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GRC0049 DWGM simpler wholesale price rule

AGL Energy Limited (AGL) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) consultation on the Declared Wholesale Gas Market (DWGM) Simpler Wholesale Price rule change request.

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. AGL has a long history of involvement in Eastern Australian gas markets and aside from delivering gas to over 1.4 million customers, AGL also owns and operates gas power generation, is a gas shipper and owns gas facilities across the east coast.

AGL considers the DWGM to be the deepest, most liquid, and most competitive gas market in Australia. Since the AEMC market review of the DWGM in mid-2017 and the supply shock of 2016, the DWGM has continued to deliver competitive outcomes.

While the DWGM is largely fit for purpose, there are several improvements that AGL considers would help to increase participant confidence in market outcomes and make the DWGM more resilient in times of future supply stress. These suggestions are outlined in this submission, and our submissions to GRC0050 DWGM Forward Trading Market and GRC0051 DWGM Improvements to the AMDQ Regime.

AGL supports the AEMO rule change proposal to align the DWGM Operating Schedule (OS) and Pricing Schedule (PS) so that constraints internal to the Declared Transmission System (DTS) will be included in the PS. Our view is that such alignment will give market participants confidence that pricing outcomes will reflect physical outcomes. AGL is supportive of the proposed solution by AEMO to apply constraints on the withdrawal side.

AGL cautions against using the events of 1 October 2016 as a 'day of focus' for assessing the rule change proposals. On that day, gas powered generators in South Australia were under direction following the state-wide black out, and a Contingency Gas Event was occurring in Sydney. Losing gas supply from Longford placed additional stress on the DTS and led to high cost gas supply being required. But AGL notes that none of the proposed rule changes address the fundamental driver in higher prices in the east coast – that is the need for greater supply.

AGL also considers that physical limitations in the DTS can lead to more uplift events. For example, while participants were seeking to refill the Iona storage facility in 2016, significant uplift costs were occurring due to congestion. One driver of this congestion was around the Brooklyn compressor, for which an upgrade was approved in the DTS 2008-2012 access arrangement, but not undertaken. Since then, the decision of the pipeline operator to use Brooklyn unit 10 has largely resolved congestion and uplift issues in that area. Accordingly, it is important that the pipeline operator be incentivised to minimise congestion, including through investment. We suggest the AEMC consider whether a planning standard should be applied to the DTS, to guide appropriate investment and help to avoid congestion uplift.

We consider that aligning the PS and OS, providing improved market information, and encouraging the pipeline operator to undertake network upgrades to minimise congestion would address the Victorian Government's DWGM risk management concerns. Our position on this, and other specific aspects of the simpler wholesale price rule are set out below.

Congestion uplift, impacts of current misalignment of the OS and PS, and DTS investment

The Victorian Government has identified congestion uplift as a barrier to effective risk management and trade in the DWGM and proposes to address this by socialising congestion uplift costs amongst all market participants into the market price. We agree that congestion uplift is complex, however AGL does not support the socialisation of uplift costs.

AGL considers that a causer pays principle (where the cause can be attributed) should continue to underlie uplift payments to encourage participants to consider how they manage their diversity of supply. Much of the congestion cost incurred by parties arises from the 'out of merit order' gas that is required from another 'uncongested source'. For example, say if Party A chose to build and supply a new retail business based on Dandenong LNG supply (a point where there is very little congestion historically) they should rarely pay for congestion. However, on a day where LNG is required and suddenly that point is congested, Party A should be required to cover out of merit gas that might be required.

AGL anticipates that aligning the OS and PS will help reduce the risk associated with uplift, as participants will no longer need to always 'bid at zero' to ensure they will be scheduled. To explain this further, without aligning the OS and PS, participants cannot have confidence in the market clearing price, which in turn hinders contract market development, and gives rise to unpredictable price and operating risks. Participants should be able to bid and offer in a market, confident that any scheduled outcomes will be rational and unsurprising. AGL believes that where the OS considers the physical limitations of a network, then so should the PS. With a constrained OS and an infinite tank PS, the outcomes can be irrational and surprising for participants.

Rationally, supply and demand would meet at a point that reflects the physical price of gas but in the DWGM, the price can be solved at a different level because the PS does not include physical constraints on withdrawals. This produces two outcomes:

- a higher market price for all participants; and
- gas that is priced between the rational price and the PS price not being scheduled.

An extreme example of this, which has occurred in the DWGM, is when constrained withdrawal offers at the Market Price Floor ($0) are being tie-broken, yet the market price clears above $0, resulting in participants being short on gas to a higher price than they intended, with no ability to price down further. We acknowledge that aligning the schedules may not address concerns around tie-breaking. However, it will mean that we can expect $0 to be the published price with the result that participants are no longer short to a higher price that they would not have chosen to be short to.

Ultimately, in a market where the OS and PS are aligned, we would expect to see rational and predictable pricing outcomes. AGL believes this is the best way to achieve a “simpler wholesale price”.

During the AEMC’s Review of the DWGM, we agreed that uplift charges can be complex and suggested that AEMC and AEMO could investigate whether the procedures can be made clearer to provide greater transparency around how uplift charges, including congestion uplift, are incurred. Providing more information for participants may assist them to mitigate against charges. This suggestion may still be worthy of consideration in this rule change.

AGL also believes that if the market is given advance notice of constraints, it can respond. Therefore, AGL suggests that notices seeking a market response, coupled with more frequent provisional schedules (e.g. every hour, 24 hours before a schedule), could be a simple change that gives participants better information to manage their exposures, though not directly simplifying the price.

Trading between DWGM and interconnected pipelines and facilities

The Victorian Government rule proposal suggests that current uplift methodology, including congestion uplift, may disincentivise participants from transporting gas through Victoria for inter-regional trade. In AGL’s view any participant that seeks to supply gas from just one injection point should be at risk of congestion charges. The DWGM enables participants to manage uplift charges, particularly by diversifying their supply options and to receive an appropriate payment if out of merit gas is required.

At a broader level, we consider that the DWGM is well set up to enable trade between regions. Gas can currently be traded in and out of the DWGM efficiently on transportation agreements at every interval of the DWGM gas day in its current state.

Regulatory and administrative burden

Realigning the OS and PS presents a low regulatory and administrative burden, as these arrangements were in place as recently as 2015. AGL does not anticipate that it will be difficult for AEMO and market participants to revert to previous market settings.

AGL notes the Victorian Government considers its proposal to socialise congestion uplift also presents a low regulatory and administrative burden, and while this may be accurate in terms of the simplicity of amending uplift calculations, it will remove the incentive to minimise congestion. Accordingly, AGL has concerns with the socialisation of congestion uplift.

If you have any queries about this submission, please contact Liz Gharghori on (03) 8633 6723 or lgharghori@agl.com.au.

Yours sincerely,

Meng Goh

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