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5 December 2016

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

Submitted online via the AEMC website

Dear Mr Pierce

Re: Review of the Victorian Declared Wholesale Gas Market (GPR0002)

Gas Trading Australia Pty Ltd (**gasTrading**) appreciates the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) Victorian Declared Wholesale Gas Market (**DWGM**) Draft Final Report (**Report**).

gasTrading was established in 2007 to assist in the smooth and efficient operation of gas sale and transportation contracts. The increasing cost of natural gas, and the reduced flexibility of gas contracts, has made the management of these contracts a vital part of corporate planning for any company which uses natural gas. A need to manage the under and over supply of companies' gas positions led gasTrading to develop the gasTrading Spot Market™. By initially offering a platform for the sale and purchase of natural gas between clients, win-win outcomes were realised for all parties. The gasTrading Spot Market™ has grown considerably since its inception in July 2009 and now services a market much wider than was initially the case. As of the 30th of November this year the last seller of "distressed gas" ceased to participate in the market as a regular seller. Almost every shipper on a major pipeline in Western Australia has now contracted in some way to use the gasTrading Spot Market™.

gasTrading appreciates the work that the AEMC has done to date on the review of the DWGM, and notes that the Report provides important further detail on the AEMC's deliberations for DWGM reform. gasTrading also wholly supports the Council of Australian Government Energy Council's (**COAG**) 'vision' of a liquid wholesale gas market – including the ability to readily move gas between trading locations. We also believe that while the current DWGM works reasonably well for the membership group most of the time, there is a definite need to improve the current DWGM Rules. Our concern is that it is the market rules themselves that have discouraged gas users from becoming whole of supply chain gas buyers and thus entering the market as active "buyers". The market rules themselves and the risk of direct market participation act as insurmountable barriers to entry for many gas users.

This submission mainly provides comment on the Final Report by PricewaterhouseCoopers Australia (**PwC**) on the 'Cost benefit analysis of the Victorian Declared Wholesale Gas Market reforms' (**PwC Report**). In our opinion, the PwC Report is over-stating the net benefit to gross domestic product (**GDP**) for the following reasons:

- The **capital productivity shock to industrial users** of 5% from being able to source additional gas seems too high. Firstly, the report makes the ill-founded assumption that industrial customers will seek additional gas. Industrial gas consumption is a derived demand and the creation of a trading platform does nothing to stimulate demand unless it goes fundamentally to the price of their final product and thus the size of the final product market. Further, industrial users will only be able to source a small percentage of their supply from spot gas and other future contracts, but not their entire gas supply.

  A significant portion of their gas supply is still likely to be purchased under long to medium term contracts. The AEMC Recommendations are focused on gas supply mechanics on the east coast of Australia and do not address the drivers of gas demand, it is simply changing the rules for trading spot gas in Victoria. So, although industrial users may be able to source a small percentage of their gas requirements from flexible sources, this cannot possibly translate to a 5% capital productivity shock.

  Of course the argument for a capital productivity shock to industrial users of 5% is predicated on the active participation of LNG producers in the contract and spot markets for gas. In such circumstances, any capital productivity shock gain to industrial users can be expected to apply to a much diminished industrial sector, so the benefits, if any, will be similarly much reduced.

- The impact of the **total factor productivity shock to LNG producers** on GDP will be negative, not positive. LNG plant disruptions will increase gas supply to the spot market, causing downward pressure on prices. It is even conceivable that the LNG producers will be selling this gas at a loss, as can be currently seen on the Wallumbilla Gas Supply Hub (**GSH**).

  However, any gas sold by LNG producers in the spot market will simply displace gas that would have otherwise been supplied under contract from higher price spot sellers. Thus the total factor productivity shock benefit to LNG producers, if any, will be, of necessity, more than offset by the loss of gas sales by others.

- A positive shock of 1% to **LNG exports** (we assume income) also seems a bit high. Data from 'www.gasbb.com.au' shows that 3,430TJ was delivered to Curtis Island on 29 November 2016. To put this in perspective, 34.3TJ (1%) would have to be purchased **per day** to obtain a 1% positive shock.

  Even should this unlikely situation apply on 365 days of the year there is no basis for arguing that the gas is additional gas sales. This gas is more likely to be gas appropriated from the market by contesting price and there is no consideration of the contribution GDP lost from the parties who failed to secure the gas they need to make widgets.

- A **productivity effect** of 4.9% across all gas users derived from improved risk management options and a lower cost structure suggests that on average 5% of all employees' time is used to extract greater value from managing gas. A modest productivity effect may apply to a small proportion of employees in a company, but not the entire workforce. Further, those companies who fail to secure gas from the spot market will have (at least theoretically) incurred the same cost to manage gas and they do to secure the spot gas. Also, if such productivity gains are included in the analysis in their own right, then great care needs to be taken to avoid double counting the effect if they are also included in the trading effect.

In simple terms gasTrading's concerns with the PwC Report is that it is predicated on the existence of highly sophisticated and fully integrated gas contract and spot markets from day one of the market. In that world with an optimised contract/spot structure it may be true that GDP may slightly be enhances by the spot market. However, in the absence of such optimum structures a spot market will simply manage the turbulence on the fringe of the contract market. Over time, depending on the success of the spot market, the contract market may be reinvented to enhance productivity and GDP. In Western Australia this process has only begun after half a decade and still has a long way to go. In the intervening period, there is little argument that GDP will grow. It is far more likely to simply be reallocated around the players and, given that any benefit will flow to the lowest price suppliers, the likely outcome is that GDP will fall, not rise.

We do note that in the Sensitivity Analysis, the Low scenario has a lot of the variables set to 0. We would argue that this may in fact be the High scenario, for the reasons stated above.

Even if all the assumptions that produce the modelling outcomes in the PwC Report are sound, the PwC Report represents:

- a 100% guaranteed cost to the industry (central estimate of $100m);
- a model producing numbers suggesting a possible increase to GDP;
- a failure to properly understand the nature of demand for gas; and
- in other words, a gamble on an unproven case.

In the comments above gasTrading is not questioning the PwC model's capacity to model the GDP of Australia. However, we are not comfortable with the design and the assumptions used in the model in this particular application. We would ask the AEMC to consider what the implications would be if the GDP outcomes forecast by PwC failed to eventuate.

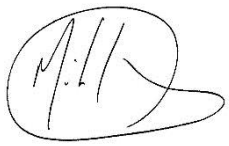
In summary, our comments regarding the AEMC's Recommendations (in particular Recommendations 1, 2 and 3) if they are based on the PwC modelling are that:

- the result will be a certain and significant uncapped cost to the industry;
- there may, or may not, be in a corresponding increase in GDP;
- in our opinion (and in the opinion of the majority of industry representatives that we have spoken to), there are more appropriate ways to improve the DWGM without the need for placing a heavy burden on the industry; and
- the case has not been made that there is a material benefit from these Recommendations.

gasTrading's strong view is that changes to the DWGM (and to the Short Term Trading Markets as well) that remove barriers to entry for gas users wishing to become participants in the market as buyers is the key to improved competition and productivity. You simply cannot have a market if you do not have buyers. What we have at the moment is, at best, a club.

Thank you for the opportunity to lodge this submission. gasTrading trusts that the comments provided in this response are of assistance to the AEMC in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact Saul Milner on, telephone, 03 9653 6489.

Yours sincerely



Mike Lauer
Director