AEMC

Review of the Victorian Declared Wholesale Gas Market
Working Group

Meeting 2

Date: 13 July 2016

Time: 10.30am to 3.00pm

Location: AEMC Office, Sydney

1 Agenda

i. Welcome and recap

ii. Detailed discussion

- Capacity allocation and trading
- Access to existing capacity
- Access to new capacity
- Economic regulation

2 Attendee organisations

Organisation	Organisation
AEMC	ExxonMobil
AEMO	Jemena
AER	Gas Trading Australia
AGL Energy	Lochard Energy
APA Group	M2 Energy
Department of Industry, Innovation and Science, Federal	Major Energy Users
EnergyAustralia	Origin Energy
ENGIE	Public Interest Advocacy Centre
ERM Power	

3 Presentations and discussion

- The AEMC provided a recap on the rationale for reform in the DWGM:
  - o the lack of risk management tools in the current DWGM; and
  - o the limited market signals for investment in pipeline capacity.

- The AEMC reiterated that the unbundling of the three elements of the DWGM auction is the main characteristics of the new model:
  1. **continuous commodity trading** inside the hub, replacing existing daily auction;
  2. **capacity allocated** on the basis of entry and exit rights; and
  3. a **balancing mechanism** on the day guarantees system security and gas delivery.

- The AEMC provided a detailed presentation on the key elements to achieve a well-functioning **capacity market**, focusing on the following issues:
  - o determining the amount of capacity rights to be made available;
  - o capacity types and allocation mechanisms;
  - o initiatives to improve access to capacity and achieve a liquid market, including reservation of firm capacity for shorter term products, short term interruptible capacity, capacity trading and capacity release mechanisms; and
  - o access to new capacity: negotiation, open seasons and integrated auctions.

- The AEMC briefly discussed the topic of economic regulation and informed the group that it will be addressed further outside the workshops, with direct conversations with APA, AER and AEMO.

- Discussions throughout the meeting tended to focus on possible issues in the design of the market, and their solutions. These discussions are summarised below:

3.1 Risk allocation

- Some attendees raised concerns regarding the possible changes in risk allocation that could arise in the new model, especially when firm capacity is constrained.
  - o A number of participants considered it inappropriate for APA, as the asset owner, to bear the risk of constraints of firm capacity, because:
    - ▪ it would significantly change to APA’s risk profile;
    - ▪ it may cause capacity to become more expensive for participants to acquire, or else not result in appropriate compensation for APA for the risks it takes; and
    - ▪ in some instances the curtailment of firm capacity may be the fault of (and be resolved by) the system operator, rather than the asset owner.

- Given that there are difficulties with AEMO, as the proposed system operator, bearing risk, other participants suggested it would be inappropriate for the risk of curtailment of firm capacity to be borne by firm shippers, given that they have paid for firm capacity. One participant suggested that firm rights should be guaranteed.
  - The AEMC noted that while this was an important issue and one yet to be settled, curtailment of firm capacity should be a rare event. Furthermore the AEMC noted the current market does not guarantee access, even to holders of AMDQs.
- A number of attendees also suggested that the new model could create more volatility in the market and hence increase risk. The AEMC explained the market design should allow for the emergence of risk mitigation products which will help participants to better manage their risks.

3.2 Commodity market liquidity and voluntary trading

- One of the attendees raised concerns around the voluntary nature of commodity trading on the virtual hub. It was suggested that in other voluntary markets in Australia participants might prefer to trade off-market in order to avoid signalling potential high prices.
- As with the first meeting, the group also discussed whether liquidity will develop sufficiently in the commodity market, with some attendees suggesting that:
  - current market concentration may limit liquidity developing; and
  - although trading might theoretically develop assuming all parties acted as rational agents, cultural and behavioural reasons may limit the development of liquidity in practice.

3.3 Coordination between commodity market and capacity market

- As with the first meeting, a number of stakeholders suggested that it may be practically difficult to simultaneously procure both entry and/or exit rights to the market and negotiate a gas supply agreement.
  - Stakeholders suggested that this may result in market participants being stranded with one but not the other and so being in a weak negotiating position.
- Stakeholders were also concerned that efficient outcomes in short-term gas exchange market (for example for balancing or in response to price signals in the National Electricity Market) may be prohibited by a lack of corresponding liquidity in the capacity market, particularly in the short term.
  - Stakeholder noted that illiquidity in the commodity market may result in inefficient scheduling, as the parties that value gas the most may not be scheduled because the capacity is not appropriately allocated.
- A number of attendees noted that the current model where AEMO allocates capacity according to bid stacks (unless there is a constraint) works well and is easily managed by traders. They believe that in the new model, purchasing capacity on the day will make things operationally more difficult as it will create another step for traders, creating executional risk.

  - Some stakeholders noted that this operational issue may be exacerbated by needing to hold capacity for a specific entry location in order to inject gas at that location. Where a shipper holds a portfolio of gas and can inject it from a variety of locations, it will have to ensure that it holds the appropriate level of capacity at any given location at any given time.

3.4 Capacity release mechanisms

- One of the attendees noted that the proposed firm day-ahead use-it-or-lose-it provision, where day ahead un-nominated firm capacity is lost, would affect market participants' ability to use or sell those firm rights for balancing on the day. This might affect the ability of market participants to monetise firm capacity rights which they have paid for. The AEMC will further investigate how to address this issue.

3.5 Alternative models

- As in the first meeting, a number of stakeholders suggested that financially firm access may be a more appropriate solution than the physically firm access model being explored by the AEMC.

3.6 Suggested next steps

- Attendees suggested that detailed examples should be explored in subsequent working group meetings, potentially drawing upon data from specific historic gas days. These might be particularly useful in examining the issue of coordination between the commodity and capacity market.
- The AEMC committed to exploring ways in which the proposed market design might be introduced transitionally.
- It was agreed that a fourth working group meeting should be scheduled in late August 2016, in addition to the existing three meetings already planned. This has been provisionally scheduled for 24 August 2016.