21 October 2022

Attention: Energy Ministers Secretariat

Submitted by email: gas@industry.gov.au

Dear Sir/Madam,

NGR Consultation – Extension of AEMO Functions and Powers

The Australian Financial Markets Association (AFMA) is responding to the consultation on amendments to the National Gas Rules (NGR), other delegated legislation to extend AEMO functions and powers to allow it to manage east coast gas adequacy.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA has more than 125 members reflecting a broad range of participants in financial markets, including a number of key energy stakeholders who are active in Australian energy markets.

The recent unprecedented disruptions in electricity and gas markets have highlighted the need to review the market's regulatory arrangements to ensure they remain fit for purpose. AFMA appreciates energy ministers' desire to ensure adequate supply of gas to the east coast; but we have reservations about the potential impact of AEMO's trading function on the energy market and the operation of the proposed information powers. This submission should be read together with our submission on the proposed changes to the National Gas Law (NGL) in which, we raised a number of concerns about the proposed amendments.

We also want to note that consultation period was inadequate given the significance of these reforms. We consider that there will need to be further consultation on the delegated legislation and encourage minister ensure that adequate time is provided for stakeholder feedback.

1. Information collection

Access to information about the gas market will be critical in ensuring AEMO is able to perform its proposed functions, identifying and responding to actual or potential threats. We are concerned that the proposed information powers are not appropriately designed for this function and may result in additional costs for AEMO and the market. We also believe it is important that AEMO's functions should not duplicate the AER's responsibilities under its wholesale market monitoring and reporting functions. AFMA has pointed out, across a number of proposed information collection consultations

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by regulators and government authorities in recent years, that industry entities should not have to report the same information under multiple *ad hoc* regulatory reporting regimes. Regulatory reporting should be designed in such a way that standardised data can be submitted once to one government authority then shared with other authorities, as required. This requires strategic planning and coordination within government. We consider that energy ministers should develop a clear roadmap of the information that they consider that each regulatory body requires and develop a set of principles guiding how information powers will be developed.

1.1. Overlap with AER's function

Energy ministers have recently consulted on reforms to enhance the AER's wholesale market monitoring and reporting functions. The final shape of AER's powers is currently unclear but where possible, energy ministers should try and avoid duplication between the AER's and AEMO's functions. In our joint submission with the AEC to the consultation on the AER's powers,[1] we argued the AER should focus on collecting information to allow it to gain insight into the energy market and into participants risk management frameworks; which would allow it to perform its role as a market and retail regulator. As operator of the physical market, AEMO performs a different role that is much more focused on ensuring the physical supply of energy. We therefore consider that AEMO's information powers should focus on ensuring there is an adequate supply of gas to meet the demand of users. We consider that, as a market operator, it is more appropriate for AEMO to do this based on total supply and demand in the market rather than looking at the contract positions of individual participants.

To illustrate this distinction, as market operator, AEMO's role should be to consider the total demand for gas in a region and the adequacy of the available gas, from all sources, to meet that demand. We do not think it is AEMO's role to look at the contracting positions of individual participants and potentially direct them to purchase addition gas to manage their risk. Fundamentally, AFMA considers that it is the role of market participants, rather than AEMO, to determine how they manage their market risks. To the extent that energy ministers consider oversight of retailers' risk management practices is required to protect customers, we consider this should be the role of the AER.

As we wrote in our submission on the AER's powers, we affirm that AEMO and the AER should look to utilize their information sharing powers to minimise the burden placed on the industry to provide data to multiple bodies.

i. There should be clear delineation between AEMO and the AER's wholesale market functions with AEMO focused on ensuring physical supply and the AER focused on retailer risk management.
ii. AEMO and the AER should utilize their information sharing powers to minimise the burden on the industry.
iii. Energy ministers should develop a roadmap and principles governing the scope and development of information powers.

[1] https://afma.com.au/getattachment/Policy/Submissions/2022/R45-22_AER_information_powers/R45-22-AER-information-powers.pdf?lang=en-AU&ext=.pdf

1.2. Frequency of collection

The proposed draft rules require the provision of a significant amount of data on a daily basis. AFMA's view is that daily data provision is unlikely to be necessary to allow AEMO to perform its proposed functions and will impose unnecessary costs on the industry and AEMO. Ensuring adequate supply is done over two time horizons; medium term to manage seasonal variations in demand and short term to manage emergencies. We anticipate that most of AEMO's focus be on the medium term with occasional periods of intense attention to the short term.

Managing supply over the medium term requires high level information about anticipated supply and demand during expected peak periods. We anticipate that the peak demand is likely to be driven by seasonal factors, such winter heating loads and summer gas generation demand; and therefore, consider that very granular daily data is unlikely to be necessary for this type of seasonal analysis. We suggest that this information is most usefully provided on a quarterly basis. It should also be noted that in its role as gas retail market operator, AEMO currently has access to extremely detailed daily data about gas usage that could be used for analysis purposes.

AEMO will need access to more timely data, potentially provided on an intraday basis, to allow it to manage emergencies. As emergencies occur infrequently and the data required to manage them cannot be know in advance, we do not believe ongoing daily reporting of data is appropriate to support these functions. Providing ongoing daily data would be expensive and there is a real risk that it would not provide the information AEMO needs for any given emergency. To the extent there are any limitations with accessing information in operational timeframes currently, a more preferable approach would be to provide AEMO with separate powers to request the information it needs to manage an emergency. The Emergency Management Facility on AEMO's existing West Coast Gas Bulletin Board could serve as an easy to implement model. Energy minister might also like to consider reporting triggers, such as already exist under the STTM's Contingency Gas rules, to ensure AEMO is advised of potential emergencies and has the opportunity to ask for additional information.

AFMA considers that confining AEMO's regular data collection to a quarterly reporting obligation and allowing it to supplement this data with additional requests during an emergency — will ensure that AEMO has the information it needs to perform its functions while substantially reducing costs for AEMO and the industry. Quarterly reporting could be supported by manual data provision or basic information portals while moving to daily data collection would require substantial IT investment by AEMO and the industry. For the reasons set out above, we do not think that the benefit from daily data provision justifies the substantial additional cost and operational complexity of providing it.

iv. Regular provision of daily data is not required for AEMO's functions and should be replaced by quarterly data provision

v. AEMO should have separate powers to, when necessary, request additional information to manage emergencies, potentially based on AEMO's current Western Australian powers

1.3. Forecasting

The proposed rules require retailers and large users to provide 7-day demand forecasts. As set out above, AFMA does not consider that daily data provision is necessary for AEMO's functions but in the case of forecasts, we believe the AEMO will get more accurate data by performing the forecasts itself, rather than relying on participants to provide them.

Forecasting short term energy demand is a well understood process. Typically, participants will use linear regression models that forecast future demand based on observed historic demand under different weather conditions. These models tend to be more accurate for larger populations as outliers have less of an impact on the larger volume. As a result, AEMO is likely to get a more accurate view of demand by performing a forecast for an entire region rather than by adding up multiple participants forecasts for their share of demand in the region.

As gas retail market operator, AEMO has access to the usage data required to perform forecasts and it has substantial experience producing short term demand forecasts in the NEM and the DWGM; additionally, its process for producing D+1 allocations in gas retail markets is essentially the same process as producing a demand forecast. The STTM is the one market where AEMO relies on participants demand forecasts to determine total hub demand, this has been an ongoing source of difficulty in the market as over time the sum of participants forecasts have been shown to be inaccurate; and this has resulted in unnecessary costs to the market.

AFMA considers that having AEMO perform demand forecasts, will give it more accurate insights into demand than relying on participants forecasts and will avoid the substantial cost of participants providing the data on a daily basis.

vi.	AEMO should perform its own demand forecasts rather than relying on participants forecasts

1.4. Disclosure

One of the key features of these reforms it to allow AEMO to provide information to the market about actual or potential threats to gas adequacy. AFMA supports this proposal but, as mentioned in our submission on the NGL amendments, much of the information provided by participants will be commercially sensitive and needs to be subject to appropriate controls against inappropriate use or disclosures. The NGL provides a well understood framework for AEMO to manage confidential information, but it permits disclosure in accordance with the NGR. We are concerned that the proposed Rule 683(1) may be drafted too broadly as it allows AEMO to disclose information obtained under Part 27 on the Natural Gas Services Bulletin Board. On the face of it, this provision allows AEMO to publish any confidential information on the Bulletin Board. We doubt this is the intention of the energy ministers and suggest that it be redrafted to clarify that publication on the Bulletin Board is subject to AEMO's obligations regarding the handling of confidential information under the NGL. Where ministers feel that specific pieces of confidential information should be published on the Bulletin Board, this should be provided individually in the NGR.

vii.	Rule 683(1) should be redrafted to provide appropriate protection of confidential information

1.5. Implementation

The proposed reforms will require participants to provide large amounts of data to AEMO. A substantial amount of time will be required for AEMO and participants to agree what information AEMO requires and how it will be submitted. Participants and regulators resources are also currently challenged by a number of overlapping gas information and transparency reforms that are currently being implemented. We anticipate that energy ministers and AEMO should allow approximately 6 months for this work and encourage them to consult on the implementation arrangements in parallel with the legislative amendments. Should energy ministers decide that participants need to provide daily data, AEMO and the market will need to undertake significant IT development to enable this which cannot be foreshortened to meet a premature implementation date. Accordingly, we anticipate the implementation period would extend to at least 18 months. Given that much of the detail of the information requirements will be contained in delegated instruments, the implementation timeframe should be calculated from when these instruments are formally made.

viii.	Energy Ministers and AEMO should allow an implementation period of: a. 6 months – if daily data is not required b. at least 18 months – if daily data is required

2. AEMO's trading role

As highlighted in our submission on the NGL, AFMA believes that markets work best when regulatory intervention is measured and restricted to circumstances to when they cease to perform their function of allowing goods or services to move to where there is demand. Consistent with this view, AEMO's intervention in the market should be limited to ensuring a reliable supply of gas. We also consider that the proposed arrangements for the trading fund are inappropriate and will result in unnecessary costs to the industry; and may not provide AEMO with adequate funds to address a supply shortfall.

2.1. A last resort power

AFMA considers that markets generally function best without government intervention. We therefore consider that AEMO's involvement in the market be only a last resort power that will only be used if the market is no longer functioning. As we pointed out in our submission on the NGL amendments, the proposed amendments do not contain an adequate framework for indicating how AEMO should exercise this function and how they will relate to the proposed signalling and directions powers. We consider that failing to adequately articulate ahead of time how AEMO will perform these functions; will introduce uncertainty in the market about when AEMO and how will intervene and introduces further, difficult to manage, commercial risk for market participants about when, how and how often AEMO will intervene.

We propose that the NGR should contain a framework setting out a hierarchy of how AEMO will use these powers. 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 positions for greater than 12 months to reduce the risk of AEMO interventions becoming a permanent feature of the market

ix.	AEMO should only be permitted to trade in gas as a last resort to prevent supply shortfalls
x.	The NGR should set out a clear framework of how AEMO should exercise its trading function, including the interaction with the signalling and directions powers

2.2. Trading fund

The amendments propose setting up a $35m fund to facilitate AEMO's trading activities. It will be funded by contributions from market participants and the consultation paper asks for input on the size of the fund and potential funding methodologies. AFMA considers that establishing a permanent fund is unnecessary, will be more expensive than AEMO financing its activity through debt and runs the risk of AEMO not having access to adequate capital to fund necessary trading activities. We consider that it would be more appropriate for AEMO to fund its trading activity using a debt facility such as it currently utilises for managing operating and capital expenses.

As set out above, AFMA considers that AEMO should only trade in natural gas as a last resort to ensure adequate supply. We therefore expect trading to be infrequent and the trading fund will remain unused for long periods. Permanently financing this fund would impose a significant cost on the industry who would have to access additional capital or divert it from other uses. Data for BBB rated corporate bonds indicates that BBB rated entities can currently raise funds at ~3.5% premium to the cash rate (currently 2.6%), implying an interest rate of ~6.1%. At this rate, the annual cost to the industry of financing the $35m fund would be ~$2.1m. This cost would be higher if interest rates increased and it is also worth noting that many participants in the energy market would have credit ratings below BBB and face higher financing costs.

AFMA considers that the preferable alternative is for AEMO to utilise a commercial debt facility where, in exchange for a relatively modest facility fee, it has approval to access funds up to a pre-approved limit but only begins paying interest when it draws down on the facility. This approach is better suited to the proposed last resort trading function as most of time AEMO (and ultimately participants) will just have to bear the cost of the facility fee and will only have to pay interest when AEMO draws down on the funds to actually trade. We anticipate that this would be substantially lower cost for the industry than the proposed trading fund model. From AEMO's most recent annual report, we note that as of 30 June 2021, AEMO had a $535m unsecured variable rate syndicated debt facility provided by commercial banks and that the facility was drawn to $358.2m— leaving $176.8m undrawn and available.[2] The existence of this facility indicates that AEMO is familiar with debt financing and has the capability to operate such a facility. The amount undrawn indicates that AEMO may not need to significantly increase the size of the facility to support the trading function. We also note that energy ministers could increase AEMO's ability to borrow, and reduce the cost of the facility, through government backed financing.

Allowing AEMO to fund trading activity through debt also removes the need to determine the amount of funds that it will need. Setting the funding at $35m (or another amount) in the NGR means that AEMO may find itself unable to access enough funds to manage a situation with no practical means to increase the available funds in the short term. Allowing them to fund the trading activity through debt would give AEMO much greater control over the amount of available funding and reduces the risk that an inadequate amount of funding would be available.

The following example emphasises why debt may be a superior approach to a trading fund:

a) *In December AEMO determines that it will need to acquire $35m of gas and related services to manage an anticipated shortfall of gas over the period from June to August in the following year. AEMO contracts to purchase the gas and related services in January.*

[2] P35 AEMO Annual Report 2020-21

$5m is payable upfront and the remainder is paid monthly after delivery i.e. $10m in each month

In this scenario, if AEMO were using debt, it would only need to fund $5m initially and would not need the additional funds until settlement for June occurs in July.

b) *AEMO delivers the gas over the winter months and is paid for it by the market.*

AEMO will receive payments for the gas it sells, as well as making payments to its supplier. As a result, it will be able to use the revenue that it has gained from selling the gas to make payments to its supplier and will probably not need to finance the full cost of the gas.

If AEMO were to use debt to finance this scenario, participants would be expected to pay the financing costs of the initial $5m and any financing costs resulting from the difference between settlement dates between when AEMO is paid for the gas and when has to pay its suppliers. Using the assumptions about financing costs stated above, and assuming that AEMO breaks even on its gas trading; we would expect the total cost of funding this transaction using debt to be <$300k to the industry. Alternatively, under the trading fund model participants would have to finance the full $35m (at an annual cost of ~$2.1m) despite AEMO not needing to access $35m at any point to fund $35m worth of trading activity.

xi. AEMO should fund trading activity through a commercial debt facility rather than the proposed trading fund

AFMA would welcome the opportunity to discuss the extension of AEMO functions and powers. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely

Lindsay Gamble
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