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Wednesday, 24 April 2019

Daniela Moraes, Andrew Pirie and Prabpreet Calais
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney, NSW 2000

Re: DWGM Rule Change Proposals (GRC 0049, GRC 0050, GRC 0051)

Dear Daniela, Andrew and Prabpreet

Thank you for the opportunity to comment on the following rule change proposals –

1. DWGM Simpler Wholesale Price;
2. DWGM Forward Trading Market; and
3. DWGM Improvement to AMDQ Regime.

About ERM Power

ERM Power (ERM) is an Australian energy company operating electricity sales, generation and energy solutions businesses. ERM has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load[1]. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the company's existing and new customer base. The company operates 662 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. ERM operates across the east coast gas market in the states of Victoria, NSW and Queensland and is a market participant in the Victoria DWGM, the Sydney and Brisbane STTMs, the Gas Supply Hubs and the recently introduced capacity trading markets.

Introductory comments

ERM is a strong supporter of the DWGM mandatory gross pool design and market carriage regime. We believe that this model has been a fundamental enabler for competition, evidenced by the relatively high level of retail competition in Victoria compared to other jurisdictions, and the diverse range of market participants active in the DWGM including large users, retailers, traders, storage providers and producers[2]. The market carriage regime allows any participant regardless of its size, to access both capacity and commodity through a transparent and economic market clearing process (unlike the contract carriage regime where smaller participants can find it difficult to contract for supply and transportation capacity due to minimum volume requirements and limitations on shaping flexibility). The mandatory gross pool regime maximizes liquidity (by ensuring that all gas flowing in the market is priced and bid into the market) and provides transparency in spot pricing. We therefore welcome the AEMC's three rule change proposals that aim to improve aspects of the current market design (rather than to unwind it).

ERM reiterates that we do not support the AEMC's longer term recommendations as outlined in its earlier Final Report on the DWGM Review, to dismantle the current market design and replace it with voluntary hub based trading model (similar to the Gas Supply Hub) with a system of entry and exit capacity rights. As discussed at

[1] Based on ERM Power analysis of latest published financial information.
[2] AEMC Final Report, 2018 Retail Energy Competition Review, 15 Jun 2018, Figure 3.6 shows Victoria as having the largest number of gas retailers in all states and territories. As at date of this submission, there are about 40 market participants (counting a company with multiple participant IDs as a single entity) operating in Victoria based on AEMO data.

length in our earlier submissions to the DWGM Review, we believe that such a change would erode liquidity, reduce transparency, and be significantly detrimental to competition.[3]

DWGM Simpler Wholesale Price

ERM supports the proposal to amend the uplift payments methodology, in particular the congestion uplift methodology (noting that our comments on congestion uplift relate specifically to the component being charged to market participants, not to the Declared Transmission System Service Provider).

The existing congestion uplift arrangements do not effectively allocate costs to their cause. This was demonstrated by the way in which uplift payments were allocated on 1 October 2016 when the Longford processing facility experienced an unplanned outage. On this day, $3.1m worth of out of merit order gas was scheduled to meet the supply shortfall. Approximately 90% of these costs were funded by congestion uplift payments.[4] While Longford shippers would have incurred some congestion uplift payments (to the extent they were withdrawing and did not have a congestion uplift hedge because they were not injecting), the current arrangements resulted in participants with no contracts for Longford gas, and who therefore had no part to play in causing the shortfall, incurring unpredictable and punitive costs simply because they had no congestion uplift hedge in the form of AMDQ/AMDQ CC and an injection at the matching location.

Under the existing congestion uplift arrangements, a disproportionately higher level of risk is imposed on participants who are purchasing from the market but not injecting (or who might be injecting but do not have matching AMDQ). Affected participants are likely to include new entrant retailers and other small participants (who are likely to find it difficult to secure contracts for small quantities of gas on competitive terms). Those wishing to buy gas from the DWGM to move to another location in the east coast gas grid also face increased risks under the congestion uplift arrangements. This outcome is at odds with recent gas market reforms that have been implemented with the objective of facilitating trading across the interconnected east coast gas market and enabling gas to flow to where it is most valued. By imposing risks on participants who are not physically injecting into the market, the congestion uplift arrangements also continue to hinder the development of financial instruments and new ways of trading.

We expect that it will be very difficult to determine a methodology (that goes further than surprise uplift[5]) that will be effective at allocating costs to their specific cause in every possible situation (given that out of merit order gas can be required in a range of different circumstances including system constraints and supply shortfalls). If costs cannot be allocated to their cause, the solution proposed by the rule change request would seem to be reasonable, that is, to allocate congestion uplift (or effectively a greater proportion of total uplift payments) on a pro-rata basis to withdrawals similar to the way in which common uplift is allocated.[6] This would result in a more even risk allocation. We would not support a smearing of costs across both withdrawals *and injections*, as this would be likely to result in gas suppliers incorporating a risk premium into their pricing to retailers (as well as retailers incorporating a risk premium into their pricing to their customers), leading to inefficient pricing outcomes and increased costs borne by gas consumers.

We agree that the market design should provide incentives for shippers to adhere to their operating schedules and forecast withdrawals as accurately as possible. This is largely achieved under the current market design by surprise uplift and deviation pricing. However there are situations when this is not achieved. For example, on 1 October 2016, AEMO issued an ad-hoc schedule (incorporating the Longford supply constraint), that replaced the 6

[3] ERM submission dated 12/02/16 on the AEMC's Stage 2 Draft Discussion Papers, ERM submission dated 29/03/16 on the AEMC's DWGM Discussion Paper, ERM submission dated 2/12/16 on the AEMC's Draft Final Report on the Review of the DWGM of Victoria, ERM submission dated 11/05/17 on the AEMC's Assessment of Alternative Market Designs paper.
[4] AER, Significant Price Variation Report, Longford Facility Outage, 1 October 2016, 21 December 2016.
[5] Surprise uplift payments are allocated to deviations that cause the system to be short and to intraday increases in forecast or scheduled withdrawals.
[6] If congestion uplift is removed, amendments will need to be made to AEMO's Wholesale Market Uplift Payment procedures to reflect the way in which total uplift payments will be apportioned across the various categories of uplift.

AM operating schedule (noting that the 6 AM price was not revised, which is the process required under the rules). The effect was that those who failed to deliver gas in accordance with the original 6 AM schedule had minimal deviations and hence minimal exposure to deviation payments and surprise uplift. This is another part of the market design that would be worth reviewing.

We also agree with the proposal to require constraints on controllable withdrawals to be included in the determination of the pricing schedule. The current approach of ignoring such constraints can distort market prices and result in scheduling outcomes that are confusing and unpredictable, creating risks for market participants. When controllable withdrawal constraints are ignored and infeasible controllable withdrawal bids included in the pricing schedule and later removed in the operating schedule (OS), AEMO will also constrain down injection bids in the OS (in order of price, and regardless of location) by an equivalent quantity. The impact of this is that supply offered in at prices lower than the market price may not be scheduled in the OS. Affected shippers are therefore exposed to the risk of not being able to inject gas to hedge a position, and may face prices up to $800/GJ. These are all suboptimal market outcomes.

DWGM Forward Trading Market

ERM believes that the proposal to implement a forward trading market (FTM) over the DWGM has its merits. However, since this proposal was first floated in early 2017, the trading of ASX Victorian gas futures has steadily increased. Should a new FTM be introduced, liquidity in the ASX gas futures market is likely to be diluted with trading activity being dispersed across the two different markets. This would not be an optimal outcome.

The ASX product has its advantages given its alignment with electricity financial instruments. Given that we are already seeing a growing number of derivative transactions in the market, it could be beneficial to place the rule change on hold while allowing further time for the ASX market to continue to develop. If the AEMC decides to proceed with the proposed FTM, the costs of implementing such a new market would need to be considered.

Improvements to AMDQ Regime

ERM recommends consideration of an alternative approach that involves phasing out the AMDQ regime after the conclusion of the current 5 year access period. In the event of tied bid or offer prices, scheduling could be done on a pro-rata basis. We do not believe that the discontinuation of the AMDQ regime would have an adverse impact on DTS pipeline investment. In our view, pipeline investment decisions should be undertaken through the existing regulatory process (similar to other regulated network assets). Capacity based instruments (such as AMDQ) that are created with the objective of providing signals for and encouraging market led investment, are unlikely to be effective under a market carriage regime given that it is a market clearing process that ultimately determines the allocation of both capacity and commodity. We believe that trying to implement capacity rights over a market carriage regime creates unnecessary complexity with little benefit, and potentially creates barriers to entry if new entrants or growing participants trying to diversify their supply portfolio are unable to access rights that have been fully contracted.

Should the AEMC decide to retain the AMDQ regime, we would be supportive of improvements to make it easier to trade AMDQ Credits and AMDQ. However we believe that the proposals need to be fleshed out in further detail and a cost benefit analysis undertaken for some of the proposals (e.g. introducing a trading platform). Notwithstanding our comments in the prior paragraph, we believe that the proposed improvements can occur regardless of whether the proposals under “Simpler Wholesale Market Price” are implemented. Even if the “Simpler Wholesale Market Price” changes are introduced, AMDQ will still have some value in the form of tie breaking rights.

Other comments

Due to the complex and technical nature of the rule changes being proposed, we recommend that the AEMC work with AEMO and in close consultation with industry, to develop the details of the rule changes. This will also help to ensure that all industry stakeholders are given an opportunity to fully understand the proposals and the impacts.

ERM looks forward to working with the AEMC to further progress these rule changes. We would also welcome a discussion with the AEMC to elaborate on the views expressed in our submission.

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