



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: 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's (AEMC's) Review of the Victorian Declared Wholesale Gas Market (DWGM) 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,

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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.

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.

The DWGM arrangements have been reasonably successful in meeting its original objective of supporting retail competition and diverse supply options. More recently however, GDFSAE has become concerned with a number of elements of the DWGM market, including the lack of a clean price which would enable secondary trading and risk management facilities to develop.

A further area of concern for GDFSAE is the lack of locational pricing signals in the current market design 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.

GDFSAE believes that the proposed reforms to the DWGM have the potential to overcome these deficiencies, and encourages further detailed design analysis. Below are some specific comments on the Draft Report.

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 expect that a reference price would emerge facilitating risk management products.

Retaining a virtual hub is supported by GDFSAE as the current DWGM has been based on this approach to date and a virtual hub should continue to provide a basis for healthy liquidity. The proposed southern hub moves away from the current mandate on participants to make bids and offers for gas injections and withdrawals, even when they are in balance. As a general principle, GDFSAE favours mechanisms that incentivise participants rather than imposing mandatory obligations. Making the southern hub voluntary with incentives on participants to ensure that their own injections and withdrawals are in balance is consistent with this principle and is therefore supported by GDFSAE.

It is suggested that the proposed southern hub will support a clean reference price that would facilitate the development of financial products to enable secondary trading and risk management. The current lack of effective hedging instruments for risk management is a barrier to entry for some potential participants and doesn't meet the needs of existing participants. As such, providing participants with more effective risk management options overcomes this barrier to entry and improves market liquidity.

The proposed arrangements for balancing at the southern hub require the hub operator initially to have a residual balancing responsibility which would be employed in the event that participants are not collectively balancing their injections and withdrawals. This approach leaves open the question of what measure would be used to assess whether the market could be opened up to participant incentives to balance, rather than a

central process. It is also unclear how the market's capability to achieve balance through participant incentives could be assessed while a central balancing mechanism is in place.

Entry - Exit model

One of the key design concepts of the proposed southern hub would see the current market carriage and annual maximum daily quantity framework transitioned to an entry-exit system for network capacity allocation.

The entry-exit framework would allow network users to book and pay for network capacity rights independently at each entry or exit point on the network. An auction process would apply to entry-exit points where there are multiple participants. A regulated charge would apply at entry-exit where there is only one active participant.

The Draft Report suggests that the entry-exit model changes the risk allocation of the network investment decisions since the network user will be exposed to some of the investment costs and benefits through the entry-exit cost and service.

GDFSAE notes that the entry-exit model does provide a potential mechanism to improve network capacity procurement and risk allocation, but is also mindful of potential complexity and has a level of concern at the suitability for the Victorian context. These points are noted in the Draft Report, which acknowledges that the AEMC intend to consider these issues further within this review. GDFSAE supports this further consideration by the AEMC.

Congestion management

The Draft Report notes that although the entry-exit model signals the need for new network capacity, it does not provide a signal that precisely identifies the specific investments that should be undertaken. Gas flow changes can result in congestion occurring even though flows at each entry and exit point remain within limits.

The Draft Report notes that congestion can be managed either through allocation of short-term rights to reflect short-term capacity, or through the hub operator imposing operational constraints to manage the network limits.

Before taking any decision to pursue new arrangements such as these, it will be important to carry out detailed consideration of how effective the new model would be in the current context, and whether the costs of moving to such a model would be justified.

GDFSAE can envisage potential benefits from employing an entry-exit model, but does not feel that it has sufficient understanding of how it would function and what the commercial and operational complexities would be. This is a crucial point. If the proposal does not resolve the operational and scheduling issues that are currently experienced in the market then the reform should not be supported. GDFSAE therefore welcomes the AEMC announcement that it will be providing further detailed analysis on this proposal.

Implementation

GDFSAE notes that the AEMC has 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.

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.

Summary

GDFSAE believes that the design concepts proposed by the AEMC for the southern hub are worthy of further consideration. Based on the level of detail provided, the proposals appear to have the potential to alleviate some of the challenges experienced in the existing facilitated market. That said, GDFSAE is conscious that facilitated markets by their very nature introduce arbitrary boundaries and the AEMC is cautioned not to introduce one form of deficiency in exchange for another. On this basis, GDFSAE supports further analysis and assessment.

GDFSAE appreciates the extensive work of the AEMC looks forward to 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 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