

The background of the cover is a dark blue rectangle at the top, with a white area below it. Large, overlapping, curved bands in various shades of teal and light blue sweep across the page, creating a dynamic, wave-like pattern.

**Victorian Declared
Wholesale Gas Market
Discussion Paper
AMEC Reference: GPR0002**

October 2015



Key Points

- The proposed variations to the existing Declared Wholesale Gas Market in Victoria all retain the disadvantages of virtual markets in that they remain complex and require a market operator to pre-empt decisions that market participants will make.
- APGA supports further development of Package E, the hub and spoke model for the Victorian system.
- The problems that may be encountered in the process of changing the DWGM from market carriage to contract carriage (Package E) are not insurmountable.
- All of the proposed packages A to D contain their own challenges and costs and all seek to deliver quasi-transmission rights within an ongoing virtual market.
- APGA believes further consideration of the removal of the redundant asset provisions in the National Gas Rules is warranted.

Introduction

The Australian Pipelines and Gas Association (APGA) welcomes the opportunity to provide comment on the Australian Energy Market Commission's Victorian Declared Wholesale Gas Market (DWGM) Discussion Paper. The conceptual designs for the DWGM have a bearing on possible structures of gas transmission markets on the east coast of Australia.

APGA supports the Commission's (AEMC) view stated on p54 of the Discussion Paper that:

the simplification and consolidation of market designs operating on the east coast to be an important aspect of reducing transaction costs in order to encourage greater trading and participation, with a view to achieving the COAG Energy Council Vision

Due to the increasingly interconnected nature of the east coast gas transmission network, APGA supports reforms that will allow improved gas transmission between production zones and demand centres. Harmonisation of market structures where possible should reduce transaction costs and be conducive to the development of financial derivatives to assist in risk management.

Regulatory Regime and Incentives

APGA considers the Commission has covered the issues regarding the regulatory framework well and supports further consideration of ways to address concerns regarding redundant asset provisions in the National Gas Rules. The alternative solution proposed by the AEMC may be appropriate to address the issue for APA Gasnet. However, these provisions have the potential to negatively impact all covered pipelines and do not have an equivalent provision in the National Electricity Rules. As such, APGA supports the removal of the redundant asset provisions from the NGR.



Possible Policy Responses

The construction and management of virtual markets over dispersed physical infrastructure has proven to be a complex and resource intensive task. APGA believes that by their nature, virtual markets have drawbacks that are difficult to effectively address. APGA's views on virtual markets have been provided in our submission to the Commission's Wholesale Markets Discussion Paper.

A feature of a regulated virtual market is that the market operator is required to make assumptions about the response that a market participant will choose in a given scenario. The array and complexity of rules, uplift payments, ancillary charges and the resultant quasi-property rights applying to the DWGM are evidence of the difficulties of the creation and maintenance of a virtual market. The large number of possible amendments, new instruments and proposals for forms of transmission rights for the DWGM discussed in Packages A, B, C and D underline the complex nature of virtual markets.

It is APGA's view that virtual markets entrench heavy handed and intrusive regulation by creating inefficiencies in respect of investment within the hub, and incentives for the pipeline service provider to withhold capacity from the market. The experience in Europe from these hubs is that the regulatory regime must then provide remedies to these disincentives, which are essentially permanent. APGA does not believe this is a model that should be preferred in the Australian context of competition regulation.

Package E is the preferred option

Consistent with APGA's preference for wholesale market reform to progress a version of Concept 1 detailed in the Commission's Wholesale Markets Discussion Paper, APGA considers Package E presented in the DWGM Discussion paper is the best reform option.

Of the options, APGA prefers further development of Package E, the hub and spoke model and believes that a series of physical voluntary hubs if developed, would provide the most conducive environment for genuine liquidity to develop. A move to a contract carriage model as envisaged in Package E presents challenges and costs, but the outcomes are considerably more predictable in comparison to the models in Packages B, C and D.

Gas contracting on the east coast has historically featured bilateral contracts of varying terms. There are signs of shorter contract terms and increased use of trading hubs emerging but it is reasonable to expect that a large percentage of gas will still be contracted under relatively long-term contracts. APGA believes that supply hubs, in conjunction with voluntary balancing markets could support increased liquidity of marginal gas at the hubs.

The balancing markets could develop into secondary markets that:



- Deliver improved market outcomes through increased liquidity in marginal gas trading;
- minimise the need for regulatory intervention; and
- provide the basis for further development of bespoke market services and financial derivatives to assist in price risk management.

Gas supply hubs and balancing markets both have a role to play in improving market liquidity. APGA understands the Commission's logic in proposing supply hubs at both Longford and Iona but notes that the proximity of these locations, along with the introduction of contract carriage, may allow a single southern supply hub to be introduced in the future.

Finally, APGA notes that Package E and the introduction of contract carriage to the Victorian system may be the option that best serves the development of the East Coast gas market. Current trends indicate flat or decreasing gas use in Victoria and increasing export of gas from Victoria to other markets. If such trends continue, the needs of the East Coast market may be best met by supply hubs and firm transportation rights in Victoria.