

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

Dear Mr Pierce

As agreed by the Council of Australian Governments (COAG) Energy Council on 11 December 2014, and as referenced in the COAG Energy Council Meeting Communique, the Australian Energy Market Commission (AEMC) was tasked to review the design, function and roles of facilitated gas markets and gas transportation arrangements in the eastern Australian gas market.

The Ministerial Council on Energy (MCE) makes this request pursuant to Part 2, Division 4 of the *National Gas (South Australia) Act 2008* (the Act). In December 2013, COAG created the Energy Council, which includes Ministers responsible for Energy. These Ministers comprise the membership of the legally enduring MCE. Energy Council Ministers responsible for energy are entitled to make requests under the Act.

Please find attached the finalised Terms of Reference for the East Coast Wholesale Gas Market and Pipeline Frameworks Review.

Sincerely



**John Ryan**  
Chair  
COAG Energy Council Senior Committee of Officials  
20 February 15

Attachment: Terms of Reference - East Coast Wholesale Gas Market and Pipeline Frameworks Review

# **Australian Energy Market Commission**

## **East Coast Wholesale Gas Market and Pipeline Frameworks Review**

### **Background**

Australian gas markets are experiencing a rapid transition as conventional gas reserves decline, unconventional gas resources become increasingly important, pipeline and storage infrastructure improves, and the influence of international price trends increase. The establishment of a liquefied natural gas (LNG) export industry based in Queensland is triggering a structural shift in supply and demand, and will lead to significant changes in the pattern and direction of gas flows.

These factors are driving a period of adjustment in the market as uncertainty around future gas prices increases. This is also leading to a renewed focus on market development and the efficiency of the gas supply chain. In particular, the establishment of well-functioning markets (commodity, financial and transportation) is key to promoting the most efficient use of gas, in the long term interests of consumers.

In light of these changing dynamics, the AEMC's *2013 Gas Market Scoping Study* highlighted the fragmented nature of gas market development and identified a range of potential issues that may be affecting the efficient operation of the market. Other reviews such as the Commonwealth Government's *Eastern Australian Domestic Gas Market Study* and the Victorian Government's *Gas Market Taskforce* have also identified areas for reform.

At its December 2014 meeting, the Council of Australian Governments (COAG) Energy Council outlined its vision for Australia's future gas market:

*The Council's vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities.*

This vision is underpinned by the Gas Market Development Plan, which outlines actions the COAG Energy Council will initiate to improve Competitive Supply, Transparency and Price Discovery, Risk Management, and Removing Unnecessary Regulatory Barriers.

In order to assist the Council realise its vision, it is tasking the AEMC to review the design, function and roles of facilitated gas markets and gas transportation arrangements.

The Council, at the request of the Victorian Government, has separately tasked the AEMC to review the Victorian Declared Wholesale Gas Market (DWGM). The two reviews are related in scope and timing, as such the Council expects the findings of the DWGM review will be incorporated in the East Coast Wholesale Gas Market and Pipeline Frameworks Review.

### **The purpose of the review**

The review will consider the role and objectives of the facilitated gas markets currently in operation on the east coast and set out a road map for their continued development in order to meet the Council's vision for the market. Opportunities to improve market outcomes including changes to the market structure to enhance liquidity, improve transparency, more effectively manage risk and support the continued integration of the east coast market will be a key focus.

It will be increasingly important given the growing international influence on the Australian gas market that gas supply can reach its highest value end-use, both domestically and for export, and that trading activities can occur across the interconnected markets with low transaction costs and supported by effective risk management processes.

The review will also consider appropriate regulatory arrangements for efficient access to and use of pipeline capacity in order to deliver appropriate incentives and signals to facilitate efficient and timely investment in gas transportation infrastructure and storage. This will include an assessment of the effectiveness of the existing arrangements and, where necessary, options for reform of these arrangements.

The Council expects the AEMC to develop specific actions that can be implemented to strengthen the structure and competitiveness of the east coast gas market. Where possible, the AEMC is to consider making recommendations for immediate implementation.

## **Scope**

The AEMC is required to review the development of the facilitated gas markets and gas transmission pipeline capacity arrangements in eastern Australia. In undertaking the review, the AEMC should consider:

### **1. Facilitated markets: enhancing transparency and price discovery in the wholesale markets, and reducing barriers to entry**

Australia has a number of facilitated markets, which include the DWGM, the Short Term Trading Markets (STTMs) and the Wallumbilla Gas Supply Hub. These markets do not seek to replace the trade of wholesale gas through bilateral contracts, but rather provide additional market options which can lead to greater transparency and price discovery.

The gas supply hub is a voluntary market where sellers offer to sell gas and buyers offer to buy gas with the market operator responsible for matching buyers and sellers at the same price.

Transportation does not form part of the transaction. In contrast, the STTM is a wholesale gas balancing mechanism established at defined gas hubs. The objective is to facilitate the short term trading of gas between pipelines, participants and production centres. It uses bids, offers and forecasts submitted by participants and pipeline capacities to determine schedules for deliveries from the pipelines which ship gas from producers to transmission users and the hubs.

The STTMs were designed as wholesale markets overlaid on existing contractual arrangements for supplying gas from multiple facilities to a defined hub to better reflect the current value of gas and provide incentives that improve system reliability. Finally, the DWGM is a single integrated market that provides participants with the ability to trade imbalances and purchase wholesale gas. The DWGM framework has provided a reliable and secure system for the trading and transportation of gas in Victoria.

The AEMC is to consider the optimal type and number of facilitated markets on the east coast, taking into account the current arrangements and changing gas market conditions. The AEMC should assess short and longer term options to improve the accuracy and transparency of market information to enhance the wholesale price discovery process and support competition in upstream and downstream markets.

The AEMC should also consider opportunities to harmonise the market parameters of the facilitated markets across the east coast, such as prudential obligations, gas day trading times and market price caps. As each facilitated market is operated differently, there may be opportunities to reduce transaction costs for participants operating in, or looking to participate in, multiple trading hubs.

### **2. Improving effective risk management in Australian gas markets**

Across Australia's facilitated markets, there are varied management techniques to mitigate price risks (long term contracts, or limited capacity instruments). However, the Council is concerned that as the markets develop the ability for participants to hedge risk using these techniques is being impacted.

The Council has committed to establishing the necessary enabling conditions for the development of a liquid trading market for the eastern gas market, including through access to transmission pipelines. The AEMC is to provide advice on the adjustments necessary in the markets and regulatory arrangements governing pipeline access to facilitate liquid and competitive wholesale spot and forward markets which also provide tools for participants to price and hedge risk. In particular, the AEMC should investigate the issues associated with, and potential benefits of, the development of an efficient financial derivative market for gas.

### **3. Signals and incentives for efficient access to and use of pipeline capacity**

Pipeline capacity in Australia has grown steadily in recent years providing a greater degree of interconnectedness between gas supply resources and demand centres. The current framework has successfully brought new capacity on line to meet demand and allocated costs to the beneficiaries of the investment. While recognising that the current framework has delivered investment, the Council has committed to examining the access arrangements governing gas pipelines, reducing any barriers to access and facilitating continued pipeline investment, as enabling conditions for more liquid gas markets in both the short and longer term.

The AEMC is to consider whether the provision of accurate and transparent information on pipeline and storage operations, and capacity, is appropriate and whether there are impediments to the efficient use and opportunities for trade in pipeline capacity. This may include more structured or harmonised capacity contracting arrangements.

Further, the Council expects the AEMC to recommend changes to the design of the markets that will, strengthen signals and incentives for efficient investment in, access to, and use of pipeline capacity across eastern Australia.

In making its recommended changes, the AEMC should consider any implications for the existing transmission access and investment framework, including the importance of existing property rights within that investment framework.

#### **Considerations**

In undertaking the review and forming its recommendations, the AEMC is to consider the:

- Size, maturity and interconnectedness of the east coast gas market;
- Types and needs of participants including producers, transporters, retailers and end users (large and small manufacturers, small business and households);
- Changes being driven by the establishment of the LNG export industry;
- Physical characteristics of the market as a whole as well as the particular locations serviced by any facilitated market;
- Legal and regulatory arrangements supporting pipeline access;
- Costs and benefits of any recommendations;
- Nature of the commercial arrangements underpinning the supply and transportation of gas; and
- Relevance of international experience to the development of the east coast gas market.

The AEMC is also to incorporate the findings and recommendations from its concurrent review of the DWGM.

More broadly, the AEMC is also to consider the:

- National gas objective; and
- COAG Energy Council's Gas Market Vision and Gas Market Development Plan.

#### **Consultation, timeframes and deliverables**

The review will be conducted over two phases. The first phase will develop the overall direction for east coast market development to support the Council's vision. Drawing on a fact-based of the

current market outcomes the report will provide a gap analysis between the Council's vision and the existing market design including an assessment of whether options currently being discussed and included in the Gas Market Development Plan could address the gap. Recommendations in the Phase 1 report will highlight specific actions for immediate implementation and identify any rule change recommendations for the Council's consideration. The second phase will more fully develop the medium and long term adjustments necessary to implement the Council's vision including the transition path required.

The AEMC will provide the Phase 1 report to the Council in June, 2015 to allow the Council to be considering rule change recommendations from that work while the Phase 2 work is ongoing. This should allow for a faster implementation timeline. A draft Phase 2 report will be provided to the Council ahead of the December meeting. This will give the Council the ability to assess whether further work on the potentially more transformative recommendations is still required as well as speeding up any final decisions from the Council on rule change requests.

Despite an accelerated timeline for this work the AEMC will hold public forums/workshops on both phases of work and invite participants to make written submissions to presentations and working papers distributed in the forums.

A single stakeholder reference group will also be convened to provide input and guidance on this review, as well as the AEMC review of the DWGM. The reference group will meet periodically and the AEMC will use best endeavours to ensure the members include AEMO, AER, pipeline owners, retailers, producers, consumer representatives and any other party the AEMC deems appropriate. The AEMC will also provide regular updates and seek regular feedback from the Gas Market Working Group.

The AEMC is to work closely with AEMO throughout the review to utilise AEMO's expert advice in assessing the operational implications of any recommendations.

<b>Milestone</b>	<b>Due Date</b>
<b><i>Stage 1: setting the direction for east coast gas markets</i></b>	
Public forum (seek written submissions)	February 2015
Draft report for consultation	April 2015
Final report to COAG	June 2015
<b><i>Stage 2: addressing the medium to long term issues</i></b>	
Directions paper and public forum	August 2015
Draft report for consultation, including request for COAG response on any longer term initiatives identified	December 2015
Final report to COAG	Following the Council's response to the Draft report