

17 December 2021

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Dear Mr Morgan

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Options to advance the east coast gas market

The Australian Energy Market Operator (AEMO) welcomes the opportunity to comment on Energy Senior Officials' (Senior Officials) consultation paper on the Wallumbilla Gas Supply Hub (GSH) and pipeline capacity trading framework.

AEMO supports the work being undertaken by Senior Officials on behalf of Energy Ministers and is keen to support the development of the Roadmap for market reform options. AEMO considers that the implementation of both the GSH and Pipeline Capacity Trading reforms (PCT) have been successful in advancing the development of the east coast market. AEMO agrees that it is an opportune time to review the regulatory framework and market arrangements given the rapidly evolving energy market and system.

In general, AEMO considers that the spectrum of reform options identified in the paper merit further consideration as potential solutions to ongoing market and regulatory challenges in the east coast gas market. Given AEMO's recent experience in implementing a number of gas reform programs, our submission provides our preliminary view on further development and implementation considerations that may aid Senior Officials in developing their Roadmap.

AEMO looks forward to continuing to work with Senior Officials to progress the Energy Ministers' priority market reforms. Should you require additional information please feel free to contact Kevin Ly, Group Manager Reform Development and Insights, at kevin.ly@aemo.com.au.

Yours Sincerely



Violette Mouchaileh
Executive General Manager - Reform Delivery

Attachments:

Attachment A - Submission

Attachment A – Submission

Accelerating Development of the Wallumbilla GSH and Pipeline Capacity Trading Markets

AEMO supports the investigation and development of measures that will improve the operation and efficiency of the GSH and Pipeline Capacity Trading Markets. This attachment provides AEMO's high level views on some of the options raised in the consultation paper and gives our perspective on areas of potential further investigation to aid the development of the policy Roadmap and the next steps for Energy Ministers.

Anonymised delivery

AEMO considers that anonymising the end-to-end delivery process for the GSH would be a significant improvement to the existing market framework. AEMO understands that GSH members may at times be reluctant to put exchange trades through the Hub because their trade position is revealed to the counterparty to facilitate delivery.

In developing and implementing the GSH, the 'bilateral' delivery model was chosen due to its relative simplicity and its compatibility with existing transportation agreements, processes and systems. Since implementation of the GSH, the market has matured and is more amenable to an enhanced delivery model. In particular, the wide use of in-pipe trading points (developed by pipeline operators) has removed a lot of the complexity and uncertainty that can be associated with gas delivery. In addition, the implementation of the Capacity Trading Platform (CTP) in 2018 resulted in AEMO and pipeline operators developing systems and process that are used to exchange trade information to facilitate "transfers" of capacity anonymously in pipeline operator systems. AEMO believes these systems and processes could be readily extended to facilitate anonymous commodity trading. Under such an approach, AEMO would provide service providers with the trade information required to facilitate title transfers of gas between sellers and buyers anonymously.

The paper identifies that there are several pathways to implement an anonymised trading approach for the GSH: a Rules-based approach (like the CTP) or a bilateral approach. There is a trade-off to consider between the speed of implementation that might be achieved under bilateral approach and the regulatory safeguards and consistency with CTP's arrangements that could be developed under a National Gas Rules (NGR) approach. In evaluating this trade-off, AEMO believes that it would be prudent to consider the potential implications of a model that requires market participants to contract for a service that is needed to participate in the market and can only be offered by service providers.

The CTP delivery model (which has a similar design to the proposed GSH trade anonymity model) for example is underpinned by the Operational Transportation Service Code (the Code). The Code provides a regulatory framework that standardises and makes transparent the terms and conditions for the commercial arrangements that underpin the transfer and use of secondary capacity traded via the CTP on a pipeline. This includes information on charges and liabilities for any capacity sold or bought in the market. The Code also provides a governance framework for proposing and making future changes.

As part of determining an implementation approach, AEMO considers that further investigation of the appropriate regulatory and governance mechanisms is warranted given the competing interests of market participants and service providers and the monopoly nature of the provision of the services that would underpin an anonymous trading model.

With respect to the balancing models proposed in the paper, AEMO does not have a strong preference at this stage. A pro-rating option might be simplest to implement especially if the in-pipe trade points are retained for title transfer. Given these points have deemed allocations it is expected that balancing would not typically be required and therefore a simple balancing approach may be fit for purpose.

Gas Market Prudentials

AEMO supports consideration of a harmonised approach to gas market prudentials across the east coast gas markets as a way of lowering transaction costs. AEMO recognises that there may be inefficiencies in participants holding collateral across multiple markets particularly where participants have offsetting positions between markets.

While AEMO supports investigation of the proposal, we note that its implementation would require changes to market systems and would require regulatory changes. Changes to the regulatory framework would involve more than simply harmonising the arrangements as the NGR would need to permit and facilitate collateral sharing and risk allocation between markets. For example, consideration would need to be given to how a default in one market may affect participants in other markets. AEMO systems would also need to be changed to calculate and manage exposure across multiple markets against a single pool of collateral.

Market Making

One of the structural challenges facing the Wallumbilla GSH is the fact that a relatively small number of industry participants control a significant share of the gas supply. Market liquidity therefore is dependent on the active involvement of these participants across GSH's product suite. In addition, smaller participants may be reluctant to participate in the market from time-to-time where they consider that, due to information asymmetries, they may not understand where the prevailing market price is relative to a larger player who may have a more complete picture by virtue of their portfolio.

Given the above challenges, AEMO supports further investigation of a market making regime to address potential information asymmetries in the market and provide greater volume and price certainty to the gas industry. We do query whether a voluntary market making regime is able to address the challenges outlined given the market dynamics and industry structure.

If a market making regime is developed, particular consideration will need to be given to the products covered by the regime as well as the timing, volume, and bid/offer spread requirements.

Virtual Hub

AEMO considers there is merit in further examining virtual hub options and additional detail is needed to undertake a full assessment. It would be useful to compare any virtual hub solutions against incremental options to develop the Wallumbilla Hub. In its review into Wallumbilla in 2015, AEMO considered a single trading zone model. Based on our review, some areas of investigation that might be helpful for Senior Officials to consider include:

- The hub definition – the geographical range of the hub and the facilities that are included. An important design consideration is whether retail markets are included or not. Inclusion of retail markets will bring about its own set of additional requirements. Definitions that span multiple facility operators will also have additional considerations.
- The hub operator model – governance arrangements and the agreement framework between the hub operator, AEMO and participants.
- Gas delivery process – the interaction between participants and facility operators for managing nominations and constraints.
- Balancing framework – how balancing is settled e.g inside the market or through a standalone market.
- Trading participation framework – voluntary or mandatory trading.
- Investment approach – how are expansions and new assets identified, developed and funded over time.

Capacity Trading Platform

The Capacity Trading Platform has only seen limited activity since its inception. However, it is not clear the extent to which this lack of activity is driven by the market's design versus broader structural issues in the pipeline capacity market.

AEMO supports further investigation of mechanisms that may improve the CTP. One potential shortcoming of the CTP is that by virtue of its design there are a large number of products that are continuously traded across the gas day. For a trade to execute on the exchange, a buyer and seller needs to have active orders for the same product at the same point in time. It is possible that, given the complexity of the CTP's product design and the large number of markets, that there are coordination issues that undermine trading. AEMO considers there may be merit in investigating options that simplify the transaction process (which could include use of auctions for in demand products), simplify the product offering and/or concentrate trade activity around a smaller number of markets for transportation legs that are likely to have reasonable demand.

AEMO notes that the paper also raises the prospect of potentially reviewing the CTP's fee structure including reducing the variable fee over time. In its 2021-2022 budget, AEMO reduced the variable transaction fees for Capacity Trading Platform to \$0.008/GJ to encourage increased participation and liquidity in the market.