

Review of the Victorian Declared Wholesale Gas Market: Draft Report

The AEMC is recommending a series of changes to the Victorian wholesale gas market to improve price and investment signals. The benefits resulting from greater flexibility in trading, improved risk allocation and lower transaction costs should flow through to retail prices paid by consumers.

Current state of the Victorian gas market

The Declared Wholesale Gas Market (DWGM) in Victoria is generally regarded to have been effective at supporting retail competition and to have encouraged a diversity of supply and upstream competition. Recently, however, Victoria has been impacted by the structural changes associated with LNG exports. This has highlighted the limited ability of participants to manage price and volume risks. In particular, the preconditions necessary for the development of financial risk management products do not exist in the DWGM. This may be deterring market entry and resulting in consumers paying more than is necessary.

The DWGM also has few mechanisms for market-driven investment in the pipeline system. Investment therefore occurs predominately through the regulatory process where costs are recovered from all consumers.

These issues are amplified by the significant changes being experienced by the industry across the east coast. In particular, the scale of LNG demand – three times the size of the domestic market – combined with shorter, less flexible domestic gas supply agreements, is expected to result in participants managing their portfolios more actively than in the past through short term trading. The need for markets which can foster liquidity and support the development of risk management products presents risks and opportunities for Victoria.

Proposed changes to the Victorian gas market

With a view to the longer term, the Commission has developed a package of reform for the DWGM and associated market carriage arrangements which govern access to the Victorian Declared Transmission System (DTS).

The Commission's recommended changes seek to develop a new "Southern Hub" for trading gas, and are focused on two key areas:

- **Trading gas at the Southern Hub:** transitioning from the DWGM where trading and balancing occurs on a mandatory, operator led-basis, to a new model where trading would occur on a voluntary, continuous basis but is underpinned by a mandatory residual balancing mechanism. A key feature of the Southern Hub would be the introduction of exchange trading, similar to that in place at Wallumbilla currently.
- **Access to transportation capacity at the Southern Hub:** to support this new form of trading, transitioning the market carriage model and associated limited pipeline transportation rights to a system of entry and exit rights for capacity allocation. This would allow network users to book firm transportation capacity rights independently at each entry and exit point to the DTS. Collectively, these enhancements would contribute to gas being able to be traded independently of its location in the system.

These changes will provide participants with greater flexibility and more options to physically trade gas in the market. Over time, reference prices would likely be produced and published by price reporting agencies, establishing the preconditions for financial risk management products to develop. The Commission's recommended enhancements will also create market-driven signals for investment in the pipeline system, a feature currently absent from the Victorian DWGM, reallocating investment risks away from consumers.

The Commission's proposed changes to the DWGM will provide a more flexible and resilient gas market framework in Victoria, whatever the future brings

Benefits of the proposed changes

The Commission's draft recommendations seek to address the key issues identified by the Victorian Government, while promoting the National Gas Objective (NGO) and the Vision for Australia's future gas market set out by the COAG Energy Council. By increasing the efficiency of the price setting mechanism in the Victorian gas market, facilitating greater access to risk management tools and improving investment signals, transaction costs should be minimised and reflected in end prices to consumers, both large and small.

In addition, the proposed changes would continue to safeguard the security of supply for Victorian gas consumers. In particular, the Southern Hub model allocates the responsibility of maintaining the system's operation to the hub operator who, in the event that participants do not balance their injections and withdrawals sufficiently, will take balancing actions to maintain network pressures within safe operational limits.

Reforming east coast gas markets

The Commission's draft recommendations form part of an integrated package of reforms to Australia's east coast gas markets as part of the wider East Coast Wholesale Gas Market and Pipeline Frameworks Review (East Coast Review) being undertaken. This package of reform has been developed with regard to the Energy Council's Vision and Gas Market Development Plan. Together, the proposed reforms support three key outcomes:

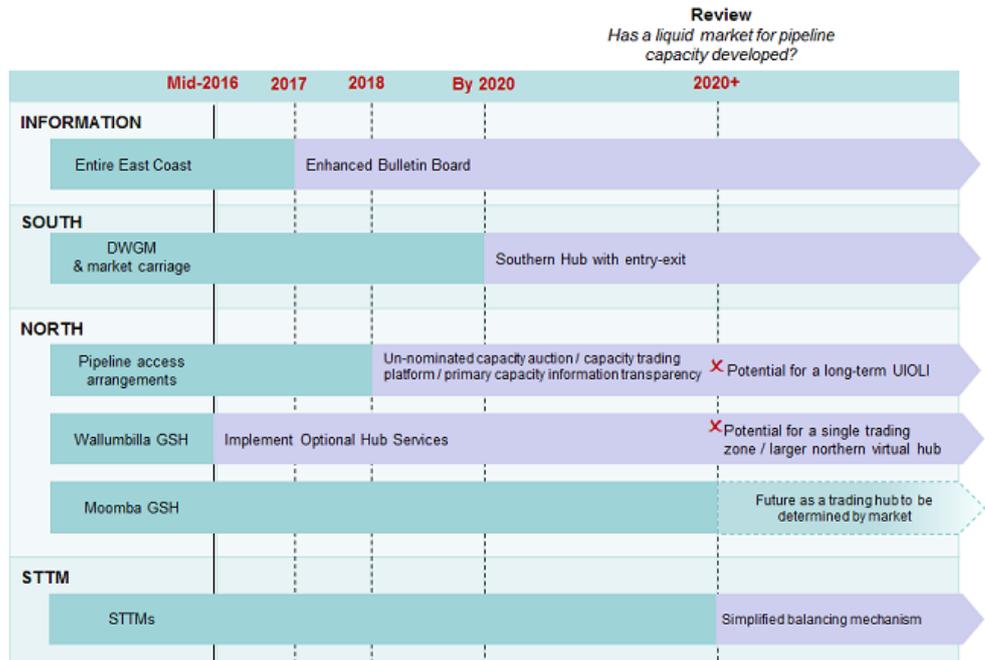
- Establishment of an efficient and transparent reference price for gas.
- Ability to readily trade gas between hub locations.
- Investment in infrastructure that responds to market signals and is facilitated by a supportive regulatory framework.

Once in place, these reforms would form a strong foundation for facilitated gas markets and transportation arrangements in eastern Australia, delivering a comprehensive set of benefits to consumers over the long-term in accordance with the NGO.

Implementing the Commission's gas market development package

While the Commission considers that many of its wider recommendations should be implemented as soon as possible, others will need to be implemented in sequence. The Commission envisages that the implementation of the complete package will occur over several phases, forming a roadmap to guide the development of the market over the next decade. This will be further developed in the Final Report and will include a suggested structure for managing the implementation of this reform program over the coming years.

An overview of the staging of the overall package is set out the diagram below, which also highlights certain dependencies later in the reform program.



Background

On 4 March 2015, the Victorian Government, with the agreement of the COAG Energy Council, asked the AEMC to conduct a review of the Victorian DWGM. The purpose of the review is to consider whether the current Victorian arrangements provide appropriate signals and incentives for investment in pipeline capacity, allow market participants to effectively manage price and volume risk and facilitate the efficient trade of gas to and from adjacent markets.

More broadly, the review will consider whether, and to what extent, the DWGM continues to effectively promote competition in upstream and downstream markets, in the long-term interest of consumers.

The AEMC has also been asked by the COAG Energy Council to review the design, function and roles of facilitated gas markets and gas transportation arrangements on the east coast of Australia. The East Coast Review is considering the roles and objectives of the existing markets on the east coast in light of changing market dynamics, and aims to set out a road map for their continued development.

The Stage 2 Draft Report for the East Coast Review was also published on 4 December 2015 and is available on the AEMC website.¹

Next steps

Submissions to the Victorian DWGM Review Draft Report close on **12 February 2016**. Feedback from stakeholders through the consultation process will inform the Commission's recommendations in the Final Report.

For information contact:

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

AEMC Director, **Andrew Truswell** (02) 8296 7873

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

4 December 2015

¹ www.aemc.gov.au.