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EnergyAustralia

LIGHT THE WAY

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Gas Market Parameter Review 2022 – Consultation paper – 14 September 2022

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity.

AEMO's scheduled review of gas market pricing parameters is timely in the wake of recent administered price events across east coast gas and electricity markets. These events have highlighted important interactions across the STTM, DWGM and NEM and hence the need to consider price parameters across all markets in tandem. We therefore support cross-market alignment being one of the major areas to be explored in AEMO's review.

While outside of AEMO's responsibility, we question whether it remains appropriate for AEMO to conduct a separate review of gas market parameters, moreover after completion of the Reliability Panel's review for the NEM. With the Panel's recommendations for 2025-28 soon to be submitted as a rule change proposal, AEMO and the AEMC should liaise on their respective review timings and analyses, and ideally accommodate joint or at least mutually consistent recommendations. Since gas reflects a fuel source for electricity generation, gas price parameters (particularly the APC) should be reviewed and decided on first, and used as inputs to electricity price setting reviews, not vice versa as per the operation of rule 492 of the National Gas Rules. If AEMO finds a need to change gas price parameters before July 2025, this will materially impact the AEMC's intention to lift the electricity APC to \$600/MWh from as early as December 2022.

The more recent proposals by energy ministers to extend AEMO's intervention powers in the east coast gas market, to identify and address threats to reliability and security, will also have interactions with the calibration of pricing parameters. The proposed powers to be implemented by winter 2023 create de facto reliability standards and market price caps, stemming from AEMO's risk tolerances and actions to address supply threats. Ministers propose that some of these aspects be formalised through eventual rule changes to be consulted on from 2023. Any process for jointly considering new gas reliability frameworks and revisiting price settings needs to be clarified and

communicated to stakeholders, given the long lead times associated with contract positions and related market impacts.

These additional process issues aside, we generally support the scope of work outlined in the Market Reform consultation paper. The discussion of recent events and scope of scenarios to be modelled is appropriately focused on testing and resolving any inconsistencies between gas markets, and with the NEM.

Our responses to the specific questions posed are below.

Question 1: Do you have any comments on the appropriateness of the calculation of acceptable risk?

The brief outline of the concept of acceptable risk on page 38 of the paper is inadequate to elicit any meaningful stakeholder response. It presumes prior knowledge and comfort around an approach developed in 2013. Given the passage of time and the critical importance of this measure for AEMO's review, we recommend further 'deep dive' or similar focused consultation on the method, assumptions and data underlying this approach. In briefly reviewing the analysis underlying the 2013 review, it is not clear, for example, how days of operating profit equate to a measure of insolvency risk given the many factors affecting an entity's ability to withstand discrete or event-driven losses. The 500 day threshold also appears to be based on the tolerance of a new entrant retailer, and the relevance of other participants (including large users that are trade exposed) is unclear. The modelling of participant risk exposures should also factor in cash-flow impacts associated with different market price settings, including as they affect prudential requirements.

Question 2: A range of scenarios to be studied are listed in Appendix A. Do you think any major scenarios are missing, or that any scenarios proposed are not relevant?

The paper notes the APC is intended to protect participants against short term events rather than address sustained increases in commodity prices, with the assumption that there is an underlying (stable) market equilibrium and associated 'typical' price levels.¹ This review should, however, explore the risk of the APC being insufficient to recover persistently high commodity prices and so inform discussion of whether and how to deal with atypical cost drivers. Proposed scenarios 4 and 13 appear to be particularly relevant in this regard and we would further suggest that there be some combination of these risk drivers (i.e. high international prices, winter demands and coal outages) in a single scenario. Current international price pressures could persist or form part of new equilibrium price levels. The ACCC's current netback series suggests pricing above \$40/GJ well into 2024, which is within AEMO's forecast horizon for this review (i.e. from July 2023). The underlying gas prices in the 2022 GSOO Progressive and Step Change datasets may be worth revisiting across all the proposed scenarios in light of the higher values that are projected in current futures trading.

The paper states that participant behaviour will be modified as part of a "truncated variation" in situations where supply costs are above the APC.² In scenarios where this situation arises, the assumptions and calculations for these adjustments should be published and appropriately justified, for example by reference to observed market

¹ Market Reform, p. 32.

²

outcomes. There are also longer-term implications for a persistent or expected misalignment between the APC and commodity costs in the form of contracting effects, which could precipitate issues with physical gas flows. We expect these behaviours and potential market effects to also be explored.

Question 3: Are there any artefacts of the modelling approach that need to be further considered or are causing concern?

As noted above, all assumptions and modelling of contracting behaviour (e.g. as described in section 5.3) should be transparent and published alongside modelling outputs.

It is not clear why the revenue adequacy of the LNG import terminal will be used to assess the lower bound of the CPT. An alternative approach would be to calculate returns accruing to the terminal as an output of the modelling of all price parameters, in a similar way to the assessment of acceptable total market risk exposure. Specifically, the MPC value is also relevant to investment returns and should be included in any revenue adequacy assessment.

The discussion in section 2.3.5 suggests that market reforms are not critical given the scenarios are designed to trigger administered pricing. However, prospects of AEMO interventions (including those that might be imposed for winter 2023) have implications on investment needs to ensure secure supply, and also the business cases for such investment.

Question 4: Do you agree that the cost of investment should be based on an LNG import terminal or some other option?

Assessment with respect to the LNG terminal seems reasonable.

Question 5: Are the investment costs and operating life reasonable estimates with respect to investment in an LNG receipt facility?

The use of published information seems to be a reasonable approach. Some sensitivities could be applied to project cost and expected operating life. To the extent the investment case is presumed to be made on the basis of forward contracting as well as spot revenue, any such assumptions should be made clear and justified.

Question 6: Recognising that that the Investment Cost Data presented above must apply across a range of industries and participant types, the investment under consideration is anticipated to be used infrequently and primarily for the purpose of addressing transitory gas market events rather than long term re-equilibration, and investors will consider long term funding costs:

- *Does the equity market risk premium for the sector (6.80%) represent a reasonable long term average?*
- *Does the combination of the risk-free rate (3.01%) and the debt margin (2%) adequately reflect the average cost of debt (5.0%) expected to apply over the project life?*
- *Is the overall estimate of post-tax real WACC (4.72%) reasonable bearing in mind it is applicable to a facility anticipated to be used infrequently?*

We support adoption of market-wide parameters from the AER's Rate of Return Instrument. The risk of asset stranding and declining utilisation, for example via electrification and longer-term emissions reductions targets, should be explored through sensitivities with higher investment hurdle rates and/ or a shorter economic life.

Question 7: Do the range of the grid points [combinations of parameters to be modelled across scenarios] seem reasonable?

The paper indicates that MPC values will be determined as modelling inputs rather than as parameters of interest in the same way as the CPT and APC. Similarly, evaluation of the LNG import terminal investment case will be explored by reference to the CPT only.

We question whether there should be an explicit consideration of the MPC by references to surveys or other data. For example, the gas MPC could be cross-checked against the values of customer reliability (VCR) estimated by the AER in electricity, or the NEM MPC. There may be further correlations in the maximum value of risk exposure used in the gas market, in terms of business customers' maximum willingness to pay or insolvency thresholds, where modelled events in gas or electricity markets cause similar spikes in energy input costs and hence profit impacts.

If you would like to discuss this submission, please contact me on 03 9060 0612 or Lawrence.irlam@energyaustralia.com.au.

Regards

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