14th August 2019

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Australian Energy Market Commission
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Dear Commissioners,

AEMC 2019, Market making arrangements in the NEM, Draft Determination

We welcome the opportunity to comment on the AEMC's draft determination on ENGIE's rule change request, Market making arrangements in the NEM. EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, solar and wind assets with control of over 4,500MW of generation capacity in the National Electricity Market (NEM).

We welcome the assessment commissioned by the AEMC from NERA Economic Consulting which highlighted the challenges in understanding the costs and benefits of compulsory market making arrangements, often implemented without a firm basis for intervention[1]. The assessment further noted that liquidity across the NEM is generally healthy and that the generation mix in South Australia (lack of dispatchable capacity) may be a key driver of lower liquidity in the state[2].

EnergyAustralia supports the intent of the AER receiving additional information to improve transparency in the over the counter (OTC) financial contract market but it is imperative that regulators are able to see the 'full picture'. That is, any reporting requirements need to apply to all parties (generators, loads, intermediaries etc). Simply focussing on the 'sell side' of transactions does not provide complete information and adds to risks of incorrect conclusions being drawn. For example, drivers for selling a Power Purchase Agreement (PPA) are likely to be vastly different to the reasons for purchasing such a product, and as such both sides of the transaction need to be recorded and understood.

We remain concerned that there are significant risks around incorrect conclusions being drawn from contract data that has been provided given the contract market is not an area of expertise for regulators. This is further exacerbated without full coverage of data, as discussed above. To this end there is likely to be some benefits regarding utilising

[1] https://www.aemc.gov.au/sites/default/files/2019-06/NERA%20report.pdf
[2] Page 8, NERA Report, https://www.aemc.gov.au/sites/default/files/2019-06/NERA%20report.pdf

AFMA's skills in financial markets through improving the AFMA survey, and we encourage the AER and AEMC to continue engage with market participants to build their expertise.

Industry's ongoing participation in the ASX voluntary market making measures (along with the mandatory MLO) and the AFMA survey highlight our commitment and support to these financial markets.

Ongoing market making concerns

EnergyAustralia continues to consider that an incentive driven market making mechanism (such as the tender proposed by ENGIE) is far superior to any compulsory mechanism levied on physical participants, such as the current Market Liquidity Obligation (MLO). To be successful any mechanism needs to encourage additional parties over and above physical participants (such as financial intermediaries) to participate in market making arrangements, thereby improving liquidity. Financial intermediaries not only have the expertise to participate in a mechanism but also the appetite to manage the associated risk.

A key focus for the AEMC should be to ensure regulatory frameworks provide appropriate signals and support for investment that is needed in the future NEM. Any market making obligation should not act in a way that forces additional risk on parties that are either unwilling to take this risk (for example due to internal risk limits) or are unable to effectively manage this additional risk. Mandating compulsory market making on physical participants (as the MLO does) is unlikely to create additional contracts and may reduce current levels of liquidity across the trading day, focussing liquidity within the compulsory trading window. This additional risk and market intervention is likely to discourage all participants – both buyers and sellers – to make longer term commitments and contracts, which will hinder their ability to make future investment.

We remain disappointed that the Energy Security Board (ESB) proceeded with the MLO given that, at the time, the ASX was well progressed with their own market making mechanism noting that the ESB has in the end aligned the MLO as much as possible with this scheme.

Liquidity assessment

As highlighted, EnergyAustralia welcomes the AEMC's assessment on current liquidity in the NEM. Specifically, that:

- liquidity across the NEM is generally healthy; and
- the structural characteristics of the South Australian market contribute to lower liquidity, including:
    - high penetration of intermittent generation; and
    - low demand levels (TWh) relative to peak demand (MWs), particularly impacted by rooftop solar penetration.

The AEMC highlights that these factors contribute to higher spot price volatility, which influences the willingness of participants to provide contracts and the pricing of these contracts[3]. EnergyAustralia considers the following also impacts liquidity in South Australia:

- higher reliance on interconnection and low accountability of the Transmission Network Service Provider (TNSP) for market impacts when scheduling transmission outages and associated interconnector constraints, substantially increasing the risk of selling contracts from outside the region; and

- frequent and material ongoing market intervention by the system operator which both distorts market prices and dramatically increases the risk of offering financial products.

EnergyAustralia remains concerned that future developments in transmission infrastructure, for example an interconnector between South Australia and New South Wales, might further increase the reliance on interconnection to meet capacity and energy requirements in South Australia, and the potential negative impact that this may have on contract availability, and its ultimate impact on retail prices. This is not an isolated issue for South Australia given the continued focus on interconnection developments across the NEM from both Network Service Providers (NSP) and AEMO. We encourage the AEMC and AER to monitor the impact of these developments on the contract market going forward.

We note that liquidity in a healthy market requires more than just the physical participants handling the balance of contracts between themselves. The AEMC should also consider the role of intermediaries as a source of liquidity and have metrics on participation by non-physical entities in the market in order to assess its performance. For example, the AEMC should investigate historically how intermediary participation changed has changed and what have been the drivers for this.

Transparency

The draft determination indicates that the AEMC is focussed on improving the transparency of the contracting market, particularly around bi-lateral (OTC) and internally traded contracts. The draft determination highlights that the ESB did not consider that an OTC trade repository should be established because:

- the OTC market is a subset of market data and information on OTC trades is available to market participants via brokers;

- there are challenges with providing the market with meaningful data given the bespoke nature of some OTC contracts; and

- the costs of an OTC repository may be significant.

It is considered (by both the ESB and AEMC) that the preferred path is for the AEMC, AER and market participants to work with AFMA to improve the transparency of the OTC market[4]. We look forward to working with AFMA, AEMC and AER to improve the AFMA survey to achieve this.

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[3] AEMC Draft Determination, page iii, https://www.aemc.gov.au/sites/default/files/2019-06/Draft%20determination.pdf
[4] AEMC Draft Determination, Page 44, https://www.aemc.gov.au/sites/default/files/2019-06/Draft%20determination.pdf

If the AFMA survey is used by the AEMC, it is worth considering the following:

- The survey has limited coverage and is voluntary. There is a need to ensure that it captures all trading participants as best as possible (including loads and financial intermediaries). This is critical to ensure a meaningful picture of the contracting market is formed.

- Risks of providing commercially sensitive pricing data to a purely member-based organisation need to be mitigated. The AEMC has noted this but further understanding of the implications and risks is needed.

- Providing monthly data will create a significant additional regulatory burden on participants, and we question the necessity.

Additional AER information gathering powers

Consultation on required information

Contracting data is complex, voluminous and recorded differently across market participants. We encourage the AEMC and AER to work with industry to, firstly gain an understanding of what contract data would be most valuable and secondly on how that data is most efficiently, and usefully, reported. The AEMC and AER should seek to also minimise duplication of reporting and information requirements.

Market making

We recognise that the AER has a clear role in monitoring compliance with the MLO given that it is a compulsory market making scheme that sits within the remit of the AER's powers. On the other hand, the ASX market making scheme is voluntary in nature and hence the AER has no role in enforcing compliance for this scheme.

EnergyAustralia understands the comments in the draft determination around monitoring the ASX voluntary market making scheme to be simply the AER monitoring the drivers of participants not being compliant with the voluntary scheme at certain times and the reasons for this. We see that this will assist the AER to understand some of the challenges and risks that a compulsory market making scheme (such as the MLO) can create on participants, particularly during times of tightening supply and demand. We note that the determination highlights some of these key monitoring points that the AER should focus on.

Under the MLO arrangements participants need to give permission to the AER to access confidential participant ASX trading data to monitor compliance for regions where the MLO has been triggered. The AER will need to work closely with participants to receive additional confidential data for times when no MLO has been triggered or to access data in a region where the MLO is not occurring to allow ongoing monitoring of the effectiveness of the scheme. EnergyAustralia is happy to discuss these challenges further with the AER and AEMC.

Reporting on internal trades

EnergyAustralia remains supportive of the principle of improving transparency and recognises the concerns from the AEMC (and other bodies) around the lack of information around large vertically integrated participants. We note again that interpretation of this information will be critical to the level of value this information will provide to regulators. Each market participant's contracting arrangements will be different depending on for example, risk appetites and hedging strategies which may impact the timing of trading activities for both generation and load.

Conclusion

We remain in principle supportive of improving transparency in the contracting market where any reporting framework captures the entire 'picture' being both the 'buy' and the 'sell' side of transactions, including transactions from loads, generators and intermediaries.

There is scope for the AFMA survey to be improved but there will be challenges around this delivering to the AEMC's expectations including, coverage, price and timeliness.

EnergyAustralia encourages regulators and the AEMC to continue to develop expertise in contract markets and understand the type of data they wish to prioritise and disseminate to maximise market outcomes for the consumer.

If you would like to discuss this submission, please contact Andrew Godfrey on 03 8628 1630 or Andrew.Godfrey@energyaustralia.com.au.

Regards

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