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Australian Energy Market Commission
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Lodged (by online): www.aemc.gov.au/Contact-Us/Lodge-a-submission

Review of the Victorian Declared Wholesale Gas Market – Discussion Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Australian Energy Market Commission's (AEMC) Review of the Victorian Declared Wholesale Gas Market Discussion Paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 34 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 59,000 people and contribute $24.1 billion directly to the nation's Gross Domestic Product.

The Association is broadly supportive of the AEMC examining the appropriateness of the declared wholesale gas market (DWGM) design in light of changing east coast gas market dynamics. The Discussion Paper provides useful context in this regard, particularly with respect to understanding the perceived limitations of current market arrangements and potential opportunities for reform. While the esaa believes it is premature to pursue fundamental changes to the wholesale gas market design and pipeline transportation arrangements at this stage, it is prudent to explore market development/improvement opportunities within the current framework. Where appropriately targeted, this will assist with facilitating flexible access to supply, drive efficiency gains and enhance competition across the broader east coast gas market.

East coast gas market dynamics are changing

The east coast gas market is currently in a state of transition. Production costs are rising, political uncertainty is hampering onshore gas development in a number of regions and most notably, the liquefied natural gas industry (LNG) is driving a step change in demand. Collectively, these developments are fundamentally changing the nature and scale of the east coast gas industry.

Given the size of the LNG export volumes that are anticipated on the east coast, it is clear continued resource development will be key to alleviating any supply/pricing pressures for domestic market participants over time. But flexible access to downstream markets will likely become increasingly more important, particularly given the desire for greater market transparency and more effective trading and risk management facilities. The Victorian DWGM has an important role to play in this regard.

The DWGM has an important role to play in providing flexible access to gas supply, but there are limitations with the current framework

The DWGM is generally considered to be beneficial to the extent it provides participants with a market-based mechanism for managing short-term trading positions. It also plays an important role in enabling new entry to the gas market, providing participants with access to gas in the initial phase of market entry and allowing them to develop the experience and understanding of demand requirements before committing to long-term bilateral contracts for supply and transportation. The size and maturity of the market as well as the pipeline carriage arrangements have assisted in this regard.

But as identified by the AEMC, there are a number of limitations with the current framework. From an operational perspective, the complexities and pricing risks associated with trading in the DWGM may diminish the market's overall value. The presence of a number of ancillary prices other than the traded commodity price makes the DWGM difficult to trade in, as the costs and risks are uncertain and difficult to hedge. These costs can also be material relative to the wholesale gas price, with uplift charges totalling $45.8 million in 2007. As a result, market participants generally seek to closely match their own injections and withdrawals to minimise exposure and manage their risk with longer-term bilateral contracts.

A lack of clarity around the definition of transmission capacity rights in the DWGM can also lead to challenges in allocating and contracting and weak incentives for infrastructure investment. This issue arises because private investors are not able to gain exclusive firm capacity rights on the pipeline they have funded. Investment decisions may subsequently be driven by the regulatory process, which may be less efficient and timely than relying on market driven investment decisions.

Strategic reform of the DWGM must be carefully considered

Considering how best to address these (and other) limitations in pursuit of the COAG Energy Council's Australian Gas Market Vision is challenging. Any consideration of the wholesale gas market design must ensure the ongoing needs of existing participants and agreements are met, while also continuing to facilitate new market entry. This needs to be achieved in an environment of substantial demand growth and changing gas market dynamics.

There are also important trade-offs to be considered when seeking to deliver greater market liquidity, lower operational costs and more effective locational signals for investment and trade. For example, transitioning from market carriage to contract carriage arrangements would improve investment signals in the declared transmission system (DTS), but it may also constrain new market entry as market participants would be required to obtain a gas transportation agreement. Similarly, moving to a voluntary wholesale trading market design may reduce operational costs for market participants, but could also lead to lower trading volumes and reduced market liquidity.

The esaa considers it prudent to explore market development/improvement opportunities within the current framework before concluding that a completely different model is required. Ideally, this approach should assist with preserving the benefits of current market arrangements while also ensuring the DWGM and associated pipeline transportation arrangements remain fit-for-purpose in the context of the broader east coast gas market.

Consistent with this, the Association believes there is merit in examining some form of simplified pricing mechanism. As discussed above, a key issue with the current market framework is the complexity and cost of trading. Linking ancillary prices back to the commodity price could improve market participants' ability to manage risk, enhance price discovery (which may also be influenced by the development other trading markets such as the Wallumbilla Gas Supply Hub) and foster greater market participation and liquidity. It may also encourage the development of financial products that participants can use to hedge their exposure to prices in the DWGM.

As noted in the Discussion Paper, the question of removing or changing the ancillary payment and uplift allocation mechanisms are inextricably linked to the issue of pipeline investment signals and mechanisms in the declared transmission system. Any consideration of the simplified pricing mechanism may therefore need to be coupled with an examination of pipeline transportation arrangements.

The Association is supportive of the AEMC examining the potential to introduce transmission capacity rights to the DWGM with the objective of better facilitating market-led investment in network expansions, balancing the advantages of access to capacity provided by the current system. But this analysis must give consideration to the potential impact on AMDQ and AMDQCC. The Association would also caution against making the transmission framework even more complex in an attempt to more closely align it with incentives for investment under the contract carriage framework.

To the extent consideration is given to an entry/exit model, it will be important to understand how this model differs from current arrangements, given both appear to offer independent entry and exit rights from the transmission system and can create firm (or firm-like) injection and withdrawal rights. The extent to which congestion may be an issue within the DTS and how this issue would be managed under an entry/exit model would also need to be investigated further.

The Association is broadly supportive of examining opportunities to facilitate more flexible and transparent access to gas supply and transportation capacity. In developing and pursuing work in this space, continued industry engagement is essential. Further, any decision to proceed with fundamental changes to current market arrangements must have regard to existing property rights and should ultimately be informed by robust cost-benefits analysis.

Any questions about our submission should be addressed to Shaun Cole, by email to shaun.cole@esaa.com.au or by telephone on (03) 9205 3106.

Yours sincerely

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