

The Australian Energy Market Commission Review of the Victorian Declared Wholesale Gas Market – Discussion Paper

Submission by the Department of Economic
Development, Jobs, Transport and Resources

The Victorian Government welcomes the opportunity to provide comments on the Australian Energy Market Commission's (AEMC) Declared Wholesale Gas Market (DWGM) Discussion Paper.

Victoria is committed to pursuing reforms in the Victorian DWGM to ensure it continues to be effective, competitive and transparent for market participants. These reforms will ensure that the Victorian economy benefits from more efficient use and trade of gas, and delivers benefits to industrial and residential customers.

The Victorian market carriage model offers many benefits, including open access, relatively low barriers to entry and exit and the promotion of efficiency in the Victorian Declared Transmission System (DTS). Nevertheless it is known to have some significant issues in terms of pricing of transmission capacity, unpredictable uplift charges and associated risks for participants. Inefficient augmentation or expansion of the gas network, potentially associated with inadequacies in the current suite of investment signals, would exacerbate these issues.

These challenges are being examined in the context of substantial recent changes to the east coast gas market to which the DWGM is linked. The commencement of Liquefied Natural Gas (LNG) exports should bring positive economic benefits to the Australian economy broadly, but the flow-on price effects from exports has highlighted significant rigidities and shortcomings more broadly across the transmission network that forms the east coast market from Tasmania to Queensland.

Natural gas is an important commodity for Victorian manufacturers who use it as an energy source and as a feedstock. Manufacturers and other industrial users are likely to face increasing cost pressures in an internationally competitive market. Likewise, households are expected to face rising gas prices at a time when many have recently experienced rising electricity prices.

The AEMC presents five options – presented as high-level packages of reform – to advance consultation with stakeholders. This presentation is consistent with reform concepts outlined as part of the AEMC Wholesale Gas Markets Discussion Paper. The AEMC does not offer support for any particular option in its discussion paper, and likewise, the Victorian Government remains open to stakeholder views regarding the merits of the alternative proposals. In principle, the Victorian Government seeks meaningful and ambitious reform to the DWGM to advance the interests of gas users who are heavily dependent on affordable and sustainable gas supplies.

The Government's response to the discussion paper is detailed below.

1.1. Victoria's interest

Victoria is the state most exposed in its domestic economy to gas prices, and most dependent upon gas supplies for heating for comfort and wellbeing. Given the expectations that LNG exports from Queensland will place upward pressure on domestic gas prices over the long term, and that these prices will filter through to the rest of the eastern gas market, Victoria must manage a range of impacts without necessarily benefiting from these exports. Victoria must also ensure that changes in the market do not imperil security of supply.

As the AEMC notes, export linkage is expected to introduce more volatility and unpredictability into the domestic gas market in addition to placing upward pressures on prices. This volatility and unpredictability works against the use of the traditional mechanism for managing gas price risk in Australia – long term gas supply contracts – as suppliers are evidently less willing to offer these under the new conditions. This is problematic for industrial customers, gas retailers, and the domestic and small business customers served by those retailers.

Hence, market reform is of great importance to Victoria. A reformed market where gas can be competitively traded across regions, allocated efficiently by the market, and which gives rise to transparent price signals for further investment, conservation and demand response, offers the prospect of better tools for management of gas price risks by consumers and retailers. Efficiency and security of supply are best delivered by such a market. But the current state of the eastern gas market is far from this ideal, as the AEMC's review documents make clear.

Victoria's interests therefore can be summarised as:

- Ensuring the continued security of supply to Victorian customers
- Ensuring competition in the production and retailing of gas to limit price pressures on Victorians
- Development of transparent market signals resulting in efficient demand response and better ways to manage gas price risks for Victorian customers
- Efficient utilisation of the Victorian principal transmission system in service of the above
- Ensuring interstate trade of gas is efficient to the mutual benefit of Victoria and the other states and territories.

1.2. Recommendations will need to be based on rigorous analysis of the costs and benefits of different options

The Victorian Government expects clear recommendations that are underpinned by solid analysis and evidence and, where appropriate, quantitative analysis should be undertaken.

The recommendations should also be informed by relevant international experience. The USA, United Kingdom, and Europe have pursued significant reform over recent decades, and the outcomes and applicability to Australia of different models trialled overseas should provide useful material for the AEMC to understand where improvement can be made.

It is also crucial to Victoria's community that any broader market reforms in eastern Australia serve the large domestic and industrial loads in Victoria well. Gains in retail competition that have been facilitated by the DWGM must be preserved, security of supply must be ensured, and interstate trade must be efficient to ensure Victorians are not exposed to price shocks and supply problems.

1.3. Options for reform need to be compatible with reform of the east coast gas markets

Options for reform to the DWGM will need to be compatible with the recommendations of the East Coast Gas Review.

Any future reform or redesign of the DWGM will inevitably present significant challenges. Broader east coast gas market reform is likely to result in the DWGM acting as one pricing point or region within a broader market framework, pricing the cost of delivered gas in the demand centres of central Victoria. Ideally, this will send the right signals about where gas and supporting infrastructure is most needed.

In the event, however, that reform to the broader east coast gas market is not robust, delayed, or in the interest of Victorian gas users, there may need to be a suite of separate standalone recommendations for reforming the DWGM. It is therefore expected that the AEMC will assess the compatibility of the potential DWGM reform packages with the three concepts established as part of the AEMC Wholesale Gas Markets Discussion Paper and give advice as to the complementarity, or incompatibility of DWGM reform options with those for the broader east coast market. This will need to include outlining potential pathways for reform.

1.4. Security of Supply

The 1998 Esso Longford gas explosion, which caused severe supply disruptions to Victoria for several weeks and significant financial losses to business and industry, influenced key design elements of the Victorian wholesale gas market, which predated the DWGM.

Any changes to the design of the DWGM and broader East Coast gas markets must not reduce Victoria's security of supply. It is expected that the AEMC will assess security of supply implications for each of the reform options for both reviews. It is also expected that the AEMC consult closely with the Australian Energy Market Operator (AEMO) on assessing system security implications for different reform options and pathways.

1.5. Is market led investment in the Declared Transmission System occurring in an efficient and timely manner

Investment has occurred in the DTS; recent examples include the Western Outer Ring Main expansion and the Culcairn interconnect expansion. However, there are ongoing concerns over the dependence of most investment on regulatory settings. The arrangements in the DTS may be impeding private investment in pipeline capacity expansions.

The Victorian Government is also concerned that some gas generation proponents have stated that they have deliberately avoided connecting to the DTS when making locational decisions due to the difficulty in obtaining firm capacity and managing price risk.

The AEMC will need to investigate whether there are appropriate and efficient signals for market-led investment in pipeline capacity expansions in the DTS. This includes whether the existing regulatory approval cycle facilitates investment in a timely manner.

Some of the questions Victoria would like to see explored are:

- What is the optimal level of investment and how do you measure it?
- Has investment been adequate?
 - Is it occurring in an efficient and timely manner?
 - If not, why not?
- What new investment is anticipated in the future?
 - What are the implications for investment if there are forecast reductions in demand?
- What tools are available to facilitate investment?
 - Can they be deployed in the current market settings, or are fundamental design principles at stake?

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

The DWGM arrangements should not impede the transportation of gas through interconnected pipelines. However, a number of risks and barriers are involved in trading gas through the DWGM on its way to other locations.

Improvements to the DWGM to facilitate gas trading could potentially involve greater cost reflectivity, better incentives to support investment in import and export capacity, greater operational simplicity, access to tradable firm capacity rights, and a greater ability to manage risks.

In assessing potential reform options for enhancing transportation of gas between the DTS and interconnected pipelines, it will be paramount to ensure the continued security of supply to Victorian customers.

1.7. Facilitation of market entry and promotion of competition

The DWGM arrangements were established to facilitate market entry and promote competition in upstream and downstream markets.

The Victorian market carriage model may offer comparative benefits to other east Australian markets, including open access, relatively low barriers to entry and exit and the promotion of efficiency in the DTS. However, given changes to the DWGM and surrounding markets, the design of the DWGM deserves reconsideration.

The Victorian Government notes that several stakeholders have raised concerns regarding the complexity of the DWGM. With a view to reducing transaction costs, encouraging participation and enhancing competition, it will be important for the AEMC to focus on making the DWGM more user-friendly. This will also include, where possible, simplifying its design, systems and/or interfaces.

1.8. Close collaboration with the Australian Energy Market Operator

Given that the DWGM is operated by the AEMO and the technical nature of this review, the Victorian Government considers that strong collaboration with AEMO will be essential for the success of this review. The Victorian Government welcomes the AEMC's collaboration with AEMO over the course of this review.

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