



Major Energy Users Inc.

20 August 2016

The Commissioners
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent by: online lodgement

Dear Commissioners

DWGM forward trading market GRC 0050

Major Energy Users Inc (MEU) is pleased to provide its thoughts on the draft decision reached by the AEMC in regard to the proposed Forward Trading Market (FTM) for the Victorian gas market (DWGM). The AMC draft decision is not to implement the proposed change by deciding not to make a rule.

The MEU was established by very large energy using firms to represent their interests in the energy markets. As most of the members are located regionally and are the largest employers in these regions, the MEU is required by its members to ensure that its views also accommodate the needs of their suppliers and employees in those regional areas. It is on this basis the MEU and its regional affiliates have been advocating in the interests of energy consumers for over 20 years and it has a high recognition as providing informed comment on energy issues from a consumer viewpoint with various regulators (GMRG, ACCC, AEMO, AEMC, AER and regional regulators) and with governments.

The MEU stresses that the views expressed by the MEU in this response are based on looking at the issues from the perspective of consumers of gas but it has not attempted to provide significant analysis on how the proposed changes might impact other stakeholders, including AEMO, producers, NSPs and retailers.

As some MEU members are active participants in the Victorian gas market, the MEU response is informed by their observations and the experiences they have had in operating in the DWGM and other gas markets.

The MEU was a significant contributor to the AEMC 2015 and 2016 review of the DWGM that the AEMC undertook at the behest of the Victorian Government. While the MEU did not support the redesign of the DWGM

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proposed by the AEMC at that time, it did recognise that some improvements could and should be made to it. In regard to the proposed introduction of the FTM, the MEU was supportive of this new market tool being introduced into the Victorian gas market.

The MEU notes the AEMC has identified the introduction of a FTM into the DWGM would provide many positive features and has expressed these well in its draft decision. The MEU agrees with the AEMC that there are a number of significant benefits that the FTM would provide consumers both directly and indirectly.

In contrast, the MEU notes that the AEMC considers there only two detriments against introducing a FTM. These are:

-) Cost for implementation, ongoing cost and learning
-) Negative impacts on existing industry led markets

Regarding cost, the MEU points out that the DWGM now has an annual turnover of some \$2 Bn¹ with an average daily turnover of ~\$6m. The costs of implementing the FTM implied by the AEMC in the draft decision are miniscule in comparison to the actual market turnover.

Even if the FTM leads to only a one cent reduction in the price of gas to consumers (ie about 0.1%), a reduction of this size will deliver a benefit to consumers of ~\$2m pa. The MEU points out that AEMO considers that the costs for the introduction of the FTM for the Victorian gas market would leverage off the work they have already implemented implying the costs would be quite modest.

The MEU considers that the potential benefits of a FTM are likely to deliver much more than the costs implied in the draft decision.

Regarding the negative impacts as to whether there are third parties likely to provide the service or if a FTM would reduce liquidity in these other services the MEU observes:

-) While a third party provider might be willing to establish a FTM, to do so will incur costs and these costs will be recovered ultimately from consumers. The import of the AEMC argument is that a third party provider will provide the service at less cost than AEMO might but as AEMO already has much of the needed infrastructure in place to provide a FTM, third party providers will have to develop this from scratch. This implies that a FTM provided by AEMO might cost less than that from a third party provider.

¹ Based on annual gas volumes in 2018 and the 2019 price for gas

-) A decision by an industry led market provider to expand its offerings into the market will not be decided on what is best for consumers, but what is best for the provider. Specifically, if it is thought there will be insufficient trade to recover the costs of a FTM along with some profit, a third party provider will not embark of developing a FTM. As the introduction of a new product is more of a “chicken and egg” process², a new provider will seek to recover an increased profit in order to offset the risk of its introduction. In contrast, AEMO can introduce the FTM at cost.
-) The MEU notes that while there has been some increase in demand for quarterly and annual products in the ASX electricity market, these are still very modest in their volume compared to the market turnover highlighting a concern why the ASX might be loath to introduce a range of products that the FTM might otherwise provide. Further, the electricity market does not have an FTM as such yet the ASX has not introduced a FTM, raising concern that it would not do so for the smaller Victorian gas market.
-) In the electricity market, AEMO provides a tool that delivers a number of benefits of a FTM, so why is the AEMC loath to allow a similar service to this for the DWGM?
-) The MEU points to the wide support for a FTM when this was discussed during the AEMC review of the DWGM³, implying there will be significant support for the FTM products.

It is intriguing that the AEMC has not discussed with the ASX about its interest in providing the products envisaged being provided by the FTM to test its interest.

The MEU does note the observation (page 19):

“The ASX has informed the AEMC that over the past year they have been working with participants to build the Victorian gas market, as they have with electricity markets. They intend to introduce voluntary market makers in both electricity and gas markets around the east coast, this would ensure there was a supply of Victorian gas products on the ASX.”

While the MEU sees this as a positive step, it also notes the observation (page 19):

“Assuming the tenures of products listed on the ASX and those proposed for the FTM do not change, the introduction of the FTM would not necessarily dilute trades on the ASX, as suggested by ERM Power and AGL Energy, as the risk management products serve different purposes. The proposed product suite for the FTM includes monthly, weekly, daily and day-ahead products,

² ie will a third party provider will be confronted by the conundrum that if there is no demand for a product because there is no product to purchase rather than a lack of interest in the product

³ In fact, in its final report on the DWGM, the AEMC recommended that a FTM was needed

which could assist participants around the margins when managing short-term price flexibility, when they are not fully hedged, or to supplement gas hedging if there is cheaper gas available.”

It is apparent that the AEMC has not discussed with ASX whether the ASX intends to provide the FTM products in addition to the other aspects that the ASX is pursuing, so the concerns expressed about the FTM diluting the ASX products might not be well founded. The fact that the ASX is looking to increase its product range for the electricity market but not a FTM for it, implies that they are looking to provide a FTM for the Victorian gas market and that a FTM would not impinge on these new products.

The MEU considers that the AEMC needs to discuss with the ASX whether it intends to introduce FTM products into its suite of new gas products⁴ and if it is, when such a tool would be provided. Failing a firm commitment from the ASX to introduce these in the near future, the AEMC should reassess its draft decision not to introduce a FTM.

The draft Commission position

While accepting there are many positives in the provision of a FTM, the AEMC has a view that there is (page 24):

1. uncertainty that the additional potential benefits from the market are sufficient to justify the cost of creating the market
2. lack of clarity that there is market failure such that risks cannot be efficiently managed by market participants through other means

With regard to the first reason for not implementing the market, the MEU considers that the cost of creating a FTM for the DWGM are much less than implied by the AEMC when considered in context of the DWGM annual turnover. Further, with the massive increase in the price of domestic gas resulting from the decision to allow export of gas from the east coast, it is likely that the price of gas will not return to the price levels seen in the past and will continue to remain high. With this in mind, the MEU considers that any tool that is likely to increase efficiency and thereby reduce the price of gas (and the FTM is one such tool) needs to be implemented. While the electricity market does not have a FTM as such, it does have tools that provide many of the same outcomes that a FTM would deliver and these tools have provided considerable value to traders operating in the electricity market. There is no such tool available for the DWGM so its introduction would benefit the market.

⁴ In this regard the MEU notes that ASX products in the electricity market have a tenure longer than tenures planned for the FTM implying that the ASX does not appear to be interested in the FTM shorter term products.

The second reason for rejecting the introduction of a FTM is that the AEMC is unsure that other means might be introduced and so make the FTM a less valuable tool. The MEU points out that the closest tool similar to the proposed FTM that is provided by others for electricity trading than AEMO, is the ASX futures market which only looks at quarterly and annual outputs. Despite a clear need for a short term trading tool to manage hourly, daily and weekly “unders and overs” in the DWGM, there has been little move by third parties to introduce such a tool, with gas traders having to rely on bilateral trades to manage this short term need. Bilateral trading is both inefficient and non-transparent, both of which are detrimental to consumer interests.

What is concerning is that there does not appear to have been any significant attempt to identify if any third party is contemplating introducing a tool similar to a FTM for the gas market.

The AEMC also poses the question as to whether there is sufficient need for the day ahead trading that is the centre piece of a FTM. In its review of the DWGM commenced in 2015, the AEMC did consider that under its proposed redesign, a forward trading exchange should be introduced⁵ and recommendation 2 of its review⁶ was:

“The Victorian Government [should] submit a rule change to the AEMC to establish a forward trading exchange over the DTS while retaining the existing daily DWGM.”

The Victorian government has done this and now the AEMC is providing a draft decision that such a tool is not needed.

The report also noted that (page ii)

“The introduction of a forward trading exchange should further stimulate liquidity in the physical forward market for gas, improve transparency and reduce transaction costs.”

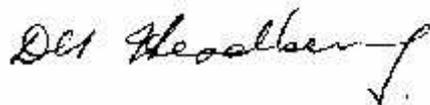
Whilst not agreeing with the AEMC on its proposed redesign of the DWGM, the MEU (and many other respondents to that review) did support a forward trading exchange which is what the FTM would be. The MEU considers that if the AEMC considered that such a tool would have been valuable after its extraordinarily in depth review of the DWGM, why it would now consider that perhaps a tool of this nature is no longer necessary and would not provide the benefits it considered would occur when it made its recommendations of the Victorian government about the DWGM.

⁵ This was supported by many of the respondents to the various stages of that review

⁶ AEMC FINAL REPORT Review of the Victorian declared wholesale gas market 30 June 2017 page vii

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary

Yours faithfully

A handwritten signature in black ink, appearing to read "D. Headberry". The signature is written in a cursive style with a long horizontal stroke at the end.

David Headberry
Public Officer