31 March 2016

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

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

Dear Commissioners

Lodged electronically: www.aemc.gov.au (GPR0003)

AEMC 2016, East Coast Wholesale Gas Market and Pipelines Frameworks Review, Pipeline Access Discussion Paper, 3 March 2016

EnergyAustralia welcomes the opportunity to respond to the Pipeline Access Additional Discussion Paper (the Discussion Paper). We are one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market.

In our previous submission outlined concerns with two of the recommendations put forward by the Australian Energy Market Commission (the Commission) in the Stage 2 Draft Report. These included a backwards step on intra-day renomination flexibility available to participants and impacts to related markets from the publication of information on primary capacity sales.

We appreciate that the Commission has addressed a number of the concerns we raised in our previous submission. In this submission, we expand on the reasons where we still have concerns and provide further support for our suggested approach. Our preference is for:

- An auction for interruptible capacity with a simple compensation method to increase access and utilisation in uncongested pipelines.
- A capacity trading platform to facilitate short-term trades of firm capacity to improve allocative efficiency during high value periods of congestion
- Publication of detailed historical data by participant which provides additional transparency without the negative effects on related markets which would arise from the publication of information on primary capacity sales

Good governance of the implementation process is integral to the success of the reforms. Our preference is for an industry council with some regulatory involvement. This approach would

provide assurance that the reforms are progressing in the right way while giving industry the flexibility to elaborate the design details to ensure they are practical and low cost.

If you would like to discuss this submission, please contact me on (03) 8628 1242 or Ben Hayward on (03) 8628 4518.

Regards

Melinda Green

Industry Regulation Leader

1. Implementing the initiatives

1.1. Industry-led or regulator-led implementation processes

The package of reforms outlined in the East Coast Wholesale Gas and Pipelines Frameworks Review are of a different nature and more comprehensive than many industry-led initiatives. The Commission correctly identifies that:

- additional rule changes may be required, leading to timing uncertainty;
- an industry-led approach can be less costly than a process requiring law or rule changes;
- industry-led approaches are often used successfully and are well-accepted by participants;
- an industry-led approach may be delayed or not produce a successful or consistent outcome where the interests of affected parties are not aligned or some parties are adversely affected by the changes; and
- industry participants cannot compel others to act quickly or in compliance with the review's recommendations.

For these reasons, EA is not averse to there being additional oversight in the development of the final details of the reforms rather than it being an entirely industry-led process. We prefer a lighter style of governance that would involve either the threat of regulatory intervention or the formation of an industry council to act as a steering committee for the reforms. A steering committee type structure would only need to encompass initiatives that were more likely to require rule changes or where participants have disparate interests. In either case, it would be useful for the Commission to be an observer to be able to be close enough to the process to:

- facilitate any rule or law changes,
- identify issues and take appropriate action, and
- understand any difficulties in meeting the recommendations and allowing flexibility and consideration of alternatives that may be more feasible or beneficial rather than holding participants to strict compliance.

1.2. Cost-benefits analysis and the implementation process

EA will not fully support the entire package of reforms until the new market environment is clearer, it can be demonstrated that such substantial reforms will achieve the desired

objectives and the reforms are backed up by a positive cost-benefit assessment. Implementation of any unnecessary or unsuccessful reforms will introduce additional expense that will ultimately be passed on to energy users.

In the Discussion Paper, the Commission requests participants to provide more information about the costs and benefits of the proposed reforms. While we completely support this as a necessary step, we don't yet know the full extent of the reforms to be able to give useful or reliable cost information. Providing information on benefits is particularly difficult, particularly at this early stage.

Ideally, we would like to see that the reforms are only fully committed to after further work to outline the details with industry involvement and the costs and benefits of each initiative is assessed. To ensure that changes are not made for little incremental benefit, we suggest that the initiatives are implemented in a stepwise manner, once it is known that other simpler and less costly alternatives are not sufficient. This approach would fit in well with the implementation process outlined above which includes industry workshops with some regulatory oversight.

2. Auction for contracted but un-nominated capacity

2.1. Interaction with existing nomination and renomination rights

We support:

- An auction for interruptible capacity with a simple compensation method to increase access and utilisation in uncongested pipelines.
- The implementation of a capacity trading platform to facilitate short-term trades of firm capacity to improve allocative efficiency during high value periods of congestion

It is essential that participants maintain the opportunity to renominate pipeline capacity as required. As outlined by the Commission, renomination rights are integral to managing fluctuating gas demand and responding to price changes through the day. Factors that contribute to this volatility include:

- weather factors that vary customer gas requirements;
- change in customer gas usage profiles (unplanned shutdowns and start-ups); and
- the needs of electricity markets in relation to gas powered generation.

This will become increasingly important as more intermittent generation is installed and LNG facility outages create large supply and demand swings across the east coast gas market.

In uncongested pipelines, interruptible capacity is a sufficient substitute for firm capacity rights. Providing interruptible capacity will achieve the purpose of the auction which is to allow short-term access to capacity and increase utilisation for an efficient price.

However, where the pipeline is physically congested and firm rights are auctioned, the incumbent shipper would not be able to utilise their firm capacity (or at least not the full amount). This would be a backward step. Firm shippers have taken long-term positions to be able to have the flexibility to renominate beyond the nomination cut-off time. We have

considered what changes would be induced in participant behaviour under the proposed capacity auction arrangements, and cannot understand how a shipper could retain the flexibility they currently have without facing higher costs through imbalance or auction charges.

During physical congestion where transport is highly valued, it is likely that firm shippers will find a revenue positive use for their transport or nominate more conservatively in case of a change in weather. Therefore it is unlikely that an auction for firm rights over interruptible will provide significant advantages to auction winners but may incentivise inefficient use of transport by incumbent shippers. The capacity auction does not provide a mechanism for efficient allocation of capacity between shippers in these cases. It's not clear that, overall, the outcomes on a congested pipeline are efficient. This issue requires further consideration.

Under the proposal, firm capacity can be obtained on the trading platform(s). This provides a balance of firm and interruptible services while maximising usage, but without negatively affecting the firm rights of existing shippers. This appears to be appropriate. However, another matter that requires more attention is the viability of short-term trades that can be aligned with commodity trades on the gas supply hub for major routes. Improvements to trading will also allow for renomination rights of existing shippers to remain unaffected as an auction for firm rights would become unnecessary.

2.2. Curtailment order

We believe that a curtailment order is appropriate and that auctioned capacity should be curtailed before incumbent shippers. For this reason, firm trades between shippers would be likely to be valued more highly than auctioned capacity.

2.3. As-available rights

Currently, where a pipeline route is only used opportunistically, as available contracts may provide additional transport above the level of contracted firm. Given that as available contracts will become largely redundant, there is the potential that in some cases less capacity will be available for short-term use.

2.4. Individual or combinatorial allocation

As capacity on individual sections is useless without the entire route, a combinatorial auction is essential. It's unacceptable that shippers could be at risk of purchasing capacity that is unusable because it's only part of the transport route required.

Complementarities between different pipelines and segments of pipelines are extremely important. For example, to bring gas from Wallumbilla down to Victoria effectively requires three pipelines and an interconnect – SWQP, QSN, MSP and the VNI.[1] A second route into Victoria would be SWQP, QSN, MAP, SEAgas and SWP.[2] A shipper would want to purchase all or none of their requested capacity across one route to avoid paying for unwanted capacity.

[1] South West Queensland Pipeline, Queensland to South Australia/New South Wales Link, Moomba to Sydney Pipeline, Victorian-New South Wales Interconnect
[2] Moomba to Adelaide Pipeline, South East Australia Gas Pipeline, South West Pipeline

A similar issue arises where a shipper wants to align purchase of commodity and transport. The capacity auction requires a shipper to commit to one of either a GSH commodity transaction or a capacity auction purchase before the other.

2.5. Prices paid by winning bidders

We agree with the Commission that in a simple auction, the second price rule (the winner pays the minimum required to win the auction) would be preferable however this may be difficult to implement with a combinatorial auction. Given that a combinatorial auction is important we agree that the first price rule (pay-as-bid) should be implemented.

We note that although the auction would take place daily, the fluctuations in the price of capacity with congestion and demand would make efficient bidding difficult for shippers under a first price rule. Where there is no congestion, it may be simple to implement the second price rule without complexity. Here, winners of auction would pay the auction floor price.

2.6. Number of rounds in the auction

We agree with the Commission that the benefits of multiple rounds do not appear to outweigh the costs of increased complexity.

2.7. Scope of the auction

Shippers will require capacity across multiple pipelines, often these will be owned by different parties. At this stage we do not see how multiple platforms can deliver the requirements to link sections of capacity in a single bid.

2.8. Institutional setting

We agree with the Commission that AEMO is the natural choice to operate a cross-pipeline auction. Participants have information sharing and reporting arrangements with AEMO which can be leveraged.

We require the ability to align capacity purchases and sales with commodity purchases and sales on the Gas Supply Hubs. This could not be achieved without a single market operator for both products.

2.9. Allocation of auction residue

In the event of a combinatorial bid being successful, the residue value should be allocated pro-rata. A Shapely value allocation method (paid in proportion to the value of the auction without that segment) is overly complicated and does not necessarily deliver a more efficient outcome. The pro rata allocation could be determined by relative pipeline length or by reserve price.

2. Capacity trading platform(s)

We support a single trading platform that covers all relevant contract carriage platforms. We consider that AEMO would be the appropriate candidate for reasons covered by the Commission. That is, AEMO is a single point of coordination for gas and transport for the

industry, using AEMO would allow participants to manage a single set of prudential arrangements, and help to minimise IT implementation costs.

The current gas trading platforms are under-utilised. An exchange for transport capacity that aligns with the GSH would increase the useability of the markets and increase trading of both capacity and commodity. The interdependency of the two markets means alignment is necessary to allow trades to be completed without the potential to gain an unusable asset where a participant only obtains transport **or** commodity, but not both. The viability of this option should be further investigated as it is a serious concern that is not yet fully resolved.

3. Information on primary capacity purchases

The Commission has recommended that information on the prices struck for all primary trades be published, along with information on the key terms and conditions that may have affected the prices struck in those trades.[3] We support increased transparency in principle as it can improve outcomes for consumers, but not where it would have unacceptable or disproportionate commercial risks to some businesses. A more appropriate mechanism to improve transparency than the proposal put forward by the Commission is to mimic the NEM by publishing detailed historical data by participant.

Detailed historical information can substitute for participant position information without the unwanted effects. This goes some way to aligning the gas market information with the transparency in the NEM. Currently, this information can be approximated by analysis of STTM and DWGM data published at the participant level. The reforms will remove the availability of this information which the Commission should remediate with a recommendation for its direct publication on the Bulletin Board.

Our concerns with the Commission's recommendations are:

- Upstream gas supply positions will be revealed by publication of contracted MDQ. This reduces the bargaining position when negotiating other gas supply contracts. A lack of upstream gas could also alert a gas seller to a strong need to buy gas from them.
- A transparent transport position at a particular location allows a gas seller to increase prices as the cost of transport has been sunk by the buyer.
- Electricity market positions will be revealed as purchased gas transport signals to the market that a gas powered generator does or does not have supply for a particular period. This will damage the competitive position of generators looking to sell electricity derivatives as well as a retailer looking to purchase a hedge rather than rely on their generator.

If the Commission proposes that aggregated primary trade information is published, we suggest it is restricted to a timeframe of one to two years in advance, as this would provide information on prices being paid aligning with new entrant hedging timeframes. To ensure discrimination is not occurring, an average price paid for firm capacity is all that is necessary. There should also be a hurdle that enough capacity has been sold to ensure an appropriate level of aggregation can be reached.

[3] AEMC 2016, *East Coast Wholesale Gas Market and Pipelines Frameworks Review*, Pipeline Access Discussion Paper, 3 March 2016, Sydney, pg 76

Additionally, primary trade information should not be published where negotiations of downstream and upstream transactions may be compromised. We note that:

- Gas Supply Agreement negotiations could take 1-2 years
- the electricity forward market is only liquid 2-3 years in advance

The Commission should also consider that there is cause for the price of capacity or the flexibility that can be offered in a contract for a particular period to fluctuate over time. For example, a reduction in the forecast usage of a pipeline could necessitate a reassessment of the efficient price as the pipeline would otherwise be left with unsold capacity. Publication of contract prices and terms holds the seller to maintaining prices and terms over time despite the opportunity for incremental benefit.

Primary trades and secondary trades are not inherently different, but generally, secondary trades are made for smaller volumes and shorter periods. We are therefore more comfortable with information on secondary trades being published. This is similar to the treatment of major supply contracts compared to GSH commodity trades, the latter of which are published.