



1 May 2019

John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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Submitted online: www.aemc.gov.au

Dear Mr Pierce

Declared Wholesale Gas Market Reforms – Consultation Papers

Origin Energy Limited (Origin) welcomes the opportunity to provide comments on the Australian Energy Market Commission's (AEMC) Declared Wholesale Gas Market (DWGM) Simpler Wholesale Price, Improvement to Authorised Maximum Daily Quantity (AMDQ) Regime and Forward Trading Market Consultation Papers.

Origin supports the overarching objective of the DWGM reforms under consideration, which is to reduce market complexity and improve the ability for participants to manage wholesale market risk. We also agree an incremental and targeted approach to reform that seeks to preserve the benefits of the existing framework while overcoming perceived shortcomings, is the most appropriate way to meet this objective.

In Origin's view, the proposals to establish a voluntary forward trading market (FTM) and improve the tradability of AMDQ and AMDQ Credit Certificates (AMDQcc) rights are relatively light-handed reforms that should be implemented. Collectively, these will enhance the ability of market participants to manage their exposure to the wholesale market price through more flexible access to supply contracts and the tie-breaking rights provided by AMDQ/AMDQcc.

Careful consideration will need to be given to the other, more significant measures being proposed. This will help in understanding the extent to which they are likely to satisfy the stated objectives and whether there are any associated trade-offs. Key issues for consideration in this respect are noted below.

- Socialising congestion uplift: Socialising congestion uplift would simplify the existing framework and potentially improve the ability of some participants (particularly new entrants) to both understand and manage their exposure to uplift. Provided AMDQ/AMDQcc still provides rights holders with tie-breaking priority, the value of AMDQ/AMDQcc to market participants would also not be significantly undermined by the change. However, such a change is unlikely to address all the factors that may limit the use of financial derivatives.

There is also a risk the removal of the current causer pay's approach could result in higher levels of congestion if market participants are not exposed to an appropriate share of the associated costs. The potential impact of gas-fired power generation (GPG) on the market is an area of concern in this regard. GPG has the potential to create significant congestion in the DTS, particularly during winter periods and intraday when GPG demand has not been forecast. At present, the impact of GPG may be moderated by the fact that operators face exposure to uplift for any congestion they cause. Socialising congestion charges could change this dynamic and expose other market participants to a disproportionate share of congestion costs caused by GPG.

If congestion uplift is to be socialised, consideration should therefore be given to the treatment of GPG to ensure they continue to face incentives to minimise congestion.

- Application of constraints in the Declared Transmission System (DTS): Internalising withdrawal constraints in the pricing schedule may not fundamentally improve the ability of participants to manage price and volume risk in the market, noting risks can be managed under both frameworks. The proposed change would simplify the existing framework by creating greater alignment between the pricing and operating schedules under certain circumstances. However, given the change is only intended to address those circumstances where a withdrawal constraint is offset by a reduction in injections (and therefore no uplift payments are required), it is unlikely to improve the ability of participants to manage congestion uplift more broadly.
- Entry and exit AMDQ/AMDQcc: Origin does not agree that entry/exit AMDQ is needed to facilitate investment in the DTS. The AEMC has noted the point-to-point nature of AMDQcc rights and first-come-first-serve process for nominating those rights to a system withdrawal point may be impeding market-led investment. This is because participants may not always be able to nominate newly acquired AMDQcc to their preferred withdrawal point (even if they have underwritten the investment), as another participant could nominate their AMDQcc to that withdrawal point first. More defined entry/exit rights would likely assist with addressing this uncertainty. However, this aspect of the framework has not fundamentally impeded investment in the DTS, given significant market-led investment has occurred at other points of the DTS in recent years. To the extent any investment concerns are limited to specific points of the DTS, these may be best addressed through the regulatory investment framework rather than fundamental changes to the AMDQ/AMDQcc regime
- AMDQ/AMDQcc tenures: To adequately manage the long-term risks of participating in the DWGM, it is important market participants are able to align the acquisition of AMDQ/AMDQcc with transportation/supply contracts outside of the DTS. The introduction of reduced tenure rights could give rise to coordination issues in this regard, potentially limiting the ability of market participants to build supply paths in/out of the DTS. It is therefore essential that participants can continue to access long term tenures. Improving the tradability of AMDQ/AMDQcc should also mitigate the need to allocate a significant portion of AMDQ/AMDQcc under short-term tenures.

Given the interrelated nature of the rule changes under consideration, Origin has provided consolidated feedback on the three individual Consultation Papers in Attachment A. If you wish to discuss any aspect of this submission further, please contact Shaun Cole at shaun.cole@originenergy.com.au or on 03 8665 7366.

Yours Sincerely,



Steve Reid
Group Manager, Regulatory Policy

1. Simpler wholesale price

1.1 Socialising congestion uplift

Market participants generally manage long term price risk within the current framework by trading gas bilaterally outside of the DTS and ensuring participation on both sides of the DWGM (i.e. offering gas to the market and at the same time bidding to have it back). Unlike the electricity market, there has been limited reliance on the use of financial risk management products to date, largely because not all trading risk is captured in a single commodity price in the DWGM. Due to separate uplift/deviation charges and the existence of multiple pricing schedules, hedging the commodity price using a financial derivative can still expose traders to other price risks.

A purported benefit of socialising congestion uplift is that it will address this issue and better enable market participants to manage their price risk. In Origin's view, socialising congestion uplift is unlikely to address all the factors identified above that may limit the use of financial derivatives. Nonetheless, the proposed rule would represent a simplification of the existing framework and potentially improve the ability of some participants (particularly new entrants) to both understand and manage their exposure to uplift. Provided AMDQ/AMDQcc still provides rights holders with tie-breaking priority, the value of AMDQ/AMDQcc to market participants would also not be significantly undermined by the change.

A key issue that must be considered by the AEMC is the potential impact that socialising congestion uplift may have on participant behaviour in the market. While demand driven congestion in the DTS has been rare in recent times, it is possible this dynamic could change in the event participants do not face an appropriate share of the costs of any congestion they may cause. An area of concern in this regard is the potential impact of GPG on the market.

GPG demand has the potential to create significant congestion in the DTS, particularly during winter periods and intraday when GPG demand has not been forecast. Market outcomes in winter 2007 should be considered in this respect, given there was a coincidence of record GPG demand and large ancillary payments totalling \$47 million.¹ The Australian Energy Market Operator's (AEMO) Winter 2018 Operations Plan also noted the ability of the DTS to support GPG demand that has not been forecast is reduced due to limited line pack.²

At present, the impact of GPG on the market may be moderated by the fact that those market participants face exposure to uplift for any congestion they cause. There is a risk that socialising congestion charges could change this dynamic, an outworking of which could be higher GPG utilisation and increased levels of congestion in the DTS during peak winter periods.

It would be a perverse outcome if the socialisation of congestion charges resulted in higher levels of congestion and exposed certain market participants to a disproportionate share of the associated costs. We therefore believe that if this option is to be progressed, consideration should be given to the treatment of GPG to ensure they continue to face incentives to minimise congestion.

1.2 Application of constraints in the DTS – internalising withdrawal constraints in the pricing schedule

Origin does not consider that internalising withdrawal constraints in the pricing schedule will fundamentally improve the ability of participants to manage price and volume risk in the market, noting risks can be managed under both frameworks. The proposed change would simplify the existing framework by creating greater alignment between the pricing and operating schedules under certain

¹ AEMC, 'Victorian DWGM Review – Discussion Paper', September 2015.

² AEMO, 'Victorian gas operations plan – Winter 2018', May 2018.

circumstances. However, given the change is only intended to address those circumstances where a withdrawal constraint is offset by a reduction in injections (and therefore no uplift payments are required), it is unlikely to improve the ability of participants to manage congestion uplift more broadly.

1.3 More cost reflective congestion uplift payments and directional flow point constraint pricing

A trade off associated with the gross pool, open access framework is the absence of locational price signals. As a result, the allocation of congestion uplift to causers and signals for investment within the system are likely to be imperfect. Scenarios can also arise where additional injections/withdrawals upstream of a transportation constraint could technically occur if the buyer at that location valued gas above the common price and the seller was able to access that higher price.

These issues would likely be best addressed through the creation of distinct trading zones in the DTS, largely as defined by the AEMC in its earlier review of the DWGM. Establishing trading zones across the DTS would provide greater market transparency, better signal where constraints occur and assist with compartmentalising the cost of congestion within a single zone. Because market participants would have greater confidence in the pricing outcomes observed at each zone, financial derivative products could also emerge and evolve in such a way that they reference trading outcomes within a single, more liquid zone, or even the weighted-average of prices observed across the market.

It is not clear the absence of more granular price signals is materially impeding the efficiency of the DWGM. As such, the justification for introducing additional trading zones may be limited at this time. However, such an option would be worthy of further consideration in preference to the AEMC's target entry/exit, continuous balancing model, should further and more fundamental changes to the DWGM be required in the future.

2. Improvement to AMDQ regime

2.1 Entry and exit AMDQ/AMDQcc

Significant market-led investment has occurred in the DTS in recent years, in part driven by changes to AEMO procedures that link AMDQcc withdrawal rights at points of interconnection with a market participant's capacity rights on the other side of the pipeline (i.e. outside of the market). Under these new procedures, APA GasNet was able to underwrite several developments through contracts for additional capacity with a number of shippers, increasing export capacity at Culcairn from 46 TJ to 57 TJ prior to winter 2014 and to 118 TJ prior to winter 2015. Subsequent investment supported further capacity expansion of the New South Wales - Victoria Interconnect to around 150 TJ/day.

Despite these investments, the AEMC has noted market-led investment may be impeded under certain circumstances. This is partly due to the ability for market participants to allocate AMDQcc associated with injection points to withdrawal points at an interconnected facility on a first come first served basis. The AEMC has highlighted the South West Pipeline (SWP) in this regard. For example, the total amount of firm capacity on interconnected facilities outside of the DTS far exceeds the amount of capacity on the SWP from Melbourne to Iona. A participant underwriting capacity on the SWP to create new AMDQcc for nomination at Iona could therefore not ensure existing AMDQcc was not then nominated to Iona by a different market participant, thereby undermining the investment.

The creation of entry/exit AMDQ/AMDQcc would seemingly resolve this dynamic. However, it is not clear such a change would fundamentally improve investment signals relative to the existing framework, noting market-led investment has occurred at other points of the DTS. Consideration should therefore be given to whether any issues relating to investment on the SWP are unique to that pipeline and if so, whether they would be best addressed through the regulatory investment framework rather than fundamental changes to AMDQ/AMDQcc rights.

An additional question raised by the AEMC is whether any of the aforementioned changes to the DWMG pricing mechanism would mitigate the need for entry/exit AMDQ, given the ancillary benefits of AMDQ/AMDQcc would be reduced/removed. While the overarching rationale for entry/exit AMDQ still requires further assessment, Origin considers AMDQ/AMDQcc will continue to be valued by market participants regardless of any changes to the pricing mechanism. This is because the primary benefit of AMDQ/AMDQcc is in the tie-breaking rights it provides, which are essential for effectively managing scheduling risk and exposure to the wholesale market price.

2.2 Tradability

Origin is generally supportive of improving the tradability of AMDQ/AMDQcc rights. The allocation of AMDQ to end-use customers represents a potential inefficiency in the market, particularly where those rights are tied to a market customer indefinitely and cannot be traded. As noted by the AEMC, this approach can give rise to underutilisation of AMDQ due to the over allocation of rights to a single large customer (tariff D) or group of customers (tariff V).

The development of an exchange trading platform that allows market participants to trade the rights associated with AMDQ could assist in this regard. However, further consideration should also be given to the allocation mechanism itself. In Origin's view, access to AMDQ/AMDQcc injection rights should be linked to a participant's firm transportation rights outside the DTS, similar to the framework in place for validating access to AMDQcc withdrawal rights at points of interconnection. This would increase the alignment of shippers' rights between the DTS and connecting pipelines and improve signals for investment in firm capacity.

2.3 Tenures

To adequately manage the long-term risks of participating in the DWGM, it is important market participants are able to align the acquisition of AMDQ/AMDQcc with transportation/supply contracts outside of the DTS. The introduction of reduced tenure AMDQ/AMDQcc could give rise to coordination issues in this regard, potentially limiting the ability of market participants to build supply paths in/out of the DTS. In determining the choice of tenure range and percentage of AMDQ/AMDQcc allocated to each, it is essential market participants can continue to access long term tenures. Improving the tradability of AMDQ/AMDQcc should also mitigate the need to allocate a significant portion of AMDQ/AMDQcc under short-term tenures.

3. Forward Trading Market

Origin is generally supportive of the development of a voluntary forward trading market (FTM) that integrates with the DTS. The DWGM framework has historically promoted trading liquidity and supported new market entry. In particular, the daily auction and market carriage elements of the DWGM provide market participants with access to spot gas and transportation capacity independent of an underlying GSA or gas transportation agreement (GTA). While GSA's will continue to play an important role in allowing market participants to manage long term price risk when they reach a certain scale, the proposed FTM would complement the existing framework by:

- providing market participants with additional flexibility to trade day-ahead and longer-dated products; and
- enhancing the level of pricing information available to market participants and stakeholders.

Origin agrees that aligning the design of the FTM with the Gas Supply Hub (GSH) framework would likely improve opportunities for cross-market trade by lowering transaction costs and complexity for participants operating across both markets. An issue that would need to be considered though is the impact of the prudential framework. The current requirement for all buyers/sellers to provide 25 per cent

of the face value of a forward trade on the GSH may be too onerous for market participants and limit trade in longer dated products. Aligning the framework with that applied for Australian Securities Exchange (ASX) futures trades, which uses risk-based assessments of individual energy portfolios to determine prudential margins, may be a more appropriate approach.

Trading on the FTM is likely to be enhanced where market participants have visibility of up to date information on capacity outlooks for all interconnecting pipelines and production facilities (e.g. a seller seeking to flow gas from Wallumbilla to the DWGM would need to ensure there are no outages on the pipelines between those points). Recent enhancements to the Gas Bulletin Board (GGB) have increased the level of transparency in this regard. However, there may be merit in developing capacity outlook reports equivalent to the short and medium term projected assessment of system adequacy (PASA) reports produced for the National Electricity Market (NEM). This would likely provide market participants with easier access to a consolidated suite of information.