Central Petroleum

Central Petroleum Limited

6 November 2017

Gas Market Reform Group
c/o Australian Energy Market Commission
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Dear Sir

DAY-AHEAD AUCTION AND REPORTING FRAMEWORK

It is with a great deal of thought and reflection Central Petroleum submits to the GMRG its response to the day-ahead auction paper—a much needed and timely reform.

One thing upon which the Finkel Report, the recent ACCC's report on the gas and electricity markets and the Energy Security Board's proposal for the National Electricity Guarantee ("NEG") all agree is the increasingly important role natural gas will play in ensuring the nation's energy security provided it can be responsive to those increasingly frequent occasions on which the electricity generation fails to match the electricity demand or the FCAS stability requirements of the grid.

Flexibility and responsiveness to external factors is the key to the increased efficiency of the market. Storage and the ability to transport the gas to the intermediate/peak generators is an essential element. To have gas available but unable to be transported even though there is actual spare capacity in the Gas Transmission System due to contractual constraints would be the ultimate national "own goal".

To ensure the maximum flexibility to meet such stochastic demand makes it imperative that all pipelines that are or soon will be connected to the East Coast Transmission System are included in this reform. It would be absurd if, for example, the Northern Territory, which will be interconnected around the time the Day-Ahead Auction commences and in time for the summer peaks of 2018-19, was excluded from the DAA on the basis that the Northern Territory isn't currently physically connected.

The requirement for increased responsiveness of the national gas grid will be even more critical when the LNG market moves increasingly towards spot market orientated trade.

We commend COAG and the GMRG for attempting to create the necessary and overdue flexibility in the energy markets and trust that our submission will be given due consideration.

Yours faithfully

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Managing Director & Chief Executive Officer

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Submission in response to the

Day-Ahead Auction of Contracted but Un-Nominated Capacity & Reporting Framework

6 November 2017

Submission Background

Following the recent ACCC and Vertigan reviews, two of the most comprehensive independent examinations ever undertaken for the Australian domestic gas market, monopolistic pricing within the pipeline sector is now recognised as a major source of market inefficiency. This recognition validates what users of gas pipelines have long highlighted as a major distortion in gas price signals which are critical to efficient gas markets by stimulating new gas production and mitigating the magnitude of demand destruction associated with increasing gas production costs.

The GMRG is now working to implement a number of the Vertigan Review recommendations, including a Day-Ahead Auction of Contracted but Un-Nominated Capacity (DAA). Central commends both the Vertigan Review in seeking to increase incentives to trade secondary pipeline capacity and the AEMC and GMRG's diligent work in seeking to structure the DAA to support that outcome. We believe the Vertigan Review recommendations generally, and the DAA specifically, are critical reforms that will fundamentally improve market efficiency within the pipeline sector.

Central welcomes the opportunity to make this submission responding to the October 2017 DAA Consultation Paper. Central has limited its responses to those questions that are most critical to the successful outcome of a DAA.

Q2) Central strongly supports the inclusion of interruptible backhaul service in the DAA for the reasons outlined by the GMRG on pages 24 and 25. In addition, we note that backhaul is currently not priced on a cost of service basis, creating significant market inefficiencies. Inclusion of backhaul in the DAA would promote the efficient utilisation of installed pipeline capacity through backhaul services.

Q3) Central believes it is critical to design an auction product that is as relevant and applicable to the gas market as possible in order to 1) promote trading in the secondary market, and 2) provide a credible market-based mechanism to allocate unused contracted capacity to the highest value usage (DAA objectives). For this reason, Central supports Option 4 – Hybrid Auction Product in that incorporating a "firm" component in the DAA would best accomplish the two DAA objectives above. As an alternative, Central would support Option 1 – Second Priority Firm as being the only other alternative identified that would achieve the two DAA objectives. Option 2 and Option 3 would both significantly weaken the DAA product to a point where it becomes irrelevant to the market.

Q8) Central would support a point-to-point contract path approach on the basis of minimising complexity.

Q11) The DAA product design, both in terms of availability and curtailment, ultimately determines the success of a DAA in achieving the two DAA objectives identified in Q3 above. As such, we think it is critical that Option 4 (or alternatively Option 1) be the basis of product design. Accordingly, we also strongly support the exclusion of as-available and interruptible nominations from the calculation of contracted but un-nominated capacity. The benefits of a DAA will be significantly and unjustifiably weakened if the DAA volume is limited by this inclusion.

Q16-19) Central supports the GMRG's preliminary positions identified in section 4.2.5.

Q21) A pay-as-cleared pricing rule is an important element in increasing market efficiency through a DAA. This pricing rule provides for significantly less complexity in bidding strategies which is important given the uncertainty in availability and curtailment already facing prospective DAA shippers. A first-price rule results in a more expensive DAA product which we believe is an inefficient market outcome. Conversely, the first-price rule results in an increase in DAA revenue for pipeline owners which is difficult to justify given they have already received a full firm tariff rate for that volume from the primary capacity holder.

Q27) DAA capacity that is curtailed by renominations should be offered spare primary pipeline capacity. The DAA product already accommodates firm renominations notwithstanding the fact that these renominations are generally not a contractual obligation of service providers. Providing curtailed DAA participants with access to spare primary capacity provides some risk mitigation without impacting a pipeline owner's opportunity for generating revenue from spare firm uncontracted capacity. In addition, we see merit in prioritising curtailed DAA participants ahead of other parties seeking as-available services for spare uncontracted primary capacity after the nomination cut-off for a Day. To be clear, this relates specifically to as-available services nominated after the nomination cut-off noting the GMRG has proposed that as-available services nominated prior to the nomination cut-off will have priority over DAA services.

Q35) Central strongly supports the inclusion of all major transmission pipelines into the DAA as proposed by the GMRG. We believe that this is critical in allowing the DAA to generate market efficiencies and it is clearly the outcome that is most consistent with the NGOs. Limiting pipelines subject to the DAA, either through an arbitrary definition of "contractually congested" or by some other mechanism, will negate the outcome intended by the combinatorial auction format and materially limit the utilisation of the DAA product as many prospective shippers require delivery across several pipelines.

Q36) The indicative list of pipelines that will be subject to the DAA in Table 5.3 excludes major transmission pipelines located in the Northern Territory (NT), specifically the Amadeus Gas Pipeline (AGP) and Palm Valley to Alice Springs Pipeline (PVASP). Whilst the NT is not currently connected to the east coast market, the Northern Gas Pipeline (NGP) is now less than 12 months away from its scheduled commissioning and will be operational at about the same time as commencement of the DAA. As it takes some time to develop a business strategy and arrange gas sales that might utilise the DAA, immediately confirming that the NT pipelines are subject to the DAA would be of significant benefit to NT gas producers and east coast customers that are currently seeking to purchase gas from this new source of supply into the east coast.

Central notes that the NT government, through its government owned corporation PWC, has contracted all capacity in the AGP and the PVASP within the NT. As PWC has a dominant market position within the NT gas market, facilitating access for smaller competing gas suppliers to this un-nominated but contracted pipeline capacity supports competition in the gas market which is fundamentally why the DAA was proposed.

Q37-39) Central is supportive of the GMRG's recommendations in relation to the balance of issues covered under Questions 37 - 39.

Other) Central is aware that opponents of the DAA have claimed that it would adversely impact investment in new pipelines. This has been used as justification to weaken the DAA product, minimise the volume available in the DAA, and limit the pipelines subject to the DAA. Central believes that this is simply a self-serving argument that is fundamentally incorrect. The DAA product is limited to contracted but un-nominated capacity, not primary capacity, and remains subordinate to firm renominations. The result is that i) any capacity sold under the DAA is capacity that has already been paid for by a primary capacity owner, and ii) provided primary capacity users sell spare capacity within the secondary market, the DAA product will always be fundamentally different from the firm capacity product which underwrites new pipeline investment. In addition, exemptions from the DAA for pipelines that do not provide third party access would further preserve the initial investment proposition for the parties that actually underwrite new pipeline investments (gas producers and gas customers).

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