17 February 2016

John Pierce
Australian Energy Market Commission
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Submitted online: www.aemc.gov.au

Dear Mr Pierce

Origin Energy Limited (Origin) welcomes the opportunity to contribute to the Australian Energy Market Commission's (AEMC) East Coast Wholesale Gas Market and Pipeline Frameworks Review. Our comments on the review of the Victorian Declared Wholesale Gas Market (DWGM) are also included in this submission.

Generally, Origin considers that the AEMC's proposed package of reforms will assist in achieving the COAG Energy Council's vision for enhanced market liquidity and transparency. It has been well documented that the east coast gas market is undergoing a significant period of change with the advent of LNG exports. Notwithstanding this, there are many aspects of the current market that work effectively. A measured and incremental approach to policy reform therefore continues to be an appropriate means of progressing market development.

Our views on the areas of focus in the draft report are outlined below.

Pipeline capacity markets

The ability to trade pipeline capacity is important in ensuring market efficiency and Origin is in favour of efforts aimed at lowering the transaction costs associated with capacity trading.

One of the central principles in contemplating any amendments to pipeline capacity trading arrangements is that the property rights of existing capacity holders is not undermined. If this is not the case, market participants would have diminished incentive to invest in primary pipeline capacity. It is therefore vital, that in seeking to enhance the trading of secondary capacity, the AEMC remains mindful of any potential adverse impacts on the primary market – without primary investment secondary trading cannot flourish.

Auctioning of contracted un-nominated capacity

Origin is concerned that as it is currently proposed, the auctioning of contracted un-nominated capacity could adversely impact the ability for shippers to re-nominate capacity. Re-nominations (including intra-day) are crucial in managing fluctuations in gas demand brought on by a number of factors including the operation of gas peaking plant in response to changes in the electricity market. It is therefore not uncommon for a shipper to negotiate re-nomination arrangements on pipelines that service gas fired generators. If these arrangements are curtailed, this would undermine the ability for shippers to effectively manage their energy portfolios.

We will reserve any substantive comments on the actual design of the proposed auction when more detail is available and the issues around the potential negative impact on re-nominations rights are resolved. However, we note the AEMC's suggestion that the auction reserve price could be set at short run marginal cost. One issue that should be considered is the extent to which this could result in free-rider issues resulting in a disincentive for some participants to invest in primary pipeline capacity and instead rely on potentially cheaper capacity available through the auction. Though this is unlikely to be a sustainable strategy for many shippers, at the margin free-rider issues could arise.

In discussing existing nomination rights, the draft report states that *it might be appropriate to consider harmonisation of nomination cut-off times as part of the harmonisation of the gas day start time.*[1]Origin does not support this suggestion, and consider that renomination cut off times should continue to be subject to commercial negotiations between the shipper and pipeline owner. This will allow market participants to tailor their requirements to suit their individual needs, which in turn enables stability across both the gas and electricity markets.

Publishing of capacity information

Origin supports the development of standardised secondary capacity products in an effort to reduce search and transaction costs. With regard to the publishing of capacity trading information, while we support market transparency we would again caution against any requirements that would reveal commercially sensitive information that could undermine a shipper's position in a related market such as electricity. Additional information requirements must continued to be justified, and should result in net benefits to the market if they are to be adopted. While transparency is desirable it is not an end to itself and does not automatically equate to greater market efficiency. Origin will continue to work with the AEMC as it looks to finalise the suitability of publishing certain types of capacity information.

Future developments

The Draft report again raises the prospect of introducing mandatory use it or lose it (UIOLI) provisions if the proposed new measures result in insufficient levels of trade. It is not clear, however, how this would be determined. In our view the primary consideration should be whether there are impediments to capacity trading and not necessarily the volume of trades executed. Additionally it would need to be conclusively demonstrated that the withholding of capacity was systemic in the market, before any UIOLI measures could be justified. We note that the AEMC states in the draft report that they consider some shippers may have a countervailing incentive not to sell capacity, but it is not clear on what basis this view was predicated.

Wholesale gas trading markets

The concept of concentrating trading activity at two main hubs – a physical hub in the north and a virtual hub in the south, takes into account the physical characteristics of the east coast gas market, and has the potential to enhance market efficiency.

Northern Hub

Origin continues to support the implementation of a single hub product at Wallumbilla through the adoption of the optional hub services model, as this should assist in improving participation and liquidity. We note that the Draft Report states that ultimately there might be a need for the northern hub to transition to a virtual hub. While a virtual hub may be suitable in Victoria, there are likely to be significant obstacles in moving to a similar arrangement at Wallumbilla particularly given the contract carriage regime, and the existence of long term gas transportation agreements. We are also not convinced that a virtual hub is a necessary requirement for an efficient and robust market at Wallumbilla. Given that the Wallumbilla hub has been in existence for less than 2 years and the optional hub services model is only now just being implemented, the current arrangements at the

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[1] AEMC 2015, Stage 2 Draft Report, East Coast Gas Market and Pipeline Frameworks Review, pg 58

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northern hub should be given sufficient time to work before there is any contemplation of yet another change in market design.

Southern Hub

Looking to implement significant changes in a relatively mature market such as the Victorian DWGM is likely to present a number of challenges as the cost of transitioning to any new arrangements must be taken into account. Origin supports the intent of the proposed changes set out in the Draft Report but considers that in order to be definitive in our views a number of issues will need to be clarified; and a thorough cost benefit analysis would need to be undertaken.

The AEMC states that a primary benefit of moving to an exchange trading regime is that the prices generated could be used as a reference for financial derivative products. One of the deficiencies with both the short term trading markets and the DWGM is that the commodity price is subject to other uplift charges rendering it unreliable as a basis on which derivative products can be developed. If derivative products are to develop through exchange trading, participants must have confidence that the prices observed reflect the delivered price of gas. It is unclear to what extent any balancing arrangements at the southern hub will impact the delivered price of gas. For the proposed exchange trading arrangements to be successful in enabling the development of a derivatives market it must avoid the pitfalls of the current facilitated markets. It is our anticipation that this will become clearer as more detail emerges on the design of the exchange.

With regard to the proposed entry/exit model, while we agree that this could assist in enhancing investment signals, a crucial starting point is the current state of investment in the DWGM. Notwithstanding the market carriage framework, participants have the ability to fund pipeline augmentations, and it has yet to be determined that the current arrangements have resulted in a sub-optimal level of investment. Another important consideration is how current transportation rights – authorised maximum daily quantity would be transitioned under the entry/exit approach, and will be vital that existing rights remain valid.

While any cost benefit analysis is likely to prove complex, an important consideration in assessing the merits of the recommendations for the southern hub, is the extent to which the expected benefits can be achieved through targeted improvements to the current market arrangements. The key decision making parameter would then be which approach (i.e. incremental changes or more radical re-design) can achieve the desired outcomes at least cost.

Short term trading markets (STTM)

We have previously stated that a major deficiency of the STTMS is there complexity. Origin therefore agrees with the recommended simplification of the STTMs and the plan to narrow their focus to balancing.

Information and the Bulletin Board

Origin generally agrees with the additional information for publication on the Bulletin Board. While we agree with broadening the purpose of the Bulletin Board in the rules, it is important that any additional information is relevant, and the net benefit of this information is taken into consideration.

In terms of expanding the Bulletin Board's coverage we support the inclusion of upstream activities to the extent this results in the streamlining of current information that is disseminated across a number of sources. This would assist in minimising duplication.

If you wish to discuss any aspect of this submission further, please contact me at steve.reid@originenergy.com.au or on 02 9503 5111.

Yours Sincerely,

Steve Reid
Manager Wholesale Regulatory Policy