



Review of the Victorian declared wholesale gas market – final report

The AEMC has made its final recommendations for changes to the Victorian gas market arrangements. These will deliver the next step in the reforms to the east coast gas market.

The existing market will not achieve the COAG Energy Council's vision

The gas industry on the east coast of Australia is undergoing a structural change, with higher gas prices and increased price volatility being seen across the east coast, including Victoria. Recognising these changes, the COAG Energy Council developed a vision for Australia's future gas market. The vision is centred on the establishment of a liquid wholesale gas market, with a key outcome being an efficient and transparent reference price for gas.

The Commission has concluded that a number of issues with the existing Declared Wholesale Gas Market (DWGM) arrangements mean that it will not facilitate the achievement of the COAG Energy Council's vision for Australia's future gas market, nor the objectives for the DWGM set by the Victorian Government in its terms of reference for this review.

Final recommendations: a staged approach to reforms

The Commission is making short and longer term recommendations to reform the DWGM to deliver benefits to Victorian customers, increase the consistency with the wider east coast market to make easier to buy and sell gas for those both inside and outside Victoria, while being relatively quick and low cost to implement. The recommendations are:

1. **Provide a cleaner wholesale market price** by including the costs currently intended to be recovered by common and congestion uplift in the market price, while retaining separate pricing of temporal constraints.
2. **Establish a forward trading exchange over the DTS** while retaining the existing daily DWGM.
3. **Improve pipeline capacity allocation and introduce capacity rights trading** by:
 - a. introducing separate, tradable entry AMDQ rights and exit AMDQ rights
 - b. introducing an exchange to improve secondary trading of AMDQ rights (permanent transfer) and benefits (temporary transfer)
 - c. making AMDQ available for a range of different tenures.

The short term recommendations would be implemented through rule change requests to be submitted by the Victorian Government.

In time, further consideration should be given to implementing the more significant changes to the Victorian market (referred to as the "target model") recommended in the Commission's draft final report.

If implemented, the target model would build upon the short-term recommendations to better achieve a nationally consistent approach to achieving the COAG Energy Council's vision and meet all the objectives of the review, most notably addressing concerns relating to investment decisions for the Victorian declared transmission system.

4. The COAG Energy Council should request the AEMC to **assess the southern hub gas market conditions** in 2020 as part of the existing biennial liquidity review, and provide recommendations on whether to proceed with implementing the target model.

The target model represents a significant change to the current market. Designing, testing and implementing the target model is likely to take a few years. This is at odds with the need to progress the reforms to the DWGM in a timely manner. There are also costs and risks involved with significant market reform of this nature. Therefore it is both prudent and beneficial to take an incremental approach to reforming the DWGM.

Benefits of the recommendations

Collectively, the short term recommendations will address many of the issues with the DWGM that have been identified by the Commission to the benefit of Victorian consumers and consumers more broadly across the east coast, while leaving the option open for more substantial reforms in the future.

Risk management

There are currently limited options for participants to manage risk in the DWGM. Improving the ability for participants to manage risks is expected to place a downward pressure on the costs of providing and using gas. To the extent that this reduces costs for market participants, these cost savings can be passed onto consumers.

By providing a cleaner wholesale price, market participants will be better able to manage their price risk by entering into physical contracts for gas delivery or financial derivative contracts. The introduction of a forward trading exchange should further stimulate liquidity in the physical forward market for gas, which also better enables risk management.

Improving the allocation of pipeline capacity rights and introduce capacity rights trading is expected to better enable market participants to manage scheduling risk, and allow for the more efficient allocation of capacity rights between market participants.

Price transparency

The DWGM spot price reflects immediate conditions, but longer-term pricing is opaque, making it difficult for participants to make efficient investment decisions. Establishing a reference price that better reflects the value of gas will help to provide market signals to promote the efficient use of gas and efficient levels of investment, throughout the supply chain across the whole east coast.

Introducing a forward exchange trading is expected to improve forward price transparency.

Trading between regions

The disjointed nature of the different market arrangements across the east coast is inhibiting trading, increasing complexity and increasing transaction costs.

The introduction of a forward trading exchange and capacity rights trading in the DWGM that is consistent with those implemented more widely across the east coast will help to reduce the complexity and costs that can discourage greater participation in the DWGM.

Reduced transaction costs may result in gas being transported more easily between regions to where it is most valued. A fully integrated east coast gas market will provide buyers and sellers with greater opportunity to participate in any of the trading markets in order to improve their commercial outcomes.

Benefits to the electricity sector

A more efficient Victorian gas market, in the context of an east coast gas market, is likely to be of key importance for the electricity sector given the use of gas as a generation fuel.

For information contact:

AEMC Senior Director, **Chantelle Bramley** (02) 8296 7862

AEMC Senior Economist, **Tom Walker** (02) 8296 7829

Media: Communication Director, Prudence Anderson 0404 821 935 or (02) 8296 7817

30 June 2017