



F2019/000096

15 February 2019

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

***National Electricity Amendment (Market Making Arrangements in the NEM)
Rule 2019 (ERC0249)***

Dear Mr Pierce

The Energy and Technical Regulation Division of the Department for Energy and Mining, South Australia (Division) welcomes the opportunity to comment on the Consultation Paper for the Market Making Arrangements in the NEM rule change proposal.

The Division considers that the lack of liquidity and very small volume in trading in the wholesale contract market in South Australia has been an ongoing issue for a significant amount of time.

This issue was highlighted in the Australian Competition and Consumer Commission's (ACCC) Retail Electricity and Pricing Inquiry – Final Report. The ACCC's Final Report noted that in South Australia the level of liquidity and the advantages enjoyed by vertically integrated retailers make it difficult for new entrants and smaller retailers to compete effectively in the retailer market.

The lack of liquidity in the South Australian wholesale market is also regularly referred to as a barrier to entry or expansion in the Australian Energy Market Commission's (AEMC) annual Retail Energy Competition Review. From the 2018 Review, it was summarised that the liquidity of the South Australian wholesale market continues to be the biggest issue for retailers, with many citing the limited access to competitively priced risk management products as a barrier to entry or expansion.

The Report also notes more broadly that a lack of liquidity in the wholesale contract market may create a barrier to entry and expansion for new and existing retailers. Further, that this will increase concentration in the market, reducing competitive pressures on existing retailers.

The Australian Energy Regulator's (AER) State of the Energy Market 2018 notes that while regular trade occurs in Queensland, New South Wales and Victoria, contract market liquidity is poor in South Australia.

The AER also noted that South Australia, in contrast to Queensland, New South Wales and Victoria, has trading levels well below regional demand for electricity, which it notes, is consistent with claims by retailers that the region's contracting market is highly illiquid.

The AER further notes that traded volumes also appear to be declining across the market. While it acknowledges that the decline in trade may be partly due to increasing levels of variable generation, it also notes that the decline in trade is due to the extent of vertical integration limiting businesses' need to contract with third parties.

The Independent Review into the Future Security of the National Electricity Market, chaired by Dr Alan Finkel AO, noted that submissions, particularly from major energy users and their associations, expressed that a lack of liquidity, combined with high volatility in the South Australian wholesale market, is resulting in forward contracts attracting a significant risk premium.

The Division notes that the illiquidity of the South Australian contract market is consistently raised as an issue, in particular as a barrier to entry and expansion, limiting growth of competition in the market. The Division also notes that vertical integration, while not the only factor, is consistently raised as a factor in the lack of liquidity in the wholesale market in South Australia.

The Division notes that the future operation of the Retailer Reliability Obligation in South Australia, should the reliability obligation be triggered, may be improved with a more liquid wholesale contract market in the State.

Noting the illiquidity of the wholesale contract market in South Australia, should the reliability obligation trigger, it may be challenging for some retailers, or large users that have decided to opt-in to the obligation, to sufficiently contract to meet their required net contract position.

A mechanism that will improve liquidity in the wholesale contract market would likely also assist liable entities in South Australia in meeting their obligation and to do so at a lower cost.

The Division therefore supports the AEMC's consideration of this issue and potential frameworks that would improve wholesale market liquidity across the National Electricity Market, in particular in South Australia.

While the Division, at this point in time, does have a view on the most appropriate model to address these ongoing liquidity issues in South Australia, the models presented by the ACCC and ENGIE provide reasonable starting points for consideration, in addition to voluntary and compulsory market making arrangements in other electricity markets.

The Division considers that the AEMC should ensure any model proposed will be able to work in conjunction with the Retailer Reliability Obligation and not raise significant additional costs for market participants.

Should you wish to discuss the submission in further detail, please contact Mr Mark Pedler, Principal Policy Officer, on (08) 8429 3361.

Yours sincerely



Vince Duffy

Executive Director

Energy and Technical Regulation

Department for Energy and Mining

