

Review of the Victorian Declared Wholesale Gas Market Working Group

Meeting 4

Date: 31 August 2016
Time: 2.00pm to 5.30pm
Location: Rendezvous Hotel, Melbourne

1 Agenda

- i. Welcome
- ii. Part I - Recap
 - Desired outcomes
 - Southern Hub overview
- iii. Part II - Transitional measures (presented by CEPA/TPA)
 - Issues and international experience
 - Transition options for a Southern Hub

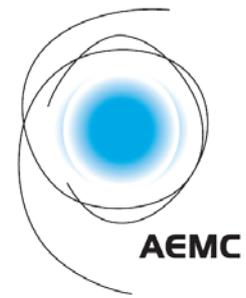
2 Attendee organisations

Organisation	Organisation
AEMC	ExxonMobil
AEMO	Jemena
AER	Lochard Energy
AGL Energy	Major Energy Users
APA Group	Origin Energy
EnergyAustralia	Public Interest Advocacy Centre
ENGIE	Vocus (ex-M2)
ERM Power	

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3 Part I – Recap and discussion

- The AEMC provided a recap of the COAG Energy Council’s Vision, along with the roadmap recommended in the East Coast Gas Review and agreed to by the Council at its recent meeting. This roadmap includes:
 - a Northern Hub at Wallumbilla, Southern Hub and simplification of the STTMs;
 - changes to pipeline capacity markets, including the auction of contracted but un-nominated capacity (short-term UIOLI);
 - improvements to information on the Gas Bulletin Board.
- Many of the reforms forming the roadmap will be progressed through a Gas Market Reform Group, in consultation with user groups, industry and governments. The group will be led by Dr Michael Vertigan as its Independent Chair, and the initial focus of the group will be on pipeline capacity markets.
- The AEMC also provided an overview of the key design features of the proposed Southern Hub:
 - continuous commodity trading inside the hub, replacing the existing daily gross pool;
 - 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.
- Discussions throughout the first section of the meeting included broader questions such as the justification for the proposed reforms, as summarised below.

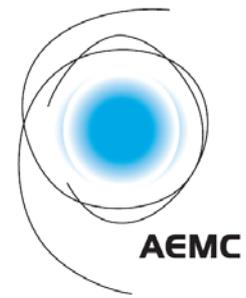
3.1 Support for proposed reforms

- A number of working group members noted that they consider that some amount of change to the DWGM is required, but that they view the amount of change represented by the proposed Southern Hub as being unnecessary. Some suggested incremental reform as an alternative.
 - The AEMC noted that it consulted on possible incremental reforms in late 2015 and concluded that the proposed Southern Hub model is likely to best meet the Energy Council’s Vision and address the concerns of the Victorian Government.
 - A number of Working Group attendees suggested that, in hindsight, they had not engaged sufficiently with the AEMC during that consultation process and suggested the AEMC revisit its analysis.

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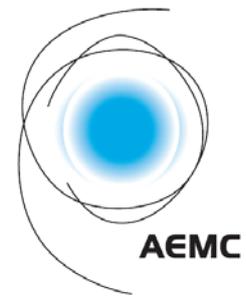
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- One participant suggested that the AEMC reflect the views of Working Group members in the Draft Final Report, so that the Council and the Victorian Government are fully informed of industry concerns regarding the proposed Southern Hub model.
 - One attendee queried whether a cost-benefit analysis of reforms to the Victorian DWGM was being undertaken, in order to assess the net benefits. The AEMC confirmed that PwC is engaged in conducting a specific analysis for the DWGM.
 - One participant questioned if the proposed Southern Hub is only being assessed against the current DWGM arrangements, or if incremental changes/options are also being assessed against the objectives defined by the Victorian Government. A cost benefit analysis, not only of the proposed model, but also of possible alternative options was suggested.
 - One attendee enquired about the transition of AMDQ and AMDQcc rights, to which the AEMC responded that the topic will be addressed in the Draft Final Report. The AEMC also noted that it was seeking further information from APA on this matter.

3.2 Potential costs for market participants

- One attendee suggested that the new design has the potential to increase the effort required by market participants to move gas around the East Coast: where a shipper holds a portfolio of gas and can inject it from a variety of locations, it will have to ensure that it holds the appropriate level of capacity at any given location at any given time.
 - 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. Indeed, where a participant holds the appropriate capacity rights and has a predictable load, the effort required by participants should be much lower than under the current arrangements.
- One attendee mentioned that the key concern for traders is being compliant with their companies' strict risk policies. The same attendee suggested that the changes to the Wallumbilla hub may also make this harder to operate from the traders' point of view.

3.3 Next steps

- The AEMC will provide a Draft Final Report to the Victorian Government on 14 October 2016 and publish this for consultation.
- Although the consultation period and process for finalising the report and recommendations have not been specified by the Victorian government, the AEMC noted that it expects a consultation period of around six weeks. However, this is likely to imply that the final report will be published early next year, as a substantive consultation period is likely to be inconsistent with submission of the final report to the next Council meeting in December 2016.



4 Part II – Presentation on transitional measures by CEPA/TPA

- The second part of the meeting was presented by CEPA and TPA Solutions, who have been commissioned by the AEMC to investigate and report on potential transition measures in relation to the balancing regime which might be implemented upon introduction of the proposed new market design in Victoria ('Southern Hub').
- The presentation focused on presenting two transitional packages, which included various elements focused in promoting market liquidity, along with financial relief mechanisms to market participants.
- Package 1 – target model from day 1 with soft landing: this package allows an immediate implementation from day 1 of all the main features of the 'target' model but with specific measures designed to engineer a 'soft landing' and encourage trading in more liquid daily products.
- Package 2 – system operator balancing after gate closure: the concept of this transitional scheme is to allow an immediate move towards day (and further) ahead trading but with a reliable interim process to tackle within day flexibility needs during an initial phase.
- After the presentation of each package there was a Q&A session, where attendees asked questions about the specificities of each package. These discussions are summarised below.

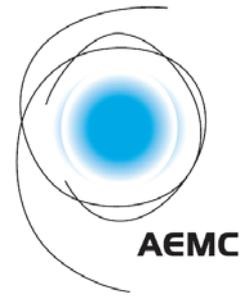
4.1 Package 1 – target model with soft landing

- A number of attendees commented on the likely smearing/socialisation of costs under package 1 that would result from 'protecting' participants from the effects of low liquidity. In particular, one attendee raised a concern around the potential gaming strategies that participants might engage in eg a causer's imbalance in the system could largely be paid for by its competitors through socialisation, and that same causer could then be compensated later by offering flexibility to the System Operator ('SO').
 - CEPA/TPA agreed that the socialisation of costs is not desirable in its own right, but explained that there can be a balance with cost reflectivity where this helps achieve other objectives ie the promotion of liquidity. There may be a case for tilting this balance towards socialisation temporarily as a market facilitator.
- One working group member noted that, following the introduction of the STTM, some market participants were penalised even though they were not the causer of costs and that, as a consequence, some participants left the market. It also raised the issue of socialisation leading to costs that were not hedgeable, and hence introducing additional risk.
 - CEPA/TPA noted that one alternative is to move the smearing/socialisation of costs to the future, such that this becomes a predictable cost.

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- One member noted that currently there is no near real time metering for most users in the DWGM which would be required such that market participants would be informed and able to take actions in a continuous balancing model.
 - The AEMC noted that it viewed the need to provide near real time information as an implementation issue, and not a transitional issue in the same sense as CEPA's work. CEPA noted that, during the time it would take to update the metering infrastructure, a 'paper trial' could be carried out.

4.2 Package 2 – SO balancing after gate closure

- One participant noted that having a gate closure could potentially lead to an opposite effect to the expected one, with market participants locking-in their positions before gate closure.
 - CEPA/TPA noted that market participants in different countries exhibit different behaviours: e.g. in the UK 70-80% of the trades are conducted day-ahead or within day, whereas in other European countries it tends to be the other way-around, with most participants trading in the longer term.
- Another attendee questioned whether market participants would be able to renominate on the day after gate closure as, if not, gas-fired generators would have to rely on balancing gas procured by the SO in order to operate.
 - CEPA/TPA explained that the transitional measure can be designed in a way that matched renominations are allowed after gate closure, and that this would help address this issue.
- A further stakeholder suggested that the balancing mechanism under Package 2 could be viewed as a backwards step from the current intra-day market and also that it could be hard to wind back.
 - CEPA/TPA noted that Package 2 is designed to have the system operator doing all the residual balancing after gate closure, with the objective of maximising the flexibility offered to the market.
- CEPA/TPA concluded the presentation by stating that the potential transitional measures are only temporary measures that could go on for as little as 6 to 12 months, and that the Victorian market is starting the reform process from a much stronger position than many other countries in Europe which had vertically integrated monopoly suppliers.