



## **Submission**

Ministerial Council on Energy  
Standing Committee of Officials

## **Draft Gas Market Principles Consultation Paper**

**12 November 2004**

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# **1 EXECUTIVE SUMMARY**

## **1.1 GENERAL COMMENTS**

### **1.1.1 MCE Gas Reform Process**

EUAA believes that prior to proceeding with the consultancy study on market design proposed in the Consultation Paper, it is essential for MCE to prepare a more comprehensive consultation paper that addresses the need for new gas market principles. This consultation paper could be prepared as stage one of the consultancy study.

### **1.1.2 Gas Market Re-design**

The discussion points in the Consultation Paper could be taken to imply a belief by MCE that a short-term gas trading market under centralised control is desirable for the gas market. EUAA does not believe that this position is supportable by evidence from other competitive gas markets or that it would find sufficient industry support. EUAA believes that the establishment of trading facilities by industry participants is a viable option that needs to be considered, since their locations and products offered can be tailored to local needs.

### **1.1.3 Gas Access Regime**

EUAA considers that the Draft Principles need to consider more closely the interaction of the gas market with the gas access regime. The gas access regime has been the principal vehicle for gas reform in Australia to date and provides a platform for further gas market development that may avoid the need to create a new “gas market regime”. EUAA strongly recommends that the development of gas market principles and reform of the gas access regime should be more strongly linked in MCE’s gas reform program.

### **1.1.4 Proposed Gas Market Principles**

EUAA feels that, if gas market principles are to be developed, then an overarching principle (or goal or objective) should be considered by the MCE. An alternative preferred by EUAA would be “Maximising the economic value of Australia’s gas resources through the promotion of reliable, competitive upstream and downstream gas markets that deliver benefits to end users.”

## **1.2 SPECIFIC COMMENTS**

### **1.2.1 Information**

EUAA supports the general principle that competition is facilitated by better information. However, the EUAA acknowledges that how much and what type of information should be provided by market participants, and at what cost and by whom, is a matter of balance and priorities. Nevertheless, it is true to say that, from a gas user's perspective, the gas industry has been characterised by too little transparency and examples of information hoarding.

### **1.2.2 Market Structure**

EUAA supports the principle of facilitating competition but believes that some elements in the supply chain, particularly distribution and transmission pipelines, will probably retain significant 'market power' in some circumstances for the reasonably foreseeable future and should, therefore, be subject to continued regulatory oversight. In our view, the existing Gas Code and the regulation applied under it has generally worked well and is not in need of major overhaul (especially for mature pipelines). EUAA is concerned to ensure that the potential introduction of a centrally controlled gas market similar to the NEM not pose an additional risk that would deter pipeline investment.

### **1.2.3 Trade**

EUAA supports the principle of free trade and notes that barriers can be presented by a number of factors. Freedom of contract within the provisions of the Trade Practices Act is an essential ingredient to development of trade. Imposition of a standardised trading format, by means of a compulsory spot market, would be premature and most likely counter to the free-trade objective.

### **1.2.4 Electricity**

EUAA believes the gas market should respond to price signals from all customers. These signals can take very different forms. The market should be free to meet the varying customer requirements and prices should be set accordingly, with no customers getting preferential treatment through cross-subsidies.

Natural gas plays a significant and growing role in electricity generation and even though electricity output in Australia generally, and the NEM in particular, is dominated by coal fired plant, gas plants take on a price setting role that is more significant than their overall contribution to electricity generated. Conversely generation offers the best prospects for large new markets for gas, particularly in view of its relative greenhouse gas efficiency.

In view of the importance of gas to electricity and vice versa, the electricity sector has a critical interest in effective gas reform. Each of the principles can impact positively on electricity generation:

- re information – additional information will reduce the information asymmetry faced by generators (and other users) in negotiating gas prices;
- re market structure – improved market structure and regulation will enhance investment in gas supply, which will have a positive longer term impact on the electricity sector and the prices and market conditions faced by users of electricity; and
- re trade – reduction of barriers to trade and creation of gas trading institutions will significantly benefit generators in view of their ability/need to trade gas.

The key to improving the gas market's response to electricity price signals is the provision of more flexible gas supply services. Within-day flexibility is largely provided by pipeline linepack, hence access to linepack, or linepack services such as park and loan, is critical. The task of encouraging provision of linepack services could be assigned to pipeline regulators.

### **1.2.5 Regulation**

EUAA strongly supports the principle of regulatory certainty and consistency across jurisdictions. This applies equally to regulation of each sector of the gas industry. Regulatory certainty should be based around further development of the current regulatory frameworks. Network regulation under the Code is not perfect and could well be improved upon but radical change is uncalled for and the need not proven. Gas market regulation also includes the matter of appeals on regulatory decisions. It has recently become very obvious that the National Gas Access Code substantially restricts the rights and abilities of end users to appeal against decisions made under the Code.

### **1.2.6 Institutions**

EUAA strongly supports the principle of market responsive institutions. The gas market operates satisfactorily on a distributed basis under normal circumstances. Centralised co-ordination is required only during emergencies. EUAA can see advantages in the creation of industry managed institutions that facilitate voluntary gas trading. To be effective and remain cognisant of the objectives of gas reform, these would need to include representation from end users. The MCE should, in developing the gas market principles, not include any principles that effectively mandate any particular wholesale gas market structure and/or the requirement for a national market manager, unless backed by a proper, transparent benefit-cost analysis.



## 2 INTRODUCTION

The Energy Users Association of Australia (EUAA) welcomes the opportunity to provide comments and suggestions on the Consultation Paper released by the Ministerial Council on Energy (MCE) seeking stakeholder views on the *Draft Principles for Gas Market Development*.

As you may be aware, the EUAA is a non-profit organisation focused entirely on energy issues. Members determine EUAA policy and direction. The EUAA represents a wide spectrum of end users in all Australian States. It currently has around 75 members, predominantly business users with activities across all states and many sectors of the economy. This includes many of Australia's largest gas and electricity users. EUAA activities cover both national and sub-national issues. [See <http://www.euaa.com.au/> for more information on the EUAA.]

It is important to note that the EUAA received a modest amount of external funding from the National Consumers Electricity Advocacy Panel (the Panel) to engage an independent expert for the electricity market aspects of the Consultation Paper. A similar amount of funding was provided from EUAA's internal resources for the same expert to address gas in its own right. This is in addition to unfunded work on gas from both the expert and EUAA staff.

## 3 DISCUSSION

### 3.1 GENERAL COMMENTS

#### 3.1.1 MCE Gas Reform Process

EUAA wholeheartedly supports the MCE's stated objective, "To provide for a reliable, competitive and efficient gas market, responsive to consumer demand", which underlies the Draft Principles. EUAA also supports the Draft Principles as an elaboration of this objective but believes that they would need to be further developed and expanded in order for them to be a complete or adequate basis for proceeding to a consultancy study on gas market options, as proposed by the Consultation Paper.

Notwithstanding our support for the MCE's objective, however, EUAA notes that the principles of increasing competition in the gas industry and free interstate trade in gas are well established through the Competition Principles Agreement and a number of COAG Agreements (eg Hobart, February 1994). Since the introduction of the National Third Party Access Code for Natural Gas Pipeline Systems in 1997 these principles have been given increasing effect and should continue to do so, provided they are given focussed support by Governments and regulators.

EUAA therefore believes that prior to proceeding with the consultancy study on market design proposed in the Consultation Paper, it is essential for MCE to prepare a more comprehensive consultation paper that addresses the need for new gas market principles. This paper would consider gas market development in more detail and would identify: the basics of supply and demand; the roles of different industry sectors; participant conduct and levels of competition; and Government influence. It would establish which sectors are competitive or potentially competitive and the means by which competition can be enhanced. The overall picture this would present would help to clarify the linkage between increasing the level of wholesale market competition, construction of new infrastructure and the commercial transactions that underpin investment.

This consultation paper could be prepared as stage one of the consultancy study. Importantly, it should establish the linkage between the MCE's Gas Market Development program and other gas reform initiatives, such as encouraging upstream competition, the review of the Third Party Access Code and the development of national distribution and retail regulatory frameworks.<sup>1</sup>

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<sup>1</sup> The gas market to which the Draft Principles are to apply is not clear. It is stated that they "are proposed to underpin wholesale gas market development activities" (Para 3, Page 1) but other sections refer to "all stages of the gas supply chain", many of which are subject to other reform initiatives.



EUAA also understands that the purpose of the Gas Market Development initiative is to “accelerate the development of a reliable, competitive and secure natural gas market and to further increase the penetration of natural gas.” The Consultation Paper, however, focuses primarily on creating a more competitive market and does not directly address gas penetration. EUAA would welcome initiatives that directly addressed the barriers to further economic use of gas, as these could have a measurable impact on consumers and the economy, as well as on the creation of a more competitive gas market.

### **3.1.2 Gas Market Re-design**

The need for a fundamental reappraisal of the gas market was not established by the Parer Report, *Towards a Truly National and Efficient Energy Market*. EUAA certainly believes that current gas market arrangements are far from perfect and need to be improved, but third party access to pipelines has produced an increasing level of competition at both wholesale and retail levels. Further and accelerated development of this framework, including greater information transparency and more sophisticated and harmonised balancing arrangements, which would facilitate increased trading, should be considered as a serious gas market development option. EUAA believes that, on current indications, this could achieve meaningful progress towards higher levels of competition.

The discussion points in the Consultation Paper could be taken to imply a belief by MCE that a short-term gas trading market under centralised control is desirable for the gas market. EUAA does not believe that this position is supportable by evidence from other competitive gas markets or that it would find sufficient industry support. In the majority of commodity markets, market institutions, such as trading exchanges, have been established by participants in response to an identifiable opportunity. In this respect, the gas industry overseas has followed other commodities in the growth of trading hubs (at the confluence of pipelines, often at the location of underground storage) and financial instruments.

EUAA therefore believes that the establishment of trading facilities by industry participants is a viable option that needs to be considered, since their locations and products offered can be tailored to local needs. The first gas trading hub in Australia has been established at Longford and other potentially beneficial hub locations are Adelaide, Sydney, Port Campbell, Moomba and Wallumbilla. Market hubs are relatively inexpensive “add-ons” to existing institutional arrangements, which do not change the way gas is dispatched or require any change in regulations. Trading at hubs is voluntary and therefore low cost. Consistent with this view that the market itself should be given an opportunity to create the market institutions, the principal role for governments would be removing barriers to competition, as has occurred to some extent under the Competition Principles Agreement. However, end user

participation would still be needed to ensure the effectiveness of this and that net benefits were ultimately delivered to end users.

EUAA would also have concerns about the cost of imposing a centrally operated market, most of which would ultimately be borne by consumers. A rigorous benefit-cost analysis (BCA) of any arrangement would be essential to offset these concerns.

### 3.1.3 Gas Access Regime

In line with the above view, EUAA considers that the Draft Principles need to consider more closely the interaction of the gas market with the gas access regime. The gas access regime has been the principal vehicle for gas reform in Australia to date and provides a platform for further gas market development that may avoid the need to create a new “gas market regime”. This requires Governments and regulators to focus on the more technical aspects of access, in addition to the economic aspects such as pricing. Furthermore, the gas delivery system operates under rules governed by the access regime and these rules would substantially impact and be impacted by any new “gas market regime”.

Third party access regulation has also been used by governments and regulators to direct market evolution in countries such as the US, Canada and Europe, by identifying specific barriers to competition as they arise over time and removing them. For example, Canadian regulators encouraged balancing over progressively shorter time periods, which stimulated short-term trading. The first seven years of regulation in Australia under the National Third Party Access Code have been dominated by financial debate – pricing, WACC, asset valuation, investment etc – with less attention being paid to the terms and conditions of access. It is timely for these matters to be given greater prominence and for industry participants, users and regulators to address the potential anti-competitive effects of pipeline capacity “hoarding”, gas allocation, balancing arrangements and other technical matters. These are clearly issues of importance to pipeline access and the development of the wholesale gas market and EUAA strongly recommends that, in view of their overlap, the development of gas market principles and reform of the gas access regime should be more strongly linked in MCE’s gas reform program.<sup>2</sup>

It is noted however that the ability of access regulation to fulfil this role may be compromised by transfer of control of access related matters to industry controlled retail market operators. The business rules established by retail market operators govern operational aspects of distribution pipeline access but are subject to less public scrutiny than pipeline access arrangements. For example, while business rule changes endorsed by REMCo for South Australia require ESCOSA approval, the initial rules do

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<sup>2</sup> EUAA’s views on the flaws in the gas access regime and the PC’s recommended reforms will be addressed in a separate submission to MCE.

not appear to have been subject to a transparent approval process involving public consultation<sup>3</sup>. The relationship between retail market operators and the gas access regime requires clarification.

### 3.1.4 Proposed Gas Market Principles

EUAA feels that, if gas market principles are to be developed, then an overarching principle (or goal or objective) should be considered by the MCE. The need for an overarching principle is created by the potential for conflict between the individual principles and the consequent need to resolve the conflicts by appeal to a higher principle (an "Object Clause"), as recognised by the Productivity Commission in its review of the gas access regime. If an overarching principle is adopted then the underlying principles are no longer required to be as comprehensive.

MCE's underlying objective "To provide for a reliable, competitive and efficient gas market, responsive to consumer demand" is a candidate overarching principle. An alternative preferred by EUAA would be "Maximising the economic value of Australia's gas resources through the promotion of reliable, competitive upstream and downstream gas markets that deliver benefits to end users."

## 3.2 SPECIFIC COMMENTS

### 3.2.1 Information

#### MCE Principle

*Information on market and system operations and capabilities at all stages of the gas supply chain (subject to recognition of existing contractual confidentiality) should be publicly available and frequently updated.*

#### EUAA Comment

EUAA supports the general principle that competition is facilitated by better information. It must be recognised, however, that competition in the Australian gas industry is dependent on new entrants investing in new supply infrastructure. Information relevant to these investments includes:

- Gas reserve estimates (those currently available from Geosciences Australia are typically several years out of date);
- Gas demand/supply projections; and

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<sup>3</sup> Apart from Chapters 5 & 6, which impose a pricing regime and for which ACCC authorisation was sought and obtained.

- Longer-term gas production and transmission cost estimates.

It is recommended that the reporting of this type of information be considered along with the information suggested in the Consultation Paper.

However, the EUAA acknowledges that how much and what type of information should be provided by market participants, and at what cost and by whom, is a matter of balance and priorities. This usually depends on the balance of power between suppliers and gas users (and between themselves), which is heavily influenced by the degree of competition and the benefits and costs of information gathering and provision. It also depends on balancing the needs of fostering greater competition with those of not discouraging investment.

It is true to say that, from a gas user's perspective, the gas industry has been characterised by too little transparency and examples of information hoarding. Users find a lack of information relating to benchmark 2-3 year wholesale gas contract prices a significant impediment to negotiating supply contracts, in contrast to the information available on spot and forward contract prices in the electricity market. This lack of information is symptomatic of a still immature gas market with limited competition. If the gas market is to become more competitive, then access to more information will be critical.

### **3.2.2 Market Structure**

#### MCE Principle

*Gas market structure to facilitate a competitive market in all sectors.*

#### EUAA Comment

EUAA supports this principle but believes that some elements in the supply chain, particularly distribution and transmission pipelines, will probably retain significant 'market power' in some circumstances for the reasonably foreseeable future and should, therefore, be subject to continued regulatory oversight.

Such regulation needs to be effective and seek to deliver an outcome that is similar to a competitive market outcome, including on price and service. In our view, the existing Gas Code and the regulation applied under it has generally worked well and is not in need of major overhaul (especially for mature pipelines). We can find no robust evidence that it has hindered investment in pipelines. On the contrary, there is a substantial body of evidence that investment has prospered since the Code was

introduced, due to the opportunities made available for competitive gas supply in previously monopolised markets.<sup>4</sup>

EUAA is particularly concerned about unregulated pipelines with only one indirect 'competitor', a situation that has arisen by revocation of pipeline coverage under the Third Party Access Code. Where one pipeline is regulated this effectively caps prices for both but where both are unregulated their market power is very significant. The fact that a duopoly is regarded as a satisfactory level of competition for pipelines is inconsistent with the view underlying the Consultation Paper that competition in other sectors of the gas market, where there are already two or more competitors, is insufficient and needs accelerating. This reinforces EUAA's view that a more integrated approach to gas reform is required.

Care must be taken to ensure that the structure of other market sectors does not inhibit new infrastructure developments. EUAA notes the issues concerning transmission investment in the National Electricity Market (NEM) and the fact that the current gas access regime has not prevented major investments, such as SEAGas, from proceeding in spite of pipeline industry views on the regime. EUAA is concerned to ensure that the potential introduction of a centrally controlled gas market similar to the NEM not pose an additional risk that would deter pipeline investment.

### **3.2.3 Trade**

#### MCE Principle

*Gas market participants should be able to freely trade between pipelines, regions and basins.*

#### EUAA Comment

EUAA supports this principle and notes that barriers can be presented by a number of factors:

- By producers who are unwilling to allow gas to trade or swap through their production plant. This can readily be circumvented by construction of a short by-pass pipeline by market participants, as has occurred at both Moomba and Longford.
- By pipelines, for example by tariff structures, which should be dealt with by regulators
- By different pipeline operating regimes, eg nomination procedures. We suggest such barriers could be progressively removed by a process of harmonisation of business rules, initiated by the pipeline companies or regulators. A process of

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<sup>4</sup> See our submissions to the PC Inquiries on the National Third Party Access Regime and National Gas Access Regime.

harmonisation of business rules has been undertaken in the US by the Gas Industry Standards Board.

- By regulation, such as the continuing restricted level of contestability on the gas distribution networks in Queensland.

Freedom of contract within the provisions of the *Trade Practices Act* is an essential ingredient to development of trade. While many markets develop standardised transaction formats, this usually occurs many years after the first trades, by which time experience has shown which formats are most valuable. The Australian gas market has yet to reach this stage and contracts are still evolving as participants determine how to meet their gas sales/purchase requirements and manage risk exposures. Under these conditions imposition of a standardised trading format, by means of a compulsory spot market, would be premature and most likely counter to the free-trade objective.

### **3.2.4 Electricity**

#### MCE Principle

*The gas market should be able to respond effectively to price signals in the electricity market*

#### EUAA Comment

EUAA believes the gas market should respond to price signals from all customers. These signals can take very different forms. For example, a large industrial user may need a low price long-term contract to justify investing in a plant expansion, whereas electricity generators require flexible delivery to meet their bidding and dispatch requirements. The market should be free to meet the varying customer requirements and prices should be set accordingly, with no customers getting preferential treatment through cross-subsidies.

Natural gas plays a significant and growing role in electricity generation, even though electricity output in Australia generally, and the NEM in particular, is dominated by coal fired plant. Gas-fired plants, particularly gas turbines, are more flexible than coal plants in meeting fluctuating load requirements and are relied upon to provide a significant proportion of intermediate and peak generation. Consequently gas plants take on a price setting role that is more significant than their overall contribution to electricity generated. Alternatives to gas in this role are liquid fuels (powering gas turbines), which are generally more expensive, or hydro plant, which is limited by water resource availability. Natural gas is therefore important to determining electricity wholesale prices and retail market prices faced by customers.

From a gas supplier's perspective, generation offers the best prospects for large new markets for gas, particularly in view of its relative greenhouse gas efficiency.

There are therefore strong incentives on both supply and demand sides to obtain the most efficient market and pricing arrangements.

In view of the importance of gas to electricity and vice versa, the electricity sector has a critical interest in effective gas reform. In the short- to mid-term this interest is probably dominated by the pricing and gas delivery issues discussed below but, in the longer term, the electricity sector and the prices and market conditions faced by users of electricity will be affected in important ways by gas supply investment. The market structure, trade and regulation issues that affect investment in gas are therefore also important to electricity markets and electricity users.

It is also worth noting the gas industry's interest in electricity reform, particularly resolution of issues that are a barrier to growth of gas fired generation. In this regard we mention the transmission pricing barrier to distributed generation, much of which is potentially gas-fired. It is well known that the fact that the National Electricity Code assigns transmission costs almost entirely to customers and provides 'free' transportation to incumbent generators has acted as an impediment to new entrants generators, including distributed generation, which is forced to pay network charges when exporting power to the grid. This is also significant for EUAA members and other large users, many of whom could invest in highly efficient cogeneration if pricing signals were more favourable.

In addition, distributed generation and gas fired generation more broadly is affected by the competitiveness of the gas market. To the extent that gas supply lacks competition and monopoly pipelines are not effectively regulated or pipelines is lacking, gas generation will suffer a competitive disadvantage and will not be able to make optimal locational and investment decisions. For example, pipeline haulage charges containing monopoly rents will hinder investment in gas fired generation whilst inefficient transmission pricing will tend to favour incumbent generators over new entrants.

## **Pricing**

Gas-fired generators have two major requirements of their gas supply: a price, that is known in advance of bidding to be dispatched, so that their operating costs are known, and (reasonably) guaranteed delivery.

Generators, and other users, can generally negotiate fixed price long-term supply agreements directly with producers and transmission pipelines or with retailers. For peaking generators, which have poor gas load factors, the unit price of firm gas may be extremely high, reflecting a high capacity reservation cost relative to actual gas usage and also a lack of competition among gas producers or retailers to supply low load factor customers. Moreover, the gas price in long-term agreements is always set at a

long-run cost and neither generators nor gas suppliers are ever able to exploit short-term opportunities for lower or higher prices.

Some peaking generators may therefore seek lower priced non-firm gas, either from a producer, retailer or the spot market (in Victoria)<sup>5</sup>, but they then expose themselves to price and/or supply risk. Retailer-owned generators can utilise spare capacity within their gas supply portfolios. Use of distillate back-up is an appropriate risk management solution for some generators and ensures fuel supply at times of gas supply shortfalls.

What appears to be most lacking is a short-term forward market (eg day ahead or week ahead) that would enable incremental quantities of gas to be sold at lower or high prices, taking advantage of price conditions in the NEM and availability of incremental volumes of gas.

In negotiating prices, generators are generally handicapped by the asymmetry of information on supply and demand. Generators costs and the value of gas for generation are well known because of the transparency of information in the NEM, but the true costs of gas production are kept well hidden and are unlikely to be revealed by the current market processes. The electricity sector would therefore benefit significantly from the additional information discussed in section 3.2.1.

Needless to say, to the extent that this creates more efficient outcomes in the electricity generation sector, customers should also be able to benefit (provided there is adequate competition in generation).

### **Flexible Delivery**

Gas delivery for generators has the potential to cause greater difficulties than pricing, because the scheduling of gas-fired generators is dependent on electricity market prices and is therefore less predictable than other gas loads. For example, the sudden loss of an electricity transmission link or coal fired generator can cause a price spike and lead to gas-fired generators being scheduled at short notice. The degree to which the gas supply chain can respond to electricity price signals therefore depends upon its ability to deliver short-term variations in supply.

The sources of flexibility in gas supply vary from centre to centre.

Very short term flexibility is available only from pipeline linepack and liquefied natural gas (LNG), which is currently available only in Victoria. Slightly longer term flexibility is available from underground storage in depleted gas-fields (within a few hours, depending on storage location relative to load). Variation in gas injected from

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<sup>5</sup> The Victorian spot market price is determined ex-post, after the generators have used the gas.



production plant provides flexibility over time scales ranging from 6 hours (in Victoria) to 2 days (in NSW).

The key to improving the gas market's response to electricity price signals outside Victoria is clearly access to pipeline linepack, or services provided by it.<sup>6</sup> These services include park and loan services, whereby a user (generator) can store gas in the pipeline for withdrawal at a later date or borrow gas from the pipeline and later replace it. On some pipelines, use of linepack is currently bundled with transportation services and a redefinition of transportation service may be required before linepack can be offered separately. The task of removing this barrier could be assigned to pipeline regulators. For transmission pipelines, which have most linepack, this would be ACCC/AER (except in Western Australia where it is the ERA).

Energy users would benefit from such developments in the gas market which would provide for more competitive conditions for gas generation and greater certainty of supply.

### **Gas Trading**

Very short-term trading of linepack, which would be the sole basis for setting gas prices over intervals of less than a day, could then follow. There would be little point having a market with prices varying within the day if participants could not access linepack to vary supply on an hourly basis.

With regard to pricing on intervals of less than a day, the recent Gas Market Pricing and Balancing Review in Victoria, conducted by VENCORP, found that there would be benefits from ultimately moving to within-day pricing. At this stage, however, the commitment is only to an improved daily pricing model. EUAA participated in and made several submissions to the Review and remains unconvinced that within-day pricing will yield net benefits for any customers, including generators, at least for the present.

In regard to the electricity industry's gas trading requirements, it is noted that use of gas for generation and the proportion of gas used for generation varies from very low levels in New South Wales to high levels in South Australia. Creation of a gas trading hub in SA would be the most effective means of meeting a large part of the gas trading requirements for generators in the NEM at a very low cost. As noted in section 3.2.6, it is within the power of the gas industry to create a hub but government and regulatory stimulation would assist. In view of their ability/need to trade gas, generators will benefit significantly from any such institutional development that would bring large benefits at low cost.

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<sup>6</sup> The Victorian market has access to short-term flexibility from LNG and underground storage, at a cost. Market control of linepack would offer much cheaper flexibility.

Clearly gas customers will also benefit from richer gas trading opportunities as would electricity users from the access to more efficient and competitive gas generation. As gas fired generation provides an economic means of meeting peak demand and the high growth in peak load, especially from domestic air conditioning, is a major challenge for electricity infrastructure in the future, developments that create more efficient and competitive gas fired generation will also assist in this important area.

### **Summary**

EUAA believes the gas market should respond to price signals from all customers. These signals can take very different forms. The market should be free to meet the varying customer requirements and prices should be set accordingly, with no customers getting preferential treatment through cross-subsidies.

Natural gas plays a significant and growing role in electricity generation and even though electricity output in Australia generally, and the NEM in particular, is dominated by coal fired plant, gas plants take on a price setting role that is more significant than their overall contribution to electricity generated. Conversely generation offers the best prospects for large new markets for gas, particularly in view of its relative greenhouse gas efficiency.

In view of the importance of gas to electricity and vice versa, the electricity sector has a critical interest in effective gas reform. Each of the principles can impact positively on electricity generation:

- re information – additional information will reduce the information asymmetry faced by generators (and other users) in negotiating gas prices;
- re market structure – improved market structure and regulation will enhance investment in gas supply, which will have a positive longer term impact on the electricity sector and the prices and market conditions faced by users of electricity; and
- re trade – reduction of barriers to trade and creation of gas trading institutions will significantly benefit generators in view of their ability/need to trade gas.

The key to improving the gas market's response to electricity price signals is the provision of more flexible gas supply services. Within-day flexibility is largely provided by pipeline linepack, hence access to linepack, or linepack services such as park and loan, is critical. The task of encouraging provision of linepack services could be assigned to pipeline regulators.

### **3.2.5 Regulation**

#### MCE Principle

*There should be regulatory certainty and consistency across all jurisdictions.*

### EUAA Comment

EUAA strongly supports the principle of regulatory certainty and consistency across jurisdictions. This applies equally to regulation of each sector of the gas industry. For example, it is not reasonable to expect a national market to develop at the wholesale level, if there are regulatory barriers to it developing at the retail level.

Regulatory certainty should be based around further development of the current regulatory frameworks. Important changes would include fewer jurisdictional derogations, greater consistency around a set of pro-competitive regulations/reforms and avoidance of 'lowest common denominator' type approaches. It is important to rationalise the instruments used and the legislation under which they are established. For example, aspects of third party access are governed by access arrangements, distribution codes, retail codes and retail business rules, which are established under different legislation and subject to different levels of regulatory transparency.

Network regulation under the Code is not perfect and could well be improved upon but radical change is uncalled for and the need not proven. However, we would acknowledge that a modified treatment of greenfields pipelines could be called for given the important role that these play in development of the gas market and the need for the higher risks associated with such infrastructure to be explicitly recognised. The options so far presented include provision of higher rates of return to reflect additional risks, other measures outlined in the ACCC's draft guideline on greenfields pipelines and the provision of regulation free periods (advocated by the Parer Report and the Productivity Commission).

Gas market regulation also includes the matter of appeals on regulatory decisions. It has recently become very obvious that the National Gas Access Code substantially restricts the rights and abilities of end users to appeal against decisions made under the Code. In particular, it fails to recognise the disadvantages experienced by end users compared to regulated industries in appeals and the greater incentive that the pipeline industry has to appeal regulatory decisions. A recent Australian Competition Tribunal ruling has also denied bodies representing users the right to appeal on behalf of their members (who are clearly "affected parties" under the Code and in contravention of other legal rulings providing for access by representative bodies).<sup>7</sup> All this is likely to result in decisions that favour the interests of regulated pipelines over gas users and will 'eat away' at the gains from reform over time.

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<sup>7</sup> The EUAA was an original party to the recent appeal to the Australian Competition Tribunal (ACT) against the decision to revoke coverage over most of the Moomba-Sydney gas pipeline. The ACT ruled, however, that the EUAA was not an "affected party" and therefore had not right to appeal. The EUAA presented significant evidence to the ACT that it was representing its members (who were affected) and pointing to case law where Courts had recognised the rights of such bodies.

### 3.2.6 Institutions

#### MCE Principle

*Market design and institutional requirements responsive to the needs of the market.*

#### EUAA Comment

EUAA strongly supports this principle and makes the following observations:

- The gas market operates satisfactorily on a distributed basis under normal circumstances. Centralised co-ordination is required only during emergencies.
- It is most appropriate for infrastructure owners to operate their assets, since this gives them the opportunity to offer innovative products such as flexibility services.
- It is within the power of the industry to create new facilities, such as trading hubs and to work to eliminate barriers to trade, although this would benefit from the development of policy setting aimed at achieving this. EUAA can see advantages in the creation of industry managed institutions that facilitate voluntary gas trading. To be effective and remain cognisant of the objectives of gas reform, these would need to include representation from end users. Our support for industry managed institutions that manage compulsory gas trading schemes is conditional on the schemes being subject to transparent regulation that provides a meaningful and effective voice for users (please refer to our comments on retail market operators in section 3.1.3).
- The above developments should be stimulated (but not mandated) by governments and regulators
- Imposition of centralised control would only be justified if the industry failed to take the lead and competition diminished instead of flourishing.

The MCE should, in developing the gas market principles, not include any principles that effectively mandate any particular wholesale gas market structure and/or the requirement for a national market manager, that would preclude the developments suggested above.

Resolution of these issues requires a far more detailed analysis, including a proper, transparent benefit-cost analysis.

## 4 CONCLUSION

EUAA supports:

- Further consideration of the need for new Gas Market Principles and the context for the Gas Market Development initiative.
- Clarification of the relationship of the Gas Market Development initiative with other aspects of gas reform, including: encouraging upstream competition; the review of the National Third Party Access Code; and the development of national distribution and retail regulatory frameworks.
- Consideration of initiatives that directly address the barriers to further use of gas (specified in this submission).
- Greater emphasis on development of the existing market framework until it can demonstrably progress no further.
- Establishment of an overarching objective such as is suggested in this submission.
- Provision of gas market information that balances the needs of fostering competition and investment.
- A balanced approach to the level of competition expected in each sector of the gas industry and in particular, re-consideration of the levels of competition required in gas transmission to justify pipelines being unregulated.
- Removal of the barriers to trade identified in this submission.
- A focus on providing access to flexible gas delivery to meet the needs of electricity generators as an essential precursor to creation of within-day gas markets.
- Rationalisation of the third party access regulation framework and creation of more transparent processes for regulating retail market operators.
- Creation of industry managed facilities for voluntary trading provided they are transparently run and include a meaningful and effective end user voice. Facilities granted monopoly rights for compulsory trading should be subject to transparent regulation.

Any queries on this submission should be directed to:

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