



public interest
ADVOCACY CENTRE

**PIAC submission to the Capacity Trading
Reform Package Draft legal and regulatory
framework**

27 April 2018

Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

Our work addresses issues such as:

- homelessness;
- access for people with disability to basic services like public transport, education and online services;
- Indigenous disadvantage;
- discrimination against people with mental health conditions;
- access to energy and water for low-income and vulnerable consumers;
- the exercise of police power;
- the rights of people in detention, including the right to proper medical care; and
- government accountability, including freedom of information.

PIAC is funded from a variety of sources. Core funding is provided by the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the NSW Government for its Energy and Water Consumers Advocacy Program and from private law firm Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, donations and recovery of costs in legal actions.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association;
- Tenants Union; and
- Mission Australia.

Capacity Trading Reform Package

PIAC welcomes the opportunity to comment on the draft legislative and regulatory framework for the Gas Market Reform Group's (GMRG) capacity trading reform package (CTRP).¹

PIAC supports the introduction of the CTRP. A central, AEMO-run Capacity Trading Platform (CTP) and Day-Ahead Auction (DAA) will improve the efficiency with which transmission pipeline and stand-alone compression facility capacity is allocated and the transparency with which capacity trades are made.²

In PIAC's view, these improvements to efficiency and transparency in the east coast gas market will contribute to the National Gas Objective (NGO) by promoting the long-term interests of consumers.

Efficiency benefits

PIAC considers the primary consumer benefit from the CTRP will be improved efficiency of capacity allocation and the price benefits associated with a more efficient gas transportation system.

Currently, there is no mechanism for market participants to openly trade for contracted but un-nominated capacity in the gas transportation system. While it is possible for shippers to trade secondary capacity bilaterally, spare capacity largely remains unused. According to the AEMC, this is due to:

- The high search and transaction costs of the trading system; and
- The bespoke nature of transportation agreements, which can impede the development of fungible capacity products and limit the pool of buyers.³

The CTRP seeks to address these problems by introducing market mechanisms to facilitate a multilateral secondary capacity market (the CPT and DAA), as well as requiring that service providers publish standard operational agreements. PIAC concurs with the GMRG that these reforms can be "expected to foster the development of a more liquid secondary capacity market and, in doing so, improve the efficiency with which capacity is allocated and used."⁴

There is also potential for a more direct efficiency benefit to consumers, from innovative retailers allowing end users to monetise their spare capacity through forms of proactive gas demand response.

For example, a retailer could enter into a contract with a gas consumer where the consumer could nominate, a day ahead, if they will not need their gas supply the following day in return for a financial incentive. The retailer (as shipper) would then be able to aggregate unrequired capacity

¹ GMRG, [Capacity Trading Reform Package: Draft legal and regulatory framework – Consultation Paper](#), March 2018.

² Like the GMRG, PIAC refers to the combination of transmission pipelines and stand-alone compression facilities as 'transportation facilities' in this submission.

³ AEMC, [East Coast Wholesale Gas Markets and Pipeline Frameworks Review, Stage 2 Final Report](#), May 2016, Sydney, 68.

⁴ GMRG, [Capacity Trading Reform Package: Draft legal and regulatory framework – Consultation Paper](#), 2018, 7.

and sell it on the CTP, recovering the cost of the incentive and retaining a margin. The benefits would so be shared between themselves, the participating consumer, and the market, as extra capacity would be available to trade.

Recommendation 1

PIAC recommends that the GMRG investigate how consumers can access direct price benefits from the CTRP.

Transparency benefits

PIAC considers that the CTRP will also improve transparency - a key feature of a functioning market - in gas transportation. As a number of recent reviews have noted, the operation of the east coast gas market is notoriously opaque.⁵ The opacity means that it is often very difficult for users to negotiate access to transportation services, particularly for secondary capacity.

The draft framework addresses the lack of transparency in two ways. Firstly, it requires the service providers to publish standardised contract terms for secondary capacity products through standard operational agreements. This will allow potential secondary shippers to more easily compare and choose between transportation facilities.

Secondly, the operation of the CTP and DAA will facilitate a public price discovery process for secondary capacity products. Where secondary capacity trades are currently confidential, the operation of an open market will allow participants and potential participants to assess the conditions on which they are being offered secondary capacity against the rest of the market, further reducing the opacity of the east coast gas market.

Recommendation 2

PIAC recommends that the COAG Energy Council adopt the draft legislative and regulatory framework for the CTRP, with amendments discussed below, as a means of promoting the NGO.

Exemptions from the CTP and DAA

PIAC contends that, to be effective, the PCT and DAA should apply to as much transportation capacity as practicable and exemptions should be limited.

PIAC notes that the draft framework provides for both automatic exemptions and exemptions upon application by service providers.

Automatic exemptions

Under the draft framework, automatic exemptions would apply to:

- Distribution pipelines;
- The Victorian Declared Transmission System; and

⁵ See: ACCC, [Inquiry into the east coast gas market, Final Report](#), 2016; AEMC, [East Coast Wholesale Gas Markets and Pipeline Frameworks Review, Stage 2 Final Report](#), 2016; COAG Energy Council, [Examination of the current test for regulation of gas pipelines, Report](#), December 2016, Canberra.

- Compression facilities that are not used to transport gas between transmission pipelines.⁶

Given that the scope of the CTRP as approved by the COAG Energy Council is limited to transmission pipelines and stand-alone compression facilities outside of the Victorian Declared Wholesale Gas Market, PIAC acknowledges that these exemptions are appropriate.

However, PIAC contends that future reform processes should seek to extend the reforms to distribution pipelines. A large proportion of gas consumers are not directly connected to the transmission system and instead receive their gas through low pressure distribution networks. For these consumers, the detriment associated with inefficient allocation of capacity does not stop once gas leaves the transmission system and enters distribution networks.

If anything, the issue is more pressing in distribution than transmission because the charges associated with these networks typically make up the largest proportion of a consumer's final bill, anywhere between 40% and 60% compared to the 3% to 8% for transmission.⁷

PIAC is not aware of a reason why the CTP and DAA could not be applied to distribution networks, improving the efficiency and transparency with which capacity is allocated in those pipelines. Therefore, PIAC contends that the CTRP could be extended to cover distribution networks as well as the transportation facilities that are currently in scope.

While PIAC acknowledges that it is not within the GMRG's power to alter the scope of the CTRP at this stage, we encourage energy market institutions to address these issues in future reform processes. PIAC understands that this recommendation could be considered in the AEMC's biennial review of the liquidity in the new capacity markets.

Recommendation 3

PIAC recommends that secondary capacity markets be extended to distribution pipelines in future reform processes.

Exemptions upon application

In addition to automatic exemptions, the draft framework states that transportation facilities may apply for exemptions if they:

- Do not provide third party access;
- Have a nameplate capacity rating of less than 10 TJ/day; or
- Are servicing a single shipper.⁸

PIAC supports the first exemption. However, we are concerned by the other two exemptions.

In discussions with other user and consumer stakeholders, PIAC has noted a concern that many of the transportation facilities in the gas system may have a nameplate capacity rating of below

⁶ GMRG, [Capacity Trading Reform Package: Draft legal and regulatory framework – Consultation Paper](#), 2018, 17.

⁷ ENA, [Energy Prices](#), 2018.

⁸ Ibid.

10 TJ/day. Under the exemption, those facilities will not be covered by the price discovery and transparency process inherent to the capacity trading model.

PIAC understands that analysis has not been produced to determine what proportion of total capacity will not be included as available for trade under the 10 TJ/day exemption. Given the risk outlined above, the GMRG should produce such analysis before deciding to include the 10 TJ/day exemption in the final legislative and regulatory framework.

PIAC notes that the 10 TJ/day threshold is consistent with the recently amended framework for reporting to the Natural Gas Bulletin Board.⁹ PIAC contends that GMRG should further investigate whether lowering the CPTR threshold below that applied to Bulletin Board reporting would present material challenges for AEMO and service providers in the operation of the CPT and DAA.

Recommendation 4

PIAC recommends the GMRG produce further analysis to determine the total capacity to be excluded from the CTRP based on the 10 TJ/day exemption, taking into account the threshold for Bulletin Board reporting.

PIAC is also concerned about the retail competition implications arising from providing exemptions to transportation facilities servicing a single shipper. PIAC acknowledges that there may be cases where only one shipper will ever seek access to a facility and engaging in the PCT and DAA may therefore represent an unreasonable regulatory burden.

However, there are many cases where shippers (mainly retailers) hold contracts for 100% of the capacity in a facility, without ever using all of it. In these cases, retail competition may be suppressed because new entrants to the market are unable to access capacity. While bilateral trades for secondary capacity are possible without the CPTR applying, it is not in the commercial interests of the incumbent to risk their market share by engaging in such trades.

This is clearly not in the long-term interests of consumers, as the incumbent retailer does not face the competitive pressure to offer efficient prices. Therefore, PIAC contends that single shipper pipelines should not be exempted.

PIAC acknowledges that the application of the CTP and DAA would not completely remove the problems associated with single shipper facilities. While the CTRP will require these retailers to release un-nominated capacity, new entrants to the retail markets supplied by the facilities may not choose to build a business model based on only receiving capacity on a day-ahead basis rather than long-term firm access.

Despite this, PIAC contends that applying the CTRP to single shipper transportation facilities is desirable as a means of increasing transparency about the how capacity is used and allowing innovative new entrants to trade for secondary capacity if they wished to.

⁹ AEMC, [National Gas Amendment \(Improvements to Natural Gas Bulletin Board\) Rule 2017 – Rule Determination](#), September 2017, v.

Recommendation 5

PIAC recommends the exemption on single shipper facilities be removed in the final legislative and regulatory framework.

Governance model for the Code

PIAC supports the GMRG's proposal to give the AER the power to modify the Operational Transportation Services Code (the Code) on its own initiative. The Code is a key feature of the draft legislative and regulatory framework that will govern the standard operational agreements that underpin the efficiency and transparency benefits of the CTRP.

In PIAC's view, the initial proposal to limit the AER's role to approving, rejecting or remitting a recommendation for changes to the Code by the industry-based OTS Code Panel did not fully serve the long-term interests of gas consumers. PIAC supports the involvement of industry through the OTS Code Panel, but considers the AER is better-placed to ensure energy regulation is maintained and operated in the long-term interests of consumers.

Therefore, we concur with the GMRG that allowing the AER to act on its own initiative will provide an additional incentive for the for the Panel to make changes where required.

PIAC also supports the requirement for the AER to consult with the OTS Code Panel, AEMO and other stakeholders when making changes on its own initiative. PIAC contends that this should include a specific requirement to consult consumers, as far as is practical. While it would be difficult for the AER to consult with small consumers directly, PIAC contends that consumer advocates and large consumers should be involved in the process. In PIAC's experience, the AER already has the guidelines and procedures in place to ensure that this consumer engagement is effective.

Recommendation 6

PIAC recommends that the GMRG proposal to give the AER power to modify the Code be adopted.

Recommendation 7

PIAC recommends that the GMRG include a requirement for consumer engagement by the AER when they seek to modify the Code on their own initiative.

PIAC also supports the proposed composition of the OTS Code Panel, which will comprise: "two service providers, two shippers (one of which must be a large end-user) and AEMO"¹⁰, in particular, the requirement that one of the shippers be a large end-user. In PIAC's view, having consumers directly represented in decision-making is the best way to ensure that the decisions made reflect the long-term interests of consumers. While small and large energy users do not always have aligned interests on particular issues, in this context large user interests could be broadly considered to promote those of smaller consumers.

¹⁰ GMRG, [Capacity Trading Reform Package: Draft legal and regulatory framework – Consultation Paper](#), 37.

Recommendation 8

PIAC recommends that the proposed OTS Code Panel composition be adopted.

Cost recovery by service providers

A key issue for consumers is the charges that service providers will levy on shippers to facilitate secondary capacity trades. PIAC supports the proposed NGR principle that charges levied by gas transportation service providers:

- as far as practicable reflect the outcomes of a workably competitive market;
- allocate the costs among shippers in a reasonable manner; and
- provide for the recovery of costs over time in a manner that promotes the efficient trade in, and utilisation of, capacity.¹¹

In this spirit, PIAC contends that the AER should ensure that service providers only seek to recover efficient cost. In PIAC's view, it is unlikely that a service provider in a workably competitive market would seek to recover the full costs associated with the operation of the CTP and DAA through charges. Instead, they would seek to provide the service at lowest price as a means of differentiating themselves from their competitors.

However, PIAC's experience with energy service providers is that they will seek to pass on the full cost associated with establishing and maintaining the systems associated with CTRP. PIAC also notes the risk of service providers 'gold plating' these systems, as identified by the GMRG.¹²

For this reason, PIAC supports giving the AER powers to conduct an *ex post* review of service provider charges if it has concerns about their level. The COAG Energy Council will need to ensure that the AER is appropriately resourced to carry out this monitoring function.

Recommendation 9

PIAC recommends that the draft power for the AER to conduct an ex post review of service provider charges be adopted and COAG Energy Council ensure the AER has the appropriate resources to effectively monitor these charges.

AER compliance monitoring

In the draft framework, the GMRG notes that the AER will be responsible for monitoring and enforcing compliance with a number of requirements in the CTRP. Some of these requirements cover central aspects of the CTRP, including:

- The standard operational agreement;
- Service provider cost recovery;
- Nomination and re-nomination by shippers;
- Reporting requirements; and
- Exemptions.¹³

¹¹ Ibid, 32.

¹² Ibid, 32.

¹³ GMRG, [Capacity Trading Reform Package: Draft legal and regulatory framework – Consultation Paper](#), 27.

PIAC supports a strong monitoring and enforcement role for the AER. However, additional responsibilities for the AER should always be accompanied by adequate resourcing to ensure it can perform its role effectively.

In PIAC's experience, this has been an issue for the AER in other contexts. During their recent review into the regulatory framework for embedded networks, for example, the AEMC found that the growth in the number of such networks placed pressure on the AER's capacity to enforce compliance with exemption conditions.¹⁴ As a result, many embedded networks were effectively under-regulated and consumers were therefore under-protected.

Recommendation 10

PIAC recommends that the GMRG and COAG Energy Council ensure the AER has the resources required to ensure compliance by service providers and shippers with the requirements in the CTRP.

Conclusion

PIAC supports the adoption of the CTRP and is keen to see secondary capacity trading implemented effectively in the east coast gas market. To this end, PIAC recommends that the GMRG limit exemptions to ensure as much capacity as possible is available for trade, ensure service providers charge no more than is efficient to facilitate trades, and gives the AER an active monitoring and enforcement role in the system.

Further engagement

PIAC would welcome the opportunity to discuss these issues in more depth. For any queries please contact:

- Policy Officer, Energy and Water, Tim Harrison at tharrison@piac.asn.au or on (02) 8898 6518; or
- Policy Team Leader, Energy and Water, Craig Memery at cmemery@piac.asn.au or on (02) 8898 6522.

¹⁴ AEMC, [Review of regulatory arrangements for embedded networks, Draft Report](#), September 2017, Sydney, 37.