportation agreements. Alternatively, a market participant could potentially enter the DWGM without long term wholesale supply and transmission contracts and rely on the wholesale market for its gas and source transmission as required.

In any case it is important for new retailers to have a flexible gas portfolio[2] in place to manage their risk. Hence:

- contract liquidity is important in managing market risk; and
- reasonable lead times are required to build a flexible gas portfolio.

Hence, we recommend that the Commission make incremental policy adjustments that encourage greater liquidity in the facilitated markets. Wholesale markets changes that encourage more liquidity will provide new entrant retailers with a better opportunity to enter the facilitated markets and assist them in managing market risk.

4. What opportunities are there for improved integration between markets?

There will be opportunities for improved integration in the markets.

Nevertheless this should not be the focus of the Review.

The Review needs to focus on making specific targeted improvements to each of the facilitated markets themselves.

Each facilitated market has been structured and designed to cater for the specific requirements of the relevant jurisdictions.

For example, the market carriage system was adopted in the Declared Transmission System (DTS) to encourage new retailers. These new players would not be required to enter into long term contracts; and they would get the equivalent access to incumbent shippers to purchase gas at a spot price.

[2] A market participant with a flexible gas portfolio that includes upstream wholesale gas and transmission supply contracts from diverse geographical sources will be less exposed to market risk compared to a participant that buys 100% of their gas from the wholesale market.

Whilst the facilitated markets were not developed in accordance with a single, high level strategic plan they were specifically designed to meet the needs of the relevant jurisdictions. This was the specific focus of each of the jurisdictions.

This leads to the conclusion that the key focus of this Review should be on making incremental improvements in each of the facilitated markets to improve their operational efficiency rather than concentrating on integrating these markets.

This being said, there are clear areas where greater integration between the markets could take place:

- the market settings in the STTM & DWGM;
- harmonizing the start of the gas day; and
- intraday trading in STTM.

B: Short Term Trading Market (STTM)

1. Are the original objectives for the STTM still relevant and compatible with the new Council vision? How have the stakeholders' experience with the STTM corresponded to initial expectations?

The original objectives of the STTM are still relevant and compatible with the Energy Council's vision.

While the specific objectives of the STTM[3] and the Energy Council's vision[4] are different they both aim to improve the efficiency of wholesale gas markets for the long term benefit of consumers.

The STTM was originally established by the Energy Council to provide a transparent and efficient based pricing mechanism for market participants. It was established as a balancing market that would provide price signals enabling participation of all major users and pricing congestion.

The Council's vision has a clear focus on providing pricing signals from liquid markets that are supported by investment and regulatory environment that encourages trade to occur. It has an emphasis on liquid markets, price discovery, trading and arbitrage.

The explicit requirement to improve the efficiency of the wholesale gas market arrangements for the long term benefit of consumers is not specifically listed in the Energy Council's vision. At the same time there is no explicit mention of this concept in the STTM policy objectives.

[3] The STTM was designed to provide a transparent and efficient market based pricing mechanism that would complement rather than replace the bilaterally negotiated gas supply arrangements or gas transportation arrangements. It was established to replace existing gas balancing arrangements at delivery points within the hubs, provide price signals to enable the participation of all major gas users and price congestion.

[4] The Council's vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage opportunities.

Nevertheless, our view is the original STTM objectives and the Council's vision is similar in substance. They both seek to improve the efficiency of the facilitated markets for the long term interests for consumers. As such they are compatible.

2. Are all STTM hubs (Sydney, Adelaide and Brisbane) delivering value to market participants?

The STTM hubs deliver value to the market.

The STTM offers market participants an invaluable service, providing them with a degree of flexibility in managing their gas portfolios.

The current STTM gas markets are based on long term bilaterally negotiated gas supply and transportation contracts which act as the primary mechanisms for the wholesale supply and transportation of gas or underwriting investment.

The STTM facilitates these long term contracting arrangements by allowing market participants to access a transparent and efficient market based pricing mechanism that allows markets participants to:

- trade their imbalances;
- purchase gas on a short term basis;
- efficiently allocate gas during system constraints; and
- buy transmission capacity through efficient contracting arrangements.

While our view is that the market arrangements that apply in the STTM deliver value they can be improved. The incremental improvements that we recommend are outlined below in our response to the following question.

3. What design features of the STTM could be improved to reduce costs and improve efficiency? (e.g. is there a role for intraday trading?)

The following incremental policy changes to the STTM market design will assist market participants to improve the manner in which they manage their risk.

These policy changes represent appropriate and proportionate response to current inefficiencies. As such they are consistent with the National Gas Objective (NGO). They include:

Intra-day trading

Intraday trading in the STTM will provide significant benefits to the market.

A problem for market participants that trade in the STTM is they are never entirely certain of their actual deviations over the course of a gas day. This lack of transparent information creates unnecessary risk for market participants in terms of them understanding their potential financial exposures following a gas trading day.

Whilst an intraday trading mechanism in the STTM would add cost and complexity, it would provide market participants with an avenue to improve the manner in which they manage their deviations over the course of the trading day.

Intraday trading would provide market participants with additional flexibility to manage their gas portfolio over the course of a gas day. In addition, it would give market participants more accurate and timely pricing information compared with the current ex-ante daily price that is currently used in the STTM.

Review the current Market Operating Service (MOS)

A review of the current MOS arrangements in the STTM would be welcomed.

In the STTM, the gas that is supplied and withdrawn in the market is settled at the ex-ante schedule at the ex-ante price. Where shippers and users deviate from the ex-ante schedule, deviation charges are applied.

Recently AEMO proposed a rule change which amended the methodology in which deviation charges are applied. The rule change attempted to allocate the MOS cost to cause principle in an improved manner.[5]

While the proposed changes to the MOS arrangements were predominantly aimed at improving the arrangements, we consider the MOS arrangements are an inappropriate way to manage deviations.

The introduction of intra-day trading in the STTM would potentially change the need for a MOS. It would allow market participants to be better informed of their actual deviations on a gas day in the STTM.

Further investigations by the Commission on finding an alternative to the current MOS arrangements would be welcomed.

Harmonizing the start of the gas day

Harmonizing the start of gas days across all facilitated markets would improve their efficiency.

The STTM trading day can be difficult to manage because the nature of the market requires trading participants to determine their strategies on the day ahead of trading. This in effect turns the STTM trading day into 36 hours.

Given the close links between the DWGM and the STTM, it is fair to say the current arrangements are less than satisfactory.

Hence any moves to harmonize the start of the trading days in the facilitated markets to streamline anomalies would be welcomed. This would make it easier to trade in these markets and expanding the ease of entry and use of the facilitated markets.

[5] AEMC, 2012, National Gas Rule Amendment (STTM deviations and the settlement surplus shortfall)

4. Given the most gas supply is bilaterally contracted, is it realistic to expect that prices in the STTM will signal underlying supply and demand conditions? If not what is the value of the STTM within the broader gas market framework?

The prices in the STTM signal the underlying supply and demand conditions on a gas day.

The wholesale supply of gas takes place in bilateral contracts outside of the STTM on the gas day. To participate in the STTM, shippers submit offers to supply gas to the hub and users submit bids to buy gas up to the close of trade on the day before a gas day (known in the market as D-1).

At the end of trade on D-1, AEMO determines the ex-ante price of gas for the gas day (D) using a bid stack that schedules lower priced gas ahead of higher priced gas. The clearing price reflects the point at which the supply of gas meets the demand of gas over the gas trading day.

It is true that the STTM is a balancing market with the majority of users relying on long term gas contracts to secure their wholesale supply. However the bids and offers of gas through a central clearing mechanism in the STTM provide the market with a transparent price. That price reflects the underlying demand/supply conditions on a gas day.

C: Wallumbilla Gas Supply Hub (GSH)

1. Is Wallumbilla adding value to the way market participants manage their gas portfolios and what directions should the development of the market take?

The Wallumbilla Gas Supply Hub (GSH) adds value to the way in which market participants manage their gas portfolios.

The GSH provides an avenue for market participants to manage their portfolios in a more flexible manner providing a broader range of options to managing a gas portfolio.

The GSH allows a market participant to enter the market when it has a commercial requirement to do so. The GSH enhances the:

- transparency of gas trading for all market participants;
- ability for market participants to buy and sell gas efficiently in the short term in a transparent manner;
- efficient trade of gas between regions;
- access to secondary transmission capacity; and
- development of diverse financial products.

Nevertheless there a range of incremental changes to the GSH that would facilitate the development of the GSH making it more efficient and workable for market participants. These changes are listed below.

Single Product at GSH

The development of a single product at the GSH is supported.

Currently, the three transmission pipelines servicing the GSH are not connected. As a result the original market design at the GSH included three different trading nodes.

The proposal to consolidate the three trading nodes into a single product for trading at the GSH is supported by Lumo Energy.

The key benefits of this policy would be to:

- increase the liquidity of the GSH by pooling both buyers and sellers into a single market. This would provide more confidence in the market as a mechanism for managing gas supply; and
- support the development of the market at the GSH by establishing a standard location for the delivery of physical transactions and a single reference price for value of gas traded.

Enhanced information provision to facilitate transmission capacity trading

Improved transparency including access to and timely provision of information to the market will facilitate transmission capacity trading.

Currently there is at least one market participant that has expressed the view at the Gas Supply Hub Reference Group (GSHRG) that the development of a hub at Moomba should be delayed. Their view is that the market would benefit more from resolving the scarcity of transmission available at the GSH rather than aim to develop another trading hub.

Providing more information to the market would help facilitate additional capacity trading. Making more fundamental information available to the market to facilitate transactions would allow additional gas to be delivered to the market. This may alleviate some of the lack of transmission trading at the GSH (if it exists).

Practical measures that could be adopted to obtain the additional information that is required by the market to facilitate capacity trading might include AEMO:

- improving the quality of information it provides in its capacity listing service on the Bulletin Board;
- providing additional information regarding pipeline capacity utilization and capacity trading information;
- develop standardize transmission contracts that would apply across the facilitated markets; and
- develop business tools and processes to expedite the transfer of contractual rights of transport on transmission pipelines.

Broader range of financial derivatives

The GSH currently includes a day ahead, a balance of day and other longer term forward products.

The development of well-defined and longer based structured products that will help market participants to manage their gas portfolios would be welcomed.

The development of a single product at the GSH should help to improve the liquidity in the GSH and make the availability of more liquid longer dated derivatives more viable.

Whilst market participants clearly require a wholesale supply contracts and transmission capacity to participate in the GSH under the Exchange Agreement we would welcome greater liquidity in the market.

We would welcome ideas that would help financial players enter this market to improve liquidity.

2. How does trading at Wallumbilla impact on trading in other wholesale markets?

Trading at the GSH has not had a significant impact on trading in other wholesale markets.

Even though the GSH has not been operating for a long time we are yet to see any evidence that suggests the GSH is negatively impacting liquidity in other wholesale gas markets.

The GSH was developed because the Queensland gas sector was due to face unprecedented change driven by the development of significant LNG export program.

The establishment of the GSH would enhance transparency, competition and reliability of supply in the environment of unexpected change.

Hence the GSH acts a facilitator of trade in a secondary market. Market participants are given additional flexibility to manage and optimize their gas portfolios. This does not come at the price of impacting liquidity in other markets.

Market participants benefit from the GSH by having a much more liquid transparent secondary market in wholesale gas and transmission capacity.

Pricing signals in both wholesale gas and transmission capacity provide crucial information for market participants that are in the process of negotiating wholesale gas deals and transmission capacity.

3. Would the establishment of a GSH at Moomba facilitate additional trade? Would a Moomba GSH impact on liquidity at Wallumbilla?

The establishment of a GSH at Moomba would facilitate additional trade.

The Moomba Trading Hub (MTH) represents an important part in the continued evolution of the Eastern Australian Gas Markets.

The MTH will be located in the middle of the facilitated markets providing a link between the southern and northern east coast gas markets. It will allow market participants to manage their gas portfolios in a much more efficient manner. The MTH is well placed to expand and develop as the range of products and market liquidity mature.

The additional costs of adding the MTH are marginal. The current IT capability and the trading platform at Wallumbilla will be expanded to develop the MTH. While the costs of developing the MTH are marginal, its benefits will be large.

The impact on market liquidity at the Wallumbilla Trading Hub (WTH) as a result of setting up the MTH is difficult to predict with any real certainty. As such, we would treat any conclusions from any party making predictions in this regard with a touch of scepticism.

Concerns regarding the level of market liquidity at the WTH as a consequence of setting up the MTH are not particularly relevant. Even if the MTH did impact market liquidity at the WTH in the short term, our view is both trading hubs will develop and mature in the long term. If there is any impact on market liquidity on the WTH as a result of setting up the MTH it will be marginal and short term.

Significant benefits will accrue to all market participants with the establishment of the MTH. These benefits will more than offset any negative impact on market liquidity at the WTH. As previously argued, any impact on liquidity at the WTH from setting up the MTH will be short term.

The improved transparency and liquidity of gas prices achieved by having the MTH coupled with the move away from bilateral contracting will deliver long term benefits to all market participants.

In addition the added service offered in secondary transmission capacity will provide benefits to all market participants, especially as the demand for gas supply increases exponentially in the next few years.

4. How useful is the information provided by the Wallumbilla Hub to market participants and what additional information could be provided to improve accuracy and transparency at the GSH?

The information provided by the GSH is very useful to market participants.

It provides for:

- transparency of gas trading for all market participants;
- ability for market participants to buy and sell gas efficiently in the short term in a transparent manner;
- efficient trade of gas between regions;
- access to secondary transmission capacity; and
- ongoing development of financial products in the future.

In general we are comfortable with the level of information that is provided to market participants at the Wallumbilla Hub.

However the range of reforms that we have listed above (enhanced information to the market to promote transmission capacity trading and the development of an end of day gas price to encourage derivatives) would be welcomed.

D: Declared Wholesale Gas Market (DWGM)

1. Are the original objectives and rationale for the DWGM relevant and compatible with the Council's vision?

The rationale and original objectives of the DWGM are relevant and compatible with the Energy Council's vision.

While the specific objectives of the DWGM and the Energy Council's vision[6] are different both aim to improve the efficiency of wholesale gas markets for the long term benefit of consumers.

A breakdown of the Energy Council's vision reveals a strong focus on the concepts of liquid markets, price discovery, trading and arbitrage. These are all policies whose primary aim is to improve the efficiency of the current arrangements for the long term benefits of consumers.

The objectives of the DWGM appear to be consistent with the Energy Council's vision.

The DWGM was established to provide:

- a balancing market providing price signals enabling participation of all major users;
- a transparent price determined by an ex-ante scheduling process which reflects forecast market bids and offers for gas; and
- the use of market carriage system which allows open access to all participants regardless of whether they have a GTA.

The explicit requirement to improve the efficiency of the wholesale gas market arrangements for the long term benefit of consumers is not included in the Energy Council's vision. At the same time there is no explicit mention of this concept in the DWGM policy objectives.

However our view is the original DWGM objectives and the Council's vision is similar in substance. Both seek to improve the efficiency of the facilitated markets for the long term interests for consumers. As such this makes them compatible.

2. Is investment in the DTS occurring in an efficient and timely manner? Or are there limitations with the current investment and /or regulatory framework?

Investment in the DTS is occurring in an efficient and timely manner.

We do not accept the view that the regulated model of transmission investment in the DTS is deterring the level and efficiency of the timing of transmission investment.

There is no evidence to suggest that this position is accurate.

[6] The Council's vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage opportunities.

The only market based evidence that we have discovered that suggests there has been a delay in transmission pipeline investment under the regulated model in the DTS is provided in the Commission's Gas Market Scoping Paper.[7]

There is a suggestion in that publication that the regulated model of transmission investment in the DTS appears to have caused the deferral of the South West Pipeline Expansion (SWP) from the later part of 2008-2012 regulatory period to the 2013-2017 regulatory period.

A review of the regulatory issues surrounding the ACCC rejection of the expansion in the 2008-20012 regulatory period on the SWP reveals some interesting facts. The relevant expansion rejected by the ACCC was the Stonehaven compressor. The ACCC's decision to reject APA GasNet's proposal to make an allowance for the Stonehaven compressor in its APA 2008-2012 GasNet's capital expenditure reveals that the investment failed to pass the relevant prudency test.[8]

A further investigation of this matter reveals that if the market was serious about having the Stonehaven compressor built for the 2008-2012 regulatory period that the regulated model of transmission investment in the DTS could facilitate it under the National Third Party Access Code for Natural Gas Pipelines (Code).

It was open to the market and APA GasNet to work together in order for the ACCC to approve the Stonehaven compressor under section 8.16(a)(1) of the Code – the incremental revenue test.

To the extent that the relevant investment was uneconomical and failed the incremental revenue test under section 8.16(a)(1) of the Code then the option was still available for a market participant to put forward the funds in order to underwrite the investment shortfall in exchange for AMDQcc.

Under the Code, APA GasNet was able to "roll in" the economically feasible part of the Stonehaven compressor that passed 8.16(a)(1) of the Code into the Regulated Asset Base (RAB).

It would also be open to APA GasNet to request the investment shortfall from a market participant in exchange for AMDQcc under either section 8.23 of the Code as a "capital contribution" or under section 8.25 of the Code as a "surcharge" in order for the investment to proceed.

The fact that a market participant failed to provide the investment shortfall to APA GasNet to guarantee that the Stonehaven compressor was approved for the 2008-2012 regulatory period implies that the market was not ready for this investment to proceed.

---

[7] K Lowe Consulting, Gas Market Scoping Study: a report for the AEMC, July 2013

[8] ACCC, Final Decision: GasNet Australia – revised access arrangement, 2008-2012, 30 April 2008, p.47 "Based on the information currently available, the ACCC considers the proposed $26.19 m Stonehaven compressor is not reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(a)(i) of the code."

The regulated model of transmission investment applied under the Code worked as it was intended to. But the market was not ready for the investment.

To expedite the Stonehaven compressor's build APA GasNet submitted a market lead investment for participants to underwrite the Stonehaven compressor in a more commercial approach in exchange for AMDQcc. Once again the market failed to take up this option proposed by APA GasNet.

Although we are unable to confirm it, it is believed that the cost of AMDQcc to market participants under a market lead investment was significantly more expensive than obtaining existing AMDQcc on the SWP. However this was not unexpected given that the expansion of a compressor on a pipeline is relatively expensive compared to other options.

We are not aware of any other major investments on the DTS that have been deferred or delayed due to the regulatory process for investment. Although we note that there have been industry anecdotes in this regard. On this basis the criticism that the regulatory process for investment on the DTS unnecessarily delays transmission investment appears to be unfounded.

Finally, the claim that intra period capital investment tends to be delayed because APA GasNet is unable to recover a return on that capital is puzzling. Rule 80 of the National Gas Rules (NGR) allows service provider to seek an advanced determination on the efficiency of the proposed capital expenditure within a regulatory period. So we would expect for APA GasNet to use Rule 80 of the NGR to seek an advanced determination on the efficiency of the proposed capital expenditure to rectify the issue of recovering a return on intra period capital investments.

3. Do the DWGM arrangements inhibit the transportation of gas between the DTS and interconnected pipelines?

The DWGM arrangements do not inhibit the transportation of gas between the DTS and interconnected pipelines.

There is reason to believe that the previous regulatory arrangements that apply to capital expenditure under the Code may potentially have inhibited the transportation of gas between the DTS and interconnected pipelines.

However, the revised capital investment test in Rule 79(2)(B) of the NGR allows the Australian Energy Regulator (AER) to consider the range of economic benefits of an investment that arise in jurisdictions outside Victoria.

This change helps a broader range of capital investment projects pass the relevant regulatory hurdle in Rule 79(2)(B) of the NGR potentially allowing more capital projects between the DTS and interconnected pipelines to proceed.

The revised test also allows the AER to factor in all of the economic benefits of an augmentation in Rule 79(2)(B) of the NGR derived by a broader range of parties. This

revised test makes it more likely that an augmentation will pass the relevant test allowing more capital investment to proceed.

Regarding the interoperability of the contract carriage and market carriage arrangements, to date we have yet to experience any significant issues that arise from operating under these different contract pipeline arrangements that would prevent us from exporting gas from Victoria.

4. How could the market design be amended to provide additional tools for participants to manage price and volume risk in the DWGM?

The following incremental policy changes to the DWGM design will assist market participants improve the manner in which they manage their risk.

These policy changes represent appropriate and proportionate response to current inefficiencies. As such they are consistent with the NGO.

The changes include:

Market Settings in the DWGM

A review of the current methodology, settings and the need for increased harmonization between the STTM of the DWGM market parameters given the close interaction of the two markets is necessary.

We recently lodged a submission with AEMO raising our concerns regarding the appropriateness of the current market settings in the DWGM given the potential for forecast market volatility in domestic prices as LNG exports begin in Queensland. Our submission also raised a number of other reasons for why we considered it important for a review of the market settings in the DWGM to proceed. [9]

As part of its response to the STTM parameter review and our submission, AEMO requested Mr. Richard Lewis an upstream gas market expert and advisor for advice on the changing risk in the domestic gas markets as a consequence of the commencement of Queensland LNG export operations.

Mr. Richard Lewis handed down his conclusions following his review.[10] His findings suggested higher LNG exports would increase risk for market participants in the following areas, including:

- difficulty /inability to obtain the desired supply portfolio;
- tight demand supply conditions;
- higher gas prices;
- changes in the supply demand pattern; and
- risks exist in aggregate.

[9] Lumo Energy will make this submission available to the Commission if it considers it to be necessary.

[10] GWCF – STTM parameter review – Findings and Discussion- GWCF Meeting 10 February 2015

AEMO concluded that it would be difficult and in some cases market participants may not be able to get their desired supply portfolio to mitigate the higher risk. Nevertheless at the same time they argued these risks were manageable. This contradiction was not reassuring.

Due to the fact that market risk and uncertainty is increasing in the DWGM and the corresponding difficulties that are predicted in the future in terms of building a desired supply portfolio we request that the Commission undertakes (or directs AEMO to undertake) a review of the appropriateness of the:

- role that the market settings in the DWGM in managing price and volume risk;
- methodology that is applied by AEMO to determine the market settings in the DWGM;
- appropriateness of the current market settings in the DWGM in lieu of the changing risk in the DWGM; and
- need for additional harmonization of the market settings in the DWGM & the STTM give the closer interrelationship of these markets.

AMDQ Review

A review investigating the feasibility of making AMDQ & AMDQcc firmer would be appropriate.

In light of the length and complexity associated with the Commission's Transmission Frameworks Review (TFR), we propose that the Commission examine the prospect of the chance of success carefully before proceeding with such a Review.

The DWGM is familiar to us. We have been operating in this market injecting and withdrawing gas for many years now. Along with other market participants we have used AMDQ & AMDQcc to facilitate the transport of gas over a period of time.

AMDQ & AMDQcc gives market participants tie breaker bidding rights and allows market participants to bid gas into the market at $0.00 in the event of congestion. In addition, it provides market participants with protection against congestion uplift. AMDQ and AMDQcc forms an important part of many market participants gas portfolios.

A key weakness of AMDQ & AMDQcc as a transmission right is that a market participant is free to bid in their gas in the DWGM at a price below a holder of AMDQ & AMDQcc. This allows the market participant without AMDQcc to be dispatched ahead of the market participant holding AMDQcc.

Market participants holding AMDQcc should not be dispatched ahead of a market participant that holds AMDQcc regardless of their bid. This situation is inappropriate and should be reviewed.

The manner in which some pipeliners treat "firm" compared to "as available" capacity in the presence of congestion of certain transmissions pipelines might be a useful analogy to draw in attempting to find a solution to this problem.

As such, in the presence of congestion, a market participant that did not hold AMDQ or AMDQcc would not be permitted to bid in below holders of these transmission rights and be dispatched.

If a market participant did bid in below a market participant that held AMDQ or AMDQcc to constrain it off then it would be required to compensate that holder of the AMDQ or AMDQcc.

We encourage the Commission to work through a solution in this regard by drawing on the work that it had previously undertaken in its TFR in electricity.

If the Commission decides to investigate the appropriateness of transmission rights on the DWGM further we would welcome an investigation of our solution.

Restriction on DWGM related rule changes

Rule 295(3)(a) of the NGR prevents anyone other than the Victorian Government and AEMO from submitting DWGM rule change to the Commission.

These limitations are inappropriate and reflect an outdated purpose.

They are restrictive and inconsistent with the STTM where anyone is permitted to lodge a rule change.

On this basis we would welcome a change to the current arrangements and make them more in line with the STTM.

Timeliness of rule changes

Given the current restrictive requirements, the time that it takes for both AEMO and the Commission to review and implement a DWGM rule change is too lengthy.

Therefore we urge for the Commission to investigate ways to reduce the time it takes to develop, review and implement a rule change in the DWGM.

E: Transmission pipelines

1. Are the original objectives of the gas access regime still relevant and compatible with the Council's vision?

The original objectives of the gas access regime are still relevant and compatible with the Energy Council's vision.

Both the original objectives of the gas access regime and the Energy Council's vision include policies whose principal aim is to deliver efficient outcomes for the long term interests of consumers.

A breakdown of the Energy Council's vision reveals a strong focus on the concepts of liquid markets, price discovery, trading and arbitrage. These policies seek to deliver more efficient outcomes for the long term interests of consumers.

The objectives of the gas access regime appear to be consistent with the Energy Council's vision. They include the elements of facilitating the development of a national market for gas, preventing the abuse of monopoly power and promoting competitive markets for gas.

All these policies all seek to deliver efficient outcomes for the long term interests of consumers. As such they are consistent with the Energy Council's vision.

2. Is the current low number of covered transmission pipelines a cause for concern or a measure of competition?

The current low number of covered transmission pipelines is not a cause for concern.

There are varying degrees of regulation[11] applied to transmission pipelines on the east coast of Australia.

The degree of regulation that is applied to a transmission pipeline is determined by the competition assessment carried out by the National Competition Council (NCC) under the National Gas Law (NGL).

Under the NGL, the NCC decides on the form (if any) of regulation that will be applied to a transmission pipeline. The degree of regulation that is applied to a transmission pipeline will reflect the degree of market power that the pipeline has.

The NCC applies the "coverage" test under section 15 of the NGL to a transmission pipeline to determine if that pipeline:

- is competitive and should not be regulated;
- has a degree of market power and should be regulated under the "light regulation" regime in the NGR; and
- holds a degree of market power that warrants monopoly regulation under the NGR.

A review of the range of coverage determinations by the NCC highlights the depth of analysis that it has applied in making these determinations. This reassures us that the varying degrees of regulation applied to transmission pipelines as a result of the "coverage" tests under the NGR as applied by the NCC (including those determined to be competitive by the NCC) is appropriate.

Finally, it is open to any party to bring a coverage application to the NCC if they consider a transmission pipeline should be covered under the NGR. Therefore, if they are not satisfied with the terms of conditions on which they are offered access to a non-regulated transmission pipeline they are free to bring a coverage application. The availability of this option is reassuring for market participants.

[11] Regulation in this case refers to the level of economic regulation that is required to apply to a transmission pipeline. It does not refer to technical regulation.

3. Are there impediments to short term trading of pipeline capacity trading? (i.e. why is secondary trading not occurring?) If so, how should these best be addressed?

There are no impediments to short term trading of pipeline capacity on the eastern Australian gas market.

However the short term trading of pipeline capacity currently occurs in the market under private bilateral arrangements.

Whilst this does not appear to be a problem in itself the current arrangements do lead to an inadequate level of secondary capacity trading of transmission capacity.

This raises an important question. What is the most efficient way in which to improve short term trading in transmission capacity?

We consider there are four options that could be adopted to improve the existing levels of secondary trading capacity.

1. **Status quo** – maintain current private bilateral trading arrangements.

2. **Enhanced information provision** – improved transparency including access to and timely provision of information will facilitate capacity trading.

3. **Voluntary trading platform** – establish a capacity trading platform to allow participants to voluntarily offer unused capacity for trade. This could potentially be beneficial to the market but the option would be expensive.

4. **Mandatory Trading options** – could involve pipeliners offering unused capacity on an "as available" basis or shippers offering unused firm capacity.

   Schemes that require shippers to give up their existing contract rights on a pipeline are not supported. This raises sovereign risk issues and interfere with existing property rights by impacting existing contracts.

We recommend that the Commission consider Option 2 for further development. It represents a proportionate and incremental response to improving the regulatory arrangements.

Providing greater information to the market would facilitate additional capacity trading. Making more fundamental information available to the market to facilitate transactions would allow additional gas to be delivered to the market.

Some practical measures that could be implemented to get the information required by the market to facilitate capacity trading might include:

- AEMO establishing a capacity listing service on the Bulletin Board;
- AEMO providing additional information regarding pipeline capacity utilization and capacity trading information; and
- AEMO developing more standardized transmission contracts to apply on the east coast; and

- AEMO developing business tools and processes to expedite the transfer of contractual rights of transport on transmission pipelines.

4. Does the increasingly interconnected nature of gas pipelines and markets on the east coast form a driver for greater harmonization of regulatory arrangements (e.g. a single carriage model of greater integration of market and pipeline frameworks?)

The increasingly interconnected nature of the gas pipelines and markets on the east coast does not necessarily form a driver for greater harmonization of the regulatory arrangements.

The assertion that because the east coast gas markets and the transmission pipelines are becoming more interconnected should in some way act as a driver for the greater harmonization of the regulatory arrangements is rejected.

This position ignores the original rationale for structuring the current arrangements in the manner that they have been today. That is that each facilitated market has been structured and designed to cater for the specific requirements of the relevant jurisdiction.

Because the gas markets and transmission pipelines are becoming more interconnected does not automatically imply that the regulatory arrangements that apply to them should automatically become more harmonized. Gas markets are different from the National Electricity Market (NEM) and interconnectedness is not a basis for one market like the NEM is.

The facilitated markets have evolved to address specific objectives and requirements in each jurisdiction. Ensuring that the markets meet their objectives and do so in an efficient manner in the long term interests of consumers should continue to be the basis on which markets are further developed.

5. How useful is the information provided on the Bulletin Board (BB) to market participants and what additional information could be provided to facilitate secondary trading?

The information that is currently provided by AEMO on the Bulletin Board is relatively useful.

The recent changes that have been enacted by AEMO on the Bulletin Board have improved the value of the information provided. We welcome all of the recent proposed changes by AEMO.

We would welcome further incremental changes relating to the supply of additional information to improve the quality of the information. These changes would include:

- AEMO establishing a capacity listing service on the Bulletin Board, and
- AEMO providing additional information regarding actual pipeline capacity utilization and capacity trading information.