



10 September 2015

John Pierce
Australian Energy Market Commission
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Submitted online: www.aemc.gov.au

Dear Mr Pierce

EAST COAST WHOLESALE GAS MARKETS AND PIPELINE FRAMEWORKS REVIEW – WHOLESALE GAS MARKETS DISCUSSION PAPER

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) wholesale gas markets discussion paper as part of its east coast wholesale gas markets and pipeline frameworks review. We note that this work is being guided by the COAG Energy Council's vision for gas market development which ultimately is aimed at ensuring there are appropriate settings in place for a resilient and efficient east coast gas market. Origin supports this intent and considers that many of the workstreams under the AEMC's current review process could assist in the achievement of this objective. Generally, we consider it prudent that the incremental reforms being contemplated under this process be completed (including a suitable period to test the effectiveness of any proposals that are adopted), before there is any move to implement more significant design changes.

We appreciate that the AEMC's discussion paper is intended to progress the debate on market development, and that the three high-level design concepts do not represent an exhaustive list or a preferred approach. We note, however, that these concepts (in particular options 2 and 3) represent a significant departure from the current arrangements and as such there would need to be a sufficiently high threshold if they were to be adopted. As a starting point any contemplated policy or design changes must have regard to the innate characteristics of the east coast gas market, including size, and geographical layout. Additionally, it is crucial that any shortcomings in the current arrangements are explicitly identified so as to inform both the areas of reform and the magnitude of the changes needed. This process, in our view has not been completed.

Our comments below outlines some of the principal issues that should be considered when assessing each of the three high-level concepts.

Characteristics of wholesale gas markets

The discussion paper describes how a liquid wholesale gas market requires different types of buyers and sellers transacting sufficient volumes of gas to support trading liquidity. It draws on three international gas hubs that are widely considered to represent liquid wholesale gas markets – the National Balancing Point (NBP) in the United Kingdom, the Title Transfer Facility in the Netherlands and the Henry Hub in the United States. The three high-level concepts, particularly concepts 2 and 3, draw heavily from these overseas examples.

While it is useful to understand how these markets developed and now operate, Origin cautions against a simplistic view that the Australian gas market should strive to replicate these models. As noted in the discussion paper, there are marked differences between the Australian market and these overseas markets. These include that the east coast gas market is characterised by lower levels of consumption, fewer market participants and different pipeline arrangements. As such, any gas market

development proposals for the Australian market should be cognisant of the unique characteristics of the Australian market.

Virtual hubs and pipeline arrangements

The discussion paper explores the concept of a virtual hub whereby title transfer of gas can occur at any location within the definition of the hub. This eliminates contractual transportation flows within the hub but still requires a complementary system for allocating and pricing transmission capacity into and out of the virtual hub area, typically through an entry-exit model. While a virtual hub is appropriate for a highly meshed, high demand network with a large number of participants such as the NBP, the applicability of virtual hubs on the east coast is not as clear given Australia's demand centres consume relatively less gas, have much fewer participants, are located long distances from each other and are serviced by a relatively small number of long transmission pipelines.

Origin appreciates there is a separate workstream on pipeline capacity trading but we suggest it is difficult to consider market design and in particular, the three high-level concepts in isolation of pipeline access and regulatory arrangements as the two are inextricably linked. Notably, many overseas markets are characterised by pipeline systems where capacity prices, access frameworks and future investment decisions are all regulated by a third party. With the exception of two transmission pipelines (the Roma to Brisbane Pipeline and APA GasNet in Victoria), the majority of the transmission pipelines on the east coast are not regulated or are lightly regulated. Given concepts 2 and 3 and virtual hubs more broadly require the economic regulation of underlying transmission pipelines, their application would require significant changes to the underlying pipeline arrangements. Not only would this be a complex exercise but also a costly one as participants have already contracted pipeline capacity for a number of years into the future so any changed arrangements would need to provide sufficient compensation and an appropriate transition mechanism.

Given the above discussion, Origin questions the practicality of virtual hubs on the east coast (notwithstanding the Victorian DWGM), and at this point is unconvinced that the broad adoption of this model would provide a viable means of fostering market development and efficiency.

Multiple hub locations

Origin has previously supported the development of supply hubs such as at Wallumbilla where they can be proven to facilitate trade; can be implemented at low cost; and where there are net benefits. We would caution against any rush to establish hubs in multiple locations without addressing the underlying concern as to whether there would be sufficient volumes to support liquidity and any meaningful trading activity.

Nature of participation

The discussion paper is unclear on whether any of the concepts require voluntary or mandatory participation. It is important to recognise there are trade-offs between voluntary and mandatory participation. For example, while mandatory participation may create larger trading volumes, this could come at the expense of increased operational costs to participants. Similarly, while voluntary participation can mean lower operational cost for participants, it may not generate sufficient overall volumes of gas to support trading liquidity. As a principle, Origin's preference is for simple and low cost markets. Any consideration of participation in a revised market design should ensure the value gained from participating in the market outweighs the associated costs.

Progressing an improved market design for the east coast

Having a clear understanding of any gaps in the current market design is a crucial starting point in the reform process, as this helps to inform what changes are required. For example a key decision is whether fundamental market design changes (as set out in the discussion paper) are needed, or a

program of targeted incremental improvements to the existing arrangements. In Origin's view there are a number of improvements that could be made to the Declared Wholesale Gas Market (DWGM), Short Term Trading Market (STTM) and gas supply hub that could enhance market efficiency.

The main issue in the DWGM and STTM is the complexity and cost to operate in these markets. The presence of a number of ancillary prices other than the traded commodity price makes these markets complex to trade in as the costs and risks are uncertain and difficult to hedge. This creates a barrier to participation. If these unnecessarily complex elements of the markets were simplified, specifically by linking the ancillary prices back to the commodity price, this would improve participants' ability to manage risk, enhancing price discovery and potentially fostering greater participation and liquidity.

With respect to the gas supply hub, the Australian Energy Market Operator (AEMO) is currently developing a single hub product that aims to improve participation and liquidity. It is currently developing detailed designs for two models – an optional services model and a single trading zone model. Origin supports AEMO's process. We see the most value to the market coming from the maintenance of a low cost, voluntary market at Wallumbilla.

Should you have any questions or wish to discuss this information further, please contact Lillian Patterson on lillian.patterson@originenergy.com.au or (02) 9503 5375.

Yours sincerely,



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