

23 May 2018

Mr John Pierce
Chairman
Australian Energy Market Commission
Via electronic submission

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Dear Mr Pierce

Draft Report – Biennial review into liquidity in wholesale gas and pipeline trading markets

Project reference GPR0005

AEMO welcomes the publication of the AEMC's Draft Report of the first biennial review into liquidity in wholesale gas and pipeline trading markets (**Draft Report**).

As recognised throughout the Draft Report, a number of key reforms to the east coast gas markets and pipeline capacity frameworks are underway. AEMO is pleased to continue to support the Commission in the evolution of this biennial review as a means to establish recommendations which will improve liquidity in wholesale gas and pipeline trading markets.

It is recognised that this first review was relatively narrow in scope, establishing the methodology and baseline measures of liquidity for future biennial reviews. Notwithstanding this, AEMO provides the following suggestions for the Commission to consider for future reviews.

Reforms and simplification of the Short-Term Trading Markets (STTMs)

AEMO supports the continued development of the STTMs as recommended in the AEMC's Stage 2 Final Report for the East Coast Wholesale Gas Markets and Pipeline Frameworks Review. AEMO considers this biennial review to be a valuable tool which can be used to inform and drive recommendations for any future simplification to the STTMs.

AEMO is of the view that this first report has missed an opportunity to establish a methodology and commence monitoring baseline metrics which would provide valuable baseline measures to inform recommendations for future changes to the STTM design. AEMO suggests that in addition to the metrics already established, for future reports, the AEMC consider establishing a comprehensive methodology for monitoring the STTM to support the recommendations made in the East Coast review. Metrics could include:

- Backhaul volumes; number of Participants using backhaul; location of backhaul
- Liquidity and competitiveness of the Market Operator Service (MOS)
- Activity that occurs after the ex-ante schedule e.g. deviations, market schedule variations and the ex-post price

Metrics informing Declared Wholesale Gas Market (DWGM) liquidity

AEMO notes the methodology adopted by the Commission to monitor DWGM traded volumes calculated as a sum of net positions of market participants at the beginning of day (BOD) schedule.¹

For future reports, AEMO suggest the Commission also considers within-day trading activity as these represent key risk management tools used by Participants within the DWGM. By only looking at the 6:00 am schedule, the analysis will under-state the level of activity in the market and provide an incomplete picture as to the health of the DWGM. Metrics could include:

- Trading to manage deviations
- Bilateral trading at injection points
- Injection source diversity as well as imports and exports

In addition, AEMO suggests the Commission consider analysing liquidity on a seasonal, monthly or peak/minimum demand day basis.² For example, traded volumes in the DWGM can observe significant seasonal or daily swings in line with changes in demand.

Pipeline capacity trading

The Commission recognises the key reforms being implemented in the wholesale gas and pipeline markets, including the capacity trading reforms currently being developed by the Gas Market Reform Group.³ AEMO supports the Commission's approach to consider information which will become available through the pipeline capacity trading reforms post March 2019 and developing metrics to monitor the performance of capacity auctions in future biennial reviews.

Transportation services reforms are expected to foster the development of a more liquid secondary capacity market, improving the efficiency with which capacity is allocated and used on transportation assets operating under the contract carriage model. AEMO suggests the next biennial review includes the development and monitoring of the following metrics:

- Liquidity of traded secondary capacity products on the platform
- Level of activity and uptake in the auction, including monitoring whether the priority of service for the auction product inhibits uptake; and monitoring curtailment of auction quantities as reported by pipeline operators
- Breadth and uptake of products (i.e. spreads) offered on the platform

General reflections on the adopted approach to monitoring gas market liquidity

AEMO supports the adoption of both quantitative and qualitative measures of liquidity within the Draft Report. In addition to the measures adopted and results presented in this first review, AEMO provides the following points for consideration by the Commission:

- The role of additional supply in improving market liquidity. While a number of stakeholders expressed expectations that an increase in physical supply of gas will lead to increased trading activity,⁴ alternate drivers can influence trading activity.

¹ Refer Draft Report s.3.1.3.

² Refer Draft Report figure 3.4.

³ Refer Draft Report s.3.1.4.

⁴ Refer Draft Report s.3.1

These include large retailers limiting contract offers; producers charging higher prices; and producers offering less flexibility.

- Stakeholders held differing views with regard to whether the STTMs and GSH play competing or complementary roles.⁵ AEMO recommend the Commission explore and consider the pricing relationship between markets (as opposed to each market in isolation), which would further inform liquidity of transportation markets.
- The Commission has adopted the Herfindahl-Hirschman Index as an approach to assess overall market concentration for each gas market.⁶ AEMO cautions the adoption of a nominal HHI threshold in drawing conclusions on overall market concentration. The HHI measure is calculated based on a subset of total trades occurring on facilitated markets, and excludes trades conducted bilaterally or OTC. The challenge of using this metric is correctly identifying and capturing the entire market which is intended to be measured, further exacerbated by not having direct producer participation. AEMO supports the AEMC adopting a more holistic approach to assessing market concentration of the entire underlying market, with further analysis investigating trends in longer term, forward markets. AEMO is of the view that this would be a beneficial metric to inform the future direction of gas markets evolution.

If you would like to discuss the contents of this submission further, please contact Ms Violette Mouchaileh on 03 9609 8551.

Yours sincerely



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⁵ Refer Draft Report s.3.1.2.

⁶ Refer Draft Report s.3.5.