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7 February 2019

Mr Russel Pendlebury
Project Leader
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pendlebury

Consultation on Market Making Arrangements in the NEM

Ergon Energy Queensland Limited (Ergon Energy Retail) welcomes the opportunity to provide comment to the Australian Energy Market Commission in response to its consultation on Market Making Arrangements in the National Electricity Market.

Ergon Energy Retail has provided a response to each of the questions raised in the consultation paper in the attached table.

Should you require additional information or wish to discuss any aspect of Ergon Energy Retail's submission, please do not hesitate to contact either myself on (07) 3851 6787 or Don Clunes on (07) 3664 4969.

Yours sincerely

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Encl *– Ergon Energy Retail comments on the consultation paper*

Australian Electricity Market Commission - Market Making Arrangements in the NEM

Ergon Energy Retail's Response to Consultation Paper

<table>
<tr><th>Consultation Paper Question</th><th>Ergon Energy Retail Comments</th></tr>
<tr><td colspan="2">Box 1: Diagnosing the Problem</td></tr>
<tr><td>1. Is there an issue with liquidity
a. What is the issue with liquidity in the contract market. What problems have there been obtaining or selling risk management products through the contract market. How has this differed by region. What trends are observable in liquidity over time?
b. How is liquidity best measured. What is the right market to consider, the right products to include, and the right threshold to consider a market liquid. To what extent are products outside the contract market used. How does this differ by region?
c. Why does liquidity matter. Does greater liquidity benefit consumers, retailers and generators. Is it likely to enhance competition and lower the cost of electricity to end users. Is poor liquidity a temporary problem?</td><td>a. Ergon Energy Queensland Limited (Ergon Energy Retail) considers liquidity in Queensland is generally acceptable. Further, Ergon Energy Retail is of the view that with the amount of renewables coming online in Queensland, liquidity is likely to increase further in the future.
b. Ergon Energy Retail considers the Australian Stock Exchange (ASX) Electricity Futures market is the best mechanism for measuring liquidity.
A potential alternative, if made publicly available would be the Australian Financial Markets Association Electricity Derivatives Turnover Report.
c. Liquidity allows for price risk management and for the hedging of the natural position to achieve short, medium and long term revenue and cost certainty. Liquidity means contracts are more available and therefore creates a more competitive environment.</td></tr>
<tr><td>2. What are the causes of low liquidity
a. To what extent is vertical integration and the withholding of capacity by market participants to blame for poor liquidity. How does this differ by region. How has this changed over time?
b. To what extent are problems contracting for fuel supply, in particular gas, to blame for a lack of liquidity in electricity contracts. How does this differ between regions. How might these issues be resolved?</td><td>a. Ergon Energy Retail considers that in markets where the majority of the market is composed of vertically integrated participants, it can create barriers to retailers to hedge their risk.
Ergon Energy Retail is of the view that a lack of liquidity is also caused by:
• The ASX placing high margins to remove credit risk, which affects the ability for retailers to deal in the market;
• Block trades on the ASX can potentially reduce contract</td></tr>
</table>

Consultation Paper Question	Ergon Energy Retail Comments
c. What other factors are to blame for a lack of liquidity in the contract market?	availability and price discovery for market participants; and • Physical interconnectedness between states impacting liquidity in inter-regional contracting. b. The issue is highly dependent on the generation mix of specific markets. A higher share of baseload generation will generally translate into better availability of firm contracts. c. The large amount of vertical integration in southern states has severely impacted liquidity and the collateral required to trade ASX Australian Electricity futures – i.e. formulae used to calculate initial and variation margins.
3. What are the solutions to low liquidity a. What different solutions are there to a lack of liquidity in the contract market. What are the costs and benefits of these solutions. Is market making the best solution? b. How does this differ between regions?	a. Ergon Energy Retail is of the view that the issue of low liquidity should be addressed by introducing new interest into the market using incentives rather than obliging existing market participants to assume potentially unwanted positions. The solutions to introduce new interest into the market could range from a voluntary (compensated) market making obligation to opening the market to the wider range of participants. Placing obligatory contracting requirements on existing market participants does not necessarily translate into better market liquidity as it is unlikely a participant will sell or buy more contracts than its risk appetite allows. A reduction in ASX fees would also significantly negate the inability of retailers to trade efficiently due to their cash flows and reserves. b. The regional liquidity issues are largely driven by the region's physical markets, the amount of vertical integration and the interconnectedness between markets.
Box 2: Range of Options	
1. Identify your preferred option from the broad range of options listed above, and compare your preferred option to the others based on the	Ergon Energy Retail's preferred option is 1 - to 'let the market provide' the solution. Otherwise Option 2 – 'voluntary market making' would be the next

Consultation Paper Question	Ergon Energy Retail Comments
assessment criteria summarised in chapter 4, and any other criteria or costs and benefits that should be considered.	most applicable potential solution. If ultimately Option 2 was chosen, it should be accompanied by a compensation scheme for the participant.
2. What costs can be identified from the experience of other jurisdictions in relation to the different market making options listed?	No comment.
Box 3: Proposed Solution	
1. How long should a tender term be?	No comment.
2. Should the key provisions of a tender be fixed for the full term?	No comment.
3. Should a tender operate on an ongoing basis, or under a triggering mechanism?	No comment.
4. What penalties should apply for non-performance under a tender?	No comment.
5. What type of participants should be allowed to take part in a tender, physical or other providers?	No comment.
6. Should a successful tenderer be permitted to sub-contract the obligations it has entered into under the tender?	No comment.
7. How might the cost of a tender be recovered from customers?	Ergon Energy Retail is of the view that this cost should not be recovered from customers.
8. How might the cost of a tender be recovered from customers?	No comment.
Box 4: Range of Products	
1. What products should be included in a market making arrangement?	Ergon Energy Retail considers firm quarterly swaps and caps should be the products available under a market making arrangement.

Consultation Paper Question	Ergon Energy Retail Comments
2. Which markets should be included, ASX, OTC, other?	The ASX would be preferable as OTC would bring with it credit constraints for retailers.
3. Over what contract timeframe should market making be required?	Ergon Energy Retail considers 1-2 years of quarterly contracts would be adequate.
4. Over what timeframe in the trading day should market making be required?	Ergon Energy Retail considers 2-4 hours per trading day should be sufficient.
5. What maximum bid offer spread should be allowed?	No comment.
6. What minimum contract size should be required?	Ergon Energy Retail recommends 1MW, being the minimum contract size allowed on the ASX.
7. What cumulative risk exposure should be required for any participant. Should this vary by region?	No comment.
Box 5: Jurisdictional Specific Issues	
1. In which regions of the NEM is there an issue with contract market liquidity?	No comment.
2. Should a market making arrangement apply in all regions of the NEM?	No. Ergon Energy Retail is of the view that if there is sufficient liquidity in the Queensland region, there is no need to require market making obligations.
3. Should the required suite of products in a market making arrangement or obligation differ by region. If so, how should they differ?	No. Ergon Energy Retail believes the products should be standard products (firm swaps and caps).
Box 6: Commencement Date	
1. Outline the activities, costs and timelines to implement the different options for market making listed.	No comment.