

**Mr John Pierce
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235**

7 December 2016

Dear Mr Pierce,

Discussion Paper - Victorian Declared Wholesale Gas Market

AGL welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Review of the Victorian Declared Wholesale Gas Market (DWGM) Draft Final Report (Report).

AGL has a long history of involvement in Eastern Australian gas markets and has actively participated in the various gas market reviews currently underway, wholly supporting the Council of Australian Government Energy Council's (COAG) 'Vision' of a liquid wholesale gas market.

The views expressed in this submission leverage on AGL's considerable market experience and previous contributions to the policy debate in this space.

Before addressing the matters in the AEMC's Report, AGL wishes to highlight that tightened and uncertain gas supply is the most critical issue facing the DWGM and neighbouring southern gas markets. AGL refers to the ACCC's East Coast Gas Inquiry findings on this issue, and in particular, that increasing the quantity of gas available by removing obstacles to the extraction of gas should be at the heart of considered sectoral reforms. Specifically, without increasing the flow of gas into the marketplace, the benefits of any market reform will largely be tinkering at the edges.

DWGM design

AGL considers that the DWGM is an active and essentially well-functioning gas market – which could benefit from targeted reform to address specific issues. From this generally positive starting position, AGL considers further that the wholesale replacement of the existing DWGM framework is unwarranted, and may not deliver the benefits the AEMC has outlined in its Report.

In short, whilst elements of the DWGM could be improved by implementing targeted reforms, AGL does not consider that it is as broken as the AEMC's Report appears to suggest, nor does it warrant amendment to the extent proposed.

If the industry was starting from scratch, with a blank canvas, it is possible that the DWGM market framing outlined in the AEMC's Report could be appropriate. However, given that the DWGM is an established and essentially effective market, AGL considers that the highest benefit can be derived from focusing on improvements to the existing market framework, because of the uncertainty of the proposed benefits of the AEMC's reforms, as well as the very high transition costs of moving to the AEMC's proposed model.

AGL considers that there are a number of clear strengths of the current market design, including:

- 'Open access' provided by market carriage;
- The gross pool market design with mandatory participation;
- Commodity, capacity and balancing being combined in one market, pooling liquidity;
- Intra-day bidding and pricing which, importantly, provides market participants with gas fired generation with the flexibility needed to bid these assets into the National Electricity Market (NEM) efficiently;
- AEMO's role in balancing the market; and
- A history of operation which provides market participants with greater confidence as to likely market outcomes under different market conditions.

However, AGL considers that targeted reform could address some of the market's weaknesses, including:

- Complexity of uplift cost allocation, which is negatively impacting the ability to frame an associated financial product;
- Non-firm exit rights;
- Communication of constraints and uncertainty of market outcomes with regards to the impacts of constraints or curtailment events; and
- No platform for short term forward physical trading of commodity.

It is these weaknesses that AGL considers should be the focus of policy makers in progressing DWGM reform, given that the current market design offers a number of clear strengths.

AEMC DWGM reform proposal

In its submission to the AEMC's DWGM Discussion Paper, AGL identified concerns with the proposed market framing around; financial risk management products, market based balancing reforms and the entry and exit capacity rights model. From AGL's perspective, these issues remain live in the AEMC's Report.

Additional to its earlier comments on this matter, AGL considers the AEMC's Report has not adequately addressed questions of:

- How the entry/exit model would work in practice – particularly the allocation of these rights and the potential for inefficiencies to arise.
 - o Further, the AEMC's Report does not demonstrate that the benefits of the entry/exit model are greater than those provided by the current open access model.
- How the proposed balancing reforms would work – particularly the separation of commodity and balancing, the potential for continuous balancing to further reduce liquidity in the market, and the increased costs brought about by implementation of new market systems and associated increased monitoring costs.
 - o AGL considers that there is merit in the AEMC undertaking, and presenting, analysis of 'a day in the life of' a new entrant retailer. How would a new entrant retailer manage its position in a continuous balancing market? How would it build a book?
- Whether a voluntary market (as proposed) will deliver the same amount of price transparency – and liquidity – as is currently delivered by the mandatory gross pool market.
 - o If liquidity reduces as a result of the transition to a voluntary market, this will reduce the likelihood of a financial market developing.

- Whether the proposed market design changes would enable market participants who have to manage gas fired generation assets to effectively bid these assets into the market on the gas day.
 - o Fundamentally, the proposed market changes should not in any way negatively impact the flexibility in the bidding of these assets into the NEM.
- How, in transitioning to the AEMC's proposed market design, the issue of existing capacity rights will be addressed.
- How constraints in the AEMC's proposed market design would be managed and the costs allocated to participants.

Conclusion

AGL asserts that the DWGM's underlying market design is not fundamentally 'broken' and therefore does not require replacement or 'fixing' to the extent proposed in the AEMC's Report. AGL therefore supports an approach to reform that specifically targets issues including:

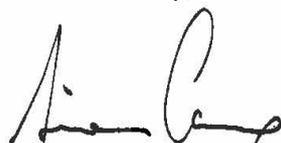
- The complexity of uplift costs allocation;
- The communication of constraints and uncertainty regarding market outcomes in constraint or curtailment events;
- The lack of firm exit rights; and
- The lack of a platform for short term commodity trading.

AGL considers that a targeted reform approach will drive the best outcomes for the market and market participants (both new and existing), delivering a market that minimises complexity and enhances liquidity – at a lower cost than a wholesale reframing of the market.

Finally, AGL wishes to direct the AEMC's attention to a piece of work recently completed by Seed Advisory, on behalf of Victorian Gas Market Participants, on the AEMC's Review. This work is provided at Attachment A. In summary, this piece of work notes the benefits of changes to the current market design (as opposed to wholesale reform), suggesting that a hybrid approach which integrates the best features of the DWGM and the AEMC proposal would achieve the best result for the market and market participants. AGL supports the conclusions of this work and considers that it raises a number of specific issues in relation to the AEMC's proposed approach which are worthy of the AEMC's consideration and response.

If you have any queries about the submission or require further information, please contact Liz Gharghori at lgharghori@agl.com.au or on 03 8633 6723.

Yours sincerely,



Simon Camroux
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