



14 June 2013

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

GPRO001: GAS MARKET SCOPING STUDY

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) Gas Market Scoping Study.

Australia's east coast gas market is undergoing an important transitional period with exports of Liquefied Natural Gas (LNG) scheduled to commence in 2014. With annual gas demand expected to more than triple by 2017,¹ the changing landscape has precipitated an increased level of scrutiny of existing market arrangements. As a result, there are a number of gas-related reviews and initiatives currently underway or expected to commence shortly.

The AEMC has recognised the new dynamic in the east coast gas market through its proposed gas strategic priority and this Scoping Study. We understand the Scoping Study is intended to provide a view of the state of the gas market and identify potential areas for improvement in downstream regulatory and market frameworks.

Origin appreciates the opportunity thus far to engage with the AEMC on the Scoping Study through a direct one-on-one discussion and workshop. In this submission, we outline our key views discussed at our two previous meetings.

Market arrangements in a changing landscape

Despite the changes underway, Origin does not consider there are material problems with the functioning of the east coast gas market that would require a fundamental change to market arrangements. We consider the current downstream market arrangements to be sufficiently robust to manage the emerging LNG industry whilst continuing to promote the long term interests of gas consumers.

Market development should therefore focus on incremental improvements that will enable market participants to operate effectively and efficiently in the changing gas market landscape. Incremental improvements that are industry led are the preferred way forward.

Improving risk management in the market

A key incremental change that could enhance participants' operations in the east coast gas market is to strengthen their ability to manage market risks effectively. Currently in both the Victorian Declared Wholesale Gas Market (DWGM) and Short Term Trading

¹ AEMC 2013, *Gas Market Scoping Study Terms of Reference*, May, p. 1

Market (STTM), the requirement for physical delivery has hindered the development of hedging products. In addition, there are a number of prices, other than the traded commodity price, that increase the complexities and costs associated with operating in these markets. For the STTM in particular, the risk of operating on a particular day is not restricted to the commodity price on that day as there are various market prices associated with trading gas in the hub that day that are referenced to other days. For example, the Market Operator Service commodity payment or charge in the STTM values the additional gas that was delivered or stored on the pipeline at the ex ante market price set two days after the gas day (D+2) for which the MOS was allocated.

Amending the current market design to keep risks and exposures in the various markets contained within the particular market to which they directly relate in order to develop prices for these risks and exposures could create opportunities for developing secondary products and financial hedging instruments. In essence, improving participants' ability to manage physical risk could promote the development of products to manage financial risk. Such risk management developments could deliver greater benefits for existing and prospective participants by facilitating better trade and competition.

For example, in the STTM this could take the form of reforms that allow participants to manage risk on a single day without reference to other days. This could be facilitated by developing daily settlement and balancing arrangements that would then allow all market and deviation changes to be referenced to these daily prices. Similarly in the DWGM, this could take the form of reforms that price the value of ancillary and uplift charges into the market.

Trading hubs

There are demand trading hubs currently operating in Victoria, Sydney, Adelaide and Brisbane and a new supply trading hub is to commence operating in Wallumbilla in 2014. The process of developing the new Wallumbilla hub has led to some discussion as to what the optimal number of facilitated trading markets on the east coast is. Origin suggests any consideration of a new hub must be clear on the purpose of the hub. Analysis should also be done on the costs and benefits of the hub to ascertain whether it is the most effective way to deliver its intended purpose.

As a general observation, more trading hubs may not necessarily result in more efficient market outcomes. Specifically, the additional perceived benefit offered by a new hub in the presence of existing hubs may not be sufficient to outweigh its cost. While a new hub may provide a new price signal, consideration needs to be given as to what this price represents and its value. For example, the price differential between an existing and new hub may simply represent the cost of transport between the two hubs, in which case the new hub is not providing any additional information to gas market participants and so is not enhancing gas market efficiency.

Furthermore, there is a finite amount of liquidity in the east coast gas market. The establishment of additional hubs is likely to result in this liquidity being spread across the various hubs as opposed to an increase in the aggregate level of liquidity. As a result, while there may be more price signals, this may be at the expense of fewer but better quality price signals. To the extent that additional hubs cause fragmentation in this manner, they may undermine market efficiency.

Regulatory arrangements aligned to the classification of gas pipelines

The National Gas Law and National Gas Rules outline the regulatory framework for gas pipelines. While this framework allows for the classification of a pipeline as either a distribution or transmission pipeline, the framework is identical for both pipeline classifications.

There are a number of physical and technical differences between distribution and transmission pipelines. In addition, in terms of access and competition, a clear difference is that a distribution pipeline is a natural monopoly asset because there is generally no alternative to distribution services for retailers and end users. In contrast, transmission services are relatively more competitive. For example, to transport gas south from Moomba, the Moomba to Adelaide Pipeline and Moomba to Sydney Pipelines are viable alternatives.

This raises the question as to whether it is appropriate that the regulatory framework is identical for both pipeline classifications, particularly in terms of the process of reaching coverage decisions and the correct form of regulation for a covered pipeline. Given the monopoly characteristics of distribution pipelines, coverage is important in ensuring fair access for retailers and end users. It may therefore be appropriate that the regulatory framework reflect a presumption in favour of coverage for distribution pipelines and that there would be a reasonably high threshold if there is any deviation from this.

Capacity trading for transmission pipelines

Recently, there has been some discussion around unutilised but contracted capacity on some pipelines and potential options to facilitate increased trade in this capacity. Origin does not consider this a significant issue that warrants regulatory intervention. In practice, shippers have an incentive to on-sell any unused but contracted capacity they may have to another shipper in order to make a return on their sunk cost. It is our experience, however, that there has been limited demand for this. This may be as a result of a lack of transparency whereby a participant seeking capacity may have limited awareness of suitable counterparties or their contact details.

To address this issue, Origin is in discussions with industry and the Australian Energy Market Operator (AEMO) to develop a webpage that would list the contact details of counterparties interested in trading capacity on transmission pipelines on the east coast. As demand for these services increases, industry can then identify options for streamlining trade.

Standardisation of distribution networks

The National Energy Customer Framework (NECF) involves the harmonisation of State-based regulatory frameworks for the retail energy market and energy distribution sector into a single set of national rules. The focus of the NECF is on providing a regulatory framework for the relationship between energy customers and the energy retailers and distributors that supply them and includes a range of energy-specific consumer protections.

A key benefit of the NECF is that it is expected to facilitate an increase in retail competition by reducing regulatory complexity and lowering barriers for energy retailers to enter into the market across participating states and territories. The NECF process undertook to standardise distribution networks' terms and conditions for access and to streamline related business processes. While some standardisation was achieved - for example with respect to distributor credit support provisions - much was

left up to networks to determine individually, including areas that could readily be standardised, such as payment terms and arrangements for indemnities. As such, Origin considers this an area for further improvement that further promotes increased competition and is in the long term interest of consumers.

Improving prudential arrangements in the gas market

Prudential arrangements in the east coast gas market require that a business participating in a number of different trading hubs provide separate bank guarantees for each of those hubs. This increases the overall number of guarantees a business must hold and there is a cost to the business of having to administer these multiple guarantees.

Origin considers a prudential offset mechanism would improve market efficiency. Such a mechanism would work both across trading hubs (i.e. a single guarantee to cover the prudential requirements for the DWGM, STTM and Wallumbilla supply hub) and across a business (i.e. a single guarantee for a number of related bodies corporate). This issue was considered as part of AEMO's Energy Market Prudential Readiness Review. An example given in its Consultation Paper shows that a business in the STTM is required to put in place \$13.1m of bank guarantees to support all its entities in the Adelaide and Sydney hubs. With prudential offsetting, there is a substantial reduction in the amount of credit required to \$1m.² The benefits of offsetting are obvious in that the cost of operating in the gas markets can be significantly reduced.

Alongside a single guarantee for a business operating in the gas market, there is also merit in considering a single guarantee for a business operating in both the gas and electricity markets. This is a more complex proposal but still warrants consideration given the potential for further reducing costs to operate in the energy market.

Relationship between market parameters for gas and electricity

The AEMC's Discussion Paper on its Strategic Priorities for Energy Market Development acknowledges that the previously expected convergence between the electricity and gas markets is likely to be delayed. This is due to lower electricity demand in the National Electricity Market leading to a deferral in new base-load generation capacity.³ In spite of this, a review of the market parameters operating in the gas and electricity markets collectively, in particular the Market Price Cap (MPC) in the STTM and National Electricity Market and Value of Lost Load (VOLL) in the DWGM, may be appropriate.

Market participants often operate across both the gas and electricity markets. This enables participants to make portfolio decisions on how to deploy gas and electricity, particularly at times of market stress. Participants use differences in MPCs and VOLL as a signal of where a commodity is scarce in a particular market.

Any combined review of the market parameters should consider whether alignment of the parameters is appropriate, the correct value for each parameter and what escalation, if any, should be applied annually to the value of each parameter. The Reliability Panel's periodic reviews of the reliability standard and settings should also have regard to the relationship between market parameters in the gas and electricity markets.

² AEMO 2010, *Gas Market Prudential and Settlement Framework*, August, pp. 8-9

³ AEMC 2013, *Strategic Priorities for Energy Market Development Discussion Paper*, April, p. 27

Further information

Should you have any questions or would like to discuss this submission further, please contact Hannah Heath (Manager, Wholesale Regulatory Policy) on (02) 9503 5500 or hannah.heath@originenergy.com.au.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Phil Moody', with a large loop at the end of the name.

Phil Moody
Group Manager - Energy Markets Regulatory Development
Energy Risk Management