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Dear Mr Pierce

Australian Energy Market Commission Draft determination – Forward Trading Market

AEMO welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) draft determination for the Forward Trading Market (FTM) rule change.

AEMO believes that there is a valuable opportunity in the southern gas markets for a physical gas forward trading exchange. The gas markets have become increasingly interconnected across the east coast with price, supply and demand outcomes in the north influencing those in the south and vice versa. This interrelationship has grown with the introduction of pipeline capacity trading which AEMO understands has already underpinned a number of bilateral transactions between participants in the north and the south. Industry participants are increasingly utilising short-term deals and trades as an important part of managing their portfolios in a more dynamic market environment. In AEMO's view, this environment has improved the value proposition for a physical forward trading exchange in the south to enable participants to trade between markets and to support the efficient allocation and pricing of gas. Victoria as the largest and most liquid gas market in the south is a natural location for forward trading of physical gas products.

AEMO remains supportive of the proposed FTM

As outlined by the Victorian Government in its rule change proposal, AEMO agrees that the introduction of the proposed FTM would be beneficial to Victorian participants by improving their risk management options. Additionally, the FTM would be an effective way to link the southern and northern markets through the creation of tradeable spreads and improved market access for east coast participants. In Victoria, the FTM would also enable:

- Retailers to manage their short-term commodity purchases ahead of the gas day by providing a transparent platform to buy and sell standardised gas products.
- Producers to participate directly in the market. For example, by allowing a producer to sell excess short-term production (above long-term contractual commitments) at a market price.
- A mechanism for gas fired generators to purchase gas supply for generation ahead of a gas day.
- Efficient facilitation of bilateral trading through the standardisation of trading products and centrally managed settlement and prudential.

Ultimately it is consumers who would benefit from the more efficient wholesale gas market that would result from the FTM's implementation. It is therefore disappointing that the AEMC's draft determination is to not proceed with the proposed rule change.

The draft determination has recommended that the rule change should not proceed due to the view that:

- the level of participation and the associated benefits will not outweigh the costs of implementation; and
- there is not a clear case of market failure as similar markets and services to the FTM have been developed on a commercial basis.

AEMO is not convinced by these conclusions and we consider that to the detriment of consumers, the benefits of the FTM will not be delivered by existing arrangements without further reform and development. AEMO considers that the benefits identified by the Victorian government, the AEMC in its 2015-2017 review and various stakeholder submissions to the consultation paper are material and would likely outweigh the cost of implementation. AEMO also notes that a valuable attribute of the FTM would be its integration with the DWGM's spot market that would allow a participant to directly manage its spot market position. Such a market cannot be developed without changes to the current regulatory framework.

Ongoing challenges to facilitating physical forward trading

The AEMC's 2015-2017 DWGM review identified that in Victoria forward trades of gas between market participants are done on a bilateral basis and occur outside of the market. There is only a limited ability for new entrants and smaller participants to participate in this type of trading. Bilateral trades are not transparent to the rest of the market, and the search and transactions costs required to execute these trades are high especially when compared with trades executed through an exchange. The relatively high search and transaction costs, coupled with the information asymmetry created by a lack of transparency, disfavour bilateral trades for smaller volumes or shorter time periods. The transparency and standardisation delivered by an FTM would address these inhibitors to trade. Without an FTM, these higher search and transaction costs will likely continue to act as a barrier to participation for forward trading of gas. AEMO expects that smaller participants and new entrants in particular will continue to be largely restricted to trading via the DWGM's spot market. In addition to improving risk management options, it was this rationale that led to the recommendation for the forward trading market to be progressed (as well as the trading market proposed in the target model) in the Review and in the Victorian Government's rule change proposal. We have seen little evidence that these issues are not still relevant today.

AEMO also contends that the proposed FTM would be beneficial to existing markets and would likely enhance their efficiency. AEMO sees the financial and physical markets as complementary rather than as substitutes. In particular, the ability to trade short-term positions through the proposed FTM is likely to aid portfolio management for participants including those trading on the financial exchange. The markets are also likely to be complementary given the different tenors of products, with financial markets offering longer-dated products and the physical market offering shorter-dated products. Furthermore, the FTM may be a more viable risk management option for smaller participants or new entrants due to the capability and regulatory requirements associated with derivative trading.

The draft determination also states that the FTM would be in direct competition with the in-pipe trade points that operate outside the DTS and suggests that this is a reason not to proceed with the FTM. While AEMO supports the development of the APA in pipe trade points (IPT) at Culcairn and Wilton it does not agree with this comment. An in-pipe trade point is only useable by shippers with a transportation service with APA Group that includes the relevant trade point and transportation capacity to and from that point. As such, a number of DWGM participants (and particularly those who operate exclusively in Victoria on the DTS)

will not have access to these trade points and would be unable to deliver or receive trades at these locations. Furthermore, IPTs also only exist on the Moomba to Sydney Pipeline (MSP), AEMO does not believe that IPTs (or similar services) are available at other locations that border the DTS. These factors may be a barrier to entry for some participants particularly if they only intend to trade on an adhoc basis or for smaller volumes for delivery to the DTS. Another key point of difference from the FTM is that trades delivered to an IPT are also made on a bilateral basis and counterparties are not anonymous to each other.

Fundamentally, the IPTs serve a different purpose to an FTM. The Culcairn and Wilton trade points and are used by shippers on the MSP to trade imbalances and as a title transfer service for off market and bilateral transactions that may be delivered into NSW, Victoria or held in pipeline linepack. Unlike the FTM, the IPTs do not provide the pricing settlement or prudential arrangements for the transactions that they facilitate. Ultimately, the IPTs are not themselves a market as the draft determination suggests and given their different purpose, they would still be of value irrespective of whether an FTM is implemented.

Gas supply hub cost recovery

AEMO would like to clarify the statements in the draft determination about the Gas Supply Hub's (GSH) costs and cost recovery structure. As previously advised to the AEMC, the GSH costs are being recovered over a 10-year period to a forecast of trade volumes not a 5-year period as suggested in the draft determination. In addition, there have been several projects post-implementation that have resulted in additional capital expenditure for example the implementation of the Moomba trading locations and the Wallumbilla single product. These various enhancements have improved participation, volume and liquidity for the GSH, and their costs are being recovered on their own 10-year periods from when the enhancements were implemented.

AEMO notes that while trade volumes in the initial years were low (which was not unexpected for a new voluntary market), they have had solid year-on-year growth as industry support and participation in the market rises. Based on our forecasts and projections, we expect that the GSH's costs will be recovered over the relevant payback periods.

If you would like to discuss the contents of this submission further, please do not hesitate to contact Paddy Costigan, Manager Market Design on 03 9609 8407.

Yours sincerely,



Peter Geers

Chief Strategy and Markets Officer