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GRC0050 DWGM Forward Trading Market

AGL Energy Limited (AGL) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) consultation on the Declared Wholesale Gas Market (DWGM) forward trading market rule change.

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. AGL has a long history of involvement in Eastern Australian gas markets and aside from delivering gas to over 1.4 million customers, AGL also owns and operates gas power generation, is a gas shipper and owns gas facilities across the east coast.

This rule change is proposing to introduce a gas trading hub over the Victorian Declared Transmission System (DTS) to provide market participants with an additional avenue to manage the spot price risks associated with the DWGM. As discussed in our submission to GRC0049 – DWGM Simpler Wholesale Price, AGL considers the best way to address price risk in the DWGM is to realign the pricing schedule and operating schedule. Implementing that change would improve confidence that scheduled outcomes and the spot price would reflect the supply and demand balance.

In addition, in the years since the conclusion of the AEMC's review of the DWGM, the ASX and OTC financial derivatives markets have developed DWGM-linked products. Financial risk management products complement spot markets such as the National Electricity Market (NEM) as well as the DWGM. We expect that re-alignment of the pricing and operating schedules will further improve confidence in financial products that are settled on the DWGM spot price, as the spot price would reflect the supply and demand for gas.

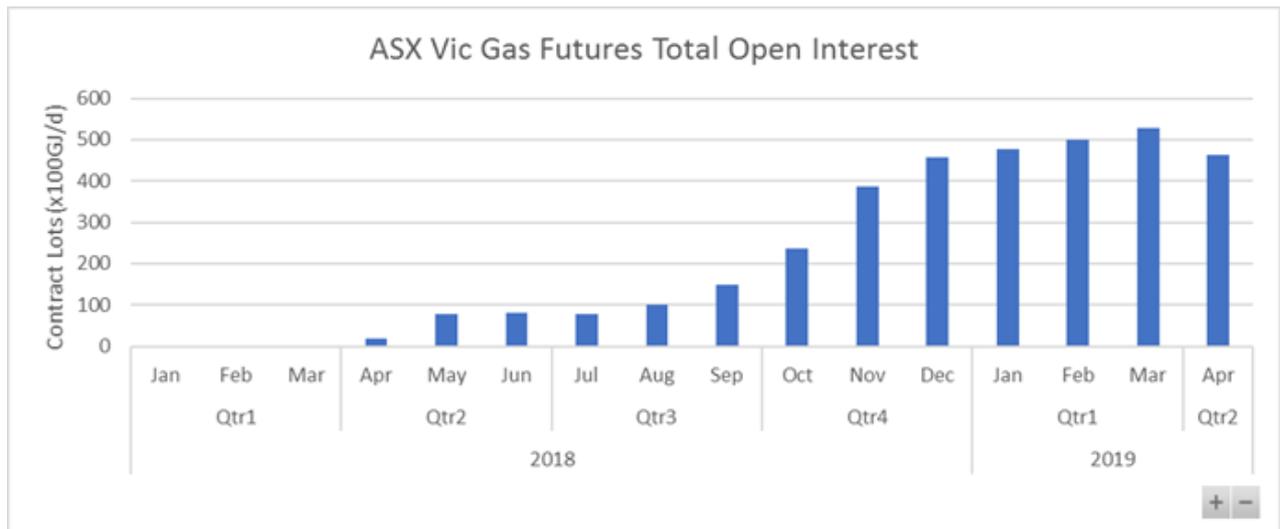
Given the development of financial derivatives to manage risk in the DWGM, and the expectation that aligning the pricing and operating scheduled will facilitate this further, AGL considers that the introduction of a forward trading market is unnecessary and may detract from the growth of the ASX and OTC markets.

Risk management in the DWGM

Over the last year, the volume of ASX Victorian Gas Futures products traded has increased dramatically. Currently, these are quarterly products that settle against the time-weighted-average of the 6am prices for each gas day across the contract period, as published by AEMO.



The graph below shows the growth in Total Open Interest in these ASX products over time, which has increased from near-zero in March 2018 to 5.5 PJ in March 2019. While this open interest is not yet at large volumes, it is a significant development from the trading activity only one year ago.



OTC contracting of Victorian Gas products has also developed over the last year. In February 2018, industry worked with the Australian Financial Markets Association (AFMA) to implement an Australian Cash Settled Gas addendum to the ISDA master agreement. This addendum covers OTC financial contracts across the DWGM and the Short Term Trading Markets (STTMs), and allows for parties to enter into more bespoke arrangements with non-standard features relating to volume, tenure and reference price, amongst others. AGL is aware that this addendum has been used to transact:

- Across multiple facilitated gas markets
- Across shorter and more bespoke time periods
- Swap products, as well as option products such as “caps” and “calls”
- Against a DWGM schedule other than the 6am schedule.

Brokers have also become involved in gas financial markets and have become a useful source of information. Some brokers have begun publishing a gas market forward curve for the DWGM and STTMs. This is more valuable to participants than price discovery from physical trades, such as from the gas supply hub. For financial trades, pricing across any period or product is usually derived from a base transparent forward curve (such as ASX settlement prices). Participants are better able to assess the “fair value” of a potential trade against a common reference.

Finally, we note that physical trading of gas occurs at Culcairn, Longford, and through in-situ account transfers at Iona. Participants that wish to secure physical gas contracts have avenues to do so.



Implications of a Forward Trading Market

AGL is concerned that the introduction of a forward trading market will compete with the financial products currently offered by the ASX or OTC markets, and will reduce liquidity to these developing markets.

In the consultation paper, the AEMC notes that financial products co-exist with the gas supply hub products at Wallumbilla. However, at Wallumbilla the gas supply hub products are for the physical delivery of gas (with penalties for non-delivery). We would not expect forward trading market products to include a requirement for the physical delivery of gas. Gas would continue to be scheduled through the DWGM and its market carriage arrangements. Participating in the forward trading market would result in the same financial flows as a hedge trade.

AGL suggests that AEMC carefully consider the implications of AEMO running a forward trading market that is effectively a financial trading market. There are certain rules and protections that apply to financial markets that prevent certain types of behaviour, such as insider trading. There could be unintended consequences if these protections do not apply. For example, there would be nothing to prevent participants from entering into forward trades based on information that is not otherwise available to the market.

We also note that, like participating in financial markets, there are costs involved in trading through the gas supply hub. Trading through the gas supply hub involves annual membership fees, prudential requirements, as well as costs for the volume of products traded. Some participants prefer to engage in OTC or bilateral contracting for this reason. AGL considers that the introduction of a forward trading market should not necessarily be viewed as a “low cost” option for participants, compared to financial markets.

If you have any queries about this submission, please contact Jenessa Rabone on (02) 9921 2323 or JRabone@agl.com.au.

Yours sincerely,

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