2 June 2015

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

Dear Mr Pierce,

RE: Qenos submission - Draft Report on Stage 1 of East Coast Wholesale Gas Market and Pipeline Frameworks Review

Thank you for the opportunity to provide a submission on the issues and questions raised by the Draft Report on Stage 1 of the East Coast Wholesale Gas Market and Pipeline Frameworks Review (**Draft Report**).

<u>Executive Summary</u>

Qenos is Australia's sole producer and leading supplier of polyethylene. Qenos spends tens of millions of dollars on gas each year, which is an important fuel source used in its manufacturing facilities. Qenos also uses ethane, a co-product of natural gas, as a feedstock in the manufacture of polyethylene.

Qenos, as a member of the Plastics and Chemicals Industries Association (PACIA), Energy Users Association of Australia (EUAA) and Australian Industry Group (AIG),supports the key points and recommendations of those organisations, including the following:

> *"A domestic gas market that is deep in capacity, liquid in supply, competitive, transparent, informed and with good price discovery."*

Qenos appreciates the work of both the AEMC and ACCC in support of the COAG Energy Council's vision. We look forward to reviewing the ACCC review of the upstream gas supply market when it becomes available.

The AEMC was asked to focus on the following:

1. Facilitated Markets: enhance transparency and price discovery;
2. Improve risk management in Australian gas markets; and
3. Incentives for efficient access to and use of pipeline capacity.

Qenos is concerned that the Draft Report's proposal in relation to amendments to the STTM are not consistent with the achievement of the above principles.

The proposal to replace the STTM with a voluntary gas balancing market would:

1. Reduce transparency and not enable real price discovery;
2. Make it more difficult for participants to actively manage their risk. In particular, the STTM allows companies to balance risk and price; and
3. Discourage gas consumers from participation in the spot market.

If the operation of the STTM is altered an alternative ex-ante price mechanism needs to be identified.

<u>Price transparency and changes to the STTM</u>

To ensure good price discovery and improved price transparency, market participation should be compulsory and barriers to participation (eg. placing of bids) need to be removed.

A survey-based gas price index and/or aggregating existing publicly available information would be of limited value. The main issue with the use of such indexes is that they do not represent a price 'that you can purchase gas at'. Suppliers can therefore disregard these prices in negotiations, which Qenos experienced with steaming coal and a reference to the Newcastle Coal Index. A price index is only of benefit if you can purchase gas at the indexed price.

Voluntary participation (eg. responding to a survey or making a public disclosure) potentially distorts the view of the market. Participants may elect to only report figures that are consistent with their preferred price outcome.

One of the objectives in the formation of the STTM was to provide participants more choice in purchasing gas supplies. Qenos is concerned that the proposed changes to the STTM actually run counter to the objectives of the COAG Energy Council's vision.

<u>Time is needed for markets to develop</u>

We suggest the AEMC give consideration to the time required for Facilitated Markets (such as the STTM) to develop before making significant changes. When the Henry Hub first commenced, the volumes traded were very low. Today, the number of trades on the NYMEX Henry Hub Futures and Options is more than 6 times the volumes at the end of the first 5 years of operation (ref – Market Reform presentation to AEMC on 25 February 2015).

It took Qenos 5 years from the commencement of the STTM to become a market participant. Qenos needed to evaluate the development of the market, monitor daily gas prices and understand how it could be used as part of its gas purchasing strategy. Once satisfied that the STTM met Qenos's requirements, it could not implement the strategy until the previous gas supply agreements expired. The main benefit of participation is being able to assess and directly manage the risks associated with gas purchasing. This ability provides a more level playing field in negotiations with upstream suppliers. Qenos no longer has to purchase all its gas from them as it can access gas on any day from the STTM. This enables Qenos to trade risk against price.

Qenos is aware of a number of large gas users that have expressed an interest in becoming market participants. In AEMO's presentation at the AEMC public information session on 25 February 2015, it advised that it had received 16 STTM registration applications. Since the start of the year, Qenos has been advised of two new product offerings being developed where gas supply is linked to the STTM gas market. The STTM is starting to develop to a point where it is providing an alternative to or used to supplement long term supply contracts as per its original intent. Qenos is therefore surprised that the AEMC is looking to remove the STTM without suggesting a replacement.

<u>Issues raised by AEMC on the STTM</u>

There is real value in the ex-ante price signal provided by the STTM. In the first 4 months since becoming a market participant in the Sydney STTM, Qenos has purchased ~35% of its gas requirements from the STTM. Access to an ex-ante price enables Qenos to make informed purchasing decisions. In doing so Qenos has saved ~20% on its gas commodity cost.

If significant changes are made to the STTM, they need to be accompanied by the establishment of an alternative ex-ante price mechanism. Further development of the Gas Supply Hub ('GSH') at Wallumbilla would not be an adequate substitute. It would require participants to separately contract pipeline transportation capacity. This would increase the cost of supply, as participants would have to contract 'firm' capacity in order to assure delivery when spot purchases were available. The benefit of the STTM is that users can purchase gas delivered to the city gate, without requiring additional contracting. Qenos acknowledges AEMC's intent to pursue more active trading of pipeline capacity. This needs to be addressed before any proposed changes to the existing markets.

Qenos recommends that the AEMC investigate what changes are required in the timing nominations by upstream producers and pipeline transporters to enable a higher volume of transactions to be based on the ex-ante price. The AEMC highlighted in its Draft Report that at least 85% of transactions across all STTM hubs are within-participant. From Qenos' experience this is primarily due to two factors. Firstly, upstream GSA's and Pipeline Transportation Agreements have different nomination requirements. This varies depending on the location. For example, the Longford gas plant requires nominations by 9 am the day prior to the gas day ('D-1') whereas the timing on the Moomba to Sydney Pipeline ('MSP') is 2.30 pm on D-1. This has a material impact on the value of the ex-ante price signal. Those shipping out of Longford require a participant to take a higher level of risk than those shipping from Moomba, since at Moomba the ex-ante price will be known. Secondly, upstream GSA's have minimum Take-or-Pay ('ToP') obligations that typically range from 80% to 100% and Maximum Daily Quantity ('MDQ') which operate to limit the ability of a participant to purchase or sell gas into the market. Through the STTM, market participants are able to place a financial value on more flexible ToP and MDQ limits and then price this into their negotiations with new GSA's.

The ability for participants to manage risk from imbalances has significantly improved from the STTM rule changes implemented by AEMO in 2014. The main driver for this rule change was to reduce the size of the monthly surplus or short fall charges, which represented an unknown risk in the market and better allocate the costs of MOS to those who contributed to the MOS requirement in the first place. The changes also aimed at providing a more direct daily price signal and encourage use of Market Schedule Variations, which provide an effective and low-cost method of managing daily deviations. Qenos recommends that MSV settlements be done through the STTM rather than through individual bi-lateral agreements a means of improving efficiency.

The AEMC raised the costs incurred by AEMO to operate the STTM being around 5 times higher originally estimated. Qenos would support a review into these costs and investigate processes that would simplify, improve efficiency and reduce the overhead costs incurred in the operation of the STTM. Qenos believes that significant savings can be achieved without stripping the STTM of its original objectives.

<u>Establishing the Gas Bulletin Board as a "one-stop-shop" for all gas market data</u>

Qenos supports the recommendations of the AEMC to improve the Gas Bulletin Board. In addition to the improvements, Qenos suggests looking at the following:

- Notice for planned maintenance of pipelines and production facilities. Similar to those provided in the electricity market.
- Gas sales offers – similar to pipeline capacity trading notice. This would allow parties with excess gas to post volume and price at STTM or DWGM.
- Listing for available MSV offers – showing different parties with imbalances available on the different days
- Data to be available in an easily downloadable format e.g. excel
- Improvements on the ability to download historical data. Ideally it would provide an excel file based on the time period selected.

Thank you for considering Qenos' comments. We welcome the AEMC's review into the East Coast Wholesale Gas Market and look forward to the Stage 1 final report in June 2015.

If you have any questions concerning this submission, please do not hesitate to contact Andrew Cheah on (02) 8336 1245.

Yours Sincerely,

Stephen Bell

Stephen Bell
General Manager Commercial