

A few  
words.

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY NSW 1235

*Submitted via email*



10 September 2015

Dear Mr Pierce,

### **AEMC Wholesale Gas Markets Discussion Paper**

AGL welcomes the opportunity to provide comments on the Australian Energy Market Commission (AEMC) high level market design concepts for the Eastern Australian gas wholesale market.

AGL has a long history of involvement in Eastern Australian gas markets and currently supplies gas and electricity to over 3.7 million customers on the east coast. Additionally, AGL utilises gas in power generation, is involved in gas extraction activities and has also recently completed the construction of a gas storage facility in Hexham, New South Wales. The views expressed in this submission leverage this experience.

AGL considers that the new trading environment brought about by the arrival of the LNG export facilities and coal seam gas production will be a feature of the Eastern Australian gas market for the foreseeable future. AGL notes that the gas market is still in transition, with the LNG trains not yet at full capacity and their effect on the market is not yet ascertainable. Accordingly, AGL considers that the AEMC should exercise caution in recommending wholesale changes to a market that is in transition.

AGL has provided answers to the questions raised on page six of the consultation document at [Attachment One](#). In summary, AGL supports further consideration of the virtual hub models proposed, noting that further analysis, including cost/benefit assessments, will provide further clarity on their merit.

AGL notes that consideration of the virtual hub models must take place concurrently, and with regards to, the AEMC's work on pipeline capacity trading. Accordingly, AGL reserves judgement on the various virtual market concepts proposed until further information and analysis is undertaken.

However, AGL does not support further consideration of Concept 1, as introducing additional hubs (i.e. Gladstone, Iona and Longford – in addition to Wallumbilla and Moomba) is likely to increase market complexity and participants transaction costs. AGL can only assume that these costs and complexities will also create barriers to entry. It is also unclear what benefits a 5 hub model would produce when the east coast gas market is still underscored by relatively few market



participants – buyers and sellers. Without a sufficient level of participation trade at each new hub is likely to be too low for substantial liquidity and transparency to eventuate.

AGL looks forward to providing further feedback on the options presented as they are developed in more detail. If you wish to follow up on any issues raised, please contact me on (03) 8633 6967.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Simon Camroux', is positioned below the text 'Yours sincerely,'.

Simon Camroux  
**Acting Head of Regulatory Strategy**

**AGL Submission on AEMC Wholesale Gas Markets Discussion Paper**

**1. Over the next 10 years, how do industry participants see their gas sales and procurement activities changing?**

AGL considers that the Eastern Australian gas market has already changed with the arrival of the liquefied natural gas (LNG) export facilities and that the market dynamics associated with LNG will be present for the foreseeable future. AGL notes that the gas market is still in transition, with the LNG trains not yet at full capacity and their effect on the market not yet ascertainable. Accordingly, the AEMC should exercise caution in recommending wholesale changes to a market that is in transition.

The LNG market and corresponding coal seam gas production are leading to shorter term fluctuations in wholesale gas supply and prices. For a traditional shipper such as AGL with a large gas retail book, this brings some challenges in being able to match a large, sticky demand base with more variable upstream supply.

AGL is increasingly participating in shorter term markets to complement long term transportation and supply arrangements to assist in balancing upstream and downstream positions. These arrangements largely occur outside long term supply and transportation contracts, which do not readily lend themselves to short term changes.

**2. Do the current market arrangements adequately support participants' needs?**

Historically, market participants have relied on long term gas and gas transportation agreements to manage their position in the market. However, AGL considers that as the market changes, due to the impacts of the LNG facilities coming on line, market arrangements will now need to be more flexible. Greater flexibility will give participants confidence that they are able to adequately manage their position and market risk, that they are able to trade out of a short position or, if long, capable of trading excess volumes in the market.

Fundamentally, AGL is keen to ensure that gas transportation and supply arrangements are sufficiently flexible to meet short term changes in supply and demand profiles. This should be the underlying driver of any policy reform proposals.

**3. Are gas trading markets expected to become more important in ensuring the efficient allocation of gas?**

AGL does not consider that adding numerous gas trading hubs to the East Coast gas market is a tenable solution. Accordingly, AGL does not support Concept 1.

The addition of gas market hubs, in and of themselves, will not create the transparency and liquidity that is being sought, as markets of any variety require a number of functional elements in order to operate efficiently. In a workably competitive market, such elements include, a large number of buyers and sellers, low barriers to entry and exit and access to information.

AGL considers that gas trading markets should be seen as a result, rather than necessary precursor, of the efficient allocation of gas. The efficient allocation of gas arises when access to gas and transportation combined with other trading arrangements (i.e. position netting, compression and re-direction services) allow molecules to efficiently, and freely, follow price.

#### **4. How many and what type of wholesale gas trading markets are required to meet the Energy Council's Vision and how should this be assessed?**

As a general principle, AGL has a view of 'less as more' when it comes to wholesale gas trading markets. Noting AGL's position on Concept 1 above, AGL considers that a larger number of trading platforms will increase the complexity and cost of trading gas, as each platform generally involves participant fees and other internal IT and staff costs involved in managing positions on each platform. AGL can only assume that these costs and complexities will also create barriers to entry. For these reasons, coupled with those outlined above, AGL would not support further consideration of Concept 1.

In regards to the options put forward by the AEMC, AGL supports further consideration of Concepts 2 and 3 – the virtual trading hub models.

These two models are clearly the most progressive of the three proposed, and AGL supports further consideration and assessment of these two models, noting that further analysis, including cost/benefit assessments, will provide further clarity on their merit. AGL notes that consideration of the virtual hub models must take place concurrently, and with regards to, the AEMC's work on pipeline capacity trading. Accordingly, AGL reserves judgement on the various virtual market concepts proposed until further information and analysis is undertaken.

#### **5. Does having multiple gas hubs contribute to or detract from the objective of achieving a liquid wholesale gas market and why?**

In the context of the Eastern Australian gas market, having too many hubs is likely to detract from achieving a liquid market – given the relatively low number of participants. Conversely, focussing trade at a very small number of hubs may maximise trading activity and liquidity. The price that arises at the hubs could then be used, if necessary, to determine prices at different areas in the network. For example, Wallumbilla netback pricing is often used to price gas at locations outside the Wallumbilla hub – additional physical hubs are not necessary to determine this price.

As mentioned above, multiple hubs create additional costs for participants both in the cost of trading through a hub and the internal costs of managing positions at multiple hubs. This is also likely to be a barrier to entry.

#### **6. What are the main barriers to achieving a liquid wholesale gas market on the east coast and are regulatory solutions required?**

As AGL noted in its submission to the Australian Competition and Consumer Commission East Coast Gas Inquiry, second only to increasing onshore gas supply, access to economic and tradeable transmission capacity is fundamental to an efficient gas market and ensuring that supply is maximised.

The contract carriage model has delivered substantial private sector investment in gas transmission infrastructure in the Eastern Australian gas market (outside of the Declared Wholesale Gas Market). AGL recognises that concerns are now being raised that contractual terms associated with these investments is limiting transparency and liquidity in the trading of capacity on these assets.

Accordingly, AGL considers there is merit in investigating whether the contract carriage model remains appropriate. Further investigation could include assessment of the relative costs and benefits of:

- secondary capacity trading;
- moving from ‘contract carriage’ to ‘market carriage’; and
- adjusting pipeline settings to support new trading hubs.

AGL recognises that, as changes to existing arrangements may have adverse implications for current and future investment in gas transmission assets, these implications will need to be addressed as part of the policy development process. For example, it will be important to have a phased transition which recognises existing property rights.

In considering the appropriate market design, AGL highlights that contract carriage instils a responsibility for security of supply with the capacity owner, which makes capacity owners risk averse and less willing to trade spare capacity – this issue would be expected to be addressed by a move to ‘market carriage’.

Further, a key principle to secondary capacity trading should be to ensure that it is the capacity owners that become the agents who buy and sell capacity rights, as opposed to the pipeline owner – this is likely to require the introduction of a market operator function to enable capacity trades to occur without the involvement of the pipeline owner.

**7. Could the virtual gas hub design concepts set out in section 8 be feasibly implemented on the east coast of Australia? If not, what barriers exist?**

A significant body of work needs to be completed by the AEMC with regards to the detailed market design, including transportation access settings, before AGL can provide a firm view as to whether the gas hub design concepts could feasibly be implemented.

**8. Do existing contractual rights and/or issues around cross border trade preclude any particular gas hub designs?**

Appropriate transitioning or grandfathering of existing contractual rights are a key consideration in implementing a virtual hub model.

**9. Are different gas specifications, such as a higher quality specification for the LNG plants and the odourisation of some transmission pipelines, likely to act as a barrier to trade in the future?**

Some producers may need to invest in processing in order for their gas to be suitable for LNG plants. AGL considers this investment is best addressed by producers/the private sector.