

13 July 2023

Department of Climate Change, Energy, the Environment and Water



Submitted by email: gas@dcceew.gov.au

Dear Sir/ Madam,

Gas Reliability and Supply Adequacy Framework

The Australian Financial Markets Association (**AFMA**) is responding to the Department of Climate Change, Energy, the Environment and Water's (DCCEEW) consultation on Stage 2 of the Reliability and Supply Adequacy Framework for the east coast gas market.

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our role is to provide a forum for industry leadership and to advance the interests of the markets and their respective participants. Our membership is comprised of over 125 of Australia's leading financial market participants, including many of the energy firms who participate in the Australian gas market.

Key Points

- **Clarity about how AEMO will perform its functions will provide much needed certainty to the gas market.**
- **Policy makers should provide guidance about how recent gas market policy initiatives will work together.**
- **AFMA does not support imposing contracting obligations in the gas market.**

AFMA welcomes policy makers' intention to provide greater clarity about how AEMO will perform its reliability and supply adequacy functions as this will provide much needed certainty to the market. We think this consultation is a good opportunity to consider the interaction of a number of recent policy initiatives and look to make sure they work effectively to ensure adequate supply to the east coast gas market.

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1. Overlapping interventions

Key Points

- **Policy makers should use this consultation to clarify how the ADGSM, Gas Market Code and AEMO's gas adequacy powers will work together.**
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Recently there have been a number of significant policy interventions in the east coast gas market. AFMA is concerned that the various gas market policy interventions have been developed on an ad-hoc basis in isolation from each other and without consideration of how they will work together. We think this consultation presents an opportunity to consider how the various new interventions will operate together.

AFMA considers that, if well designed and implemented, the reforms proposed in this consultation will make a positive contribution by providing greater clarity to the market about how AEMO will assess supply and demand when AEMO will intervene in the market. But we remain concerned that under the ADGSM and the Gas Market Code, AEMO is not the only party who is able to intervene in the gas market and we would like policy makers to provide greater certainty about how these functions will operate together. Particularly, the market would like certainty about:

- the role the reliability standard will play in AEMO's advice to the Resources Minister under the ADGSM.
- how AEMO and the Resources Minister will coordinate their actions when both the ADGSM and AEMO's gas adequacy powers could address an identified issue.
- how AEMO will consider the impact of commitments given under the Gas Market Code when performing its adequacy functions or advising the Resources Minister.

AFMA Recommendations

- i. Policy makers should clarify how the ADGSM, Gas Market Code and AEMO's gas adequacy powers will work together.

2. Clarifying AEMO's functions

Recently the east coast gas market has been subject to a large number of policy interventions many of which have given ministers and regulators broad discretionary powers to intervene in the market. As AFMA has pointed out in a number of earlier submissions to consultation on; the Australian Domestic Gas Security Mechanism (ADGSM),¹ the Gas Market Code² and Stage 1 of the gas adequacy reforms,³ broad discretionary powers undermine certainty in the gas market which limits participants ability to invest and manage risk. We therefore welcome DCCEEW's proposal to provide greater clarity about how AEMO's gas adequacy powers will operate.

¹ [https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-\(7\)/R09-23-ADGSM-guidelines.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-(7)/R09-23-ADGSM-guidelines.pdf?lang=en-AU&ext=.pdf)

² [https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-\(21\)/R30-23-Gas-Market-Code-Exposure-Draft.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-(21)/R30-23-Gas-Market-Code-Exposure-Draft.pdf?lang=en-AU&ext=.pdf)

³ <https://afma.com.au/getattachment/e40473fb-4d80-4a7b-bfba-49b90f663bff/R068-22-gas-adequacy-NGR.pdf?lang=en-AU&ext=.pdf>

Key Points

- **AFMA supports clarifying how AEMO will perform its functions, including by developing an appropriate reliability standard.**
 - **The standard should be set by an independent body**
 - **The PASA function should not overlap with existing AEMO GSOO and Gas BB functions.**
 - **Where possible AEMO should rely on existing information powers.**
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2.1. Reliability Standard

AFMA supports the development of a gas reliability standard to provide certainty about when AEMO will use its powers to intervene in the market. However, we think it is important that the development of the standard is not rushed and that it is developed in close cooperation with the industry. AFMA's members also consider that, as in electricity, the reliability standard should be set by a body independent from government and AEMO; and that DCCEEW should focus on establishing appropriate governance arrangements for this body.

2.1.1. Governance

AFMA considers the gas reliability standard should be set by an expert body that is independent from AEMO. Our view is that developing the reliability standard will be a complicated task requiring significant market and technical expertise, additionally we consider that the standard is likely to need to be reviewed regularly. AFMA does not consider that this an appropriate function for government and considers that AEMO's system operation functions mean it not an appropriate body to set or maintain the standard as it is likely to adopt a more conservative approach than warranted.

We therefore recommend that DCCEEW should not use this consultation to set a standard but instead should establish a governance framework to create a body that is able to set and maintain the standard in a similar way to the electricity reliability panel.

2.1.2. Setting the standard

While AFMA does not think that it is appropriate for government to set a reliability standard, we want to make the following observations about the challenges of setting appropriate reliability standards for gas and electricity.

Electricity has both a reliability standard, that sets a standard for unserved energy in a region in a financial year, and AEMO's Lack of Reserve (LOR) framework that looks at the adequacy of instantaneous supply following the loss of large sources of supply. The consultation paper has proposed a variety of options based on these approaches or an alternative one based on expected peak demand.

The challenges to ensuring reliability are different in the gas and electricity markets. The electricity market has a comparatively diverse number of suppliers who can react rapidly to changes in demand, but it has limited ability to store energy. Therefore, the key issue in electricity is ensuring there is adequate capacity to meet instantaneous demand. Gas supply is more concentrated and there is substantial storage in the form of linepack, the ability to draw down on linepack gives the gas market

substantial resilience against short term shocks but once depleted, it takes some time to replace. As a result, gas is less prone to short term (intra-day) reliability issues than electricity, but more exposed to multi-day events.

AFMA's members have a range of views on the most appropriate approach to setting a gas reliability standard but they consider that an N-1 infrastructure approach (as used in AEMO's LOR framework) is problematic as the concentration of production and transportation means most gas markets are supplied by one or two key pieces of infrastructure. This means that most gas markets would constantly be in a state equivalent to LOR 2 in the NEM, and it is unclear what could be done to address this without massive uneconomic over-investment.

2.2. PASA

AFMA supports improving transparency in the gas market to ensure all participants are operating from a consistent base of knowledge. We think this is best done by creating a single source of truth for the gas market rather than by creating a completely new gas report that would duplicate elements of the Gas Bulletin Board (Gas BB), the GSOO and the VAPR. We consider the Gas BB is the most logical single source of truth, particularly given its recent enhancements as a result of prior efforts to increase transparency in the gas market. AFMA therefore recommends that policy makers should build on the existing Gas BB rather than creating a new report.

While not wanting to duplicate the Gas BB, AFMA considers that high quality information is critical to support the development of financial markets as it gives participants confidence that material information about the market is available and that no participants are misusing non-public information. A number of our members have commented that, while the Gas BB has made a significant improvement to the quality of data in the market, it remains unreliable with many notices about asset availability issued to customers, by asset owners, well before the Gas BB is updated. AFMA recommends that policy makers should ensuring accurate information is provided in a timely manner and also consider the extent to which other market relevant information currently held by AEMO could be published.

2.3. Information requirements

There has been a substantial increase in the gas industry's data provision requirements recently, including as a result of; phase 1 of these reforms, the enhancements of AEMO's Gas BB and the AER's new wholesale market monitoring functions. These reforms have resulted in market bodies having access to a significant volume of new information and have imposed significant costs on the industry.

AFMA encourages policy makers to take the opportunity to consider what information market bodies need to perform their functions and what the most effective way to collect this information is. AFMA questions the extent to which additional information powers will be required to support a reliability standard. We encourage policy makers to consider the extent to which information already collected by AEMO and the AER will be adequate to support these functions.

AFMA Recommendations

- ii. AFMA supports developing a gas reliability standard as a mechanism for providing greater clarity about how AEMO will perform its gas adequacy functions.
- iii. The gas reliability standard should be set and reviewed by a body independent from AEMO and government.
- iv. The standard should be developed in close cooperations with the gas industry.
- v. Data collection for the reliability standard should be built on the existing Gas BB.
- vi. Policy makers should review the data requirements of all market bodies and look to streamline their processes for data collection.
- vii. Consideration should be given to if additional data is required to support the reliability standard.

2.4. Intervention powers

2.4.1. Threat signalling

AFMA supports increasing certainty for the market by developing an objective process for AEMO to signal and respond to threats. We also encourage policy makers to ensure that the threat signalling process can work together with the current process for the NEM, DWGM and STTM.

We would like to draw attention to feedback from some of our members regarding the current threat signalling processes. Typically, under the current market processes AEMO only advises participants in a particular regulated gas market of threats. AFMA considers this approach is inadequate as it means that a number of participants in the broader gas market, who will be affected by the threat, will not receive notice at the same time as the participants in the other relevant regulated market. We therefore encourage policy makers to ensure that all threats are communicated to the broadest possible audience.

2.4.2. Supplier of last resort

AFMA was critical of AEMO's supplier of last resort function in our response to the phase 1 consultation. We were concerned that:

- a) the lack of clarity about how AEMO would exercise these powers would undermine certainty in the gas market
- b) AEMO's efforts to acquire gas in a tight market could have a negative impact on other participants attempts to purchase gas
- c) AEMO's gas trading activity will impose unnecessary costs on the market

We therefore welcome moves to develop a framework that provides greater clarity about how these powers will be used but would like to ensure that the impact of any purchases of gas by AEMO on the market are minimised.

As discussed in our submission to the phase 1 consultation, we think the framework should:

- a) Be linked to AEMO's function of identifying actual or potential threats.

- b) Make clear that the trading and directions powers will only to be used as a last resort and that a market response is always preferred.
- c) Require AEMO to publish information about actual or potential threats and allow the market to respond, before it can use these powers.
- d) Provide clear criteria about when AEMO will use the powers, including setting out when directions powers will be used in preference to the trading function.
- e) Prevent AEMO from holding gas trading positions for greater than 6 months to reduce the risk of AEMO interventions becoming a permanent feature of the market.

AFMA considers that the empowering provisions for AEMO’s supplier of last resort power should be written broadly enough to allow the power to be used in any region but considers that it will generally be more useful to consider the supply dynamics within regions.

AFMA Recommendations

- viii. AFMA supports developing an objective process for AEMO to signal and respond to threats.
- ix. The threat signalling process should work with the current process for the NEM, DWGM and STTM.
- x. Notice of threats should be provided to the broadest possible audience.
- xi. The NGR should set out a clear framework of how AEMO should exercise its supplier of last resort and directions functions.
- xii. AEMO should only be permitted to trade in gas as a last resort to prevent supply shortfalls.
- xiii. The supplier of last resort powers should apply to all regions, but AEMO should consider the supply dynamics within regions.

3. RSA Contracting Obligations

Key Points

- **Uncertainty is the main driver of limited forward contracting.**
 - **AEMO’s other gas adequacy powers are adequate to ensure gas security without imposing a contracting obligation.**
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3.1. Barriers to forward contracting

DCEEW has rightly identified that forward contracting rates are currently not adequate to support the required investment in infrastructure and new production to replace Longford’s declining production. AFMA wants to reiterate that the low rates of contracting and the failure of the market to invest in replacement infrastructure are in large part, a function of State and Commonwealth policy decisions. While not the main issue under consultation here, AFMA wishes to point out that State government policy has either prevented or delayed a number of concrete proposals for both new production capacity and LNG imports to ensure supply to the southern states and that the failure to make this investment is a major cause of the current difficulties experienced in the southern states.

More relevantly for this consultation, AFMA's view is that recent policy interventions by both the Commonwealth Government and Energy Ministers have undermined certainty in the east coast gas market which has weakened the incentives for, and put barriers in the way of, forward contracting. To restate AFMA's comments on the impact of the ADGSM and the Gas Market Code, the prospect of government intervention to disconnect east coast gas prices from global prices has:

- a) reduced the incentive for domestic users to forward contract to lock in gas supply as there is the potential that government policy will make gas cheaper in the future.
- b) reduced incentives for producers and infrastructure providers to invest in new capacity as they are unsure of the return they will make from the investment.
- c) the penalty provisions in the Gas Market Code, and the ACCC's guidance, have made it extremely difficult for suppliers to contract before the final code is available.

In addition to these specific concerns, the ongoing uncertainty about government policy towards the gas market and concerning the role of gas-powered generation in the energy market transition continues to undermine the incentives for parties to contract and invest. AFMA therefore suggest that the best way for governments to address the lack of forward contracting is to promptly implement clear policies that will give the market certainty to invest over the medium term.

3.2. A contracting obligation will not help

AFMA does not think a contracting obligation would assist with the issues currently faced by the southern states. Our view is that without policy certainty, it is unlikely that investors will choose to invest in the necessary assets to manage the decline of the Longford gas plant, regardless of any contracting obligation. We note that the Retailer Reliability Obligation, which was intended to perform a similar role in the electricity market, has not supported investment and policy makers are now considering other measures, focused more directly on the physical infrastructure challenges, to replace it. AFMA considers that RSA contracting obligations would be similarly unsuccessful in gas.

DCCEE's modelling drew particular attention to the contracting behaviour of gas-powered generators and suggested that there would be merit in requiring them to increase their contracting. AFMA does not share this view as we consider that, as with other participants, generators' contracting behaviour is driven by the incentives in the market and that the current market environment discourages them from long-term contracting.

Gas powered generators' decisions are largely driven by market outcomes in the NEM. Currently, the NEM is experiencing a period of rapid transition as renewable generation expands and coal generation exits. The transition is challenging for gas powered generators as, while their capacity is becoming increasingly valuable to firm renewable generation, they are also exposed to long periods of low prices when it is uneconomic for them to run, this trend has been amplified by the introduction of 5-minute settlement. As a result, gas powered generators are now attempting to recover their costs from shorter runs during unpredictable periods of higher prices. This changing market dynamic has made it less economic for generators to contract the large regular volumes of gas needed to support regular

running; as they are now more likely to run for shorter periods at unpredictable times for which short term and spot gas purchases are more suitable. AFMA's view is that the contracting behaviour of gas-powered generators is driven by the market signals sent by government policy and the energy market transition, and that more clarity is needed about the role of gas-powered generation in the energy market transition to give generators the confidence to contract gas to support predictable longer run periods.

We also note that the modelling paper proposed the contracting obligation as an alternative to a RERT like function for AEMO, given AEMO has been given a gas trading function, we do not consider that the contracting obligation is required as well. AFMA's view is that AEMO's enhanced signalling powers will assist the market to respond to any identified shortages, and in the event this is inadequate, AEMO's gas trading powers will allow them to ensure gas supply.

AFMA Recommendations

- xiv. Policy makers should increase certainty in the gas market to encourage longer term contracting.
- xv. A specific contracting obligation is inappropriate for gas powered generators.

4. Notice of closure

Key Points

- **AFMA supports measures that increase transparency about changes to gas market infrastructure.**
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AFMA supports the DCCEEW's proposal to increase transparency around the retirement of gas market infrastructure. That said, we note that gas infrastructure is extremely long lived so closures are likely to be rare. AFMA is not aware that any significant gas pipelines have ever closed in Australia as while their upfront capital costs are high it tends to be economic to maintain and incorporate them into future networks, we anticipate the same is likely to be true for many storage facilities.

Gas production facilities also tend to have long lives that are limited by the size of the resource they serve. But we also want to highlight that many production facilities will continue to operate for many years after their production has peaked as their fields slowly decline. As a result, gas production facilities are unlikely to close suddenly, in the same way as large power stations, but will decline over many years. It is also worth noting that information about reserve levels is already tracked by Geoscience Australia and state petroleum regulators; and this information already gives insight into the expected output of production facilities.

AFMA supports improving transparency about changes to gas infrastructure but questions if a notice of closure framework is the most appropriate mechanism. We encourage DCCEEW to work with the industry to develop an appropriate mechanism.

AFMA Recommendations

- xvi. DCCEEW should work with the industry to develop an appropriate framework for identifying changes to the capacity of gas infrastructure.

AFMA would welcome the opportunity to discuss the Reliability and Supply Adequacy Framework reforms. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lindsay Gamble', written in a cursive style.

Lindsay Gamble
Policy Director