20 October 2015

Mr John Pierce
Chairman
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Lodged via www.aemc.gov.au

Dear Mr Pierce,

Review of the Victorian Declared Wholesale Gas Market (Ref GPR0002)

GDF SUEZ Australian Energy (GDFSAE) appreciates the opportunity to comment on the Australian Energy Market Commission (AEMC) Victorian Declared Wholesale Gas Market Discussion Paper (the Discussion Paper).

GDFSAE is appreciative of the work to date carried out by the AEMC reviewing east coast gas market, and in particular, of the concise descriptions of the Declared Wholesale Gas Market (DWGM) mechanisms, their strengths and weaknesses, and possible packages of reform.

The sudden growth in the Australian gas industry has been well documented and forecasts suggest that the nature of gas supply across Australia is fundamentally changing. The DWGM is the first facilitated gas market established in Australia and although it has generally achieved the objective of promoting retail gas competition in Victoria, it is not at all clear that the DWGM will continue to meet the needs of the rapidly changing Australian gas industry.

Although the Australian gas industry is growing, it is relatively small in terms of the number of participants, and the pipeline network is long and relatively non-meshed. These somewhat unique features need to be carefully considered when weighing up the various options for industry reform.

On the other hand, if we are to encourage new entrants into the Australian markets, and promote efficient investment in new pipeline capacity, then it will be necessary to ensure that there are well functioning, competitive commodity markets and pipeline capacity trading.

GDF SUEZ Australian Energy
Level 33, Rialto South Tower, 525 Collins Street
Melbourne, Victoria 3000, Australia
Tel. +61 3 9617 8400 Fax +61 3 9617 8401
www.gdfsuezau.com
INTERNATIONAL POWER (AUSTRALIA) PTY LTD
ABN 59 092 560 793

In the following section, GDFSAE has provided some comment on how we perceive the current arrangements in the DWGM, and in particular, what problems we believe need to be addressed. Later in this submission we provide some comment on the five packages that have been outlined by the AEMC.

The ability to manage risks is fundamental to any successful market arrangement. As outlined in section 3.1 of the discussion paper, smaller parties trading in the DWGM are unable to manage their price risks, whereas larger participants with secure contract positions are able to manage risk. This places an asymmetrical burden on smaller participants and acts as a barrier to new entry.

In addition, participants that do not hold rights to authorised maximum daily quantity (AMDQ) or AMDQ credit certificates (AMDQcc), have no means to hedge against congestion uplift charges. This further complicates and restricts the ability of participants to effectively manage their price risk exposure.

Separate uplift payments mean that the commodity price is not “clean”, with the result that participants are unable to effectively manage their market price risk exposure through hedging. As noted in the discussion paper, the current multiple price component arrangements of the DWGM mean that participant price risk effectively cannot be hedged. In addition, the existence of the separate uplift payment means that it is unlikely that a standardised physical product reference price will emerge.

Although uplift payments have been low in recent years in the DWGM, the expected increase in gas flows between the north and Victoria in response to the demands of Liquid Natural Gas (LNG) development in Gladstone in Queensland may increase constraints and therefore uplift payments in the coming years,

Although the DWGM market is a compulsory market, many participants have underlying gas supply contracts and therefore do not need to rely on the DWGM, other than for balancing their injections and withdrawals. The AEMC stage 1 report indicated that only 20% of trades through the DWGM reflect daily imbalances. As a result, the DWGM commodity price is unlikely to be a true reflection of the underlying supply – demand balance for gas.

GDFSAE is concerned that the DWGM does not provide effective signals for investment in new or enhanced gas infrastructure. The allocation of AMDQ and AMDQcc does provide a mechanism for participants to partially manage their exposure to congestion price risk, but the fact that the additional AMDQ or AMDQcc only becomes available after AEMO or APA have agreed to extend or expand pipeline capacity means that this does not provide a signal for investment, but rather an opportunity that becomes available after an investment decision has been made.

The ongoing uncertainty over whether AMDQcc will continue to be classified as a reference service and whether a reference price will continue to be set by the AER, or whether a return to the arrangement whereby APA decide on AMDQcc prices will eventuate, further undermines the effectiveness of the AMDQcc as an investment signal.

GDFSAE does not believe that the market carriage model as currently applied in the DWGM promotes efficient and timely investment in the Victorian pipeline infrastructure. A more effective investment signalling mechanisms is desirable for the market to be effective and will ensure the market will evolve appropriately in response to changing gas flows.

Comments on proposed policy responses

Package A: Target Measures

Package A includes a number of targeted measures aimed at improving opportunities for risk management, addressing the free-rider issue for new investment and improving the process for allocation of AMDQcc.

Package A does not seek to overcome the issues that prevent the DWGM from providing an efficient reference price and so would not facilitate the development of financial risk management products.

Package B: Simplified DWGM pricing mechanism and transmission rights

This package would see the removal of ancillary payments and a simplified pricing mechanism used that would be based on a single schedule that optimises bids and offers subject to all pipeline constraints. This would improve market price transparency and facilitate the establishment of a reference price for financial trading.

A single pricing schedule that includes all constraints is likely to increase price volatility, although participants would have improved ability to hedge against the price risk.

This package would also amend the AMDQ arrangements and allow participants to contract with APA for firm transmission rights, or choose to enter into a service agreement with APA for non-firm access.

As noted in the discussion paper, the success of this package would be critically dependent on being able to set the tariff for over-run by non-firm participants, so that it is high enough to incentivise new investment, but low enough to ensure that any spare pipeline capacity can be efficiently utilised.

Package C: Zone-based pricing and capacity rights

This package would have the same simplified pricing mechanism as package B, and would also establish a number of different pricing zones (perhaps four) across Victoria. This would provide more effective pricing signals that identify where congestion is occurring, and thus, stronger locational signals for investment.

Package C would also introduce financial capacity rights through which inter-zonal investment would be triggered. These would operate in a manner somewhat similar to the settlement residue auction process in the National Electricity Market.

Package D: Entry-exit model

This package would convert the current market carriage model into an entry-exit model, where network users secure capacity rights independently at their preferred entry and exit points, with no need to specify a transmission path.

A virtual hub would be established for all of Victoria, removing the current mechanism which implicitly allocates capacity through trading of wholesale gas,

This model has been successfully implemented in Europe and it is worthy of consideration for the DWGM, as well as the other gas trading zones in Australia. However, there would need to be a very detailed assessment of its suitability to the Australian context, with relatively long and un-meshed pipelines, and limited numbers of participants.

There would need to be evaluation of a number of design elements, including whether trading and balancing were to be carried out on a voluntary or mandatory basis and the price discovery mechanism.

Package E: Hub and spoke model

The final package in the discussion paper involves a balancing hub at Melbourne, gas supply hubs at Longford and Iona, and converting pipelines to contract carriage.

Changing from the current market carriage to a contract carriage model is likely to be a challenging reform, but offers the potential advantage of more efficient investment in pipelines and better allocation of investment risk.

Assessment of the packages

The AEMC has done a very good job describing in high level, five alternative packages of potential reform of the DWGM, ranging from an incremental improvement to a fundamental re-design. Nevertheless, in assessing the advantages and disadvantages of these packages, inevitably questions turn to matters of detail – how would the reforms be implemented exactly, what are the costs and risks, how would existing property rights be protected, etc.

The discussion paper suggests that aspects of package A would be relatively easy to implement compared to the other packages. This might lead to package A being favoured by some stakeholders who are concerned that a major change may not be justified.

GDFSAE suggests that the problems identified with the DWGM are material issues now, and are likely to become more limiting as the gas industry grows. This east coast gas review provides an important opportunity to overcome these limitations and move towards a more effective gas market. GDFSAE therefore believes that package A does not go far enough in tackling the issues that have been identified with the DWGM.

GDFSAE suggests that before any strong commitment can be given to any of these packages, or any other proposals, there needs to be greater design detail made available, including modelling and examples where applicable.

Although GDFSAE does not at this stage feel that it has enough information to endorse any one package over another, our general view is that something more than package A would be desirable.

GDFSAE is attracted to the use of models which provided stronger price signals at specific locations and give stronger investment signals. Working through these issues with the AEMC in greater detail is a necessary next step to progressing the reform of the DWGM.

GDFSAE trusts that the comments provided in this response are of assistance to the AEMC in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8331.

Yours sincerely,

Chris Deague
Wholesale Regulations Manager