AUSTRALIAN
ENERGY
COUNCIL

Australian Energy Market Operator (AEMO)

Submitted via email: GWCF_Correspondence@aemo.com.au

7 October 2022

Submission to AEMO's Gas Market Parameter Review 2022: Draft Consultation Report

The Australian Energy Council welcomes the opportunity to make a submission to AEMO's Gas Market Parameter Review 2022: Draft Consultation Report (**Consultation Report**).

The Australian Energy Council (**AEC**) is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

The AEC believes that the market price settings for the DWGM and STTMs should be aligned. As recently demonstrated earlier this year, the lack of alignment between the markets created distortions in the east coast gas market. While it appears that harmonisation between the DWGM and STTMs are out of scope and unlikely to be achieved in this review, the AEC suggests that a consultation and review process on this matter could be conducted by the Reliability Panel (**the Panel**).

In addition to this, because of the linkages between gas and electricity markets consideration should be given to moving responsibility for gas market parameter reviews to The Panel. The Panel could also look to establishing a reliability standard for gas because without a standard it is difficult to determine the trade-offs between reliability, risk and cost.

Question1: Do you have any comments on the appropriateness of the calculation of acceptable risk?

The Consultation Report (p. 38) describes a method based on 500 days of lost profit by a participant to establish the maximum level of risk that the market settings are allowed to permit. However, the Consultation Report it does not provide any detail on assumed hedging levels. Nor, is there any description of assumptions relating to what hedging options participants are assumed to use to manage their risks (ie, contracts, storage, LNG storage, curtailments and demand response). If it is just contracting, then the modelling will be based on unrealistically elevated levels of risk for participants. In light of the above, it is not possible to provide an opinion on the Consultation Paper's approach.

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 range and types of scenarios broadly appears to be reasonable. While Scenarios 12 and 13 have some of the characteristics of the 2022 energy crisis, consideration could be given to having the actual events of that crisis as a scenario. That is, low variable renewable energy (VRE) output, flood impaired coal mines, low coal stockpiles, extreme global coal gas and oil prices, cold winter (particularly in Queensland), etc. and all leading to a shortage of megawatt hours.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 98 052 416 083

With respect to Scenario 5, the AEC is unsure if there ever have been three consecutive days of one in 20 gas and would be interested to know if it has ever occurred or at the least come close to that.

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

It is difficult to comment on modelling artefacts without more detail on the modelling. The AEC would like to see more transparency with respect to the modelling.

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

The AEC agrees with an LNG import terminal being the marginal new entrant as it is the only way to introduce an external source of supply into the system in a relatively short period of time. The Consultation Paper appears to base its analysis on a proposed LNG import terminal at Port Kembla. There are critical aspects of this approach which are not discussed in the Consultation Paper including:

- The assumed capacity factor noting that the next question in Consultation Paper states that it will be operated infrequently.
- Will it be a merchant facility or will its cashflows be underpinned by contracts with market participants. Alternatively, a hybrid of the two. Whatever of these assumptions are applied will also influence some of the WACC parameters such as gearing, equity beta and credit spread.

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

We are unsure on the operating costs. With respect to the life of the asset, the AEC considers a 20-25 year asset life would be more appropriate. With net zero by 2050 and plans by state governments and territories to progressively replace natural gas with electrification of households and businesses, investors may baulk at a 30-year life assumption for an LNG import terminal.

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?

It is unclear why different types of participants and industries are mentioned in this question. When valuing an asset for the purposes it is to be used here, one would generally assume a stand-alone asset with an

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone +61 3 9205 3100
Email info@energycouncil.com.au
Website www.energycouncil.com.au

ABN 98 052 416 083

assumed credit rating based on the type and size of cashflows it generates relative to its costs. As an example, the AER regulates electricity networks on the assumption that they are stand-alone, 60 per cent geared business with the type (ie, regulated) and size of cash flows relative to its costs to result in a business that can sustain an investment grade BBB+ credit rating. Hence, the AEC considers it should be assumed to be a stand-alone asset.

The AEC is of the view that:

- The equity market risk premium should be 6 per cent.
- The risk-free rate should be the prevailing yield on a 10-year Australian Government Bond (**AGB**), which is currently 3.79 per cent.
- The credit spread to AGB (ie, debt margin) will be a function of the credit rating assumption of the facility, which in itself will be dependent on the business model of the plant alluded to in our response to Question 4 and the gearing assumption. The Consultation Report states a debt margin of 2 per cent but there is no mention of the credit rating of the assumed facility. If the credit rating is BBB- and the tenor of debt is 10 years, then as at 31 August the spread would have been 3.23 per cent.[1] If the venture has a sub investment grade rating it will be significantly higher.
- The equity beta needs to reflect the systemic risk of the business. An equity beta of one is the same as that of the market. Whether the plant is purely merchant, is underpinned by contracts or some mix of the two will determine the stability of its cash flows and hence influence its systemic risk (ie, equity beta). Consideration also needs to be given to the gearing assumption and deleveraged beta and leveraged beta.

Other valuation metrics such as internal rate of return and EBITDA multiples for this type of asset should be considered as well as the proposed discounted cash flow analysis. Overall, the AEC would like to see much more rigor applied to the assessment of the financial (eg, WACC parameters) and business model of the LNG import terminal because the Consultation Report is seriously lacking in this respect. As with other aspects of the modelling, the AEC would like to see more transparency.

Any questions about our submission should be addressed to Peter Brook, by email to peter.brook@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,

Peter Brook

Wholesale Policy Manager
Australian Energy Council

[1] Source RBA. https://www.rba.gov.au/statistics/tables/#interest-rates

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

Phone +61 3 9205 3100
Email info@energycouncil.com.au
Website www.energycouncil.com.au