AGL Energy Limited
ABN: 74 115 061 375

699 Bourke Street
Docklands
Victoria 3008

Locked Bag 14120 MCMC
Melbourne VIC 8001

T: 03 8633 6628
F: 03 8633 6974
www.agl.com.au

A few words.

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

Submitted online via www.aemc.gov.au

Reference GPR0002

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) Discussion Paper (the Paper).

AGL has a long history of involvement in Eastern Australian gas markets and aside from delivering gas to its numerous customers, AGL also utilises gas in power generation, is a gas 'shipper' and owns gas facilities. AGL has also actively participated in the various gas market reviews currently underway, including the ACCC East Coast Gas Market Review. The views expressed in this submission leverage on AGL's considerable market experience and previous contributions to the policy debate.

At the outset, AGL recognises the considerable effort by the AEMC in completing the review of the DWGM thus far, including the AEMC's suggested recommendations. AGL 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.

The DWGM is an active and largely well functioning gas market, and whilst AGL sees benefits to implementing exchanged based trading, it considers that the proposed reforms in broad require further detail and analysis. Specifically of the impacts and implications of the proposed changes which will facilitate a full assessment of their merits.  Further, and as a possible first step, AGL considers that an effective way of opening up the Victorian gas market – and facilitating the export of gas – may be through focusing specifically on existing congestion issues which could be resolved through incremental adjustments to the DWGM.

The following sets out AGL's considered position on the proposed reforms.

***Financial Risk Management Products***

AGL acknowledges and shares the AEMC's goal of developing the derivatives market in Victoria as an effective means by which to enhance market risk management and price transparency. However, AGL is uncertain that the proposed reforms will increase liquidity in Victorian gas derivatives, such as the Victorian Gas Futures listed on the ASX, until such time as the following market issues are addressed.

Firstly, AGL considers that there would need to be some involvement from gas producers themselves. There is currently little incentive for participants to trade derivative products as the traditional sellers of derivative products – producers – currently sell gas through bilateral gas supply agreements, rather than through the spot or derivatives markets (as is the case in the National Electricity Market). Therefore trading on the derivatives market will likely be limited to residual volumes of gas between participants with Gas Supply Agreements.

Secondly, AGL suggests a potential reason for the lack of liquidity in the Victorian gas derivatives market could be the limited amount of 'market making' that has occurred to date; this is a necessary element to facilitate trade and encourage interest. Accordingly, it may be necessary to revisit the specification of the Victorian Gas Futures contracts on the ASX to ensure it represents the best product for participants to manage their risk. This could be achieved via an industry survey or forum aimed at addressing what products and specifications will attract participants to the exchange. This approach may then create the momentum to incentivise others to participate.

Fundamentally, AGL considers that if the aforementioned issues can be addressed it may facilitate the further development, and greater use of, the Victorian gas derivatives market.

***Market Based Balancing Reforms***

AGL has a number of specific concerns with moving to a market based balancing mechanism. This is because it may not necessarily result in increased liquidity in the trading market – as participants may continue to rely on bilateral arrangements rather than the voluntary market in order to remain in balance and not be exposed to relevant penalties. Consequently, if the market for balancing gas is illiquid, this will create a barrier to entry for new retailers, due to the spread between bids and offers and possible increase in balancing costs (including any associated penalties).

In relation to the 'continuous' or 'fixed period' balancing proposals specifically, these proposals may not address the issue of incentivising participants to trade on the voluntary exchange. A specific concern AGL has with the continuous mechanism, is that the Dutch version requires retailers to profile injections to manage load. This goes well beyond the level of control shippers typically have under their arrangements with gas producers in Australia. With regards to the fixed period proposal, AGL also has reservations with this approach as it smears the balancing costs across the market rather than adopting a much fairer 'causer pays' methodology.

Finally, both approaches will impose significant costs on participants as they will require greater monitoring and resources than the current design.

### *Entry and Exit Capacity Rights Model*

Whilst there is a need to modify the open access capacity model to help participants manage entry and exit risk (which AGL notes is a more pressing risk as participants seek to exit gas from Victoria), a further cost/benefit analysis of the entry exit model is required.

AGL considers that the proposed reform may deliver limited improvements in investment signals. Firstly, because it will be difficult to get long term price signals from market participants. Evidence indicates that participants are increasingly entering into shorter term (three years or less) supply contracts. Shorter term supply contracts will prevent investment signals being made known for periods longer than the contracted supply timeframes. Secondly, the reform may not provide any investment signals for congestion within the network as it only captures price signals at the entry and exit points.

In addition, AGL considers that the creation of a separate market for trading capacity rights may split liquidity with the existing physical gas market. This is an issue particularly when the liquidity in the secondary gas market is still developing.

The obligation to acquire numerous entry and exit rights will also add to market complexity and costs for all market participants. Further, there exists also the real risk that a market participant may not be able to acquire sufficient capacity that aligns with their gas contracts in the short to medium term. The aforementioned issues may also act as a barrier to entry for new retailers.

Finally, AGL is unclear as to how the entry/exit model will address the risk to security of supply and congestion. As approximately 70% of the gas supply in Victoria comes from the one entry point – the Longford plant. Ensuring sufficient capacity is available to deliver gas to residential customers is a key concern. AGL considers that there would need to be entry rights at Longford allocated to participants to ensure that they are able to secure supply to meet residential customer demand.

However, this alone does not address what happens in the event of congestion. This is in contrast to the existing Authorised Maximum Daily Quantity (AMDQ) model, which provides tie breaking benefits to holders of AMDQ rights to use in the event of congestion. AGL considers that there would be merit in the AEMC considering the creation of exit rights under the AMDQ model.

## Conclusion

AGL recognises the considerable effort of the AEMC in framing its analysis, and possible solutions, in relation to the DWGM. However, AGL asserts that the underlying DWGM market design is not the reason for the lack of liquidity in the derivatives market as noted.

AGL also has reservations with regards to the proposed entry/exit capacity rights model, as it considers it may introduce additional complexity and cost – diminishing the possibility of the reforms achieving the COAG EC objective.

AGL considers that further work is now required on the part of the AEMC to specifically target reforms to the DWGM that address existing impediments, minimise complexity, and enhance liquidity.

AGL notes that the conclusions of the ACCC East Coast Gas review are imminent and that the recommendations contained therein will have a significant impact on the AEMC's recommendations and ultimately, the achieveability of the COAG EC Vision. There should clearly be close alignment between the ACCC conclusions and the AEMC final recommendations.

AGL is keen to continue working with the AEMC in delivering reforms that achieve the COAG vision and has appreciated the engagement thus far.

If you have any queries about the submission or require further information, please contact Josynta Singh at jsingh@agl.com.au or on 03 8633 6628.

Yours sincerely,

Simon Camroux
Manager Wholesale Markets Regulation