



14 June 2013

Daniel Hamel  
Australian Energy Market Commission  
GPO box A2449  
Sydney South NSW 1235

Dear Mr. Hamel,

### **Response to AEMC Gas Market Scoping Study**

This submission represents the views of the Energy Users Association of Australia's (EUAA) members on AEMC's gas market scoping study. The EUAA represents some of Australia's largest consumers of gas and electricity. Our members are keen to ensure that they can source reasonably priced gas from competitive gas markets; however there are a number of issues that are preventing this from occurring and users are expecting the situation to deteriorate further.

The EUAA recognizes that the focus of the scoping study is on downstream issues as they affect gas users and our members' principle concerns are with upstream issues. We reiterate our belief that the downstream issues cannot be fully resolved without a whole of industry assessment. We understand that the AEMC has asked for quantitative information from stakeholders supporting the feedback it has received during the consultations and workshop. Given that the EUAA is not a participant in the east-coast gas market our submission is heavily based on information provided to us by our members.

There are additional gas market reviews being undertaken at the national and state level which include; the Victorian Government inquiry, the Department of Resources and Energy inquiry and the New South Wales Inquiry into Downstream Gas Supply. All of these inquiries require considerable resources that only the large producers and network providers could fully devote and hence potentially skew the data coming forward to the study

**AEMC: What benefits and value have the facilitated markets (STTM/DWGM) delivered for participants?**

Both markets provide a framework that enables the trade of gas to occur between buyers and sellers. In this regard the markets have enabled limited short term trade of imbalances ranging from 1.5% to 4% on the Moomba to Sydney and Adelaide pipelines, virtually no trade on the Roma to Brisbane Pipeline and the SEAGAS Pipeline; limited spare capacity is the main factor behind the limited trade for imbalances. With forecast supply shortages for the east coast domestic gas market and a lack of long-term contracts (largely the result of Queensland LNG export commitments), the wholesale gas markets must enable users to meet their short term gas requirements however there must be gas to trade.

The Australian Energy Market Operator (AEMO) publishes information on the STTM and the DWGM however the information is not user friendly in its current format or interpretability. Users of the information spend a significant amount of time and effort into converting the data into meaningful outputs in order to understand basic market outcomes. For new entrants with no prior experience in the market, the complexity and potential costs can be a barrier for new entrants.

**Some stakeholders have noted that complexities and risks associated with the facilitated markets are imposing costs on participants and may be deterring entry or affecting locational decisions.**

The gas market design seems unnecessarily complex in certain areas. For example, in Victoria, the allocation of uplift charges is defined by procedural documents in excess of 20 pages. The rule change currently in place is another example of the complexity of the market where the rule changing relating to STTM deviation charges and payments is complex in terms of the number of parameters and conditions that form inputs into the calculations. A new entrant, without prior operating experience, is likely to encounter difficulty in trying to understand and quantify its potential risk exposures in both these markets. Such complexity may be acting as a barrier to entry.

The AEMC may wish to consider as a future area of study, aspects of the existing market design which may be unnecessarily complex and how these areas could be simplified while still preserving their desired intent or objective.

**Concerns have been raised around an inability to hedge risks in the facilitated markets. How significant is this issue? Is the current design of these markets acting as a barrier to the development of hedging products?**

Specific elements of the existing market design impose risks that cannot be managed, or effectively managed, in particular by gas users or small new entrants.

In the STTM, a key exposure arises from Market Operator Costs (MOS), or the costs of balancing gas. This cost is allocated to deviations, which for gas users, stems from load forecasting errors. Minimising these costs involves having a perfect load forecast which is likely to be impossible as there will always be a degree of error. The additional cost to a Gas User, stemming from MOS over the course of the year can be significant and is often directly unrecoverable through a Gas User's normal core business operations.

The impact of MOS costs can to some extent be mitigated by being a MOS Provider, being allocated MOS and receiving payment for it. Not all participants are able to provide MOS, for example if the pipelines or relevant services on those pipelines are already fully contracted, or, the participant is a Gas User who is simply not positioned to enter into gas pipeline contracts. This aspect of the market design simply increases the risk exposures faced by gas users who may not be positioned to operate as a MOS Provider.

The appropriateness of the value of the \$50/GJ MOS Cap (cap for the bid price of MOS Capacity), which determines the magnitude of the potential risk exposure faced by non-MOS providers is questionable given that two independent consultants engaged during the STTM development process recommended a maximum payment less than half of the cap. Given the detailed STTM development and analysis undertaken by the basis for the decision to adopt a higher cap despite the recommendations is unclear and should be reviewed

In the Victorian gas market uplift charges have not been incurred by the market for some time but they still pose a significant market exposure (especially following 2007's experience during which nearly \$50 m of uplift costs were incurred and charged to the market). We note that congestion uplift can theoretically be hedged by AMDQ or AMDQ Credits supported by injections nominated as an uplift hedge. Those without this hedge will bear the full burden of congestion uplift. This methodology is supposedly intended to "allocate costs to cause".

In situations where ancillary payments have been incurred (for example, in the case where there has been a system constraint or some supply source has failed, requiring LNG to be injected), we question whether it is those participants without a hedge (but who have been withdrawing gas in line with their schedules), who have in fact, "caused" those costs. It is possible that such events arise due to circumstances completely unrelated to the unhedged participant. The equitableness of the current methodology for the allocation of congestion uplift and whether changes are warranted is an area of market design that is worth a review.

### **Does the existing market design fail to support the effective functioning of financial products?**

It is observed that financial products are not widely used in any of the gas markets. In 2009 the SFE/ASX introduced Victoria wholesale gas futures, however these products have had limited uptake (if any) and there are no listed STTM instruments on ASX. The development of financial instruments is directly hindered by the current market design, in particular, the mismatch between actual risk, and risk being hedged by the instrument – In both the Vic market and STTM, the published "market/spot price" is not representative of the full risk or cost to which a retailer is exposed. In the STTM, deviation costs (which are essentially the costs of MOS) pose a significant additional cost and in Victoria uplift charges are a significant market exposure. In both of these markets, a financial instrument structured around the spot price, is therefore not effective at protecting a retailer against key market risks.

### **A market design that would support the creation or effective functioning of financial hedging instruments would attract new entrants, including financial institutions, as well as new buyers and sellers, thereby enhancing liquidity and competition.**

This is an area for the AEMC to include as an area for future study of ways in which the existing wholesale markets could be enhanced to support the use of financial products. At a minimum the creation of a hedging product may give stakeholders a guide to future gas prices which has been a feature of the electricity market since 2003 when the first electricity futures contracts appeared on the Sydney Futures Exchange.

**Is the rule change process working effectively?**

The rule change process is a long and protracted process and very few rule changes from users have been initiated and the ones that have been initiated have been unsuccessful. The supply side has initiated a large number of rule change requests and most are usually successful. The costs and length of process deters users from undertaking a rule change.

**Is there scope for having minimum third party standards for unregulated pipelines (e.g. non-discriminatory terms and published tariffs; and is regulating gas and electricity networks the same way appropriate?**

Having minimum third party standards for unregulated pipelines may give some market transparency in terms of price and contract terms. While contract terms may differ depending on the needs of participants to the contract, having minimum standards would allow new entrants to get an idea of their obligations should they choose to participate in the markets.



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