



**EnergyAustralia**

LIGHT THE WAY

15 May 2017

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Dear Commissioners

Lodged electronically: [www.aemc.gov.au](http://www.aemc.gov.au) (GPR0002)

### **AEMC, Assessment of Alternative Market Designs, 30 March 2017**

EnergyAustralia is one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market.

We are again pleased to provide comment on the work undertaken by the Australian Energy Market Commission (the Commission) on the Victorian Declared Wholesale Gas Market (DWGM) and in particular the options put forward in the recent alternative market designs paper (Paper). EnergyAustralia seeks to remain engaged through this consultation process and appreciates the opportunity to provide further feedback in this submission.

We note that the broader industry position appears to be that the high-level design put forward by the Commission offers potential improvements to some aspects of the market operation but also risks introducing deficiencies. This submission seeks to cover our views as to which of the options provided in the Paper are suitable for ongoing consideration to ensure that the best model is developed. Additionally, we consider that several of the options put forward are problematic, at best, and should be disregarded from being included in the final model.

As stated previously, our major concerns are:

- The potential volatility, loss of liquidity, and hence system security issues that will result from removal of defensive gas offers from the market.
- The risks, workload, and under-utilisation of the network resulting from overly complex capacity right processes and allocation mechanisms, including additional fixed costs on Gas Powered Generation (GPG).

Further, we continue to assert that answers to the following key questions regarding the proposed model need to be answered through the next stages in this process:

- Will the model provide barriers to efficient utilisation of the pipeline infrastructure?
- What will be the effect on liquidity due to hedging gas withheld from the market?

We provide high level comments below on our consideration of each of the options. In summary we believe that the following options are most suitable for ongoing review by the Commission, noting that we do not categorically support any of these prior to completion of a more detailed assessment.

#### Options suitable for further consideration

##### 6.3 – Zonal pricing

Our initial view is that zonal pricing may provide better incentives for market-led investment in inter-zonal pipeline capacity through a more representative price. This would likely improve trading in the market, both financial and physical. Our chief concern with this option is that it would impose additional market rules to solve for constraints that occur on very few days each year.

Some possible outcomes of zonal pricing are:

- The pricing signal may promote additional LNG capacity within the market, however it may also be that there is very little divergence in terms of prices between zones which would dampen these signals.
- It may provide some of the benefits proposed through the congestion pricing option, in that the price would be more reflective of actual supply and demand on constrained gas days.
- It may allow some customers access to cheaper gas; although we note that there is a potential for overall increases in wholesale gas prices for a larger proportion of customers, depending on the zone design chosen.
- It may be an option that is relatively less complex to implement, and the pricing separation may only occur on an infrequent basis.

While an easier option to implement than others, the complexity of the mechanism may be a concern. This includes the manner in which allocation of existing AMDQ is conducted. Further, additional details regarding the operation of inter-zonal rights and how they would be sold or traded would need to be assessed. Overall we consider that even though there are some substantial issues to overcome, further assessment of this option should occur.

##### 4.3 – Forward Physical Trading (combined with 5.3 – Exit AMDQ cc<sup>1</sup>)

The forward physical trading option is a design choice that we are likely to support and is compatible with nearly all of the new options proposed in the paper. While it does not solely address the defined problems with the DWGM, it is likely to assist with increasing liquidity in the market. Additionally, we do not see that there are substantial downsides

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<sup>1</sup> Authorised Maximum Daily Quantity Credit Certificates

to the option. Although it is not possible to predict the volume of forward trading that would be used under this option, it would go some way to addressing the current lack of flexibility in supply contracts and shortage of storage options. This may allow for more regular trade in the market than currently occurs.

The present mechanism for forward trading in the DWGM is cumbersome and presents barriers to altering a position in the market. Currently, through the accreditation of controllable quantities process<sup>2</sup>, at Longford both the buyer and seller must commit to giving up and receiving the Maximum Daily Quantity via a letter which is executed by both parties and confirmed by the Australian Energy Market Operator (AEMO). The buyer and seller also have to submit an application to change controllable injection and withdrawal quantities and only one sub-allocation is possible per participant ID. All of these factors prohibit efficient forward trading.

Of the options provided in the paper for improved forward trading, we support the progression of physical forward trading within the DWGM (4.3), specifically the sub-option of outstanding trades not automatically bid or offered into the DWGM. We consider that this option, in combination with (5.3) withdrawal 'exit' AMDQ cc would provide greater certainty for participants looking to ship gas beyond the Declared Transmission System (DTS) (eg. into Iona). The forward trading option provides access to the gas which is not automatically offered into the DWGM, whilst the exit/withdrawal AMDQ cc would allow gas to be sent out of the DWGM on a firm basis (either sold into other markets or put into storage). The combined option would be likely to improve optionality and flexibility not only within the DWGM on any given day, but improve the ability to optimise sending gas into other markets or storage on other days.

The process of obtaining the firm pipeline capacity would require detailed review in order to ensure that an additional injection AMDQ auction is avoided, as this would likely lead to extremely high clearance prices. This process would be prohibitive for new market entrants.

### 3.1 – Transmission constrained pricing schedule

Our view of this option is that constrained pricing on the injection side of the market may serve to increase prices. Additionally, there is the potential for an increase in market volatility. We understand that AEMO has proposed a Rule change that will provide constrained pricing on the withdrawal side. We believe this will remove the random element to participants having access to withdrawals without an increase on the injection side. This proposed rule would mean that price would reflect actual demand (a more appropriate value of gas). It also means that participants are better able to manage their gas portfolio by reducing the risk that their injection offers below market price are not scheduled but withdrawals are exposed to the market price. As such we consider that consideration of this option should focus on constraints within the DTS being applied to the pricing schedule when gas is being withdrawn from the market but not when being injected. This would minimise the increase of costs to customers.

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<sup>2</sup> <https://www.aemo.com.au/-/media/Files/PDF/Wholesale-Market-Accreditation-Procedures-Vic-v3.pdf>

### 3.4 – Prohibiting Physical Contracting

Our view is that this option, from a pure market design, could potentially promote liquidity and financial trading primarily because the producers are forced into the market. This design would have some level of similarity to the National Electricity Market. Instead of buying through a Gas Supply Agreement (GSA), market customers or retailers would buy derivative swap contracts directly from the producer which would reflect many of same attributes within the existing GSAs. Depending on the derivative products structure, the producers would still have the opportunity to receive the guaranteed underlying return, while trading of the financial products would create a liquid market which would encourage non-physical players (such as financial institutions) to enter the market. This could potentially improve the ability for all market participants to better manage price risk.

The implementation difficulties of this option are relatively high; however the end result is a more proven market design that may be worth further consideration.

### 6.4 – Entry/exit

At this stage we still have some level of concern with an entry/exit model, particularly with regards to the potential effects on Gas Powered Generation, however the option presented in the paper appears to be a less acute version of the option presented as part of the Commission's Draft Final Report. Although we continue to have concerns that the benefits of this design option do not outweigh the potential costs, these concerns may be alleviated through further detailed review.

#### Options not suitable for inclusion

We believe the following options should no longer be considered for inclusion in the model due to their very likely detrimental impact on the market.

### 6.5 – Point-to-point carriage on the DTS

Of the options proposed, we have the greatest concerns with regard to this option. Any mechanism that would have the effect of turning the market into a contract carriage model would compromise the DTS's position as the lowest cost pipeline system on the east coast. Any model that would result in the pipeline system having, in effect, two operators (AEMO and APA Group) would likely see inefficiencies emerge. We also consider that AEMO will have strong incentives to over-contract capacity, which would result in less firm capacity for others participants and would drive price higher.

### 3.2 – Simplified uplift

In regard to this option, we believe that any design providing lower penalty for participants who deviate from forecasts is likely to compromise the reliability and security of supply. The level of security and reliability over the life of the DWGM is testament to the incentives that uplift charges provide. We strongly consider that a level of self-curtailment has provided assistance to the market, brought about by these incentives. While it may be possible to simplify uplift charge mechanism to some extent, we do not support the removal of surprise uplift.

### 3.3 – Discrete schedules

We consider that the option to have discrete schedules is highly complex and highly administrative with no real benefits. We find it difficult to see a benefit compared to the current scheduling horizon methodology.

### 6.1 and 6.2 – Improved scheduling priority and firmer financial rights

On the information provided so far, we do not see that either of these options will provide any substantive benefits and do not support their continued inclusion in the process.

### Final comments

Given the numerous options that have been proposed and the inherent complexity that exists in selecting and integrating them into an appropriate model, we would be keen to discuss these further with the Commission. We look forward to continued participation in the development of these gas market reforms. If you would like to discuss this submission please contact me on 03 8628 1242 or Chris Streets on 03 8628 1393.

Regards,

Melinda Green  
Industry Regulation Leader