

Our Ref: AER213325
Contact Officer: Alistair Newman
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Date: 23December 2021

Energy Senior Officials
Via email: gas@industry.gov.au

Dear Senior Officials

RE: Consultation Paper – Options to advance the east coast gas market

Thank you for the opportunity to comment on the options to advance the east coast gas market - Wallumbilla Gas Supply Hub and pipeline capacity trading framework consultation paper.

As you are aware, the AER has regulatory oversight of the Wallumbilla Gas Supply Hub (GSH) and pipeline capacity trading framework, including the Day Ahead Auction (DAA) and the Capacity Trading Platform (CTP). Specifically, we enforce information and reporting standards to promote confidence in gas market data, and we also monitor for the manipulation of gas markets. Additionally, we publish regular analysis and update statistics to provide transparency about gas market dynamics.^{1 2}

The AER also has access to a range of confidential information that is not available to the broader market, has received feedback from market participants and observed behaviour in the market which we believe will provide a valuable insight into market performance that may help guide the policy debate.

We are supportive of the proposed reforms discussed in the consultation paper but feel the cost, complexity and any potential compliance issues that may follow need to be carefully considered against the potential benefits.

We have **enclosed** Attachment A – Stakeholder feedback template with our submissions, noting that the questions that we do not wish to make submissions in respect of have been left blank.

¹ See <https://www.aer.gov.au/wholesale-markets/performance-reporting>.

² See <https://www.aer.gov.au/wholesale-markets/wholesale-statistics>.

If you have any questions about our submission, please contact Jeremy Llewellyn on (07) 3835 4610 or Alistair Newman on (02) 6243 4958.

Yours sincerely,

A handwritten signature in black ink that reads "Jim Cox". The signature is written in a cursive style with a large, stylized initial "J".

Jim Cox
AER Board member
Australian Energy Regulator

Attachment A: Options to progress the east coast gas market – Stakeholder feedback template

Submission from Australian Energy Regulator (AER)

Chapter 2: Rationale for undertaking consultation

Section 2.4 What are the objectives of Energy Ministers?

No.	Questions	Feedback
1	Do you have any comments about the rationale for undertaking consultation? Does the rationale broadly cover the issues that you face in your interaction with the gas market?	
2	Are there any issues which have not been identified which Energy Ministers should consider in the context of undertaking these workstreams?	
3	Do you have any comments about the proposed objectives of this work?	

Chapter 3: Consultation focus 1: Wallumbilla Gas Supply Hub

Section 3.1 What are the potential problems?

No.	Questions	Feedback
4	Do you agree with the problems that have been identified for Wallumbilla GSH and what effect do you think they could have on meeting the objectives outlined in Chapter 2.4?	<p>The AER has access to a range of data that is not available to the market more broadly. We report regularly on the performance of the GSH and DAA through our online statistics, <i>Wholesale markets quarterly</i> and reports.</p> <p>In particular, we are concerned with the lack of on screen liquidity and limited participation at the Wallumbilla GSH which limits price discovery and presents a risk for traders. Off screen trading has progressively grown over the past few years, making up 82% of all trade in the 2020-21 financial year. By contrast, on screen trading has waned, falling last financial year to its lowest volume since 2016-17. Similarly, participation on screen remains lower with 15 active participants in the 2020-21 financial year, compared to 17 off screen.</p> <p>We also note the limited diversity in participants at the GSH compared to other east coast gas markets. In our <i>Wholesale markets quarterly Q3 2021</i>, we list 59 participants in the east coast gas markets, but currently there is only one industrial participant participating in the GSH. Further, no retailers use the GSH that do not have a gas powered generation position. This may indicate concerns from smaller users around liquidity at the GSH, preferring to use other arrangements to manage their positions.</p>

No.	Questions	Feedback
5	<p>Are there any other problems that you think should be considered? If so, please set out what they are, what effect they may be having on liquidity at Wallumbilla GSH, and how these problems could be addressed.</p>	<p>We believe there is a risk that disruptive events such as outages and maintenance could increase risk for smaller traders and subsequently compromise their trading. This is because customers that contract directly with facility operators/producers may receive more detailed information faster than the information made available to the market as a whole. The AER is concerned that this potential information asymmetry will disadvantage smaller traders by reducing their appetite for risk and consequentially impact overall market liquidity. At present there are limitations on the reporting of infrastructure outages and the new transparency legislation will increase the scope of reporting on outages.³</p>
6	<p>Are there structural issues regarding the nature of supply and demand for gas in Australia which could impact the success of reforms aimed at increasing liquidity of gas markets?</p>	<p>One such issue is that several large participants, as a result of their relative buying/selling power, have more influence in impacting market outcomes than smaller participants. While liquidity has increased recently, this has been due to the behaviour of a small number of participants.</p> <p>Another issue is the importation of international price volatility. Volatility and the associated risks are likely to be a disincentive to some traders in increasing their involvement and subsequent liquidity in the Australian gas market. Such volatility can occur when southern markets need to import gas from northern producers or if there is a reliance on import terminals in the future. Smaller traders without expansive portfolios who have a lower risk tolerance have expressed to us that during periods of high price volatility they will take a conservative approach to gas trading.</p>

³ National Gas (South Australia) (Market Transparency) Amendment Bill 2021; National Gas Amendment (Market Transparency) Rule 2021 and National Gas (South Australia) (Market Transparency) Variation Regulations 2021.

Section 3.2 How could these problems be addressed?

Section 3.2.1 Anonymised delivery

No.	Questions	Feedback
7	<p>What benefits could anonymised delivery offer for gas market participants which could assist in achieving the objectives in Chapter 2.4? What do you think the costs and benefits of implementing such an option would be to your business in terms of your participation in the Wallumbilla GSH?</p>	<p>The AER considers that anonymised delivery, given the difference in the size of some participants and their relative buying/selling power, could reduce the opportunity for the larger participants to exercise market power over smaller participants.</p>
8	<p>What do you believe would be the most appropriate design for an anonymised delivery model at Wallumbilla GSH?</p> <p>(a) Is a model which emulates the CTP most appropriate for anonymised delivery of gas traded through the GSH?</p> <p>(b) What balancing regime represents the best trade-off of complexity and benefit to liquidity?</p> <p>(c) Would implementation via a Rule change or bilateral agreement be more preferable in terms of achieving the NGO?</p>	
9	<p>In terms of an implementation roadmap, what importance would you place on addressing this issue and over what timeframe?</p>	

Section 3.2.2 Streamlining prudential requirements

No.	Questions	Feedback
10	Do you think there is likely to be a net benefit in harmonising prudential requirements across the east coast facilitated gas markets? What effect do you think this will have on your business, and suppliers and users more generally?	Smaller participants have raised concerns with us in relation to facility operators' prudential requirements. In particular, the need to provide credit support or collateral in order to bid for capacity at the DAA for each facility. These prudential requirements may not be as easily absorbed by smaller participants as they can be by larger participants. ⁴
11	Do you think the introduction of the ASX physical delivery futures product will alleviate the current concerns around collateral requirements of forward-dated products? If not, please explain why.	
12	Which option for sharing prudential requirements do you consider would be likely to offer best value for money? Are there other options that should be considered?	
13	In terms of an implementation roadmap, what importance would you place on addressing this issue and how quickly do you think it needs to be addressed?	

⁴ AER, *Pipeline capacity trading - Two year review*, April 2021, p 26.

Section 3.2.3 Market making

No.	Questions	Feedback
14	<p>Do you think a market making regime could make the Wallumbilla GSH better suited to your gas trading needs? Is a market making regime necessary in order to develop liquidity at Wallumbilla GSH or is this better achieved through other means?</p>	<p>The AER produces information on the difference between the highest bid to buy and lowest offer to sell each day (bid-offer spreads) that shows mixed results in terms of spreads reducing over time.⁵ We believe that this may indicate a role for a market making regime to assist with building liquidity, particularly for some products with high spreads.</p>
15	<p>What form of market making regime do you think would be most appropriate for achieving the objectives in Chapter 2.4?</p> <p>(a) What parties would be most appropriate to be market makers (and in what markets e.g. physical, financial)? Should this be voluntary or mandatory in terms of participation?</p> <p>(b) How do Energy Ministers ensure that there is minimal adverse impact to participants selected as market makers in such a regime? Are there elements of the design of market making regime that could assist in minimising the implementation cost?</p> <p>(c) What role (if any) could energy market bodies and/or governments play in facilitating a regime at Wallumbilla GSH?</p>	<p>The AER feels the most appropriate entity would ideally be highly sophisticated, with a large gas trading portfolio. If there are no willing domestic entities, there may be some benefit in approaching international gas traders who may be interested in providing market making services</p>
16	<p>Does a market maker within the ASX physical futures product sufficiently reduce the need for an alternative market making regime for Wallumbilla?</p>	<p>Our understanding is that this would require so much trade in the ASX physical futures product that this is an unlikely scenario.</p>
17	<p>In terms of an implementation roadmap, what additional work is required to consider the merits of market making regimes and to assess the cost and benefits of different designs?</p>	

⁵ <https://www.aer.gov.au/wholesale-markets/wholesale-statistics/gas-supply-hub-bid-offer-spread-metric-wal>.

Section 3.2.4 Virtual hub design

No.	Questions	Feedback
18	What benefits do you think a virtual hub for Wallumbilla GSH could introduce and why? Do you think it could make it easier for your business to trade gas?	
19	Do you have views on the design details that would need to be considered in designing a virtual hub, for instance which form of carriage model or balancing regime would be most appropriate?	
20	What level of regulation should be imposed upon the hub operator? And what activities should be regulated as part of this? Should consideration be given to an independent hub operator?	
21	<p>Regarding the idea of expanding a virtual hub to encompass the SEQ trading location and the Brisbane STTM:</p> <p>(a) What additional benefit would this provide your business, and the gas market generally, compared to a virtual hub covering Wallumbilla alone?</p> <p>(b) What are the major risks associated with this proposal, particularly considering management of existing contracts and congestion?</p> <p>(c) Would a liquid trading hub be an adequate replacement for the mandatory Brisbane STTM?</p>	<p>While we find the idea interesting we note that the Australian markets are significantly different to those in international jurisdictions where the various models of virtual hubs currently operate. We would welcome contributing to a review of this issue and commenting on potential changes to refine requirements in the rules should an expansion of the virtual hub proceed.</p>
22	In terms of an implementation roadmap, are there other considerations which should be considered for future consultation and assessment, if this option was to be investigated further?	

Section 3.2.5 Other options considered

No.	Questions	Feedback
23	Do you agree with the initial analysis of these other options? Do you think there is merit in exploring these options further in order to assess whether they could contribute to meeting the objectives outlined in Chapter 2.4?	
24	Are there additional options which should be considered by Energy Ministers in more detail?	

Chapter 4: Consultation focus 2: Pipeline capacity trading frameworks

Section 4.1 What are the potential problems?

No.	Questions	Feedback
25	Do you agree with the problems that have been identified with pipeline capacity trading frameworks and what effect do you think they could have on future liquidity growth in the east coast gas market?	While there may be room for improvement, based on participant feedback we believe the low activity on the Capacity Trading Platform (CTP) is more of a reflection of buyer satisfaction with the DAA, rather than any particular failure of the CTP. Trade on the CTP may increase in time if prices continue to rise on the DAA, as they have recently.
26	Are there any other problems that you think should be considered? If so, please set out what they are, what effect they may be having on pipeline capacity liquidity, and how these problems could be addressed.	Participants raised concerns in late 2019 that highlighted an issue between the scheduling and allocation of gas into the Victorian market via Culcairn. In particular, the differing viewpoints as to whether contract carriage rights or market carriage rights are intended to prevail in the legislation. The AER considers that this issue should be addressed by the reforms, particularly as this interaction may not have been considered previously. We would welcome contributing to a review of this issue and commenting on potential changes to refine requirements in the rules. ⁶
27	Do you agree that these identified problems are relevant to meeting the objectives in Chapter 2.4? If not, please explain why.	

⁶ AER, *Pipeline capacity trading - Two year review*, April 2021, p 33.

Section 4.2 How could these problems be addressed?

Section 4.2.1 Reviewing fee structures and levels

No.	Questions	Feedback
28	Do the fees charged by AEMO for participation in pipeline capacity trading act as a barrier to further growth in usage? How could this be alleviated?	
29	<p>To what extent should pipeline operator fees be reformed in order to increase the efficiency of the market, noting the options outlined above?</p> <p>(a) Do you agree with the AER's initial findings that the fee structures imposed by pipeline operators did not represent a substantial barrier to trading?</p> <p>(b) Would an increased level of regulation on pipeline operator fees be warranted in order to better improve market outcomes? Are there any risks which could arise from this approach?</p>	<p>In discussing auction fees as part of our <i>Pipeline capacity trading - Two year review</i> and other industry consultations, participants have highlighted a range of fees or prudential requirements that may impact their use of the DAA and GSH. These include variable pipeline delivery fees to the interconnected downstream STTM markets, fixed market registration fees for commodity or capacity markets, variable (\$/GJ) fees, which add up for larger trades conducted on screen at the GSH and may disincentivise on screen trades, and credit support required to be provided to pipelines to bid on DAA capacity. These fees, combined, may act as a disincentive for smaller participants to use the auction and participate downstream.</p> <p>The AER's initial review of CTP/DAA fees focused on standardised pipeline operator fees only and we consider it important to weigh any reform in the context of all fees paid by participants. For DAA facility operator fees, we have observed some fees reduce to zero over time as operators have recovered DAA fees as anticipated within the original regulatory regime. This should encourage more use of the DAA – across 2021 DAA use increased, although the degree to which this is the result of lower fees is difficult to assess. Some facility operators continue to impose fixed fees on routes which are more lightly traded, although in this context some trade has now been observed on both MAPS and SEAGas. The expectation of fees reducing over time has not been as effective on these two pipelines because smaller operators do not have the same scale or risk appetite, and large volume users have been absent.</p>

No.	Questions	Feedback
30	In terms of an implementation roadmap, what importance would you place on addressing this issue and how quickly do you think it needs to be addressed?	

Section 4.2.2 Reviewing bidirectional pipelines restrictions

No.	Questions	Feedback
31	<p>Are there specific pipelines for which access to backhaul capacity is an issue for participants?</p> <p>(a) Would an interruptible backhaul auction product on bidirectional pipelines such as the one described above be feasible? If not, please explain why.</p> <p>(b) Is there a need to strengthen the conditions by which a pipeline can be made bidirectional? What risks could eventuate through a higher barrier to reclassification of pipelines?</p>	<p>Participants have raised concerns with us about the lack of backhaul auction services on the Moomba to Adelaide Pipeline System (MAPS).⁷ At the time, this was due to a lack of contracts on MAPS for delivery at Moomba, meaning there was no contracted, but unnominated capacity available.</p> <p>While Adelaide is a much smaller market, having backhaul auction capacity available on MAPS would improve the opportunity for participants to arbitrage at times when the Adelaide STTM is cheaper than northern markets.</p>

⁷ AER *Pipeline capacity trading - Two year review*, April 2021, p 24.

No.	Questions	Feedback
32	<p>In terms of an implementation roadmap, is there a preferred approach or other considerations which should be considered for future consultation and assessment, if this option was to be investigated further?</p>	<p>The AER has been actively monitoring the DAA since its commencement in 2019. We have issued a number of infringement notices in 2021 relating to concerns around record keeping requirements, and missing or incorrect AQL calculations. We continue to follow up a number of outstanding issues and have reported to industry forums on the varied causes of AQL errors or missing AQL data.</p> <p>Accurate AQLs are important for the efficient operation of the DAA. However, some participants have had considerable difficulty in implementing systems that accurately calculate AQLs for use in the DAA, with issues still occurring in late 2021. Considering the additional complexities in adding backhaul services to these calculations, we are concerned that this will inevitably lead to an increase in the potential for errors.</p> <p>Broadly, we consider these measures could assist to create more trade. However, in assessing the options, the complexity of implementation and regulatory oversight should also be considered. This is a particular concern of ours given that participants' compliance with the rules relating to the DAA is a current compliance and enforcement priority of the AER and that we have ongoing concerns around participants' compliance based on our monitoring of the market.</p>

Section 4.2.3 Alleviating issues around auction timing

No.	Questions	Feedback
33	<p>Would shifting forward the nomination cut-off time within the gas day present any difficulties? How might this impact the certainty for gas users to nominate for the next day?</p> <p>(a) Would the benefit in shifting forward the nomination cut-off time, and consequently the DAA, be sufficiently material to justify change?</p>	<p>From our observation of the market we believe that the further the DAA nomination cut-off time is from the auction, the more likely that the nomination will not accurately reflect the shippers' final gas transportation capacity needs. As the nomination goes to determining the AQL and the available gas transportation capacity available in the DAA, we would suggest caution be exercised when considering moving the DAA nomination cut-off time to earlier in the day.</p>
34	<p>Are there thoughts on the usefulness of an automated nomination process for auctioned capacity in order to alleviate timing concerns from smaller participants? How might this be best implemented?</p>	<p>We offer our general support for an automated nominations process to assist the timing concerns of smaller participants.</p>
35	<p>In terms of an implementation roadmap, what importance would you place on addressing this issue and how quickly do you think it needs to be addressed?</p>	

Section 4.2.4 Reviewing firmness of auction product

No.	Questions	Feedback
36	<p>Should the firmness of the auction product as initially recommended by the GMRG be revisited, given the outcomes of the auction and use of the CTP?</p> <p>(a) What risks could shifting to a hybrid auction introduce (e.g. impact on investment signals)? What measures could be put in place to limit any impacts?</p>	<p>Altering the firmness of the auction product could assist to create more trade but the complexity of implementation and regulatory oversight should also be considered. While participants may desire a firm auction product, this may change incentives for how firm shippers behave in offering capacity. While there are currently regulatory prohibitions on firm shippers submitting misleading nominations, these prohibitions should be reviewed if the firmness of the auction product changes.</p> <p>We also note that since the inception of the reforms materially more auction curtailment events have been observed on the Moomba to Adelaide Pipeline (MAPS) compared to other pipelines.⁸ The curtailments on MAPS occurred mostly during the peak winter demand period when the MAPS operates close to capacity. Importantly, these curtailment events have had little to no impact on auction scheduled volumes.</p>
37	<p>In terms of an implementation roadmap, what additional work is required to consider the merits of reviewing the firmness of auction products?</p>	

Section 4.2.5 improving the usefulness of the Capacity Trading Platform

No.	Questions	Feedback
38	<p>Could the usefulness of the CTP be improved through a simplified product offering or coordinated trading mechanism for secondary capacity? How could simplification best be achieved?</p>	

⁸ With the only other one curtailment event being on the Roma to Brisbane Pipeline (RBP).

No.	Questions	Feedback
39	<p>Would increasing access to primary capacity products on pipelines through the CTP result in a more efficient gas market, and improve flexibility for shippers and buyers? Is this an attractive alternative to bilateral contracting for short-term primary capacity?</p> <p>(a) What products could be made available? Is the CTP the most appropriate platform to make these products available? If not, please explain why.</p> <p>(b) How could pricing for these products be set? How could any incentives for economic withholding be addressed?</p>	
40	<p>In terms of an implementation roadmap, what additional work is required to consider the merits of trading primary capacity products on the CTP?</p>	

Section 4.2.6 Other options considered

No.	Questions	Feedback
41	<p>Do you see potential benefit in any of these other options which would help to achieve the objectives outlined in Chapter 2.4 and may warrant further exploration?</p>	
42	<p>Are there additional options which have not been explored or identified here and should be considered by Energy Ministers in more detail?</p>	

Chapter 5: Other enabling framework reform options

Section 5.1 Third-party access to gas infrastructure

No.	Questions	Feedback
43	<p>Do you think there is currently an issue with third-party access to gas facilities other than pipelines? Would a regulatory access regime for these facilities lead to better outcomes for the gas market and support achievement of the Energy Ministers' vision?</p> <p>(a) What types of facilities should be the focus of a third-party access regime (if any)? To what extent are the issues associated with these facilities similar to or different from the issues considered in the Pipeline RIS?</p>	<p>We recognise that there are a number of large storage facilities that have historically been owned by one party for their own storage requirements. In a market where the movement of gas is becoming more flexible there may be merit in promoting competition in the gas storage facilities through a third-party access regime. We feel that third-party access to storage facilities is a service that would likely be in high demand due to movements between the northern and southern gas markets that we have observed. However, while we understand there are concerns around access to storage facilities, there are additional storage facilities being constructed at the moment, for example the Golden Beach storage facility which is due for completion in next couple of years.</p> <p>We therefore feel it is important to factor the increased access that future development of storage facilities will create into any decision about a third-party access regime. We would welcome commenting on any potential changes to the legislation to effect a third-party access regime.</p> <p>We also note that the ACCC has an interim report due in January. This report will discuss storage as well as access to other upstream infrastructure, including processing. We feel that this report should be considered as it will likely assist in the evaluation of potential options and amendments to the legislation.</p>
44	<p>Are there alternatives to implementing a third-party access regime for this kind of infrastructure, such as an independent body like AEMO or governments owning and/or operating infrastructure such as storage or compression?</p>	

No.	Questions	Feedback
45	In terms of an implementation roadmap, what additional work is required to consider whether access regulation should be extended to other forms of gas infrastructure? What risks exist with regards to the introduction of any regulatory regime?	

Section 5.2 Improving contracting practices to support greater on-screen trading and liquidity

No	Questions	Feedback
46	<p>What do you consider to be the main benefits of off-screen bilateral contracting arrangements (for example, under an MSA) as compared with on-screen trading through the Wallumbilla GSH?</p> <p>(a) Are there any contracting practices associated with the Wallumbilla GSH that you consider currently act as a disincentive to on-screen trading?</p> <p>(b) What further procedural, regulatory or contractual changes would encourage increased on-screen trading through Wallumbilla GSH and would support your gas portfolio needs?</p>	<p>Participants typically prefer off screen trading if they have legacy arrangements in place, established relationships with brokers or the resources to negotiate trades. In contrast, new entrant participants are less likely to benefit from off screen trading because they do not have the same resources, relationships with brokers, or legacy arrangements to leverage. As such, new entrant participants are more likely to utilise on screen trading.</p> <p>Participants have also indicated to us a preference for off screen trading to avoid paying GSH fees, and a preference for negotiating and executing transactions over the phone rather than through the GSH trading platform.</p>
47	How important is it to you to ensure confidentiality of commercial terms like price and volume when trading? To what extent would the option to anonymise delivery of gas at Wallumbilla GSH (outlined above) address confidentiality concerns?	
48	Are there any regulatory or other barriers preventing the entry into the market, or effective operation, of brokerage service providers?	

Section 5.3 Potential government support for infrastructure

No	Questions	Feedback
49	<p>Do you think that government support for infrastructure would be an appropriate means of helping achieve the objective of more liquid trading in capacity/gas?</p> <p>(a) Is there a risk that government support could crowd-out and displace private investment?</p> <p>(b) Is there a role for the market bodies or government as independent owners or operators of infrastructure, including as an independent operator of the Wallumbilla GSH?</p>	

Section 5.4 Access to regional pipelines

No.	Questions	Feedback
50	<p>Do you see regional pipeline access as an issue that requires addressing as part of achieving the Energy Ministers' objectives?</p> <p>(a) Does the ACCC's proposed capacity surrender mechanism represent an appropriate means of addressing regional pipeline access issues?</p> <p>(b) Do you have comments on the other potential options which have been explored above? If so, please explain.</p>	<p>As part of assessing registrations, exemptions and performance of the DAA, the AER has observed limited interest in the auction on regional pipelines. Our reporting on the DAA has highlighted that major routes have been commonly used for generator assets and for arbitrage between gas commodity markets (particularly between Sydney/Victoria and Wallumbilla). However, participants have indicated a preference for firm rights (rather than relying on the potential for available capacity) in selling gas to regional pipeline users. This has happened recently, with another retailer taking firm capacity as a second shipper on the Carisbrook to Horsham Pipeline. These observations indicate that other interventions such as a capacity surrender mechanism (of firm rights) may be more effective in promoting new entry on regional pipelines, rather than the DAA.</p>
51	<p>In terms of an implementation roadmap, what importance would you place on addressing this issue and how quickly it needs to be addressed?</p>	