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Australian Energy Market Commission

via the AEMC website

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Submission to Market Making Arrangements in the NEM – ERC0249

AGL Energy (**AGL**) welcomes the opportunity to comment on the Australian Energy Market Commission's (**AEMC**) Market Making Arrangements in the NEM Draft Determination (**Draft Determination**).

AGL is one of Australia's leading integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy and provides energy solutions to over 3.5 million customers in New South Wales, Victoria, Queensland, Western Australia and South Australia. We are active in energy market derivatives across the NEM.

The AEMC's draft determination found that trading liquidity across the NEM is generally healthy, although liquidity in South Australia is much lower compared to other jurisdictions (as would be expected). It was noted that the structural factors that would seem to impact contracting are much more pronounced in South Australia, such as the high percentage of non-firm renewable supply, the reliance on gas for gas-fired generation, and the peakiness of the state's load shape. The draft determination also found that if the ASX's voluntary market making scheme is successfully adopted by participants, then there is no additional benefit from introducing an incentivised or mandatory market making arrangement.

AGL supports the draft decision to not make a rule. The ASX voluntary market making scheme commenced on 1 July 2019. AGL has been a key supporter of this scheme and has liaised closely with the ASX to ensure the operational design elements meet its key objective of supporting contract market liquidity. The Market Liquidity Obligation (as part of the Retailer Reliability Obligation) also mandates certain entities to provide bids and offers under defined parameters in periods when there is an identified reliability gap. The introduction of any further market making requirements would impose additional costs while providing no additional benefits.

While we are supportive of the ASX scheme, we note that market making arrangements do not address the policy risks and regulatory uncertainties that continue to affect the underlying energy markets. We consider that more generally, policy certainty will help contribute to an increase in generation capacity that is capable of supporting firm contracts and may exert a downward pressure on price.

The draft determination also raised concerns with the levels of transparency of OTC markets, and provided recommendations on the next steps for the Energy Security Boards work on improving OTC market transparency and expanding the AER's role to include monitoring of financial contracts, should the COAG Energy Council wish to proceed with this work. AGL has provided comments on these topics below, in addition to comments on the AEMC's assessment of liquidity.

Liquidity metrics and market structure

AGL provides the following comments that may assist with ongoing assessments of liquidity and market structure, whether this is carried out by the AEMC or another regulatory body such as the AER:

- The liquidity metrics used to inform the assessment in the draft determination focus on the number of trades that occur, but liquidity should be considered and potentially measured through any number of complementary metrics such as:
    - The size of bid and offer spreads
    - The depth in the market of bids and offers
    - The volume of trades in addition to the quantity of trades
    - The time bids and offers are listed in the market, prior to trading or not trading at all
    - The clearing, credit and funding requirements
    - The number of market participants
    - The availability of listed contracts and regulatory risk appetite (impacted by regulatory change, such as the five-minute settlement rule change).
- Going forward (and noting the further work on transparency to occur), ideally any liquidity assessment would take into account the wide variety of risk management activities that customers and participants undertake in preference to firm contracting, that would help to explain the perception of lower liquidity levels in some states compared with others. It should also include interregional interactions. For example, trading occurs in Victoria to manage risks in South Australia.
- The draft determination notes that the recent gas market reforms would assist with the risks involved in obtaining gas for fuel supply. While the pipeline capacity trading platform may be of use if capacity is offered for quarterly blocks well into the future, we do not consider the pipeline capacity day-ahead auction, which is more likely to be available at a lower price, can support contracting. The day ahead auction does not provide sufficient certainty ahead of time that fuel will be available to run a gas generator.
- The draft determination notes the impact of demand and spot price variability on generator incentives to enter contracts, but the demand profile and market structure in South Australia also influences the incentives on users to enter into contracts. This contributes to the low trading liquidity in that jurisdiction.
    - The load profile in South Australia is ‘peaky’ with relatively little baseload demand. This reduces the incentives for participants to seek contracts for bulk load.
    - The concentration of large end-use customers in South Australia is also low and these customers use a large volume of the average load. Trading liquidity can affected by the risk management approach and desire for contracting on the demand side.
- AGL was surprised at the conclusions that the levels of firm generation in South Australia would remain at current levels, as the Riverlink interconnector is based on the assumption that gas generators would close in South Australia. AGL asks that the AEMC provide some further explanation around these conclusions.

Improving OTC transparency

The AEMC has recommended that OTC transparency be improved by expanding the survey carried out by the Australian Financial Markets Association (AFMA) to: include a wider range of products; include pricing information; be carried out monthly (instead of annually); and be completed by a wider range of participants (currently only approximately 14 participants complete the survey).

AGL is supportive of this suggestion and would be happy to work with AFMA to consider whether they are able to expand the survey in this manner. AFMA have already commenced the voluntary survey for financial year 2019 to help ensure timeliness and transparency of OTC data, as recommended by the AEMC.

While the details of this work are yet to be finalised, we would like to raise one potential issue with providing prices to AFMA that would need to be addressed. It may be a breach of contract to provide pricing information to a third party, and so may need to be aggregated and weighted prior to providing it to AFMA.

AER's monitoring of financial contracts

The AEMC has provided further recommendations around expanding the AER's role to include monitoring of contract markets. The draft determination includes a list of tasks the AER should carry out to deliver this function. It also recommends that vertically integrated companies should report additional information to the AER to indicate whether there is any exercise of market power. This information would not be published, unlike the information provided in the recommendation above on OTC transparency, and instead would only be used for AER monitoring and enforcement purposes.

AGL trusts that in developing this recommendation further, the overlaps with other reporting obligations and regulatory reviews are taken into account and any duplication avoided.

The ACCC is currently carrying out a seven-year inquiry into electricity supply in the NEM, which includes an assessment of prices, profits and contract liquidity (among other things). This will run until 2025. AGL notes that:

- While this ACCC inquiry is a 'temporary' measure and AER monitoring would be an ongoing feature, it is unnecessary to have two regulatory bodies assessing the same question. The administrative burden on companies complying with information requests for these types of inquiries is significant. Duplication adds to the administrative burden, as information requests are inevitable slightly different and need to be tailored to each regulator's needs. AGL does not believe that there can be a persuasive case for both of these processes being run simultaneously.
- The AEMC has suggested that the AER requires this power to assess whether there is any 'exercise of market power'. The ACCC is responsible for enforcing the Competition and Consumer Act (**CCA**), including the prohibition against misuse of market power. AGL also notes that the ACCC have significant powers to compel the production of documents and information in respect of any suspected breach of the provisions of the CCA. This raises the broader question about the roles of the ACCC and the AER in monitoring energy markets, and whether it is appropriate or useful to have both entities considering the same issues simultaneously. Before there is agreement to expand the AER's role, this question should be considered and addressed.

There may also be duplication between the information provided to the ASX under the “improving OTC transparency” recommendation discussed above, and the information required by the AER under this recommendation. Again, AGL is keen to minimise reporting duplication, and suggests that if this recommendation proceeds, the AER set up suitable information sharing arrangements between the ASX and industry members.

Conclusion

AGL is supportive of the draft determination to not introduce further market making obligations at this stage, and looks forward to working closely with AEMC, AFMA and regulators to improve transparency of financial markets in an efficient way.

If you have any queries about this submission, please contact Jenessa Rabone on (02) 9921 2323 or JRabone@agl.com.au.

Yours sincerely,

Chris Streets

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