

27 April 2018

Gas Market Reform Group
Level 6, 201 Elizabeth Street
Sydney, NSW 2001

To whom it may concern,

Chemistry Australia – Submission to the Capacity Trading Reform Package

Chemistry Australia welcomes the opportunity to provide this submission to the Capacity Trading Reform Package and its potential for meaningful improvements to Australia's broken gas markets.

Chemistry Australia is the peak national body representing the business of chemistry. Members include chemicals manufacturers, importers and distributors, logistics and supply chain partners, raw material suppliers, plastics fabricators and compounders, universities, research agencies and service providers to the sector.

For Australian manufacturing to be globally competitive, it's domestic gas markets must also be competitive. This is consistent with the strategic focus on the long-term interests of consumers enshrined in Law under the Australian Gas Objective¹ and supports the Vision of the Department of Industry, Innovation and Science 2016-2020 Strategy² to:

“enable growth and productivity for globally competitive industries.”

Our members and their broad customer base are major industrial, base load gas consumers for chemical feedstock and process energy use. Nationally, chemistry feedstock alone accounts for 10% of domestic demand. In addition, major plants and their thousands of customers use gas for heat, steam and other forms of process energy. Most of this gas is transported via pipelines often operating as effective monopolies with large concentrations of ownership, and therefore the opportunity for the exercising of market power.

The entrenched issues relating to pipeline monopolies and market power are well understood, having been highlighted in the 2002 Parer Report and elsewhere. Gas pipeline reform remains a complex and critical area for urgent progress to ensure that currently failed gas markets are able to deliver globally competitive depth, liquidity, transparency and price discovery.

Critically, the value of the reform process and the outcomes of the reform package can only be tested against the realities of the market place and its consumers including:

- 1. Consumers being able to obtain timely and competitive access to affordable gas, and gas transportation, at reasonable terms**
- 2. Consistency with the National Gas Objectives and its underpinning Law**

¹ National Gas Objective.

² Department of Industry, Innovation and Science Strategic Plan 2016 – 20.

3. **Enabling users to be globally competitive businesses by ensuring their domestic energy inputs are themselves globally competitive including market depth, liquidity, transparency, information availability and price discovery**
4. **Ensuring meaningful and achievable improvements consistent with the scale and impact of the problems consumers face - not marginal, incremental or administrative**
5. **Being focused on the needs of current and future market participants adapting to new market dynamics, not just historical users and legacy market architecture**
6. **Effectively dealing with information asymmetry including by providing greater transparency and allocation of risk**
7. **Being supported by targeted, timely and accountable monitoring and enforcement by regulators.**

To these ends Chemistry Australia is pleased to provide the following feedback into the Consultation Paper.

1. Reform package welcome

Chemistry Australia welcomes the reform package. The identified areas for improvement are components of how more competitive domestic markets should deliver gas and its participants behave. Chemistry Australia and others have consistently called for meaningful reform to the full range of supply and service needs for gas transmission that industrial users will need to support them being globally competitive.

As stated, the ultimate effectiveness of the reforms can only be tested by its relief to consumers operating in a currently failed marketplace.

2. Assumptions underlying gas market reforms

A key assumption underlying the gas market reforms – including, but not limited to, the capacity trading reforms – is that these reforms are consistent with the National Gas Objective and will deliver outcomes that are in the long-term interests of consumers.

The ongoing challenge of gas markets and pipeline and transmission operations includes its complexity and information asymmetry. As domestic market participants adapt to a globally linked marketplace the challenges of highly specialised information, its complexity and asymmetry remain barriers to delivering competitive outcomes in line with the NGO. People can be in a position where they don't know what they don't know.

There appears to be limited evidence about how the reforms to improve price, increase transparency and limit the exercise of power in gas markets particularly by pipeline operators and large retailers, will be passed through to users and consumers. While gas market reforms are welcome, user and consumer confidence remains an issue.

Chemistry Australia recommends that for the reform package to be effective it should include:

- **Modelling that sets out the anticipated improvements to consumers**
- **An understanding of the amount and market %age of gas and gas flows covered**

Chemistry Australia also recommends the reform package, or its supporting materials, provide an understanding of how the package benchmarks against economies where Australian manufacturers need to compete against domestic energy input supply, cost and competitiveness considerations. Given Australia has an abundance of gas reserves and therefore large volumes of gas able to be brought to the market, this is a reasonable measure given the intent of the NGO and Department of Industry, Innovation and Science Strategy 2016-2020.

Chemistry Australia recommends the reform package be established to suit new as well participants in the future, as well as existing. COAG Energy Council members have noted the new market dynamic that is here to stay. Reforms should be developed and implemented for ease of understanding and access by consumers wishing to exercise more choice as well as the type and range of activities to manage supply and price risks.

3. Coverage of gas market reforms

Limitations on the scope of coverage of gas market reforms could compromise their ability to effect beneficial change for users and consumers. In particular, the capacity trading reforms are limited to contracted, secondary capacity for transmission pipelines. Exemptions apply e.g. pipelines below a 10TJ/day volume threshold and pipelines with a single shipper. We look forward to these reforms continuing to ensure similar application to distribution pipelines.

Clear evidence to justify limitations on the scope of coverage of the reforms is needed, or a reduction in the threshold with 1) a commitment from wholesale market participants (pipeliners and shippers) to greater transparency across the board and 2) ongoing monitoring and reporting by the AER.

Australia has a historically heavy concentration of pipeline ownership. This legacy brings with it the potential for multiple sub-10PJ pipelines to still represent a significant portion of the market able to exert market power.

Chemistry Australia recommends the reform process details the pipelines covered by the reforms and what market %age of rated gas flows are included.

4. Opportunities for gaming

The availability of exemptions from some aspects of the regulatory framework and the process for determining zones may present opportunities for entities to “game” the new market mechanisms. The criteria and application of those criteria when determining exemptions and zones will need to be closely considered and monitored to ensure that the objectives of the reforms are not undermined.

5. Redressing power imbalance through appropriate governance arrangements

It will be important to ensure that governance arrangements around development and implementation of key aspects of the gas market reforms (e.g. development and amendment of the OTS Code) are not captured and/or exploited by vested interests. These governance arrangements need to be carefully thought through to ensure that power imbalances in favour of pipeline operators and large retailers is effectively curtailed. The regulations and other instruments that will give effect to the legislation must reflect ministers’ intent.

6. Effective compliance and enforcement of the regulatory framework

The requirement that participants in the capacity trading market report information to AEMO for publication will help enhance market transparency. However, transparency on its own will not deliver benefits for users and consumer unless the information generated by these reporting obligations is accessible and digestible and the integrity of the information can be assured.

Chemistry Australia note that the AER’s role in proactively monitoring and ensuring compliance with these reporting obligations will play a critical role in achieving these outcomes.

More generally, the success of the regulatory framework will rest, at least in part, on effective compliance and enforcement activity by the AER.

Chemistry Australia recommends:

- **The AER's power to monitor and secure compliance should be activated before non-compliant and, potentially, anti-competitive behaviour or arrangements become entrenched**
- **The timing and reporting of all compliance activity needs to match the market failures they seek to redress. Quarterly reporting would seem to be a minimum time-frame. Any more and the damage is done and unlikely to be re-dressed.**

7. Outcomes-based cost recovery by service providers

The mechanism available to service providers for recovery of costs associated with compliance with the regulatory framework should be based on outcomes, rather than inputs. In other words, the ability of a service provider to recover costs should be linked to demonstration of compliance with the objectives and details of the regulatory framework, rather than input costs, to benefit consumers.

8. Communication of benefits for users and consumers

A critically important component of the gas market reform program should be for AEMO and other oversighting bodies to communicate the benefits and opportunities for users and consumers. This will include communication about the ability of large users to directly participate in the capacity trading market and the scope, availability and uses of information generated through reporting requirements and the National Gas Bulletin Board. The AER also has a critical and ongoing role in assessing the effectiveness of the new arrangements.

Chemistry Australia suggests three key questions should be able to be answered:

- 1. How are industrial and residential consumers actually better off, in real terms as a result of market reforms, and how will they know? – was it all worth it?**
- 2. What actual and practical things can consumers do to engage with the result of the reforms so they can realise these benefits? - what can they do differently and who do they work with?**
- 3. How will ongoing changes evolve as the market does? Inevitable, constant change needs a system that keeps up.**

9. Timely review of impact and effectiveness of reforms

Review of the impact and effectiveness of the gas market reforms in achieving the National Gas Objective and, particularly, serving the long-term interests of consumers following implementation, is needed sooner, rather than later to avoid unintended and/or perverse market outcomes.

Chemistry Australia recommends that the review should be based on accurate information that can form a sound and reasonable basis for conclusions and recommendations regarding any amendments that might be needed to the new gas market arrangements.

10. Zones

Zones will play a critical role in delivering competitive outcomes under the Reform Package. This is particularly important for consumers choosing to operate as participants and sourcing gas across multiple jurisdictions and hubs.

The zonal model contemplated under the Reform Package is aimed at maximising the pool of prospective buyers and sellers of capacity and a particular service point.

It is proposed that AEMO will determine the zones that will be used for the capacity trading platform, day-ahead auction and secondary trading reporting framework. The Capacity Transfer and Auction Procedures will set out the arrangements AEMO will use to assess, consult on and determine the zones, while the NGR contain the principles AEMO is to employ when making a decision about zones.

Chemistry Australia recommends that the determination of the final form of zones and their operating principles be made in close consultation with buyers / participants who will be operating within the system.

The capacity of the zonal model to deliver competitive outcomes will depend upon the criteria for determination of zones and the practical application of those criteria by AEMO. While the proposed principles in the NGR for determining zones emphasise the need to account for demand and liquidity at a particular service point, they also specifically contemplate that a zone may consist of a single service point, which could severely limit competition at that point. Moreover, AEMO has broad discretion to group service points within a zone 'when to do so seems reasonably likely to promote efficient trade in and use of transportation capacity'.

The very general and, potentially, conflicting principles that apply to the determination of a zone coupled with a broad administrative discretion vested in AEMO when determining zones could lead to less than ideal competitive outcomes. This possibility is likely to be all the more pronounced if AEMO is obliged to consult with stakeholders, including pipeline operators, when determining zones which is expressly contemplated by the NGR.

The NGR also require non-exempt service providers to provide AEMO with the information it reasonably requires for the assessment of the proposed zones and to undertake any modelling or assessment of proposed zones required by AEMO. It will be important that this assessment and modelling is done undertaken rigorously and regularly by AEMO to ensure that dynamic changes in supply and demand for pipeline capacity at particular service points are appropriately reflected in the zones.

For more information or clarification on this submission, please contact me at:
pbury@chemistryaustralia.org.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Peter Bury', with a horizontal line extending to the right from the end of the signature.

Peter Bury
Directory – Strategy, Innovation and
Research Chemistry Australia