

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
Sydney NSW 2000

Dear Mr Pierce

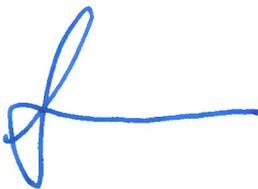
On 14 August 2016, the COAG Energy Council (Energy Council) agreed to implement the Gas Market Reform Package. One of the agreed measures requires the Australian Energy Market Commission (AEMC) to conduct a biennial review into the growth in liquidity in the gas and pipeline capacity trading markets and to report to the Energy Council on whether further reforms are required to achieve its Vision for the Australian Gas Market and/or to promote the National Gas Objective.

The Energy Council has now agreed to the Terms of Reference (ToR) at Attachment A developed by the Gas Market Reform Group (GMRG) in consultation with the AEMC, the Australian Energy Regulator and Australian Energy Market Operator.

The ToR have been developed in accordance with section 80 of the NGL and are intended to guide the AEMC's development of the biennial review and will remain in place until such time as directed otherwise by the Energy Council.

Should you wish to discuss the ToR, please contact Mr Brenton Philp, Assistant Secretary, Gas and Governance Branch on (02) 6275 9026 or by email at brenton.philp@environment.gov.au.

Yours Sincerely



The Hon Josh Frydenberg MP
Chair
COAG Energy Council

12 December 17

Terms of Reference: Biennial review into the growth in liquidity in wholesale gas and pipeline trading markets

1. Background

On 14 August 2016, the COAG Energy Council (Energy Council) agreed to implement the Gas Market Reform Package (Reform Package), which consists of 15 reform measures across the following priority areas: gas supply, market operation, gas transportation and market transparency.¹ The development of the Reform Package was informed by the findings and recommendations contained in the Australian Energy Market Commission's (AEMC) *Eastern Australian Wholesale Gas Market and Pipelines Framework Review (East Coast Review)*² and the Australian Competition and Consumer Commission's (ACCC) *Inquiry into the East Coast Gas Market*.³

One of the agreed measures requires the AEMC to conduct a biennial review into the growth in liquidity in the gas and pipeline capacity trading markets and to report to the Energy Council on whether further reforms are required to achieve its *Vision for the Australian Gas Market (Vision)*⁴ (see Box 1.1) and/or to promote the National Gas Objective (NGO).⁵

Box 1.1: Energy Council's Vision

The Energy Council's Vision is for:⁶

"...the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities."

The importance of liquidity was highlighted in the AEMC's East Coast Review, which noted that:⁷

"A liquid trading market is a means to promoting greater efficiency in the supply of natural gas. It is not an end in itself. An efficient market supports outcomes where gas is supplied to those consumers who value it the highest, at the lowest possible cost, over time. A liquid trading market facilitates the buying and selling of gas on an equal basis to other players, and the hedging of price risk, which lowers barriers to entry and promotes competition. Trading gas through well-functioning markets is fundamental to consumers not only knowing whether the gas price reflects underlying demand and supply, but also forming expectations of future price movements."

This review was recommended by the AEMC, who also recommended that the Australian Energy Regulator (AER) publish a range of quantitative liquidity metrics on its website on a

¹ COAG Energy Council, Gas Market Reform Package Bulletin, August 2016.

² AEMC, Stage 2 Final Report: East Coast Review, 23 May 2016.

³ ACCC, Inquiry into the East Coast Gas Market, April 2015.

⁴ The Vision also set out a number of outcomes that the Energy Council agreed to pursue in the next phase of gas market reforms including (but not limited to): (a) increased flexibility and opportunity for trade in pipeline capacity; (b) liquid and competitive spot and forward markets that enable participants to price and hedge risk; (c) access to regional demand markets through more harmonised pipeline capacity contracting arrangements; (d) harmonised market interfaces that enable participants to readily trade between locations and find opportunities for arbitrage and trade; and (e) identified development pathways to improve interconnectivity between supply and demand centres, and existing facilitated gas markets, which enable the enhanced trading of gas.

⁵ The NGO is set out in section 23 of the NGL and states that the objective is to "promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas".

⁶ COAG Energy Council, Australian Gas Market Vision, December 2014.

⁷ AEMC, Stage 2 Final Report: East Coast Review, 23 May 2016, pp. i-ii.

regular basis so that market participants, energy market bodies and policy makers can monitor how liquidity is emerging in these markets on an ongoing basis.⁸

2. Energy Council Directed Review

Pursuant to section 79 of the National Gas Law (NGL),⁹ the Energy Council¹⁰ requests the AEMC to conduct a biennial review into the growth in liquidity in the wholesale gas and pipeline capacity trading markets in accordance with these Terms of Reference. The first review is to be completed prior to the mid-2018 COAG Energy Council meeting and subsequent reviews completed every two years thereafter.

These Terms of Reference, which have been developed in accordance with section 80 of the NGL, are intended to guide the AEMC's development of the biennial review and will remain in place until such time as directed otherwise by the Energy Council.

3. Scope of the Biennial Review

The purpose of the biennial review is to:

- objectively monitor the growth in liquidity in the wholesale gas and pipeline capacity trading markets;
- report on the effectiveness of the reforms that have been made to these markets and the progress that is being made toward achieving the Energy Council's Vision; and
- identify whether any further reforms to these markets may be required to achieve the Energy Council's Vision and/or to otherwise promote the NGO.

The markets that should be examined as part of the biennial review include:

- the facilitated markets, which include the Gas Supply Hub (GSH), the Victorian Declared Wholesale Gas Market (DWGM), the Short Term Trading Market (STTM) and the secondary capacity trading market, which is currently under development; and
- any other physical or financial markets that enable participants to trade gas, pipeline capacity or other related services, or to hedge risk, to the extent that information on these markets is publicly available.

Given a number of the Energy Council's agreed reforms to the trading markets will not be in place by the time the first biennial review is carried out, the initial review is expected to be relatively narrow in scope and to focus primarily on:

- the development of the methodology the AEMC intends to use to monitor the growth in liquidity over time and the information it requires to carry out this monitoring role;
- establishing a baseline measure of liquidity that can be used in future reviews to assess the success of the reforms the Energy Council has agreed to implement; and
- the growth in liquidity that has occurred in the Wallumbilla GSH and Moomba GSH and the effect that the introduction of Optional Hub Services at Wallumbilla has had on liquidity in this market.

The second biennial review, on the other hand, will be carried out in 2020, which will be between one and two years after most of the reforms are expected to be implemented. This

⁸ AEMC, Stage 2 Final Report: East Coast Review, 23 May 2016, pp. 42 and 155.

⁹ Section 79 of the NGL allows the Ministerial Council on Energy (MCE) to give a written direction to the AEMC that it conduct a review into a range of matters, including any matter relating to a market for gas or access to pipeline or pipeline services.

¹⁰ The Energy Council comprises Ministers responsible for Energy matters all of whom are members of the legally enduring MCE.

review, and subsequent reviews, are intended to examine the extent to which liquidity is emerging in all of the wholesale gas and pipeline capacity markets.

Reflecting that the focus of the trading market reforms to date has been on markets in the east coast, the initial biennial review is expected to focus on the performance of trading markets in this area. In subsequent reviews, however, the AEMC will be expected to monitor developments in the Northern Territory and Western Australia, where it is relevant to do so.

3.1 Monitoring the growth in liquidity in trading markets

In undertaking the biennial review, the AEMC should assess and report on, amongst other things:

- the quantitative and qualitative liquidity metrics in Table 3.1 (where the information is publicly available) as they relate to each market and any other metrics it considers relevant, which should be measured on a consistent basis to enable trends to be measured over time;
- any relevant structural indicators of competition in the trading markets; and
- the extent to which liquidity is emerging in each market and if there are any barriers to the development of liquidity in these markets.

Table 3.1: Metrics to monitor liquidity

Metric	Description
Quantitative Metrics	
Traded volumes	Volume of trades in each market over the measurement period.
Churn rate	Ratio of all traded volumes to the demand for the underlying physical product
Bid-offer spreads	The difference between prices on the bid and offer side of the market
Number of active participants	The number of participants that have actively traded in the markets and the breakdown of the types of participants (e.g. producers, retailers, industrial customers, physical or financial participants)
Concentration of trades amongst active participants	The proportion of trades accounted for by individual participants
Range of products traded	The types of products available to trade, including bilateral products, over the counter products and exchange traded products.
Number of trades per product	The number of traded transactions per product
Trades conducted through the facilitated markets vs bilateral and OTC trades	The proportion of trades conducted through the facilitated markets versus trades conducted bilaterally or OTC (to the extent this information is publicly available).
Qualitative Metrics	
Confidence of market participants	Survey-based measure of market participants' confidence in the trading market and any perceived impediments or barriers to using the markets <i>vis-à-vis</i> entering into bilateral trades.
Market participants perception of future market developments	Survey-based measure of market participants' perceptions of the future state of the market and the potential for further growth in liquidity.

Where relevant, this assessment should be informed by, amongst other things:

- the liquidity metrics published by the AER and any other relevant information published by the AER, the Australian Energy Market Operator (AEMO), or the ACCC in the context of the 2017-2020 Gas Inquiry;
- a survey of market participants that is to be carried out as part of the biennial review; and
- stakeholder engagement that is to be carried out as part of the biennial review.

The Energy Council understands the AEMC does not have formal information gathering powers, so its ability to report on some metrics may be restricted by the availability of public information.

3.2 Effectiveness of reforms and progress toward the Vision

In addition to monitoring the growth in liquidity in each market, the AEMC should consider and report on:

- the effectiveness of the reforms that the Energy Council has agreed to make to the trading markets and whether the reforms are achieving their stated objectives; and
- the progress that is being made toward achieving the Energy Council's Vision.

The AEMC should also consider and propose appropriate thresholds and/or benchmarks in the first biennial report against which the effectiveness of the reforms and progress toward the Vision can be measured in subsequent reviews. This consideration should be informed by, amongst other things, the liquidity metrics outlined in section 3.1, the survey of market participants and stakeholder engagement.

3.3 Identification of whether further reforms are required

Having regard to the matters set out in sections 3.1 and 3.2, the AEMC should advise the Energy Council on whether any further reforms to the trading markets are required to achieve the Vision and/or to promote the NGO, or if it is too early to render such a judgement. If further reform is considered necessary, then the AEMC should explain why it is necessary and how it will, or is likely to, contribute to the achievement of the NGO.

The reforms that the AEMC could consider in this context include, but are not limited to, the measures that were identified in the AEMC's East Coast Review and the *Review of the Victorian Declared Wholesale Gas Market* (Victorian Review).¹¹

If the further reform proposed involve any of these measures, then the AEMC will be expected to set out how it could be implemented. If, however, the proposed reform involves other measures that have not previously been considered in any detail, the AEMC should set out the nature of the reform that would be required and inform the Energy Council of whether further work is required before consideration can be given to implementing this reform.

4. Consultation, Timeframes and Deliverables

The biennial review is expected to take less than six months to complete and involve consultation with market participants and other interested stakeholders, the AER, AEMO, ACCC, Gas Market Reform Group (GMRG), Energy Consumers Australia (ECA), the Gas Major Project Implementation Team and the Senior Committee of Officials. In a similar manner to other market wide reviews, the AEMC will be expected to publish:

- a notice informing market participants that the biennial review has been initiated, the scope of the review and the approach the AEMC intends to take;
- a preliminary report outlining its initial findings and recommendations for stakeholder consultation;
- a final report that sets out the results of the biennial review and the AEMC's recommendations on whether any further reforms are required; and
- an information sheet and/or infographic that contains a summary of the key findings and recommendations arising from the biennial review.

The AEMC should provide its final report to the Energy Council six weeks prior to the mid-year meeting, with the first report to be provided in 2018. Unless determined otherwise, the final report will be published on the same day it is considered by the Energy Council.

¹¹ AEMC, Review of the Victorian declared wholesale gas market, 30 June 2017.