



April 15, 2005

Manager – Energy Market Reform Team
National Energy Market Branch
Department of Industry, Tourism and Resources
Canberra ACT 2600

Email: MCEMarketReform@industry.gov.au

Dear Sir/Madam,

Re: Options for the development of the Australian wholesale gas market

EnergyAustralia is pleased to provide comments on this paper and welcomes the initiative of the MCE Reform Team to further the advancement of a wholesale gas market. We endorse the gas market design principles enunciated by the MCE that will be applied to provide guidance on the appraisal of future wholesale gas market development options. EnergyAustralia, as a growing and emerging gas retailer, has a keen interest in the progression towards a competitive and open wholesale gas market.

We understand that none of the four options detailed in the consultant's report is the preferred or optimal option. Our position is that we would encourage further development of Option 2 (developing a mechanism to facilitate information flows) and Option 3 (advancing the city gate scheme). EnergyAustralia would ultimately seek that Option 3 be realised in the gas market, recognising that Option 2 could be a progress milestone to this end.

Overall, the consideration of these models leads us to the conclusion that our two preferred options each offer elements that provide the potential to meet the MCE's gas market development objectives. A hybrid or 'best of breeds' approach could be pursued, where the most favorable features of these options are combined.

Alternatively, such an approach would be well suited to a gradual phasing in of each of the options, since each option builds on the previous. This is evident through the evaluation analysis. Options 2 and 3 respectively offer practicality and simplicity, meaning they are readily available to start the market development process. This in turn would ensure a planned approach to the future development and direction of a national wholesale gas market.

Option 1 - this is effectively not an option. As experience shows, without significant encouragement, competitive markets will not automatically develop of their own accord. This is particularly true in the case of gas. The wholesale market is based on large upstream capital investment by a few players, underpinned by long term commodity gas and pipeline transportation contracts. Large transactions and the attendant knowledge of their pricing are concentrated with incumbent participants. Under this option, the current low levels of market liquidity, transparency and informational symmetry will persist or at best improve organically over time.

Option 2 – this has merit and is worthy of further development. An essential theme of wholesale gas market development and reform will be the flow of adequate information to and from market participants. The industry is characterised by long term contracts at the gas field and pipeline level, which are generally shrouded in confidentiality. This hampers price discovery and prevents trading opportunities, which are needed to promote liquidity. Meaningful information should be disclosed to the market at an aggregate level (such as pipeline flow data, linepack, calorific value, gas specification parameters and city gate point energies). EnergyAustralia would see benefits in a pricing information bulletin board if of course gas is available to be traded at those prices. Information has value, but this is limited if a new entrant or participant seeking to trade incrementally can't act on the information. Counterparties to existing contracts will be bound by confidentiality provisions and will resist disclosure of information to the market and be reluctant to place bids and offers on a bulletin board. An alternative strategy may be to explore (or even mandate) ways to encourage producers to make small volumes of gas available outside of long term contracts either directly or through a market maker. For this market to work effectively, standardised contracts would be required.

Option 3 – we encourage further development of this work and see this option forming the blueprint for an achievable competitive wholesale gas market. The establishment of spot gas markets at key market hubs, for example, Moomba, Otway Basin, Longford, that feed into load centres could establish increased transparency, promote wholesale competition, interstate trading and open the way for financial derivative products. Published information, facilitated through the introduction of option 2 (thus supporting the pursuit of a planned approach) on uncontracted pipeline capacity would provide valuable discovery for determining optimum purchase arrangements.

This being said, the establishment of citygate trading points rather than gas field hubs is more likely as this is the point of transfer from the upstream market into gas distribution networks. Pricing would be at a combined gas and transport level and would not have the confidentiality issues involved with pricing at source or with pipeline contracts. Citygate trading points would also work alongside existing wholesale contracts. This schema would also give retailers the ability to purchase 'on the day' gas or balancing gas at a known or derivable price to supplement underlying contracts.

The ability to purchase balancing gas on a liquid and transparent basis at known or derivable price is quite important. For example, the new SA wholesale gas market in South Australia and Western Australia, operated by REMCo is based on a 'swing' model where gas imbalances are deemed 'parked' and 'loaned' between transmission pipelines with users paying for the service allocated to them. Gas and pipeline capacity is tightly held in the SA market by incumbent participants, making access to gas and swing service problematic in that market. The swing market has little or no liquidity and consequently prohibitive balancing gas costs, as the incumbents can set price. EnergyAustralia would see the progression of Option 3 as assisting to improve this situation.

Option 4 – there are limited merits to extending the Victorian gas market system into other jurisdictions. The Victorian model is market carriage based and tailored to a market with a meshed transmission system and low available linepack. Therefore, it is not directly transportable to other jurisdictions. EnergyAustralia would see the implementation of this option 4 as being high cost and high complexity. Expected development of the Victorian market in 2006 and 2008 will only increase the complexity of this system. On this basis, we do not favour this option.

We see potential merit in a dedicated common market operator. This principle could be extended to ensure that one central body is charged with the responsibility of coordinating a national market. A central body covering key aspects of the market will improve information flows. This can be achieved through the provision of a central market clearing house, serving such functions as; advising of system demand, supply adequacy and capacity - through mechanisms like the PASA or the annual Statement Of Opportunities that exist for electricity, and importantly managing system reliability.

The other significant benefit now available is the opportunity presented by the infancy of market development to pursue a national wholesale market strategy that is not based upon jurisdictional lines, which is creating inefficiencies. With the pipeline interconnections of recent years, such as SEAGas and the Eastern Gas Pipeline, an interconnected national wholesale gas market, similar to that of the National Electricity Market is achievable.

Although much of the national wholesale market discussions are at proposal stages, it needs to be clear, from the outset, the criteria for assigning responsibilities and functions. The current report could perhaps provide more clarity on these issues. The report suggested that under Option 3, the AER would be given the administrative role to approve the scheme (and monitor) in accordance with the rules and criteria established by the AEMC. However, it is also recommended that an independent market management entity would develop and administer the detailed market rules and operate the city gate. Consideration is needed for the appropriate separation of the functions of rule development and administration. We would also urge that industry be given the opportunity to become heavily involved in developing the market rules, as they are key stakeholders, as evident by the proposal put forward by the retailers association. As such, we would be keen to explore the suggestion made in the Allen's Report that the independent market management entity be participant owned. Perhaps, this provides further weight that this body should not have a market development role, on the grounds that it may not be sufficiently independent. It would seem counter productive to duplicate the roles and functions of the AEMC. It is important that a timetable with specific deliverable targets be developed and adhered to by participants to drive change in the wholesale gas market landscape.

We encourage the MCE Reform Team to pursue these options and work progressively towards the establishment of a truly competitive wholesale gas market. Please contact our Manager - Regulation, Mr Mark Bourne on 02 9269 2459 if you have any enquiries on this submission.

Yours Sincerely,

Ken Harper
Acting GM – Energy Risk Management