



Ch-ch-changes in the east coast gas market

Stage 2 Draft report. East Coast Wholesale Gas Market and Pipeline Frameworks Review

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Energy + Water Consumer's Advocacy Program

1. The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade and Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

1.1 Energy + Water Consumer's Advocacy Program

This Program was established at PIAC as the Utilities Consumer's Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council of NSW;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW; and
- The Salvation Army Eastern Australia Conference.

2. Introduction

PIAC welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) *Stage 2 Draft Report: East Coast Wholesale Gas Market and Pipeline Frameworks Review*¹ and the *Draft Report: Review of the Victorian Declared Wholesale Gas Market*.²

Historically, gas has been traded via long-term gas contracts called gas supply agreements (GSA) that serve to underwrite investment in pipeline and transmission infrastructure. Many of these GSAs are due to expire soon and some gas users have reported difficulties negotiating new contracts at a fair price, or for the length of time they require. In addition, the demand profile has changed significantly, international market conditions are in flux and attempts to develop liquidity in the domestic wholesale market have stalled.

Within this context, AEMC has been charged with undertaking a review of the East Coast Wholesale Gas Market and the Victorian Declared Wholesale Gas Market. The AEMC was directed to focus on improving competition and liquidity in the wholesale gas and transmission market, with a specific focus on:

- the appropriate structure, type and number of facilitated markets on the east coast, including options to enhance transparency and price discovery, and reduce barriers to entry;
- opportunities to improve effective risk management, including through liquid and competitive wholesale spot and forward markets which provide tools to price and hedge risk; and
- changes to strengthen signals and incentives for efficient access to, use of, and investment in, pipeline capacity.³

Meanwhile, the Australian Competition and Consumer Commission (ACCC) has been directed to undertake a separate inquiry into the East Coast Gas Market. The ACCC has greater information gathering powers and has been directed to examine competition within the wholesale market, specifically:

- availability and competitiveness of offers to supply gas;
- competitiveness of, access to, and any restrictions on market structures for gas production, gas processing and gas transportation;
- significance of barriers to entry into the upstream production sector;
- existence of, or potential for, anti-competitive behaviour and the impact of such behaviour on purchasers of gas; and
- transaction costs, information transparency including gas supply contractual terms and conditions, and other factors influencing the competitiveness of the markets.⁴

The final reports for the reviews are due in April (ACCC) and May (AEMC), and the results of the ACCCs inquiry will be incorporated into the final AEMC report.

¹ AEMC, *Stage 2 Draft report. East coast gas market and pipeline frameworks review*, 2015.

² AEMC, *Draft report. Review of the Victorian declared wholesale gas market*, 2015.

³ AEMC, above n 1, 5.

⁴ Australian Government, *Inquiry into competitiveness of the wholesale gas industry*, Terms of Reference, 2015, 1.

3. East coast gas market

The demand and supply profile of natural gas in Australia is undergoing a profound shift. Conventional gas has been the main gas supply in Australia until recently when improvements in extraction technology facilitated the extraction of Coal Seam Gas (CSG) and other unconventional gas supply options. This led to an increase in proven and probable reserves and the production potential of natural gas in Australia. The result has been the development of an international export market from the east coast gas market, predominately located in Queensland.

Meanwhile, residential and commercial gas demand is predicted to remain stable over the next five years despite population growth. This is in part due to the improved efficiency of appliances and homes, some switching from gas to electrical appliances and a shift to smaller multi-residential units and apartments.⁵ In addition, there have been significant federal policy changes that have impacted on the demand profile; primarily the removal of the carbon tax and the incentives to use gas-fired electricity plants instead of coal-fired.

Natural gas has been positioned as a transition fuel between coal and renewable energy, and at one point, when gas was cheaper, residents were encouraged to change to gas appliances to save on energy costs. Given what we know of the carbon intensity of gas, the risks associated with the production process, and the increase in gas prices, it is unlikely that gas will remain a preferred long-term energy supply option.⁶

There are significant sunk costs involved in gas supply both within the residential sector and in the distribution of gas. As the world moves towards a low carbon economy, there is a need to consider the phasing out of natural gas in the residential sector, rather than continuing business as usual. While these issues are not part of the review's terms of reference, it is important to keep them in mind when assessing the proposed recommendations.

3.1 East Coast Wholesale Gas Market and Pipeline Frameworks

The AEMC has identified three priority areas to address key constraints in the market. These include the wholesale market and trading hubs, transmission capacity markets and information provision.

3.1.1 Wholesale market and trading hubs

The AEMC has made four recommendations that to improve liquidity in the market. They have recommended:

- the development of two primary trading hubs on the east coast, one in the north and one in the south, with a common trading mechanism applying to each.
- the Northern Hub be a physical hub at Wallumbilla, with the potential for a virtual hub at a later date.
- the Southern Hub to consist of a virtual hub covering the Victorian transmission system, with an entry-exit regime for allocating capacity.
- the simplification of the Short Term Trading Markets (STTM) to a balancing role, once liquidity has developed at the Northern and Southern hubs and in pipeline capacity trading.⁷

⁵ AEMO, '2015 National gas forecasting report' *Energy Update industry newsletter*, December 2015, 7.

⁶ ATA, *Are we still cooking with Gas?* Report for the Consumer Advocacy Panel, 2014, 5.

⁷ AEMC above n1, 108.

These recommendations are intended to concentrate trading in two locations to simplify trading, increase the number of participants, and allow for the development of two reference price points in the market. These developments are expected to reduce the search and opportunity costs of trading gas while also improving price transparency to allow all parties to negotiate a fair and transparent price.⁸ PIAC supports moves to establish price transparency and reduce the cost of negotiating contracts or trading gas, as long as these changes result in better prices and outcomes for consumers.

If the entry-exit regime is to benefit residential consumers, it must provide opportunities for second tier or new retailers to purchase gas without the need to balance the system by also injecting into the system. It must also provide these retailers the opportunity to purchase a smaller volume of gas at a non-discriminatory price and without the need to secure long-term contracts.⁹ This will enable smaller retailers to enter the market and provide competitive offers, particularly in the smaller and seasonally demand-driven residential market.¹⁰ PIAC cautiously encourages the diversification of market participants if it does result in a positive flow-on effect for consumers. However, it will be difficult to assess how successful the long-term trading hubs and diversification of the market will be for residential consumers if the majority of gas remains under long-term contracts. An additional concern is that new entrants to the market will be buying gas from the incumbents who they are attempting to compete with.

Once sufficient liquidity has developed in the two trading hubs, the STTMs will be simplified to provide balancing services. PIAC supports the simplification of the market, but would like more information about how the AEMC will determine whether the market has reached the level of liquidity required to move to the simplification of the STTM. This is a particular concern if the STTM is currently providing flexibility to new entrants in terms of purchasing gas¹¹ as this is something that may take time to develop in the new trading hubs, if it develops at all.

The benefit of the Australian Energy Market Operator (AEMO) developing an additional trading hub at Moomba, and establishing yet another hub that would then need to be simplified after liquidity develops in the northern and southern hub is unclear.¹² It appears that the development of a Moomba hub is counterproductive to the recommendations and measures outlined in the review and appears to demonstrate a lack of coordination between AEMO and AEMC. In this respect, the Energy Council vision¹³ lacks clarity. It would be prudent to re-examine the underlying assumptions of the vision and the National Gas Objective (NGO), as these form the basis for the review and subsequent recommendations.

Recommendation 1

PIAC supports the development of the southern and northern hubs and simplification of the market design, on the basis that it should reduce the costs of participating in the market and improve price discovery.

⁸ Ibid 77-79.

⁹ Hughson, B and Johnson, M M, *Gas wholesale markets and retail competition in NSW and Victoria*, 2012.10.

¹⁰ Ibid 11.

¹¹ AEMC above n1, 92.

¹² Ibid 90.

¹³ COAG Energy Council, *Australian gas market vision*, 2014, 1.

Recommendation 2

PIAC recommends that AEMC develops clear indicators for liquidity in the market and establish regular reporting and monitoring to ensure that the market does develop in line with clear criteria.

Recommendation 3

PIAC recommends that liquidity indicators have a clear consumer-focus to ensure that consumers remain at the forefront of market development.

3.1.2 Pipeline capacity markets

Capacity is required in order to move gas between production zones and the demand zones. Primary capacity is sold through long-term contracts, while secondary capacity has previously been sold to shippers who for various reasons do not need that capacity and on-sell it.¹⁴ There are a number of constraints inhibiting the trading of secondary capacity and the AEMC has made the following recommendations to address them:

- the introduction of an auction for contracted but un-nominated capacity with a regulated reserve price on all pipelines.
- the mandatory creation of capacity trading platforms, through which information regarding all capacity trades, including prices, must be published. Capacity product standardisation would facilitate trading through the platform.
- publication of the actual price of all primary capacity sales, and terms and conditions of those sales, which might impact the price.¹⁵

These recommendations are anticipated to increase transparency and improve price discovery, reduce transaction costs, information deficiencies and reduce actual or perceived discriminatory access to secondary capacity.¹⁶ PIAC supports these measures to improve access and transparency in the previously opaque capacity market.

The auction will require a reserve price which will prevent capacity being sold for less than the cost of providing the service and enable the pipeline owner to recover costs. The volume of un-nominated capacity will fluctuate, but there will need to be a floor volume that is traded to ensure that the pipeline owner does not withhold capacity to inflate the clearing price. The AEMC has not yet determined who will be responsible for determining these elements of the auction design.¹⁷ PIAC is of the view that the Australian Energy Regulator (AER) should be responsible for developing the methodology and applying the formula to the reserve price and the minimum tradable capacity volume. This will give participants more confidence in the auction design and function.

There is the potential for conflict between the requirement for pipeline owners to auction secondary capacity and the current regulatory management of covered pipelines.¹⁸ This provides an opportunity for a follow up review examining the regulation of pipelines and the coverage test to determine which pipelines are covered and not covered to ensure they best serve the current natural gas climate and market. There is currently little transparency in pipeline capacity,

¹⁴ AEMC above, n1, 52.

¹⁵ Ibid 51.

¹⁶ Ibid 4 and 65.

¹⁷ Ibid 60-61.

¹⁸ Ibid 62.

particularly in uncovered pipelines. This is one area where the ACCC has more scope to investigate and its inquiry may find significant barriers to competition or anti-competitive behaviour. If the ACCC finds evidence of anti-competitive behaviour, the benefits of mandatory trading obligations using long-term use it or lose it provisions, would increase.¹⁹ PIAC recommends these be investigated as a potential mechanism to deal with shippers withholding capacity to gain a competitive advantage over other market participants.

Recommendation 4

PIAC supports the establishment of an auction for secondary capacity, mandatory trading platforms, and publication of the actual price of capacity sales and terms and conditions.

Recommendation 5

PIAC recommends that AER be responsible for developing and implementing the methodology for establishing a reserve price and floor capacity volume.

Recommendation 6

PIAC recommends that the coverage test for pipelines be reviewed to ensure that regulations for pipelines are adequately regulated for the changed market environment.

Recommendation 7

PIAC recommends that if the ACCC finds evidence of anti-competitive behaviour, stricter mechanisms be developed to ensure secondary capacity is released into the market. Consideration of long-term use it or lose it provisions should be included in this evaluation.

3.1.3 Information Provision

The Bulletin Board was established to provide a public platform of market prices and volumes for all market participants. The Bulletin Board has not been reviewed since its inception and has not kept pace with developments in the market.²⁰ Gaps in information provision and reporting requirements were identified during stage one of the review and a rule change was developed to address some of these gaps.²¹ Stage two of the review has developed further recommendations, including:

- to broaden the purpose of the Bulletin Board in the National Gas Rules to reflect the wider role that information plays in the sector.
- to expand the coverage of the Bulletin Board and improve and strengthen the reporting framework.
- to make the Bulletin Board more responsive to changes in market conditions by removing funding methodology from National Gas Rules and creating a framework to support ongoing improvement.

One method of addressing these recommendations is to extend reporting requirements to participants who have historically been exempt from reporting to the Bulletin Board, including

¹⁹ NERA Economic Consulting, *Analysis of policy options to facilitate enhanced gas transmission capacity trading*. A report for the Standing Council on Energy and Resources, 2013, vi.

²⁰ AEMC above n1, 99-101.

²¹ PIAC, *Improved transparency just one piece of the puzzle*, Submission to the AEMC rule change: National Gas Amendment (Enhanced information for gas transmission pipeline capacity trading) Rule, 2015,2; AEMC, above n 1, 1.

upstream activities (uncontracted, proven and probable reserves), compressors in the hub, and large users that have the potential to affect the market, such as LNG trains and production facilities.²² PIAC supports additional reporting requirements and increased frequency of reporting, and is especially supportive of the requirement for producers to report their uncontracted reserves.

The AEMC has outlined methods to strengthen the reporting framework and compliance, specifically ensuring the accuracy and timeliness of reporting. There are reports of inaccuracies in the information provided to the Bulletin Board, with some operators revising their information by 50% and some providing their information on average four days late.²³

Previous submissions to the review suggest that these failures are from new facility operators, and that existing operators provide high quality data. The AEMC has recommended that a new reporting standard be introduced into Division 5 Part 18 of the NGR with a civil penalty for failures to comply.²⁴ In addition, the AEMC has recommended improved training/information about reporting requirements be provided to new facility operators. PIAC supports these recommendations, but recommends that if these issues are not addressed by the changes, options for stronger penalties and standards be investigated.

The AEMC has also made recommendations in relation to cost recovery for the provision of information and for AEMO to run the Bulletin Board. PIAC supports the AEMC's recommendations not to allow participants to recover the costs of providing information and removing cost-recovery provisions for pipeline owners for performing aggregation and information services. These requirements should be considered as part of the general costs of business and complying with regulations. The AEMC has recommended that the specific cost pass through mechanism that allows AEMO to recover the costs of operating the Bulletin Board be removed from the NGR and that a framework be included in AEMO's general cost recovery mechanisms. PIAC generally supports the measures to simplify the cost recovery process, as long as the Bulletin Board is sufficiently funded to enable it to be effective.

Finally, the AEMC has recommended additional requirements for AEMO to regularly update the Bulletin Board and to publish a biennial report on the Bulletin Board in consultation with market participants, Bulletin Board users, AER and AEMC. PIAC supports this additional reporting step and would recommend that the report be developed in consultation with advocacy groups as well as the industry stakeholders. PIAC also requests that there be a section on the Bulletin Board that provides information in a form the general public can understand. The Bulletin Board is a public good and should therefore be in a form that is accessible and easy for the public to understand.

Recommendation 8

PIAC recommends that the AEMC's recommendations to expand the types of participants required to report and improve the quality of information provided be adopted.

²² Ibid 22.

²³ Ibid 48; 59-60.

²⁴ Ibid 60.

Recommendation 9

PIAC recommends that the AEMC's recommendations to improve compliance and accuracy of information be adopted and that this process be monitored to ensure it is sufficient to improve the quality and timeliness of information, with provisions in place to strength compliance and penalties if needed. This should be a key focus in the first biennial report.

Recommendation 10

PIAC recommends that there be a section on the Bulletin Board that provides information in a form the general public can understand.

Recommendation 11

PIAC recommends that the biennial report include a short summary targeted at the general public to assist them in understanding the report.

4. Victorian Declared Wholesale Gas Market

The AEMC has assessed a number of options for reform, including market development with improvements to either transmission rights and capacity rights or larger market reform, which would see either the implementation of an entry/exit regime or a physical hub and spoke model. The AEMC has recommended the implementation of a virtual market with the entry/exit system.²⁵

The current system requires the system operator, AEMO to balance all trades. The new model would be voluntary and gas would be traded using the entry/exit regime, with AEMO playing a balancing role.²⁶ This would improve how new entrants purchase gas and participate in the market. The concentration of market participants in the southern hub would also help facilitate liquidity in the market and encourage the development of financial products to manage risk.

PIAC supports the market reform recommendations that will see the DWGM become a southern hub for the east coast gas market. PIAC supports the implementation of the entry/exit system and trading and balancing arrangements simultaneously, as long as there are clear steps and mechanisms in place to protect consumers during the transition phase.

It is envisaged that the final design and implementation of the Southern Hub will occur towards 2020. This is in part to allow time for the design of the market and to transition the system in line with regulatory processes such as the development of new access agreements in 2018-2019. PIAC welcomes the opportunity to provide comments on the design and implementation process and requests that the AEMC provide workshops and meetings for consumer advocates to ensure they are able to effectively participate in this highly technical process as it unfolds.

Recommendation 12

PIAC recommends the adoption of a virtual hub with an entry and exit regime at the location of the DWGM.

²⁵ AEMC above n2, 21.

²⁶ Ibid 24.

Recommendation 13

PIAC recommends the transition from the current model to the entry/exit system happen simultaneously, and that there be an opportunity for public comment before implementation.

Recommendation 14

PIAC recommends that AEMC hold workshops/meetings with stakeholders during the market design process to ensure relevant stakeholders are consulted on the design and are equipped with the information they need to adequately provide input to the design process.

5. Implementation and timeline

This review is the next step in a long-term process to improve the functioning of the gas market and may take upwards of 20 years to be effective. PIAC appreciates this, but is concerned that there is only one review milestone in the proposed implementation timeline. PIAC would like to see more regular review steps included in the timeline, to ensure that progress is occurring and to provide stakeholders opportunities to comment on progress. In addition to these review milestones, PIAC would like the AEMC to develop indicators to measure progress that consider the impact of these changes on consumers, to ensure their long-term interests remain at the forefront of this market transition.

Recommendation 15

PIAC recommends additional review milestones be included in the implementation timeline to enable assessment of the progress of the market transition.

Recommendation 16

PIAC recommends that the market transition be assessed against relevant indicators to ensure it is working in the long-term interests of consumers.

6. Conclusion

The review is a step forward to improve the current system. However, PIAC is concerned that this review and the market mechanisms proposed are isolated from wider systemic issues. This represent attempts at fixing a complex and fragmented industry, and may not make significant enough changes to benefit consumers and the broader Australian economy. Given the uncertain future of gas demand in Australia as we move to a low carbon economy, it would be irresponsible not to undertake an analysis of the basic assumptions that underpin this review, the NGO and the Energy Council Vision, which assume it is possible to create a competitive market in what is essentially a monopoly service, that will ultimately benefit the consumer.

PIAC is generally supportive of the AEMC's recommendations, but is cautious that there has not been enough emphasis on translating the recommendations into a form that end-users are able to understand and from which they can discern the impact of these changes. PIAC is also concerned that there is not enough information about what a liquid market looks like, and on what basis we will determine when the market has sufficient liquidity to benefit the end users. Finally, PIAC would like to see more detail on monitoring and transition mechanisms that would ensure that consumers are protected during these long-term market developments.