



**Interim Report to the
Energy Users Association of Australia
on the
Development of the
Gas Short Term Trading Market**

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Introduction

This is a brief interim report to the Energy Users Association of Australia (EUAA) on the development of the short term trading market in gas (STTM) to the end of 2008. Ross Calvert Consulting Pty Ltd has been representing the EUAA on the STTM Steering Committee and Working Group to ensure that the interests of major gas users are taken into account in the design of the STTM. This report is being provided as one means of informing the EUAA membership of progress in the development of the STTM.

The STTM is a wholesale day-ahead market where suppliers and sellers can trade gas at a hub. The market establishes a daily hub price for gas and schedules gas to be shipped to the hub and for delivery at the hub. It is fundamentally different from the current Victorian gas market which operates on a market carriage basis. In the Victorian gas market a consumer does not require a contract with a pipeline owner or gas producer but also cannot contract for the right of access to system capacity. The STTM will operate in conjunction with existing and future bilateral contracts between gas market participants.

It is expected that the STTM will facilitate greater opportunities for participants in the gas market to trade in gas rather than being solely reliant on bilateral arrangements. For example, an industrial user might not require normal quantities of gas because a section of its plant is involved in a short term shutdown. The STTM will enable that user to make its surplus gas available to the short term market. Another gas user may have the opportunity to secure an order but lacks access to sufficient gas to fill that order. The latter user could purchase gas from the market. Many major gas users will have a level of gas demand which varies somewhat over the year. However their contracts must provide for their maximum daily quantity (MDQ) even if they reach MDQ on rare occasions. Under the existing gas access regime such users are able to trade gas (and pipeline system capacity) bilaterally but the opportunities for such trade are limited. Moreover, the increasing use of natural gas for power generation will greatly increase opportunities for trade in gas. Hence the advent of the STTM in June 2010 will be timely.

The STTM will be established initially with hubs at Sydney and Adelaide. A Canberra hub is currently under consideration. It is expected that additional hubs will be developed later.

Market Operator Service

Because the physical dispatch of gas is a different process from the market scheduling of gas, it is possible that these schedules will differ, thus giving rise to a deviation from the market schedule. Moreover, uncertainty of actual gas demand on a particular day may create further differences between the gas scheduled by pipeline operators and the gas that actually flows, generating additional

deviations. A contract service called the Market Operator Service (MOS) will enable physical balancing to occur with deviations settled via the market.

Market Governance

The STTM will be established under the National Gas Law, based on policies set by the Ministerial Council on Energy. The market will be operated by the Australian Energy Market Operator (AEMO) in accordance with the National Gas Rules. The National Gas Rules will be administered by the Australian Energy Market Commission and regulated by the Australian Energy Regulator.

Development of the STTM

The Gas Market Leaders Group (GMLG) is the principal governing body for the STTM Establishment project until AEMO is formed in July 2009. The responsibilities of the GMLG for the STTM Establishment Project include:

- establishing strategic direction, objectives, and priorities for the STTM Establishment Project, and approving a project charter to reflect this;
- approval of key plans, strategies and budgets, and any variance of these;
- approval of key market design and other policy decisions;
- setting delegated authorities for the STTM Establishment Project;
- providing advice and direction to the Chief Executive Officer of VENCorp (with respect to the STTM) – including resolution of issues escalated to it by the same;
- providing assurance to government, and other stakeholders, of program progress; and
- delivering a STTM that addresses the augmented national gas market principles that the Ministerial Council on Energy has endorsed.

In late 2008 the GMLG confirmed June 2010 as the date for STTM commencement.

The STTM Steering Committee manages the industry-wide program of change related to the STTM on behalf of the GMLG. The Steering Committee reports all outcomes and decisions to the GMLG and is given direction from the GMLG on all material matters.

The STTM Working Group is the principal forum for industry consultation on a wide range of topics relating to the business requirements for the market. This includes all market design matters, the market rules, formal market procedures, business issues related to systems (other than technical issues), and market readiness. The STTM Working Group currently meets weekly and outcomes are reported to the Steering Committee.

A Technical Liaison Group to cover Information Technology issues has recently been convened as a forum for industry participants.

Figure 1 below illustrates the relationships between these groups.

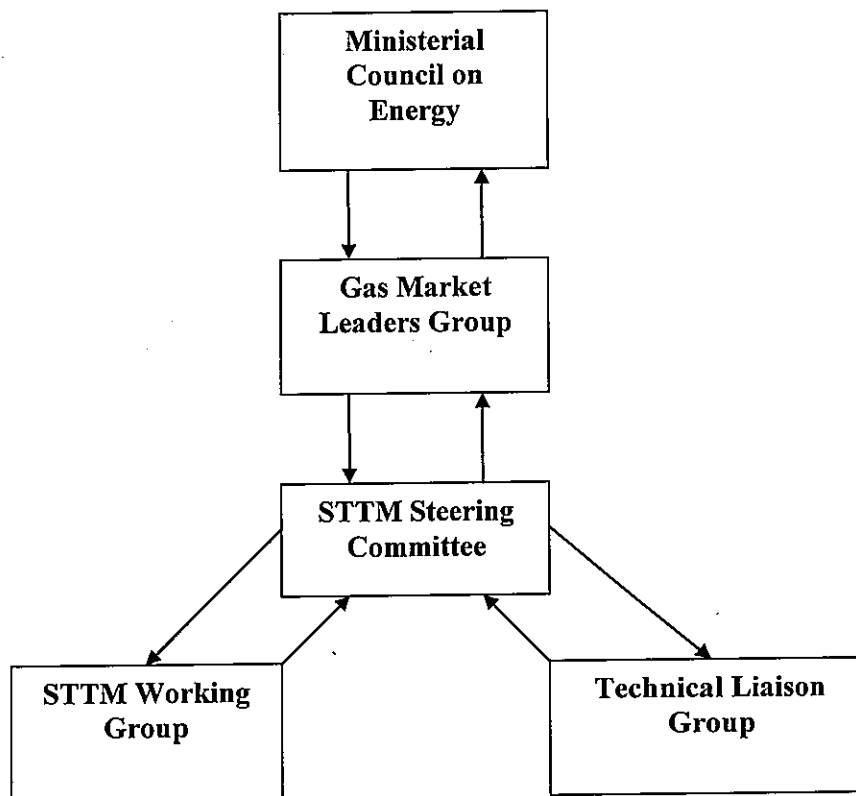


Fig. 1: Groups involved in development of the STTM

Phase 1 Development

Phase 1 of STTM development was completed on schedule in November 2008. Its scope covered:

- basic design of MOS;
- the form of bids and offers;
- market clearing logic;
- establishment of the market price; and
- calculation of deviations and variations.

A paper trial conducted in November 2008 covered a number of scenarios, including typical winter load days with and without large imbalances. It yielded no particular surprises in its outcomes but the potential was noted for significant costs to be incurred for deviations when the market price is high. An industry workshop on the paper trial will be conducted in early 2009.

Phase 2 Development

The second phase is concerned with detailed market design. Its scope is to specify the detail of how the various elements of the market will operate so that functional specifications for market systems can be developed, thus enabling software development to proceed. This phase is scheduled for completion in late January 2009.

Phase 3 Development

Phase 3 is scheduled for completion by April 2009. This will include development of rules and procedures and the definition of terms and conditions for MOS. Changes required in retail markets for STTM will also need to be identified.

Market Trial

An important element of preparation for commencement of the STTM will be the market trial which is scheduled to occur between March and May 2010. Prior to commencement of the trial, training will be available to market participants and suitable materials will be prepared.

Participation in the STTM Development Process by EUAA

Gas producers, pipeline operators, distributors, retailers, state market operators, power generators and major gas users are represented on the Steering Committee and Working Group. All groups are adept at representing the interests of their constituents. It is important that the EUAA continues to be represented in the process because the needs and interests of gas users must be adequately considered in the design of the market. For example, other sectors of the industry may seek to incorporate features or procedures in the market design which may assist their own sector but disadvantage major users.

An important issue considered to be in the interests of gas users is the promotion of competition at the retail level. The consistent EUAA position has been to support measures which will promote competition at the retail level as a means of providing greater choice for gas users. For example, protection of second tier retailers from extreme exposure to adverse trading outcomes has been a supported objective.

A number of EUAA members prefer to contract directly for the supply of gas rather than obtaining a bundled service from a retailer. It is quite possible that the advent of the STTM will encourage more large users to contract directly because greater liquidity in gas trading is expected. Hence as the detail

of various features contemplated for the market is debated, the EUAA will continue to support measures which may be expected to facilitate participation in the market by larger users.

Gas powered electricity generators are expected to be active participants in the market and can be expected to provide greater gas trading liquidity. While this development may be expected to assist major gas users in principle, it remains a clear objective of the EUAA's participation in the market design that specific features proposed do not serve to disadvantage major users.

Another objective is to ensure that incentives exist for long term investment in gas industry infrastructure. Hence, balancing the interests of the various market participant groups presents continuing challenges in decision making associated with STTM development. As far as practical, provision of some flexibility in the market design is also considered to be desirable. This will enable refinement or revision of certain provisions after market commencement if appropriate.

The EUAA seeks to keep its membership informed about STTM development and the potential it offers EUAA members to run their operations more efficiently and profitably. Any feedback from members is therefore welcomed. Members who wish to follow the development in more detail may be interested in visiting the VENCORP website at www.vencorp.com.au and searching via the keyword "STTM".

Kerry Connors

From: Roman Domanski (EUAA) [roman.domanski@euaa.com.au]
Sent: Tuesday, 2 December 2008 4:35 PM
To: Kerry Connors (AdvPanel)
Subject: FW: Gas Market Leaders Group STTM Project
Attachments: 081116 ltr EUAA.DOC

As discussed.

From: Roman Domanski (EUAA) [mailto:roman.domanski@euaa.com.au]
Sent: Wednesday, 26 November 2008 8:20 PM
To: Kerri Connors (CUAC) (kerry.connors@cuac.org.au)
Subject: Gas Market Leaders Group STTM Project

Dear Kerry

As you would be aware, the Panel has approved funding for a representative of EUAA to take part in the above project, which includes being our representative on the GMLG STTM Steering Committee and Working Groups. Ross Calvert is undertaking this work on our behalf. He is an expert on gas markets.

When we applied for funding, there was no information available from the GMLG about details of their process for developing the STTM. We envisaged, based on known information, that monthly meetings of the Steering Committee and Working Group would be held and that Ross would take part in there. The funds applied for provided for this. In the event, expenditure on the project greatly exceeds the budget, the reason being essentially that a number of workshops have been held by the Working Group around the development of the STTM and papers have involved more reading time than was envisaged. The attached letter from Ross explains this in more detail.

Ross' letter also envisages that there could well be other months where this happens in order for the GMLG to meet its timetable. We see the development of the STTM as an important development in gas market in eastern Australia, the need for which is heightened by factors such as the lack of any real price transparency in gas markets and the rise of gas fired generation over the next decade in response to the CPRS.

Given this situation, I thought there was a need to alert you to this situation and seek your guidance as to how we should best address it to ensure that our project stays on track and achieves its objectives, but also considering the cost implications.

I would welcome your views on this.

Regards

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