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## Review of the Victorian Declared Wholesale Gas Market Working Group

### Meeting 1

Date: 15 June 2016  
Time: 10.30am to 3.30pm  
Location: Stamford Plaza Hotel, Melbourne

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## 1 Agenda

- i. Welcome, introduction and background
- ii. Rationale for change
- iii. Overview of the proposed model
  - Continuous commodity trading in the Southern Hub
  - Balancing mechanism
  - Capacity allocation
- iv. Examples of how proposed model addresses issues into the DWGM

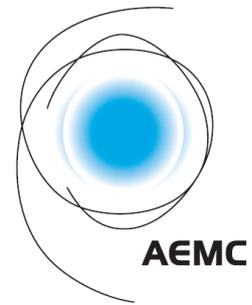
## 2 Attendee organisations

Organisation	Organisation
AEMC	ERM Power
AEMO	ExxonMobil
AER	Jemena
AGL Energy	Lochard Energy
APA Group	Origin
EnergyAustralia	Public Interest Advocacy Centre
ENGIE	

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### 3 Presentations and discussion

- The AEMC provided an overview of the rationale for change to the DWGM market:
  - the need to develop the market in a way that supports more effective risk management tools in light of more expensive and less flexible gas supply agreements and limitations in the existing DWGM design to provide this risk management;
  - the limited market led investment signals for capacity expansions; and
  - to increase consistency in the arrangements with trading hubs at Wallumbilla and Moomba.
- The AEMC provided an overview of the key design features of the proposed market:
  - **continuous commodity trading** inside the hub, replacing the existing daily auction;
  - **capacity allocated** on the basis of explicit entry and exit rights; and
  - a **balancing mechanism** on the day to provide for system security and certainty of gas delivery.
- The AEMC noted that future workshops would discuss these topics in greater detail, including transitional measures that might be required.
- The AEMC provided examples of how current problems in the market might be addressed by the recommended changes, including:
  - how limited capacity to withdraw gas at Iona would be allocated under the new arrangements;
  - how investment for additional capacity to withdraw gas at Iona could be better signalled; and
  - how market participants which wish to transport gas across the Declared Transmission System would be better able to manage risk.

Discussions throughout the meeting tended to focus on possible issues in the design of the market, and their solutions. These discussions are summarised below:

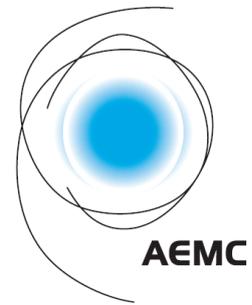
#### 3.1 Commodity market liquidity

- The group discussed whether liquidity will develop sufficiently in the commodity market, particularly initially after the introduction of the new design. Some attendees suggested that:
  - current market concentration may limit liquidity developing;
  - although trading might theoretically develop assuming all parties acted as rational agents, cultural and behavioural reasons may limit the development of liquidity in practice; and
  - relatively few different types of products should be available on the exchange, in order to concentrate liquidity. Most attendees agreed that the range of standardised

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commodity products available on the exchange should be determined by market participants, and fit for their needs.

### 3.2 Capacity allocation and expansion, and pipeline regulation

- Attendees discussed the appropriateness of standardised entry and exit rights. Some felt standardised rights were important to improve fungibility, while others suggested that bespoke rights should be added on top of basic contracts to better meet market participants' needs. One stakeholder suggested that bilateral negotiations for entry and/or exit rights would be preferable to an administered process for capacity allocation and/or expansion.
- Concerns were raised that the introduction of capacity rights might have the potential to introduce problems currently seen in contract carriage arrangements on the east coast of Australia outside of Victoria, ie:
  - limited liquidity in the secondary capacity market and resultant inefficient use of capacity by market participants that do not value it highest; and
  - incentives for inefficient over-expansion of capacity.
- There was also discussion as to the extent to which the much less complex nature of entry and exit rights (ie, applying at a single point rather than between two specific points) might mitigate these concerns.
- One attendee noted that further consideration was required of the means by which the pipeline owner would be economically regulated under the new model, including the use of revenue caps or price caps.
- It was also suggested that penalties for the transmission owner to fail to deliver sufficient entry or exit capacity, without conversely having rewards to deliver additional capacity, represented an asymmetrical incentive scheme, and was inappropriate.

### 3.3 Interaction of commodity market and capacity market

- A number of stakeholders suggested that it may be practically difficult to simultaneously procure both entry and/or exit rights to the market and negotiate a gas supply agreement, particularly where capacity rights are auctioned. This may result in market participants being stranded with one but not the other and so being in a weak negotiating position.

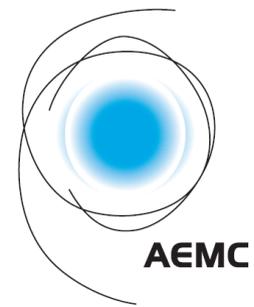
### 3.4 Balancing and system operation matters

- Attendees suggested that problems may arise in operating the system due to the assumption, inherent in the virtual hub design, that all gas in the system is equivalent and fungible, despite locational and temporal constraints on the declared transmission system. The possible need for locational products was discussed in this context.
- One stakeholder noted the importance of timely and accurate information in order to take informed balancing actions.

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- One stakeholder raised the possibility of charging for the use of linepack regardless of whether balancing actions were required by the system operator.

### 3.5 Costs and burden for market participants

- One stakeholder noted that the new design has the potential to increase the effort required by market participants to manage their own balancing and capacity rights. The AEMC noted that while market-led balancing and procuring capacity rights is a different way of operating, it may not necessarily result in an additional burden, depending on the circumstances of each participant.

### 3.6 Institutional arrangements

- APA Group referred attendees to a report it commissioned by Boston Consulting Group, which discusses institutional arrangements in international transmission markets.<sup>1</sup>
  - This report suggests that AEMO might be the appropriate market operator (ie, run the commodity exchange) but that other roles, particularly system operation (ie, operating gas flows and determining the appropriate amount of available capacity), might be more appropriately performed by APA rather than AEMO.
  - Another attendee suggested AEMO could be the system operator, and noted that such a task is performed by AEMO in the National Electricity Market.

### 3.7 Alternative models

- One attendee raised the possibility of firm *financial* transmission rights, as opposed to the firm physical transmission rights in the model proposed by the AEMC. The attendee suggested this would result in more efficient utilisation of capacity than firm physical transmission rights, while still introducing more market driven signals for capacity investment. The group discussed whether this would imply the introduction nodal pricing, and potential difficulties in doing so in gas, as opposed to electricity, markets.

### 3.8 Suggested next steps

- Attendees suggested that a cost-benefit analysis of reforms to the Victorian DWGM (as opposed to the east coast reforms that will be published by the AEMC) may be appropriate. The group suggested that this might be discussed in future working group meetings. The AEMC confirmed that it was investigating specific analysis for the DWGM, and would seek to discuss this further with the working group if appropriate.
- Some attendees felt that a paper trial or simulation of the recommended market may be useful, in much the same way paper trials were conducted prior to the introduction of the National Electricity Market.

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<sup>1</sup> Available on the AEMC website at: <http://www.aemc.gov.au/getattachment/075291ba-b383-4dfe-a12e-1469bd98e982/APA-Group-Boston-Consulting-Group.aspx>