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12 February 2016

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Re: Submission to the East Coast Gas Review Stage 2 Draft Reports

The AER welcomes the opportunity to respond to the AEMC's Stage 2 Draft Report (Draft Report) and the supplementary paper dedicated to information provision released as part of its East Coast Wholesale Gas Market and Pipeline Frameworks Review (the east coast gas review). This submission also responds to the AEMC's draft recommendations from its separate but complementary ongoing review of the Victorian Declared Wholesale Gas Market (DWGM).

Introduction

The AEMC's draft recommendations are designed to support the achievement of the COAG Energy Council's (COAG EC) vision for Australia's future gas market (the Vision). We note when the COAG EC released its Vision in December 2014, it reaffirmed its commitment to the National Gas Objective (NGO). The AEMC's draft report notes "the elements that make up the Vision can be considered the "means" of promoting the overarching objective – the National Gas Objective".

The AER is supportive of reforms which we consider will likely further the NGO. In preparing this submission, we have considered the likelihood that, and the extent to which, the draft recommendations will further the NGO.

As the AEMC will likely recognise, the complexity of some issues will require full and transparent justification given the extent of changes proposed. More information is required in order to progress consideration of specific issues.

To this end, we support the AEMC's announcement of an updated consultation schedule and the publication of complementary discussion papers. We will continue to work with the AEMC on this important policy reform.

The following sets out our responses to the AEMC's draft recommendations.

The road map for gas market development

At a high level we support the AEMC's efforts to develop a road map to guide and inform future gas market development. A roadmap is likely to provide a sound basis for cohesive reform of the gas markets and ameliorate the risk of concurrent and/or competing policy reform processes.

We consider the recommended pathway to concentrate trading at two points on the east coast (the Northern and Southern hubs) may have some merit, and we support the AEMC's continued work to further the NGO.

However, as set out below, we consider some of the draft recommendations which comprise the road map require further detailed development.

The Victorian gas market and the 'Southern hub' changes

The AEMC's overall recommendation is for governments (in particular the Victorian Government), to commit to the detailed design of the new Southern Hub trading model covering the existing Victorian declared transmission system (DTS). Implementation of the Southern hub will involve significant changes to both the DWGM and the transmission network regulation framework.

While we note the AEMC acknowledges the draft report does not constitute a detailed technical design, we consider there is insufficient detail at this point to form a view in support, or otherwise, of the overall recommendation.

This is particularly important when seeking to make changes to the Victorian arrangements, which many participants consider have been broadly successful in achieving its key purposes.

Specifically, the Victorian arrangements were designed in part to improve the efficiency and transparency of pricing signals and the responses to these pricing signals by market participants. These arrangements work together to ensure reliable supply of gas and overall system security. As acknowledged by the AEMC, the arrangements were also designed with the objective of supporting retail competition and encouraging diversity of supply and upstream competition.

Despite this success, the AEMC considers that the current arrangements are no longer suitable in light of the emerging significant structural changes associated with Queensland's liquefied natural gas (LNG) industry. We agree the impact of Queensland's LNG industry will be felt across the east coast of Australia and note significant changes have already occurred including in Victoria. It follows that the AEMC's review of the current Victorian arrangements is warranted.

Further detail is required to explain how the changes to the DWGM and the transmission network regulation framework will work individually and together.

Set out below are our preliminary thoughts on several of the more significant issues.

Changes to the wholesale market design

The draft report describes the proposed Southern hub market design as "voluntary trading with market-based balancing". The AEMC considers that participants will be incentivised to balance their injections and withdrawals from the DTS, and will also be able to procure gas from the exchange, bilaterally using over the counter contracts, and traditional longer term gas supply agreements (GSA).

Under the current arrangements participants are already incentivised to balance their injections and withdrawals. Although, as with most arrangements, there may be room for improvement, we consider further information is required to understand how the recommendations are an improvement on the status quo.

In addition, arrangements already in place allow participants to procure gas from the Victorian Market, bilaterally or through longer term GSAs. It is not clear how the Southern hub market design will improve the gas procurement options already available to participants.

While we accept trading in the Southern hub could be characterised as 'voluntary', it seems the overall level of participation under the proposed Southern hub will be similar to the current market. At a minimum, participants will still be required to notify AEMO of the quantities of gas they need to withdraw from the system, and will be 'billed' for this gas by AEMO if the withdrawal isn't balanced against a corresponding injection. We note this is a complicated issue and we will work with the AEMC to gain further insight on the proposal.

We understand the proposed changes to the Victorian market are driven in part by a desire to encourage the development of a derivatives market to help participants manage risk. Further work may be necessary to investigate derivatives markets in Victoria. This could help stakeholders better understand why a derivatives market has not successfully developed to date, what problems have emerged in the absence of such a market, and the likelihood the proposed changes will result in one being established. We note the Wallumbilla hub was also designed with the aim of encouraging the development of a derivatives market; however trading activity in the related derivatives products has been low.

The introduction of exchange based trading may be an improvement on current arrangements to the extent it enables the trade of gas over more time frames (day ahead, weekly, month ahead, etc.). We are interested in hearing responses from stakeholders on this topic (in particular market participants) as they best placed to understand what products will be useful to the market.

Changes to the network regulation framework

The entry-exit system for DTS capacity allocation

We are supportive of regulatory arrangements which promote market driven signals to further efficient investment, consistent with the NGO. The AEMC recommends moving away from the current market carriage arrangements to an 'entry-exit' system for allocating capacity on the DTS. This proposed system is designed to provide a market based mechanism to signal new investment.

However, it is not clear whether or the extent to which inefficient or untimely investment has been an issue.

Our March 2015 submission in response to the AEMC's public forum addressed APA's (the owner of the DTS) concern that five year regulatory cycles had caused investment delays in the DTS.¹ In our submission we referred to the AEMC's 2013 Gas Market Scoping Study which examined this issue. Relevantly, the scoping study stated:

“given that there are a number of provisions in the NGR that are designed to enable investment to occur within the regulatory period, this claim was surprising”.

Our submission also explained that the previous owner of the DTS, GasNet, sought pre-approval of the Corio Loop expansion project under provisions in the Gas Code (which preceded the Gas Rules) prior to the commencement of the 2008–12 regulatory period.

The draft report notes stakeholders consider the current market carriage arrangements have been successful in achieving their original objectives. Under market carriage, shippers do not have to obtain firm access rights for the DTS. However, under the proposed entry-exit model, shippers will be required to obtain capacity rights to enter or exit the DTS, which could create a barrier to entering the Victorian market, which may reduce the attractiveness of the Victorian market for new entrants, such as retailers and industrial users, and reduce liquidity. These issues may need to be explored further.

In order to progress these matters, it is imperative to better understand how the market driven signals (auctions or individuals triggering investments) and the regulatory approval process of setting tariffs will work together. This will require further information and discussion.

Determining tariffs

The AEMC recommends tariffs be set to recover the prospective costs of satisfying additional demand at each entry and exit point, and considers a methodology based on long run marginal cost (LRMC) will help achieve this.

As a general principle, we do not consider the Gas Rules should prescribe any particular methodology. Instead, it is more appropriate for the Gas Rules to set out principles to guide the approach of determining tariffs.

We support the AEMC's aim to increase locational signals and consider the economic costs of expansion. However we consider that further work is required to better understand the proposed approach and how it differs from the current pricing framework that applies to the DTS.

The AEMC proposes the Southern hub be implemented by 2020. Given APA GasNet is due to lodge a revised access arrangement for the DTS at the start of 2017 (for the period 2018–22), we consider transitional arrangements for the regulation of the DTS need to be considered as a priority.

¹ APA raised these concerns at the public forum. In its October 2015 submission to the AEMC's discussion paper it did not identify any investments in the DTS which were considered to be inefficient or untimely.

The 'next steps' for the other wholesale gas markets

The development of the Wallumbilla hub

Like the AEMC, we support AEMO's work in continuing the evolution of the Wallumbilla hub to improve liquidity. The extent to which participants respond to the "Optional Hub Services" arrangements will help inform policy options to further develop the market.

The AEMC has put forward some ideas for future market development, such as transitioning from the physical hub to a virtual hub and expanding its coverage. We welcome the draft report's exploration of these issues as it helps provide a guide to what future market reforms may look like.

Short Term Trading Markets

We support a review of the STTM hubs to find ways to simplify and lower costs for participation. We note, however, that this work is somewhat contingent on the development of the Northern and Southern hubs, which in itself is a draft recommendation at this stage. However, we note that currently several participants use the STTMs not just as a balancing mechanism, but also to buy and sell gas. Any changes would need to consider the impact on these users as a priority.

Proposed Bulletin Board reforms

Recent market developments have meant that participants are becoming increasingly reliant on Bulletin Board information to monitor changes in production and other market conditions. Like the AEMC, we note that "gaps" in the current framework mean that some important information is not published. The fact that actual and forecast demand data is not provided by the three liquefied natural gas (LNG) export facilities in Gladstone is one such example.

We consider that the issue of "gaps" in the current framework is so important that it warrants immediate attention. The draft report sets out a comprehensive package of reforms to facilitate the provision of more useful and accurate market information. While we note some specific comments below, broadly speaking we support the Bulletin Board reforms package.

Extending the range of information available to market participants will improve the ability of relevant parties to make more informed decisions.

Data quality standard

We have previously noted (such as in our Quarterly Compliance Report) the importance of participants providing accurate and timely information to the Bulletin Board. We have taken steps to help improve the accuracy and timeliness of Bulletin Board data provision, such as conducting targeted compliance reviews, making improvements to internal systems, and emphasising the importance of this area with industry.

The AEMC is concerned the Bulletin Board provisions establish a "low standard for information to be reported" and that this could adversely affect the market's confidence in the Bulletin Board. It has proposed the introduction of a reporting standard to address this problem.

We are supportive of measures to improve the accuracy and timeliness of data reported to the Bulletin Board.

Generally, any rule (and where relevant, any procedures) should be clear about:

- Precisely what information is required and
- The timeframes for submission

The introduction of a data quality standard could also help to further improve the accuracy and timeliness of data reporting. However before we can make a full assessment we would need to consider how the standard would fit within the proposed new reporting framework. We are keen to better understand how it could sit amongst the other obligations, what form it might take (good gas industry practice, or something else) and precisely how it would apply. For example is it proposed that the standard apply to the actual data itself, or the systems and processes the participant applies to prepare and report that data? We will continue to work with the AEMC to fully explore these issues.

The other Bulletin Board recommendations

The proposal for some large users to be allowed to delay the reporting of nomination data and/or actual pipeline flow information where they can clearly demonstrate the release of this information would affect competition in another market appears appropriate. We also support the recommendation that the AER take on the role of assessing these situations. It is, however, important that we see more detail on the proposal, such as the definition of 'other markets' and the criteria and process for the AER to apply.

We support the draft recommendation to clarify which provisions, if breached, could lead to a breach of s. 223 of the National Gas Law (which is a civil penalty provision) as this helps participants better understand their obligations and further strengthens the overall compliance framework. Also, we support the simplification of the registration provisions (and classifying the obligation to register as a civil penalty provision) and exemption criteria as well as broadening the coverage of the Bulletin Board.

The AEMC has indicated there may be additional consultation through a working group focussed on information provision and the Bulletin Board. We are committed to continuing our involvement in the development of this important reform.

The facilitation of pipeline capacity trading

We agree that a well-functioning gas transmission sector is required to achieve the NGO and the objectives of COAG EC's Vision. We broadly support the relevant draft recommendations to the extent that they free up short term transmission capacity at a competitive price. We understand the need for short term capacity has grown recently in response to the commencement of LNG exports from Queensland. More efficient use of existing transmission pipeline infrastructure could produce further benefits downstream in the wholesale markets which may flow through to consumers.

The ACCC Gas Inquiry is investigating pipeline capacity issues, and we support the AEMC's final report being informed by the ACCC's findings. Also, further consideration needs to be given to the effect the pipeline capacity trading recommendations will have on the regulation of covered pipelines.

The draft report outlines a number of potential new roles for the AER. It is appropriate for these roles to be performed by us. The draft report notes that further work is required to determine the details of the overall framework and how it will impact stakeholders. Once this is completed we will be better placed to consider the specifics of any new roles for the AER.

We would be pleased to provide further assistance to the AEMC on its east coast gas review. Please contact Peter Adams, General Manager, Wholesale Markets, on (03) 9290 1465 if you would like to discuss any aspect of this submission.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'P. Conboy', with a stylized flourish at the end.

Paula Conboy
Chair
Australian Energy Regulator