

# IMPACT & IMPLEMENTATION REPORT (IIR)

## Summary Section

<b>Impacted Jurisdiction(s)</b>	Victoria	<b>Company</b>	AEMO
<b>Proponent</b>	Arjun Pathy	<b>Consultation process (Ordinary or Expedited)</b>	Ordinary
<b>Affected Gas Market(s)</b>	• DWGM	<b>Date Industry Consultative forum(s) consultation concluded</b>	Monday, 6 January 2020
<b>Industry Consultative forum(s) used</b>	GWCF		
<b>Short Description of change(s)</b>	Lower DWGM cumulative price threshold to \$1,400 and adjust clause 5(d)(ii)		
<b>Procedure(s) or Documentation impacted</b>	Wholesale Administered Pricing Procedures (Victoria)		
<b>IIR Prepared By</b>	Arjun Pathy	<b>Approved By</b>	Danny McGowan
<b>Date IIR published</b>	31 January 2020	<b>Date Consultation under 135EE concludes</b>	28 February 2020
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## CRITICAL EXAMINATION OF THE PROPOSAL

### 1. DESCRIPTION OF ISSUE

This IIR proposes substantive changes to the DWGM cumulative price threshold (CPT) and to clause 5(d) of the Wholesale Administered Pricing Procedures (Victoria). It also proposes a number of minor clarificatory or editorial changes to the Wholesale Administered Pricing Procedures (Victoria).

#### 1.1. Lowering of DWGM Cumulative Price Threshold

In 2018, AEMO conducted a review of market parameter settings for the Short Term Trading Market (STTM) and the Declared Wholesale Gas Market (DWGM). Rule 492 of the National Gas Rules (NGR) required AEMO to conduct this review in respect of the STTM, and AEMO considered it prudent to simultaneously consider parameters for the DWGM. The full suite of papers relevant to this review can be found [here](#)<sup>1</sup>.

**Table 1 Market Parameters subjected to review**

Parameter	STTM	DWGM
Market Price Cap (STTM) VoLL (DWGM)	\$400/GJ	\$800/GJ
Administered Price Cap	\$40/GJ	\$40/GJ
Cumulative Price Threshold	\$440/GJ (110 percent of the MPC)	\$1,800/GJ
CPT horizon (STTM) Cumulative price period (DWGM)	7 consecutive gas days	35 consecutive scheduling intervals (7 gas days)
Minimum Market Price (MMP)	\$0/GJ	\$0/GJ

The review was conducted in accordance with the NGR's extended consultative procedure, and responses were received from seven participants<sup>2</sup>. AEMO commissioned Market Reform Pty Ltd to conduct the requisite modelling work, which consisted of analyses of the economically efficient parameter setting for each market under a range of scenarios and market-participant types.

The outcome of this review and associated consultation was that all reviewed STTM and DWGM market parameters would remain unchanged except for the DWGM CPT, which was recommended to be reduced to \$1,400/GJ. Market Reform recommended this change on the basis that the tightening supply and demand conditions in the DWGM meant the \$1,800/GJ CPT provided inadequate risk protection to market participants buying gas.

As part of the [proposed procedure change](#)<sup>3</sup> (PPC) change consultation, AEMO noted that the slight softening of DWGM market prices since the modelling were not sufficiently substantial to warrant remodelling. No participant submitted feedback indicating that they believed market circumstances had changed substantially since the 2018 review; as such, no participant disputed this contention.

One late submission suggested that a CPT of \$1,400/GJ was preferable to a CPT of \$1,800/GJ, but considered that the former figure was still too high. As the final decision of the review was to set the CPT at \$1,400/GJ, and as this consultation is designed to give effect to the recommendations of the review, it would be outside the scope of this consultation to further change the CPT.

<sup>1</sup> <https://www.aemo.com.au/Stakeholder-Consultation/Consultations/Gas-Market-Parameter-Review-2018>

<sup>2</sup> These being: Alinta Energy, CovaU, ERM Power, M2 Energy, Meridian Energy, Origin Energy, and Snowy Hydro.

<sup>3</sup> [https://aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Gas\\_Consultations/2019/PPC/PPC---DWGM-Administered-Pricing-Procedures-amendments.pdf](https://aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Gas_Consultations/2019/PPC/PPC---DWGM-Administered-Pricing-Procedures-amendments.pdf)



## 1.2. Methodology for market price calculation

AEMO believes that the Administered Pricing Procedures (Victoria) currently employs an operationally complex, imprecise and non-transparent strategy with which AEMO is to calculate the market price in an administered price period if it is unable to use pricing schedules as determined by the Market Clearing Engine. This information is set out in clause 5(d) of the Administered Pricing Procedures (Victoria), in which “Strategy 2” requires AEMO to calculate the market prices “as the average of the published market price for the preceding six months”, with AEMO taking into account a range of factors (such as seasons, holidays, and weekends).

Given that Strategy 2 would only be employed if market systems were unable to determine a market price, there are operational restrictions in how complex it may practicably be. AEMO’s internal analysis identified three practicable alternatives to the current Strategy 2 that approximate the market price:

- a) Strategy 2 - The cumulative price as of the most recently published schedule, divided by 35.
- b) Strategy 2 - The average of the market prices for the preceding 30 *gas days* at scheduling interval S as of the most recently published schedule.
- c) Strategy 2 - The average of the imbalance-weighted average daily price for the preceding 30 *gas days* as of the most recently published schedule.

Of these options, option a) is practicable to implement without system changes for AEMO (AEMO does not believe there are system changes for participants for any option). Option a) is less variable than options b) or c) but may give an estimated market price that is slightly positively biased (on the sample of data used). Options b) and c) mirror, on average, the market price quite closely but are both relatively variable around the market price. More detailed analysis was provided in Attachment B of the PPC, and no participant disputed the results of this analysis at either the 12 December 2019 GWCF meeting or as part of the PPC consultation.

AEMO included option a) in the draft Administered Pricing Procedures for the PPC as the least-cost, most readily implementable solution to ensure that clause 5(d)(ii) is precise and transparent. No participant submitted feedback on the PPC; as such, no participant expressed a preference for AEMO to implement system changes in favour of options b) or c). Therefore, AEMO has included option a) in its draft Administered Pricing Procedures for this IIR.

While AEMO believes that clause 5(d) ought to be amended in the interests of making the Administered Pricing Procedures (Victoria) transparent for participants, AEMO notes that the use of Strategy 2 is a very low-probability event: clause 5(d)(ii) has never been put into effect in the period in which the DWGM has been operating.

## 2. REFERENCE DOCUMENTATION

- Wholesale Market Administered Pricing Procedures (Victoria)

## 3. OVERVIEW OF CHANGES

The following changes are proposed to the Wholesale Administered Pricing Procedures (Victoria):

- The definition of the CPT in section 2.2 is changed from \$1,800/GJ to \$1,400/GJ.
- Clause 5(d)(ii) is changed to align with option a) in the above Section 1.2 of this PPC.
- Additionally, some minor clarificatory changes have been proposed to:
  - Section 3, to ensure consistency with Condition 5 of the Gas Scheduling Procedures.



- Clause 5(a), to allow for schedule republication during an administered pricing period if a constraint is received after publication of the original schedule.

## **4. LIKELY IMPLEMENTATION REQUIREMENTS AND EFFECTS**

### **4.1. Lowering of DWGM Cumulative Price Threshold**

AEMO's IT systems will only require minor configuration changes to make the requisite changes. AEMO does not believe there will be any necessary changes to participant IT systems, and no participant disputed this as part of the PPC consultation.

### **4.2. Methodology for market price calculation**

The changes to clause 5(d) will require minor changes to AEMO's operational processes.

## **5. IMPACT OF ISSUE NOT PROCEEDING**

There are two key implications for participants if the proposed changes do not proceed:

- If the change to the DWGM CPT is not implemented, then market participants may be inadequately protected from prolonged period of very high prices.
- If one of the proposed changes to Strategy 2 under clause 5(d) is not implemented, then Strategy 2 will remain imprecise and non-transparent for participants.

## **6. OVERALL COSTS AND BENEFITS**

### **6.1. Lowering of DWGM Cumulative Price Threshold**

As per the Market Reform report and modelling, the lowering of the CPT will improve risk protection for market participants buying gas. Given that the change to the CPT is not accompanied by a change to the cumulative price period or to the value of lost load (VoLL), there will be minimal impact on market efficiency—i.e. participants are still heavily incentivised to pursue good hedging practices. The CPT remains sufficiently high that a VoLL event could occur without the DWGM's entering an administered pricing period.

### **6.2. Methodology for market price calculation**

Given that Strategy 2 would only be employed in the event that the AEMO is unable to determine the market price by use of the pricing schedules produced by the Market Clearing Engine and is also unable to calculate the market price through use of Strategy 1, AEMO believes that use of Strategy 2 is a low-probability event, and as such, changes to it are unlikely to materially impact the market. To the extent that the change would have an impact, the change would increase transparency of Strategy 2 for participants.

## **7. MAGNITUDE OF THE CHANGES**

The change to the CPT affects administered pricing, and as such AEMO believes this change to be *material*. No participant identified any other material considerations that would result from the change to the CPT as part of the PPC consultation.

There are only minor operational process changes as a result of the clause 5(d) changes, and AEMO does not believe that it should necessitate any changes to participant IT systems. As such, AEMO believes the changes to clause 5(d) to be *non-material*. No participant identified any material considerations resulting from the changes to clause 5(d) as part of the PPC consultation.



## 8. AEMO'S PRELIMINARY ASSESSMENT OF THE PROPOSAL'S COMPLIANCE WITH SECTION 135EB:

National Gas Objective

*"The Natural Gas Objective is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."*

Given the benefits and costs stated in section 6, AEMO believes that lowering the CPT and amending clause 5(d) will satisfy the NGO in terms of the efficient operation and use of natural gas services for the long term interest of consumers of natural gas with respect to price.

AEMO does not believe the proposed changes in this IIR are in conflict with any existing Access Arrangements. No participant raised concerns as part of the PPC consultation in relation to the effect of the proposed changes on their Access Arrangement.

## 9. CONSULTATION FORUM OUTCOMES

AEMO published the PPC on AEMO's website on 5 December 2019<sup>4</sup> and issued the PPC by email to the Gas Wholesale Consultative Forum (GWCF). AEMO also raised the PPC at the 12 December 2019 meeting, at which no participants raised concerns or questions about the proposal<sup>5</sup>.

## 10. SUBMISSIONS TO THE PPC

AEMO received one late submission to this PPC. Full details of the submission and AEMO's response are included in Attachment B.

## RECOMMENDATIONS

### 11. SHOULD THE PROPOSED PROCEDURES BE MADE)?

AEMO recommends that the changes described in Attachment A be made to the Wholesale Administered Pricing Procedure (Victoria).

### 12. PROPOSED TIMELINES

AEMO proposes the following indicative consultation timeline:

- Impact and Implementation Report (IIR) issued 31 January 2020
- IIR responses due 28 February 2020
- AEMO Decision issued 27 March 2020
- Effective date of 1 July 2020

This effective date then aligns with the effective date stipulated in the Gas Market Parameter Review 2018<sup>6</sup>.

<sup>4</sup> [https://aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Gas\\_Consultations/2019/PPC/PPC---DWGM-Administered-Pricing-Procedures-amendments.pdf](https://aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Gas_Consultations/2019/PPC/PPC---DWGM-Administered-Pricing-Procedures-amendments.pdf)

<sup>5</sup> Draft meeting minutes from this meeting have been distributed to the GWCF; final meeting minutes will be published following the 19 March 2020 GWCF meeting.

<sup>6</sup> <https://www.aemo.com.au/Stakeholder-Consultation/Consultations/Gas-Market-Parameter-Review-2018>



## **ATTACHMENT A – DOCUMENTATION CHANGES (SEE SECTION 3)**

Please see the attached track-changes DWGM Administered Pricing Procedures, using option a) from Section 1.2.



## ATTACHMENT B – AEMO RESPONSES TO PARTICIPANT FEEDBACK

Ref #	Participant	Issue / Comment	AEMO Response
1	AGL (late submission)	<p>AGL makes the following revised submission on the proposed amendments to the Wholesale Administered Pricing Procedures (Victoria). We ask that AEMO further review the Declared Wholesale Gas Market (DWGM) Cumulative Price Threshold (CPT), determined at \$1,400/GJ in the Gas Market Parameter Review 2018.</p> <p>AGL considers that a CPT of \$1,400/GJ, while preferable to the current CPT of \$1,800/GJ, is still far too high. The DWGM CPT is significantly higher than that applied in the Short Term Trading Market (STTM), and when considered against the DWGM Market Price Cap (MPC) of \$800/GJ, is at a far greater ratio than the STTM with its \$400/GJ MPC.</p> <p>In terms of practical outcomes, a \$1,400/GJ CPT potentially allows a very high price to be in effect for up to 48 hours (for example two \$600/GJ Balance of Day schedules – on the assumption the remaining intraday prices are less than \$200 in aggregate). By comparison, the National Electricity Market (NEM) only allows prices to sit at the MPC for 7.5 hours before the Administered Price Cap takes effect, a far shorter period of exposure for participants.</p>	<p>Support for \$1400/GJ CPT compared with \$1800/GJ</p> <p>AEMO notes the participant’s preference for a \$1400/GJ CPT as opposed to a \$1800/GJ CPT.</p> <p>View that \$1400/GJ CPT is too high</p> <p>As outlined in section 1.1, the setting for the CPT was decided as part of the 2018 Gas Market Parameters Review. As part of that review, no participant submitted feedback identifying that \$1400/GJ was too high<sup>7</sup>. As such, AEMO does not believe there is evidence that the review failed to consider feedback indicating a preference for \$1400/GJ and will therefore proceed with implementing the recommendations of that review.</p> <p>Risk of two 6am daily schedules with high market prices</p> <p>AEMO agrees that this is a possible, but unlikely outcome. A variation of this scenario was discussed in Market Reform’s Final Report to the Gas Market Parameter Review<sup>8</sup> which noted that some risk of exposure to high prices promotes good hedging practices.</p> <p>Reducing CPT from \$1800/GJ to \$1400/GJ reduces the likelihood of two consecutive high 6am market prices.</p>

<sup>7</sup> Summaries of submissions can be found in the below two links:

[https://www.aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Gas\\_Consultations/2018/GMP/Gas-Market-Parameters-Review-2018---submissions-received.pdf](https://www.aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Gas_Consultations/2018/GMP/Gas-Market-Parameters-Review-2018---submissions-received.pdf)

[https://www.aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Gas\\_Consultations/2018/GMP-Final/Gas-Market-Parameters-Review-2018---submissions-received-to-Draft-Report.pdf](https://www.aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Gas_Consultations/2018/GMP-Final/Gas-Market-Parameters-Review-2018---submissions-received-to-Draft-Report.pdf)

<sup>8</sup> [https://www.aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Gas\\_Consultations/2018/GMP-Final/Attachment-1---Gas-Market-Parameter-Review---Final-Report---Market-Reform.pdf](https://www.aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Gas_Consultations/2018/GMP-Final/Attachment-1---Gas-Market-Parameter-Review---Final-Report---Market-Reform.pdf)



Ref #	Participant	Issue / Comment	AEMO Response
		AGL considers that there is an opportunity to improve consistency in price signals across the gas and electricity markets.	<p>View that there should be greater consistency in treatment of administered pricing between DWGM, STTM and NEM</p> <p>AEMO notes AGL's view that there is scope to improve consistency in the treatment of administered pricing between AEMO-administered markets; this is, however, out of scope for this review, which pertains exclusively to the Wholesale Administered Pricing Procedures (Victoria).</p> <p>Further, AEMO has previously stated publicly that "... AEMO will consider proposing more comprehensive changes to the NGR and the National Electricity Rules (NER) so that market parameters for all energy markets are reviewed on a similar basis and timeframe"<sup>9</sup>.</p>

<sup>9</sup> See page 3 here: <https://www.aemc.gov.au/sites/default/files/content/8320f985-2098-4c8d-a1da-63cae6fcf259/Rule-change-request.pdf>