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Mr John Pierce
Mr Neville Henderson
Dr Brian Spalding
Australian Energy Market Commission

Dear Commissioners

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Stage 1 Draft Report - Wholesale Gas Market and Pipeline Frameworks Review

EnergyAustralia welcomes the opportunity to make a submission on the 'east coast gas market and pipeline frameworks review stage 1 draft report' (*the draft report*).

EnergyAustralia is one of the country's leading retailers, providing gas and electricity to more than 2.6 million customers. We own and operate a range of generation and storage facilities, including coal, gas and wind assets, in NSW, Victoria and South Australia.

We agree with the draft report's characterisation of the east coast gas markets and the impact of the rapidly expanding gas export industry. Our gas markets are opaque and dominated by inflexible long term bilateral gas supply and transportation agreements. The facilitated markets are complex and underutilised. Gas exports are increasing the influence of international prices.

The opaque nature of the gas market makes it difficult to understand the efficient price of gas. However, it is apparent that prices are rising and that producers have achieved their objective to link at least some new gas supply agreements to US dollar oil prices.

It is in this context that Australian gas consumers have raised concerns about their ability to access competitively priced gas. Multiple gas reviews to date have been unable to assure them. In part, this is what the COAG gas market vision seeks to address. We are concerned that the draft report does not define a strategic objective and direction to implement the COAG vision to create more liquid and transparent gas markets.

EnergyAustralia believes gas market reform must ensure Australian gas consumers can confidently access competitively priced gas to meet their needs. Our wholesale gas markets should deliver an efficient price today, tomorrow and up to three years ahead that is transparent, liquid and priced in Australian dollars. This will ensure consumers who value it most can access gas at efficient, competitive prices. However we also acknowledge that the cost of significant changes to the market must be justified and be subject to the NEO

The current market arrangements are complex, costly and inconsistent. This is recognised in the draft report. However, in raising these issues we are seeking solutions to increase transparency and liquidity for the benefit of all consumers. We are concerned the direction outlined in the draft report may reduce cost and complexity by reducing transparency and liquidity for the benefit of suppliers and transmission owners only.

The need for coordinated gas market development strategy

The draft report does not define and articulate a coordinated strategy for improving gas market transparency, liquidity and competitiveness.

Reforms are needed to simplify and align the facilitated markets to increase trade through the market. Trade through the market is essential to maximising transparency and liquidity, and should be encouraged primarily by reducing barriers that impede voluntary value adding trades between participants. However this may also require improved regulation of some additional pipeline services where effective monopoly provision is likely.

Market reform must deliver on four key priorities.

1) Improve the accuracy, timeliness, and transparency of market information about physical supply and demand;

2) Encourage trade in pipeline capacity, and harmonise market designs and interfaces, to encourage trade between locations;

3) Facilitate price discovery and transparency in spot markets; and

4) Support the development of liquid and transparent forward markets.

We encourage the AEMC to define a clear strategy for consultation as soon as practical to guide the more detailed work that is needed on the facilitated markets and transportation arrangements. While we support many of the initial recommendations, some of the directions outlined appear likely to reduce market liquidity and transparency at demand hubs.

The development strategy should challenge key assumptions around what aspects of the current market structure should be carried forward in the long-term, particularly the role of long term bilateral gas supply and transportation contracts. The strategy should build on the history and strengths of current arrangements in each location while providing clear forward direction to overcome their limitations and weaknesses.

An argument between the relative merits of contract carriage vs market carriage, or STTMs vs the DWGM for a single national model is unlikely to be productive. A more nuanced discussion and strategy is more likely to deliver progress. Such a strategy could explore the potential benefits of market carriage or expanded hub services within trading zones, contract models for transmission lines between zones and the simplification and alignment of the STTMs, DWGM and supply hubs.

The draft report accords a low priority to facilitating on-market trade at the domestic demand zones in Victoria, Sydney, Brisbane and Adelaide. Facilitating competition and transparency for these consumers should be a high priority for the Commission. The actual market price within these zones at any time will be more important for most consumers than a remote reference price that varies considerably from the price at their location.

The oil and gas companies exporting through Gladstone are better placed than most users to negotiate gas contracts off market. We welcome and recognise their active support for the development of transparent, liquid markets that will better inform all Australian gas users.

Stage 1 recommendations

We support improving information and price transparency, and simplifying the facilitated markets. However, the stage 1 recommendations will have limited impact and should not distract or delay achieving more substantial reform.

We strongly support establishing a technical working group to guide the analysis and simplification of the STTM design. A technical working group to support the review of the DWGM should be established at the same time. There will be overlap between members and issues so joint meetings would be desirable. The working groups should be coordinated with the existing STTM and DWGM consultative forums run by AEMO.

In relation to the other stage one recommendations:

- *Improving price transparency*: a new price survey or aggregation of existing public information is unlikely to make a material difference and neither can substitute for robust market trade data.

- *Bulletin board 'one stop shop':* the core issue is the absence of information rather than fragmentation, however this may be a useful initiative at the margin.

- *Addressing information gaps*: we support addressing additional information requirements through stage 2 and the COAG rule change already underway.

- *Harmonisation of gas days:* we support harmonisation and suggest that 6am would be appropriate. However, this is not urgent and can be considered as part the package to harmonise other key settings across the DWGM and STTMs.

- *DWGM rule change:* we support removing the restriction on who can make DWGM rule changes. However it may be better to delay this until after the review to ensure rule changes are considered in the context of the overall gas market development strategy.

Stage 2 direction

We are concerned that the overall direction for stage 2 is not focussed on increasing competition, liquidity and transparency. In particular, we are concerned about the proposal to reduce the volume of trade through the STTMs and DWGM and the bias to embedding the primary role of long term bilateral contracts.

We would like to see more evidence and rational for proposals to:

- Separate the commodity and balancing markets;
- Move the point of commodity trading upstream to supply points; and
- Make participation in the STTMs voluntary.

We believe there is significant potential to incorporate learnings from the Gas Supply Hubs within demand hubs to simplify their design and deliver 'clean' prices. However we do not understand the rational to downgrade the demand hubs, particularly where they are serviced by multiple supply sources and allow for arbitrage between different hubs.

Further comment on the detail of the draft report is attached. For any questions regarding this submission, please contact me on (03) 86281034.

Regards

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Assessment framework

The gas export industry is dominated by large international oil and gas companies. It has developed largely in isolation to the existing facilitated markets, pipeline access regime, and other competition regulation. The primary role for government begins where domestic users are affected. The NGO should be interpreted in this context. This is by no means calling for distortionary policy, but a reflection on the imbalance in information and market power between local industry and international energy companies.

Gas export is part of the gas supply chain rather than a primarily consumptive use. A useful way to visualise this is to consider the hypothetical situation where Sydney invested in an LNG import facility. In this case gas flowing through Wallumbilla would have two options to access the Sydney market, compressed and shipped through existing pipelines or chilled and shipped by boat through Gladstone. The interpretation of the NGO in the draft report would regulate these two paths differently.

Strategic Direction

The AEMC has failed to identify the ideal gas market which is integral to the gap analysis required in the TOR. The Stage 1 report has failed to convey how the direction of stage 2 review will progress the COAG Gas Market Vision. The AEMC has identified failings in the current market design but is at risk of cementing in the role of long-term contracts by creating a market designed around supporting negotiations rather than reducing their necessity.

Producers have shifted focus from consumers to LNG shippers evidenced by contracts in USD linked to oil unconnected to the export market. The cost of both new supply and substitutes such as electricity are priced in Australian dollars and this has introduced an unnecessary risk premium to all Australian gas users.

There is an absence of evidence to support the market development direction that the AEMC has defined. In this context we support the creation and enhancement of facilitated markets at strategic supply points and at all major demand zones. Liquidity will naturally gravitate to certain locations; however it is difficult for policy makers to determine this in advance. It may be that commodity trading should concentrate at supply points or even at a single supply point, but we have not seen conclusive evidence for this. In any case it will be important to maintain efficient markets at the major demand points to transparently and efficiently expose the true marginal value of gas at these locations reflecting the very real physical and contractual locational constraints.

Assumptions must be challenged around the long-term structure of the market. In particular, the primary role of bilateral supply contracts and the role of gas in Australia’s energy mix going forward. More than ever electricity is competing in traditionally gas dominated areas. Is the market providing the flexibility to respond to changing consumer preferences? The objectives of the facilitated markets and how they operate in a cohesive way needs to first be examined before changes can be progressed.

Separation of commodity trading and balancing markets

Moving commodity trading upstream and removing the complexities from the price should enable a cleaner price. This will improve decision making and portfolio optimisation as prices at different nodes will be comparable. However this model will make it harder for large customers to participate directly in the market and will require registration in two markets as well as a capacity contract. Less trade at the point of use may make price less transparent for gas users.

The clear separation and identification of the mechanisms for commodity trading and balancing should provide representative prices. These mechanisms should be consistent throughout the east coast. The report looks to harmonise these but makes assumptions about the locations which they are required. It may be clear that balancing is not required at Moomba, however every other hub will require it (with the abolishment of the Brisbane STTM). It is also not obvious that commodity trading should be excluded from Sydney and Adelaide. This could also allow for capacity trading via the GSH spread products, single intra-day mechanism, and a commodity price at the point of use.

Intra-day trading

Intra-day trading is important. Limed improvements can be made in this area when the market is framed around inflexibilities imposed by producers and pipeliners. Nomination times and charges are the major barriers to flexibility which should be examined together with potential intra-day mechanisms.

The GSH model provides a mechanism to trade intra-day and should be considered as a cohesive replacement across the east coast.

Transmission pipeline frameworks

Point-to-point rights

How delivery points are specified in transport contracts and their flexibility is a barrier to capacity trading. The DWGM groups exit points which are located geographically close when dealing with AMDQ (cc); perhaps a similar system could be adopted for contract carriage pipelines.

Capacity trading

GSH capability at other demand centres could allow for spread products to replace the need for a liquid capacity market. Owners of capacity would arbitrage between markets providing transport at clear on market prices. The existing GSH model can be used to facilitate capacity trades without the need for extensive development or access regime reviews.

Failure to release

We do not believe this to be a significant issue. Pipelines that are uncovered have demonstrated that there is sufficient competition in downstream markets. Reducing costs and facilitating trades will see capacity used where it is valued most. An increase in traded volume will diminish the power available to incumbent holders of capacity.

STTM

We agree that the simplification of the STTM should be pursued. The loss of complexity may mean a movement away from causer pays to socialised costs. To what extent inefficient outcomes may result and the gains in access, ease, and liquidity outweigh them should be examined.

The ex-ante price has been unrepresentative of the long-term commodity price. However this is a price which enables flexible gas users to purchase or forego gas at a price they set. This price signal is important and this capability should not be removed from the market.

Work should be done on redefining the objectives of the STTMs before specific reforms are pursued. The simplification agenda being progressed will come at a loss of functionality. It needs to be ensured that this fits within an integrated national strategy.

Voluntary Brisbane STTM

Volume and pricing information is made available to the market through a gross balancing market which is lost when off-market transactions are encouraged and participants' positions are opaque. We question whether the cost savings of downsizing the market are significant. The loss of market information will allow for the extraction of rents.

We are concerned that voluntary participation in the Brisbane STTM will lead to market fees payable by a shrinking pool of participants. Without the socialisation of costs which comes from all gas passing through the STTM, the traded gas will elicit higher charges, and move transactions off market. This will lead to the eventual abolishment of the Brisbane STTM.

It is likely the case now that other means of balancing could be cheaper for current participants in Brisbane than an STTM model. However, this may be contrary to the COAG Gas Market Vision if it comes with a loss in transparency.

The trialling of a particular design in particular conditions which may not require any market at all will not represent the effectiveness of the market in Sydney or Adelaide. The Linear nature of the gas infrastructure and Roma Brisbane Pipeline covered status may allow for all commodity trading to move upstream to the GSH, but again this is particular to Brisbane and may not translate to other markets.

The more effective STTM design to be progressed in Stage 2 may suit the conditions of Brisbane. We suggest delaying the move to a voluntary market in Brisbane until further work is done simplifying the STTM design.

Balancing-only market

A balancing-only STTM would require participants to effectively purchase gas downstream and transport at short notice for short periods. If indeed participants can utilise upstream GSHs to largely balance their portfolio, a separate mechanism to deal with imbalances may not be needed. A single price cleared using a bid-stack which represents any gas bought or sold could replace the functionality of imbalances, deviations, and contingency gas.

DWGM

The Victorian gas market manages the majority of gas consumption within Australia. The NGO as applied to Victorian consumers should dictate the direction of the market.

Alignment of the DWGM with other facilitated markets is important for a cohesive solution. However this should not come at the expense of Victorian or other customers. We believe a coherent strategy for hubs at demand centres should be developed before progressing specific changes. However in principle we support the development of a 'cleaner' price. Some uplift charges could be socialised and included in TUOS.

All production and storage facilities should be treated equitably under the NGR.

GSH

We support the development work done by AEMO. The current timelines proposed by AEMO for the Moomba GSH would see implementation and trading before winter 2016. Given that the direction of Stage 2 defines a market requiring a supply hub at Moomba, we encourage COAG Energy Council to endorse AEMO's proposals at the next meeting, and to continue the development of Moomba GSH.

The GSH model may require further development depending on the outcomes of Stage 2 however this can involve changes after implementation just as Wallumbilla is progressing towards a single product after the beginning of trade. We believe a single product at Wallumbilla is a natural and necessary step towards the COAG Gas Market Vision.

Information

We support greater transparency. This includes the physical system at both an aggregate and participant level. There are legitimate commercial concerns, but it is up to the AEMC to decide what information supports an efficient market. Much of the information provided at the moment was once commercially sensitive information but is now accepted as a necessity. Movement towards a voluntary STTM will diminish the volume and pricing information available to participants.

We would like to see investment in the bulletin board systems to improve the timeliness of the information. Real-time data is necessary to support the new direction of the market and aids decision making in emergencies and on high demand days. Likewise, providing data on large users and reserves will enable shippers to make better decisions.

We agree measures to increase the accuracy of data should be examined. Often we have found capacity outlook information on the bulletin board to be less than representative. All production and storage facilities should be treated equitably under the NGR.