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John Pierce
Australian Energy Market Commission
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Sydney South NSW 1235

Submitted online: www.aemc.gov.au

Dear Mr Pierce

REVIEW OF THE VICTORIAN DECLARED WHOLESALE GAS MARKET – DISCUSSION PAPER

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) Discussion Paper in relation to its review of the Victorian Declared Wholesale Gas Market (DWGM).

The Discussion Paper canvasses five packages for the DWGM that range in the extent of change from relatively minor targeted improvements through to fundamental reform. As a principle, Origin supports market developments aimed at simplifying market operations through incremental improvements to address known issues. While the east coast market design needs to be robust to respond to continued shifts in assumed supply and demand patterns, we consider significant departures from current arrangements should only be contemplated where a proven market failure exists following the completion of more targeted design changes.

Origin believes the greatest benefits to the Victorian market are most likely to come from improving the pricing mechanism to remove existing complexity and the inability to effectively hedge as opposed to some of the more complex and hence costly suggestions in the Discussion Paper. In our view, a simpler market framework would best promote efficiency and participation, and hence is more likely to align with the COAG Energy Council's Vision.

Given the degree of change across the AEMC's five packages, Origin suggests that in developing its draft report, the AEMC consider the possibility to mix and match a proposed package of future development from across the packages if appropriate. We note that it may be beneficial for elements from two different packages to be progressed; for example, future developments could include a commodity-specific element from one package with a pipeline-specific element from another package. As a result, our below comments refer to the different elements of each package where appropriate rather than the package as a whole.

Package A – targeted measures

Package A is intended to be a series of targeted improvements that could be progressed over the short to medium term to fix 'known issues' while retaining the principles of the current market design.

While Origin appreciates this package is intended to be relatively easy to implement compared with the other packages, we consider it does not sufficiently address the key issue in the DWGM at present, namely that it is complex to operate in. Package A also does not have explicit mechanisms to deliver an efficient reference price, which is the first of the AEMC's characteristics of a well functioning market. As such, it may not be effective in moving the DWGM towards the COAG Energy Council's Vision and Gas Market Development Plan. In addition, some of the elements in Package A would be complex and costly to implement, which is likely to outweigh the potential anticipated benefits.

We have the following comments on each of the elements of this package:

- *Targeted transmission rights* – This measure would establish a usage charge that would apply to market participants that use an asset which has been privately funded by another market participant and refunding or rebating the revenue collected from this charge to the foundation market participant as compensation. Origin questions the net benefit of this approach, particularly as its application is likely to be limited and its implementation is likely to be costly and complex. As noted in the Discussion Paper, targeted transmission rights may not fit easily with the current market carriage framework and as such, a complex process of developing using and allocation rules would be required as well as other regulatory changes. It also does not address other concerns such as financial risk and lack of physical certainty.
- Authorised Maximum Daily Quantity (AMDQ) and AMDQ credit certificates (AMDQ CC) trading mechanism – Consistent with the Australian Energy Market Operator's (AEMO's) Portfolio Rights Trading (PRT) mechanism rule change that was considered by the AEMC in 2014, this measure would allow market participants to trade the financial rights associated with AMDQ and AMDQ CC while retaining their physical access rights. While the PRT proposal is based on sound reasoning, Origin suggests any assessment of whether to progress this proposal again must include a cost-benefit analysis. As part of the previous rule change process, it became apparent that the anticipated benefits were not as high as originally thought while AEMO's expected implementation costs increased. If a revised cost-benefit analysis suggests the costs outweigh the benefits, then this proposal should not be progressed.
- AMDQ and AMDQ CC allocation processes – The AEMC suggests there is merit in exploring the options:
    - to increase transparency around the allocation process;
    - have a more consistent approach to the allocation of AMDQ and AMDQ CC; and
    - undertake the ADMQ CC allocation process prior to, rather than after, pipeline capacity expansions or extensions have occurred.

  Origin supports these suggestions. Currently, there is a lack of transparency and detail around the current auction process for AMDQ CC, including about the timeframes for when an auction should be held or for how long the tender process should run and APA's allocation process. We welcome the current DWGM-AMDQ allocation rule change, which requires both AEMO and APA to provide a minimum notice period prior to an allocation of AMDQ or AMDQ CC, but consider there is further scope to improve transparency around these processes.

Package B – transmission rights

Package B considers removing the current ancillary payment mechanism operating in the DWGM and replacing existing limited capacity rights with a set of firm and non-firm transmission rights. Origin strongly supports the simplified pricing mechanism component of this package. This aligns with our previously stated position that pricing in the DWGM is overly complex, which subsequently complicates operations as risk in the DWGM is not embedded in the market price and is therefore unhedgeable. We believe that incorporating ancillary payments and uplift charges into the market price would improve participants' ability to assess and hedge risk. Simplifying and enhancing the transparency of market prices in this manner would promote the development of complementary financial products as it would be easier to develop products to manage participants' risks.

Package B also involves translating the existing AMDQ and AMDQ CC mechanism into a transmission right by introducing different tariff arrangements for use of the Declared Transmission System (DTS). Origin questions whether this will improve market outcomes. Not only would this be a difficult task to undertake but as noted in the Discussion Paper, any rebalancing of transmission tariffs will create winners and losers. As such, the effects on various parties would need to be carefully assessed. Our initial concern is that consumers could bear a greater cost as the cost for contracting firm transmission rights for market participants is likely to be more than the current cost of contracting for AMDQ CC. Typically, firm rights are contracted for significantly longer timeframes and the need to actually use that firm service when the pipeline capacity is reached is limited to an infrequent number of days.

The AEMC suggests that removing or changing the ancillary payment and uplift allocation mechanisms are inextricably linked to the issue of pipeline investment signals and mechanisms in the DTS. As a result, it couples the simplified pricing mechanism with the revised set of transmission rights. In Origin's view, this is not necessary as the link between ancillary payments, uplift hedges and market signals for investment is a weak one. We consider it would not be in the best interests of the market to reject the simplified pricing mechanism because of a decision to not progress transmission rights in the DTS.

Package C – capacity rights

Package C seeks to establish a number of different pricing zones across the DTS and introduce capacity rights between the zones. The intention of this is to generate prices across the DTS that better signal where constraints occur. When combined with the introduction of capacity rights between the zones, this would provide a market determined price for usage of the system by users without such rights and therefore a signal for investment.

Origin sees little value to progressing this package. Firstly, there are a number of conceptually and technically difficult issues, such as the calculation of zonal prices and the issuance and pricings of capacity rights, which would need to be worked through if zonal pricing was to be progressed. As a result, the market framework is likely to be complex to operate in; for example, given the potential for different prices to arise in multiples zones at the same time, participants would have to manage this price risk in each zone. These complexities are likely to outweigh the potential benefits from being able to better identify constraints and the need for investment.

Secondly, the perceived investment benefit is incomplete as the investment signals would only relate to inter-zonal congestion. There would be no signals for intra-zonal congestions and as such, a separate process would be required to govern investment within zones. The Discussion Paper suggests the most likely approach would appear to be retention of the existing regulatory process. Having to operate in a more complex market that only partly addresses the investment signal issues it is intended to address is not an efficient outcome.

Finally, the potential for different prices in multiple zones at the same time means that Package C does not lend itself to the development of a reference price or a secondary market whereas other packages promote the development of financial products.

Package D – entry-exit model

Package D would convert the existing market carriage arrangements applying to the DTS to an entry-exit model similar to those applied in European gas markets. An entry-exit system would allow market participants to specify entry and exit points into and out of the system independently from each other. Coupled with a virtual hub, this means that market participants would not need to consider how gas is transported from an entry point to an exit point as its transfer would occur at the virtual point.

The DWGM is currently a form of virtual hub allowing the transfer of gas at any point in the system. The AEMC's Discussion Paper notes, however, that the DWGM implicitly allocates capacity on the DTS. To implement an entry-exit model, the DWGM would need to be redesigned to solely involve the trading of gas to remove this implicit allocation of DTS capacity.

Origin considers there is value in further developing this model to better understand if an entry-exit model can deliver better outcomes to the market than the current arrangement. As the DWGM already operates as a form of virtual hub, it is not clear what the implications of removing the implicit allocation of DTS capacity would be and as a result, what an entry-exit model would deliver to the market compared with what is currently in place. Key to this process is an investigation of the extent to which congestion may be an issue within the DTS and how this issue would be managed under an entry-exit model.

Further consideration would need to involve an assessment of the associated costs to implement and administer this change on an ongoing basis to ensure the perceived benefits outweigh the costs. As pointed out by the AEMC, it would also need to consider operational issues such as whether trading and balancing would be conducted on the same market platform and the nature of participation.

Package E – hub and spoke model

Package E is designed to test the concept of converting the transportation arrangements applying to the DTS from market carriage to contract carriage. This would involve establishing a balancing hub at Melbourne (the 'hub') and converting all other sections of the DTS to contract carriage (the 'spokes'). It would also involve establishing gas supply hubs at Longford and Iona, making the DTS consistent with the remainder of the east coast.

Origin does not support this package. In our view, the DWGM and market carriage arrangements have been effective in achieving their original objectives. This package is a significant departure from the current arrangements that is unwarranted and could represent a market regression. We would be particularly concerned if this package rolled back the current intra-day operations in the DWGM to better align with the day-ahead approach in other hubs. This would reduce current market responsiveness, which is a key beneficial feature of the current market arrangements. In addition, a virtual hub is more suited to the meshed nature of the transmission network in Victoria, as is evident from overseas market examples.

Should you have any questions or wish to discuss this information further, please contact Lillian Patterson on lillian.patterson@originenergy.com.au or (02) 9503 5375.

Yours sincerely,

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