



17 February 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,

RE: East Coast Wholesale Gas Market and Pipeline Frameworks Review (Ref GPR0003)

GDF SUEZ Australian Energy (GDFSAE) appreciates the opportunity to comment on the Australian Energy Market Commission's (AEMC's) East Coast Wholesale Gas Market and Pipeline Frameworks Review stage 2 Draft Report (the Draft Report).

GDFSAE owns and operates around 3540 megawatts of renewable, gas-fired and brown coal-fired generation in South Australia, Victoria and Western Australia. GDFSAE's retail business, Simply Energy, serves customers in Victoria, South Australia, New South Wales and Queensland.

There has been a great deal of commentary in recent months on the changing dynamics in the Australian gas industry, with particular focus on the challenges facing the eastern Australian gas markets. These challenges include the establishment and growth of the Queensland liquid natural gas (LNG) export industry and the changing dynamics of gas fired electricity generators due to increases in the volume of intermittent generation sources.

These changing dynamics are already causing unprecedented variations in the volumes and patterns of gas flows across the Australian east coast. Given the potential scope of changes it is important for industry and governments to assess the durability of current markets and to ensure that the eastern Australia gas market arrangements continue to provide participants with a suitable level of liquidity and flexibility to trade gas for both the short term as well as the longer term.

In response to these challenges, the Council of Australian Governments Energy Council has established a vision for Australia's future gas markets as follows:

"The Council's vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established,

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

and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities.”

This vision is supported by GDFSAE as it captures the essential desirable features of markets that are both liquid and geographically focused, as well as providing supply and investment signals.

The eastern Australian gas market arrangements have been reasonably successful in the past in providing mechanisms for participants to trade in gas supply and transport. More recently however, GDFSAE has become concerned that the gas market arrangements have been evolving in a number of different directions with now three different and complex hub designs in use across eastern Australia.

GDFSAE appreciates the points made by the AEMC in chapter two of the Draft Report which describe why there may be justification for going to the effort and cost of structural change to the gas markets. There are a number of specific areas of concern for GDFSAE with the current gas market arrangements. For example, GDFSAE believes that the detailed design of both the Short Term Trading Market (STTM) and the Victorian Declared Wholesale Gas Market (DWGM) are overly complex, with the multi-layered approach to gas pricing making it difficult for secondary trading and other risk management mechanisms to evolve.

A further area of concern for GDFSAE is the lack of locational pricing signals in the current market designs which mean that signals to prompt new investment are poor and non-transparent. A recent example of this is the South West Pipeline in Victoria where there have been several instances of participants being constrained with little forward warning, and very little opportunity to respond.

Lack of flexible options for trading in gas pipeline capacity is another area that GDFSAE believes warrants attention as the current arrangements can mean that pipeline capacity is not always available to the party that values it most in the short term.

As the Draft Report has proposed a number of key reform ideas, and GDFSAE has set out below its response to each of the key elements.

Southern Hub

The Draft Report outlines the proposal for the evolution of the DWGM to a “southern hub”, which would be a voluntary exchange-based virtual trading hub with balancing ultimately achieved through active trading. Pipeline capacity allocation would be carried out through a new entry-exit regime, and the AEMC expects that a reference price would emerge facilitating risk management products.

The AEMC have published a separate draft report – “Review of the Victorian Declared Wholesale Gas Market” specifically focussing on the proposed development of the DWGM. GDFSAE believes that the ideas proposed by the AEMC are worthy of further consideration as they would appear to have the potential to overcome the deficiencies identified in the current arrangements.

Notwithstanding this general support, GDFSAE would need to have the opportunity to understand and comment on a more detailed assessment of how the proposed southern hub would operate in practice, and importantly, how the transition from the existing arrangements to the new would be managed, including the protection of existing property rights.

GDFSAE has provided more detailed comments on the southern hub in a separate submission to the AEMC in its Review of the Victorian Declared Wholesale Gas Market.

Northern Hub

The AEMC have proposed that the existing Wallumbilla supply hub should evolve to become the “northern hub”, which would initially remain as a physical hub, with the potential to expand to a virtual hub in the future, subject to consideration of the costs and likely benefits.

Compared to the recommendations for the southern hub which appear to be quite bold, the recommendations for evolution of the northern hub seem somewhat tentative. Given this has been the area of significant attention in recent years this is somewhat of a surprise. Nonetheless, the recommendation to assess the impact of the hub-services initiative that the Australian Energy Market Operator (AEMO) has proposed for Wallumbilla does appear to GDFSAE to be a prudent step to take.

A key question for the success of the proposed northern hub is whether a sufficient level of liquidity is likely to develop. Given that AEMO already have a proposal in place to develop a new hub at Moomba, and the existence of the STTM at Brisbane, GDFSAE has a concern that these hubs will in some respects, compete with each other in a manner that reduces liquidity.

With this concern about liquidity in mind, GDFSAE agrees that simplifying the Brisbane STTM to form a balancing service is appropriate. The manner in which this occurs requires further consideration but the proposal suggests that Brisbane gas demand will be increasingly dependent on Wallumbilla supply. Whether this is appropriate for the Adelaide and Sydney hubs requires additional discussion. Issues of liquidity aside, a reduction in complexity across the STTM's is desirable.

Expanding the northern hub to a larger virtual hub has conceptual appeal and suggests a way to better manage liquidity concerns, but as noted in the Draft Report, may be cost prohibitive. Nonetheless, GDFSAE has some reservations with the AEMC's suggestion to assess how well the proposed hub-services arrangement evolves before deciding on whether a larger virtual hub might be warranted.

The AEMC is well placed to critically appraise the suitability and value of the proposed hubs services model and make recommendations that perhaps industry has been unable or unwilling to. As this review process presents the important opportunity to review the markets development and make firm recommendations a wait and see approach may ultimately prove ineffective.

If hub services are to be used going forward, and noting the concerns with the hub services model, the AEMC needs to clearly articulate how and where hub services are acceptable and how they will be regulated, if required.

Pipeline capacity framework

The key element of the AEMC proposed changes to the pipeline capacity framework is to introduce an auction for contracted but un-nominated capacity with a regulated reserve price. The capacity auction would be carried out for short-term products only, which the AEMC claim would avoid the auction process undermining long-term investment signals.

GDFSAE is generally supportive of reasonable steps towards improving the flexibility and transparency of trading in pipeline capacity. GDFSAE believes that if these improvements were to be achieved, it would likely result in more efficient outcomes as the parties that most value pipeline capacity on a given day would have the opportunity to purchase capacity to meet immediate needs but would not have the benefits of long term access which would still be highly valued in the market.

GDFSAE is aware of a number of areas of concern with regard to this proposal, and agrees that these would need to be further considered in detail before committing to an implementation program. Some of these concerns are set out below all of which GDFSAE does not believe are insurmountable.

One area that will need close examination is the terms and conditions within gas transport agreements that relate to rights and obligations for parties to renominate their requirements. GDFSAE understands that under the standard gas transport agreement, the pipeline owner may not be obliged to accept a firm renomination, which would leave the party that is seeking to renominate having their capacity then made available for sale through the auction process. The extent to which this is a contractual issue, a revenue issue or a market design problem is somewhat unclear, but this should be considered carefully to ensure the appropriate balance between long-term contractual rights and short-term trading incentives.

The arrangements need to be carefully considered for owners and operators of gas powered generators that may need to respond to quite volatile and short term price signals emanating from the electricity market. It would be an unfortunate outcome if the electricity market were negatively impacted through gas powered generators not being able to generate at peak periods due to their gas pipeline capacity being unavailable. This would also appear counter to the intentions of the proposal.

The value that a party places on pipeline capacity may change dramatically and suddenly in response to changes in either or both of the gas and electricity markets. For example, a gas powered generator may, based on low forecast prices in the electricity market, decide that it is unlikely to run during the upcoming twelve hours, and decide to sell its pipeline capacity rights. However, if a large thermal generator in the same region were to unexpectedly trip, the wholesale electricity price is likely to increase dramatically, and the gas powered generator may then have a commercial interest (or need) to generate.

The dynamic nature of gas and electricity markets does not mesh well with fixed auctions, but rather are better served by a regular series of trading opportunities to reflect changes in circumstances.

Market Information

GDFSAE agrees with the AEMC observation in the Draft Report that a workably competitive market requires participants to have ready access to the information that they require to make informed decisions about expected market outcomes and behaviour. It is also true to say that to come to a reasonable pricing expectation a range of information about production and consumption, transportation and investment levels is required.

The gas bulletin board currently provides a range of real time information and standing data on a number of different measures including gas flows, nominations, forecasts and longer-term outlooks.

The AEMC have formed the view that there are some gaps and asymmetries in the information provision that may be impacting negatively on gas market efficiency. In response the AEMC Draft Report includes a number of recommendations to improve the gas bulletin board information transparency and governance.

GDFSAE is cautiously in support of the general thrust of the recommended changes, although we remain somewhat concerned at the apparent trend by regulators and governments towards placing increasing information disclosure obligations on businesses without sufficient justification of the need, balanced against the compliance costs and potential confidentiality problems.

The proposed expansion of the gas bulletin board to include, among other things, proven and probable reserves, hub services reporting and large user ratings and consumption seem reasonable, but will need to

be framed to ensure that the reporting and compliance obligations are not unnecessarily onerous, and that, to the extent possible, commercially sensitive data and information can be protected.

GDFSAE supports the proposed improvements to the governance framework for the gas bulletin board which reflect the more significant future role of the gas bulletin board compared to its humble beginnings. This includes removing the current cost recovery prescription from the national gas rules, and incorporating these costs into the AEMO fee methodology process, along with the other market fees that AEMO manage.

Implementation

GDFSAE notes that the AEMC has very recently (4 February 2016) announced additional detail consideration of four key elements of the proposed eastern Australia gas review; namely pipeline capacity trading, information and bulletin board, along with gas balancing and capacity allocation for the southern hub. It is proposed that this work is completed in time for the AEMC to then publish its final report and recommendations in May 2016.

As noted previously in this submission, GDFSAE is of the view that the proposed reforms outlined in the Draft Report are worthy of more detailed consideration, and is supportive of the AEMC publishing the proposed four additional design papers.

Without having seen the upcoming design papers, GDFSAE would expect that they contain a greater level of detail, including description of how the new arrangements might work in practice, and how they would respond to a range of unusual conditions. It would be beneficial to include a number of scenarios to allow participants to consider the resilience of the new models to changing circumstances and for the AEMC to host sessions where industry and the AEMC can progress through the detail as a group.

To the extent possible, the implementation should be carried out in stages with transparent decision gates to ensure that preconditions have been met prior to proceeding to the next step. Developing the detailed implementation plan will be an important milestone and this should be shared with participants prior to finalising the plan.

Liquidity measures

GDFSAE supports utilising transparent measures to assess the development of the proposed northern and southern hubs. The AEMC has proposed four liquidity measures in the Draft Report, namely level of participation, price relevance, liquidity threshold and liquidity trading horizon.

Whilst the proposed four measures are focused on factors that are relevant to an assessment of liquidity, GDFSAE is somewhat concerned with setting specific quantitative targets at this early stage, particularly given that the detailed design elements of the proposed new hubs has yet to be determined and tested.

It may be that a better approach for applying measures is not to set absolute thresholds, but to observe the trend in various measures over time to establish that the arrangements are trending towards increased liquidity.

GDFSAE would prefer that the measures proposed are initially simply monitored and reported on a regular basis. After a period of at least 12 months, an assessment could then be made as to what might be appropriate thresholds for the four metrics to assess whether liquid markets have been achieved or not.

In summary, GDFSAE believes that the AEMC proposals for gas market reform are appropriately targeted towards addressing the most apparent deficiencies in the current gas markets, and if implemented correctly, have the potential to enable participants to trade more efficiently. GDFSAE is supportive of the AEMC's work and working further with AEMO and industry on the detailed design considerations and confirming that implementation can be managed effectively.

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