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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

9 December 2016

Dear Mr Pierce

REVIEW OF THE VICTORIAN DECLARED WHOLESALE GAS MARKET

Shell Pty Limited (Shell) (a member of the Shell Group) welcomes the opportunity to respond to the Australian Energy Market Commission (AEMC) Draft Final Report (the Report) on the Review of the Declared Wholesale Gas Market (DWGM). In summary,

- Shell supports the development of liquid and transparent markets and overall supports the Gas Market Reform Package agreed to by the COAG Energy Council. This includes reform of the DWGM to achieve the AEMC's stated objectives. We also view this as a combined package and DWGM reforms should be undertaken in the context of improving the integration of the entire East Coast Gas Market.

- Through our involvement in the East Coast Gas Market, we recognise that the market arrangements/design, including the DWGM, could be altered or improved to enable gas to flow to where it is needed most.

- We are not currently a registered participant at the DWGM and as such are unable to provide an assessment of how efficiently the market performs. However, as a potential new entrant the current market arrangements appear a possible barrier to entry. Specifically, the rules are complex and significant price and volume risk exists for new entrants (i.e. those without Authorised Maximum Daily Quantity (AMDQ)). The entry of new supply participants would increase upstream competition and aid overall liquidity.

- Conceptually these issues could be addressed through an Entry-Exit model where firm capacity can be procured such as the AEMC proposal. Shell has also observed that this type of model works effectively in a variety of other mature gas markets where we operate. However, it is important that the unique characteristics of the Victorian market (including its interconnectivity with other States) is fully understood.

- In a broader sense, we have undertaken a qualitative assessment of the DWGM and the AEMC proposal. The results suggest that the Entry-Exit model is likely to offer a preferred solution to the current DWGM design.

- Notwithstanding these points, valid issues have been raised by stakeholders on potential new risks (e.g. continual balancing) that could emerge under the AEMC proposal and we are concerned these are not presently well understood.

- **The process would benefit from further analysis by the AEMC of participant risks and alternative market design options.** We suggest the timing for finalising the report is extended by six months to allow the AEMC to explore and report on these issues and undertake further consultation with DWGM participants and other stakeholders. We have a preference this is undertaken as part of the Review before moving into implementation. Without this extension, the process is at significant risk around delivering unclear outcomes which may both negate the work the AEMC has already undertaken and add unnecessary regulatory uncertainty for industry.

Attached is an appendix containing further detail on these points and please do not hesitate to contact me or Ms. Erin Bledsoe (0409 877 116) if you have questions. We are also happy consider further opportunities to share Shell's insights into the operation of the European Gas Markets.

Yours sincerely,

Tom Summers
Vice President Supply and Optimisation

Introduction

Shell supports the development of liquid and transparent markets and generally supports the Gas Market Reform Package agreed to by the COAG Energy Council. This includes reform of the DWGM to achieve the AEMC's stated objectives. We view this as a combined package and DWGM reforms should be undertaken in the context of improving the integration of the entire East Coast Gas Market.

To date, our primary focus has been on the broader East Coast Gas Market Reviews conducted by the AEMC and the Australian Competition and Consumer Commission. We have advocated for the introduction of mechanisms to encourage the more efficient pricing of pipeline capacity (particularly short-term). Addressing fundamental issues around the pricing structures of transportation capacity should enable market participants to more effectively access and trade gas across the East Coast markets.

Moving forward, through our involvement in the East Coast Gas Market, Shell has found that the market arrangements/design, including the DWGM, could be altered or improved to enable gas to flow to where it is needed most. Furthermore, Shell seeks to respond to price signals across the entire East Coast Gas Market including Victoria and for example, over winter 2016, sold volumes into the domestic market with a major proportion flowing to customers in southern states.

For these reasons we have an interest in the long-term development of the DWGM and how changes may impact gas flows across the integrated east coast system. Additionally, we are not currently a registered participant at the DWGM and as such we are unable to provide an assessment of how efficiently the market current performs. However, as a potential new entrant we are able to provide some relevant insights - we have also observed to date that most of the commentary has been provided by incumbent market participants. We are also able to draw on Shell's international experiences of participating in markets where the Entry-Exit model is in operation. As such our comments cover the following areas:

- Identified concerns with the DWGM and how these issues may be addressed through the AEMC proposal.
- High level insight into Shell's experiences/observations of the Dutch (TTf Hub) Entry-Exit market and other similar designs around the world.
- Relevance of the Walumbilla model to the DWGM/Southern hub.

Issues with the DWGM Design and the AEMC Proposal

We are not currently a registered participant at the DWGM. In part, we have identified that the current market design acts as a barrier to entry. Specifically it is complex (mandatory participation and gross pool) and significant price and volume risk exists for new supply entrants (i.e. those without AMDQ. Our specific concerns relate to:

- The current structure is unreasonably complex. The Rules are detailed and difficult to understand particularly in relation to financial risk for market participants including the operation of AMDQ and deviation and uplift payments. AEMO's procedures and technical guides are complex and not explicit on these issues. The registration process is also complex including the requirement for credit support, access to market systems, etc.

- Price and volume risk are also disincentives to participating in the market for traders and other participants without firm AMDQ. We note that while a number of small retailers have entered the market there are few gas traders. The majority of gas is traded by incumbent players who have held positions since the market was established. This is not surprising as we understand that the mass market retailers are allocated AMDQ, which does not necessarily apply to other participants.

- We have observed that under certain conditions DWGM pricing does not necessarily reflect underlying supply conditions and is subject to "disorderly bidding". These pricing events can expose participants without AMDQ to unmanageable price and volume risk. In a similar way to some price events in the National Electricity Market (NEM), the occurrence of these events and the level of price and volume risk are difficult to predict.

- For example, a participant without AMDQ is scheduled to supply 10TJ of gas at the 6:00am market interval at the prevailing market price of $10/GJ. An event (such as a pipeline constraint) occurs in the system and by 10:00am the participant's gas flow is interrupted. Given the participant does not have an AMDQ allocation, this results in the participant needing to purchase gas at the DWGM to manage its position. In this situation, not only is the participant required to "purchase" gas, the price at which it is sourced (at the 10:00am scheduling period) is likely to be unpredictable due the nature of the event.

- Conceptually these issues could be addressed through an Entry-Exit model.

Observations of the Dutch (TTF Hub) Entry-Exit market

We recognise the AEMC, in developing the proposed market design for the DWGM, has looked to international markets for insight and learnings. It has recommended a model similar that operating in the Dutch Gas Market (TTF Hub). Drawing on Shell's international experience in this market and other European gas markets, Shell is able to offer some very high level insights and observations into aspects of the Entry-Exit design and market based balancing regimes.

Overall, the Entry-Exit model seems to be operating successfully across all European gas markets and has largely enabled the entry of new participants including traders, retailers (small and large) and producers. The model has been introduced gradually in order to take stock of specific market conditions, including in South and East Europe where markets were or still are more concentrated and less liquid. These markets differ in demand, production and other supply sources, number of participants and seasonal variability. On specific issues:

Voluntary market and continual balancing - Essentially, the markets are all "voluntary" markets with the Dutch market having enabled shippers to better manage their imbalances thanks to the ability of the system operator to provide real time information on the system balance combined with the availability of hourly re-nomination and short term capacity products. In other markets where metering data is of lower quality a number of deviations have been considered or allowed, e.g. imbalance tolerance bands.

The separation of commodity trading from access to capacity - has not appeared to present additional risks for participants. Capacity is traded on a common platform (mostly PRISMA) offering products covering a range time periods from yearly products (marketed for up to 15 continuous years) to within day capacity. Auctions of capacity are coordinated across the EU and follow the application of the same allocation methodology. Also, secondary capacity markets together with congestion management measures further ensure the efficient allocation and use of capacity.

Market transparency – the voluntary nature of the market has not impeded price transparency. Even in markets where there is a preference to trade "Over-the-Counter" the presence of price reporting agencies and brokers has ensured the availability of information.

Liquidity levels – liquidity levels are very diverse across different European markets and in some cases markets have been facilitated by the introduction of gas release programs. Notably, the development of liquidity does not occur immediately and it is the result of a combination of factors, including a

strong and clear policy direction. However, it is on the rise and according to a recent ACER/CEER Report[1], across the EU, total traded volumes at EU Hubs in 2015 were approximately nine times the physical gas consumption. Over recent times, the Dutch TTf market has had the greatest growth, which trades both physical and financial products.

Linkages to the proposed northern hub and Wallumbilla Gas Supply Hub

Shell views the Gas Reform Package as a combined package and DWGM reforms should be undertaken to improve the integration of the entire East Coast Gas Market (i.e. it does not only relate to the issues facing current Victorian Participants). Furthermore, we see merit where appropriate to introduce similar market designs across the proposed southern and northern hubs. In this regard:

- The model adopted for the Wallumbilla Gas Supply Hub (**Wallumbilla**) in the form of a voluntary market with continuous trading is a "fit-for-purpose design" and has the potential to develop into a successful trading location. Some stakeholders are suggesting the lack of trading at Wallumbilla is sufficient enough reason to avoid redesigning the Southern Hub along similar lines.

- We disagree with this point and suggest the lack of liquidity at Wallumbilla is largely due to transportation charges, which make it uneconomic to trade gas at this point. It is our expectation that the implementation of other gas market reforms, such as the day-head capacity auctions, will lead to more efficient pricing of short-term capacity and more trading at Wallumbilla. We do not necessarily see the Entry-Exit model suffering from these same issues.

[1] ACER, Annual Report on the Results of Monitoring the Gas Markets in 2015, September 2016.