By email

Hi Roger

Thanks for the session on Tuesday. ERM appreciates the presentation made by Market Reform and AEMO and all the work done to date.

We have some comments following Tuesday's presentation for your consideration.

ERM believes that this review provides a valuable opportunity to consider the benefits of moving the existing DWGM VOLL of $800/GJ to $400/GJ to align with the STTMs. As such we recommend that the review incorporate some specific analysis of the impacts (benefits and costs) of reducing the DWGM VOLL to $400/GJ.

Benefits of moving to a $400/GJ VOLL

ERM believes that the benefits of moving to a $400/GJ VOLL include –

- Reducing financial exposure and lowering barriers to entry. Smaller participants, new entrants and large C&I gas users are not likely to have the supply portfolio diversity and degree of access to flexible gas supplies that the larger retailers have, and therefore are more likely to be impacted by a high price event due to lower hedging capability. The risk associated with the current VOLL may be discouraging new entrants, and possibly also deterring producers from becoming more active in the spot market. We note the extreme VOLL value also magnifies the potential uplift exposure given that out of merit order gas could be priced at VOLL. Lowering financial risk to a more acceptable level (as well as the level of perceived risk) will encourage new entrants.
- Achieving consistency across the east coast gas market, which is an objective of other regulatory reforms currently underway (e.g. Gas Day Start Time harmonisation, capacity trading reforms etc.).
- Reducing the risk of inter-market inefficiencies, noting that under the current market settings, a 7 day event in the DWGM could result in an average price of $150/GJ, while in the STTM this is $91/GJ (refer to last paragraph for the calculation). If gas is inefficiently diverted to Victoria from other regions, this could also pose a supply security risk for those regions.
- Lowering costs to gas consumers by reducing the risk premium that retailers have to incorporate into their retail pricing (and ensure that gas consumers are not paying excessive prices).

Reducing VOLL is unlikely to -

- Impair efficient clearing of the market (noting that the highest DWGM price in the last 9 years has been $44/GJ, which is about 5% of VOLL)
- Dis-incentivise investment – in our gas market, investment in new gas supply sources and pipeline infrastructure is largely driven by the ability to secure certainty of longer term revenue (i.e. longer term contracts). Evidence of this is that we've had investment occur in pipeline infrastructure and gas supply in areas outside the DWGM (where the concept of a max price doesn't exist) and in Victoria, despite the highest price in the last 9 years being only 5% of VOLL.

Modelling participant risk exposure

We recommend the following scenarios be included in the modelling -

- An event that impacts multiple markets and where a participant is impacted in both markets e.g. Sydney and Victoria.

- The scenario where a VOLL event occurs at 6 AM and the impact on an unhedged participant. In a simple example, a VOLL event at 6 AM would result in a retailer with 5 TJ of unhedged load (which could have been caused by a supply source failure) incurring $4m of charges just for that day – we would argue that this risk exposure is excessive.

Comment on the calculation of the Average Price over a 7 day event on slide 24 of the Market Reform Presentation

- In Market Reform's presentation, the average DWGM price over a 7 day event has been calculated as ($800*2 + $40*33)/35 = $83/GJ. We don't believe that this approach correctly captures the average price over a 7 day event, and suggest it be calculated as follows – *(1 day X $800 + 6 days X $40)/7 days = $150*. (i.e. Day 1 6 AM price of $800, 10 AM price $800, and APC for the rest of the schedules for Day 1 and all the schedules over the next 6 days).
- This is a lot higher than the STTM equivalent ($91/GJ), implying an inconsistency across the markets, a significant risk of inter-market inefficiencies and relatively higher price risk in Vic compared to the STTMs. This provides another argument to reduce the DWGM VOLL to $400/GJ.

Thank you for considering our comments. Please feel free to contact me if you'd like to discuss any of these points or have any questions.

Kind regards

Sarah Kok | Commercial Manager - Gas
02 8243 9109 | 0419 921 218

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ERM Power Limited | ermpower.com.au

Level 8, 15 Castlereagh Street, Sydney NSW 2000