

Jemena Limited

**Submission to the Gas Market Reform Group -
Operation and Administration of the Capacity
Trading Platform(s) and Day-Ahead Auction -
Consultation Paper**

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EXECUTIVE SUMMARY

- Jemena owns and operates a diverse \$9 billion portfolio of energy and water transportation assets across the east coast of Australia. Jemena is committed to proactively implementing the key pipeline recommendations from the Gas Market Reform Package, supportive of the establishment of a liquid gas market on the east coast of Australia and actively seeking to contribute to achieving the National Gas Objective.
- The Operation and Administration of the Capacity Trading Platform(s) and Day Ahead Auction Consultation Paper (the **Paper**) canvasses two options for the implementation of a Capacity Trading Platform(s) (**CTP**) and a Day-Ahead Auction (**D-AA**):
 1. Each pipeline operator develops and operates their own trading and auction platforms; or
 2. A single trading platform and centralised auction are developed, with further sub-options around the entity responsible for the operatorship:
 - a) the Australian Energy Market Operator (**AEMO**);
 - b) a joint venture between pipelines; or
 - c) another party with relevant capabilities.
- The Paper is heavily skewed towards AEMO operatorship of the CTP and D-AA on the basis that its independence and proven track record would allow it to deliver and operate a market platform that could best enhance competitive gains.
- Jemena considers that the adoption of any trading platform or option should be premised on the concept of being fit-for-purpose, which includes:
 - a mechanism that incentivises commercially minded outcomes;
 - incentivises minimising costs;
 - promotes transparency;
 - provides for short-term operation that is practically implementable;
 - accounts for the unique characteristics of the market (including the size and depth of the market); and
 - does not create overly onerous centralised overheads that offset any potential competitive gains.

With respect to the above points, pipeline operators would be best placed to achieve these objectives as they have both a proven track record for operating trading platforms and are appropriately incentivised to keep costs down.

- A pipeline run platform would allow for the most effective and maximum utilisation of available pipeline capacity. In light of the Federal Government's key public assurances following meetings with representatives from the gas industry to secure gas supply for the east coast of Australia to meet peak demand periods in the National Electricity Market (the **NEM**), there is a necessity for the maximum amount of pipeline capacity to be available to ensure gas can be delivered to the NEM's gas-fired generation portfolio. Consideration needs to be given to broader energy market implications when making market design decisions.

- Pipeline operator auction platforms, to a large extent, will utilise existing processes and procedures where possible, including shipper interfaces and AEMO interfaces. These existing procedures will be expanded and modified to include the auction process requirements. This approach will assist with cost management. Pipeline operators also have an incentive to keep costs down and to deliver products that best meet their customer's needs.
- Jemena is concerned that AEMO's operating model may dilute any incentive to deliver a fit-for-purpose market platform given it operates on a cost pass-through basis and that it may end up delivering an overly complex market platform for a small number of participants. The low costings provided by AEMO are premised on a number of high-level assumptions around the design of the CTP and D-AA as these details are still being worked through. Any changes to these assumptions which increase the complexity of the design proposed by AEMO will result in a higher level of costings.
- As such, Jemena does not support the Gas Market Reform Group (the **GMRG**) making a recommendation on the operator and administrator of the CTP and D-AA until the detailed design is resolved. This will enable a fully informed, and costed, decision to be made.

1.1 INTRODUCTION

Jemena welcomes the opportunity to provide a submission to the Paper. As a member of the Australian Pipelines and Gas Association (the **APGA**), Jemena welcomes the APGA's submission to the Paper and support's the APGA's commentary on the proposed reforms.

Jemena owns and operates a diverse \$9 billion portfolio of energy and water transportation assets across the east coast of Australia. This includes a regulated electricity distribution network which serves 320,000 customers in north-west Melbourne, as well as part ownership of the United Energy and ActewAGL electricity distribution networks. We also own gas distribution and transmission assets throughout eastern and northern Australia.

The Australian east coast gas sector and its governance arrangements are currently going through a period of unprecedented change. This has been largely in response to the rise of the Queensland LNG export industry around Gladstone and the impact this has had on the market. The Council of Australian Governments (the **COAG**) Energy Council requested the Australian Energy Market Commission (the **AEMC**) and the Australian Competition and Consumer Commission (the **ACCC**) to review the east coast gas markets in light of these developments. In August 2016, the COAG Energy Council launched a comprehensive Gas Market Reform Package, informed by the findings and recommendations of the ACCC *Inquiry into the East Coast Gas Market* and the AEMC's *Eastern Australian Wholesale Gas Market and Pipelines Framework Review: Stage 2 Final Report*.

The COAG Energy Council endorsed the recommendations within these reports and developed a Gas Market Reform Package for the east coast Australian gas market based on these recommendations. In relation to the AEMC's *Eastern Australian Wholesale Gas Market and Pipelines Framework Review: Stage 2 Final Report*, there are two pipeline recommendations which form the basis of the consultation in the Paper:

1. a CTP should be developed to enable shippers to trade secondary pipeline and hub service capacity ahead of nomination cut-off times and should comprise both: an anonymous exchange trading mechanism for commonly traded products; and a listing service for more bespoke products; and
2. a D-AA of contracted but un-nominated pipeline and hub service capacity be developed and provide for the auction to be carried out shortly after nomination cut-off time.

To deliver these key pipeline recommendations, the GMRG chaired by Dr Michael Vertigan has been established to provide advice to the Senior Committee of Officials (SCO) and the COAG Energy Council in consultation with industry Working Groups. Jemena is represented on the Working Groups tasked with implementing these recommendations and has been committed to proactively implementing the key pipeline recommendations from the Gas Market Reform Package.

Throughout this process, Jemena has maintained its stance that the market framework for gas (transmission) pipelines needs to continue to provide a strong incentive for efficient investment, given how critical this is to the long-term interests of customers. Indeed, the pursuit of efficiency for (long-term) investment and day-to-day market operations should not be solely confined to pursuing the paradigm of competition i.e. pursuing competition for the sake of competition.

The principles of any well-functioning market should be premised on providing signals so participants can make informed commercially focussed operation and investment decisions. There needs to be a balance between optimising short-term operating decision-making and providing certainty for long-term investment costs. Creating additional complexity for participants to comply with in order to realise any of these benefits is also not commensurate with good market design. Finally, the practicality of implementing a market design to achieve a desired competitive outcome must also be considered as creating additional central market costs to facilitate this market operation will ultimately be borne by customers. With respect to the above, Jemena has concerns that the accelerated pace these gas market reforms are moving at will deliver trading platforms that do not meet these principles of good market design and not achieve the stated reform objectives of the GMRG.

1.2 ASSESSMENT OF PREFERRED OPERATOR

The Paper proposes two broad options in relation to the operation and administration of the CTP and D-AA:

1. Each pipeline operator develops and operates their own trading and auction platforms; or
2. A single trading platform and centralised auction are developed, with further sub-options around the entity responsible for the operatorship:
 - a) AEMO;
 - b) a joint venture between pipelines; or
 - c) another party with relevant capabilities.

The assessment undertaken in line with framework in Chapter 2 of the Paper appears to have concluded that AEMO is best placed to operate the CTP and D-AA. There are a number of assumptions and assertions contained within the text of the Paper underpinning this conclusion that Jemena does not consider there is any evidence to support and that the level of detail available to adequately assess all options on the table is not contained in the Paper. This is particularly relevant for the D-AA. Design considerations that are directly relevant to deciding which organisation(s) are best placed to deliver the D-AA include:

- determining which pipelines the auction will apply to;
- the service to be auctioned, including characteristics such as its place in the curtailment order and the specificity of its delivery and receipt points; and
- determining the amount of capacity to be released through auction.

All of these matters are under active consideration by the GMRG and the D-AA project team. These concerns are also valid for the CTP. Based on this, Jemena does not consider that a fully informed recommendation on the appropriate organisation(s) to operate and administer the CTP and the D-AA can be made in advance of finalising their design. That being said, due to the implications that this decision will have on the success of capacity trading, Jemena feels compelled to provide the following response with the limited information that we have at hand.

With respect to the GMRG's review objectives, the COAG Energy Council's vision for a future Australian gas market and the National Gas Objective, the focus should be on delivering a market platform that is 'fit-for-purpose', which is premised on:

- a mechanism that incentivises commercially-minded outcomes;
- incentivises minimising costs;
- promotes transparency;
- provides for short-term operation that is practically implementable;
- accounts for the unique characteristics of the market (including the size and depth of the market); and
- does not create overly onerous centralised overheads that offset any potential competitive gains.

With these principles in mind, Jemena has structured its commentary in responding to the Paper on the following basis:

- which entity would be best placed to handle the operatorship of the trading platform and auction; and
- a targeted response relating to the feedback sought from the Paper asked from the stakeholders in relation to the CTP and D-AA.

1.3 OPERATOR OF THE CAPACITY TRADING PLATFORM(S) AND DAY-AHEAD AUCTION

As previously noted, the Paper is heavily skewed towards AEMO operatorship of the CTP and D-AA on the basis that its independence and proven track record would allow it to deliver and operate a market platform that could best enhance competitive gains. While participants need to have confidence in the market operator's capability to operate the trading and auction platforms in an impartial manner that will provide them with opportunity to maximise efficient commercial returns, Jemena contends that there should also be focus on delivering a market platform that is fit-for-purpose.'

With respect to the concept of fit-for-purpose, the pipeline operatorship solution could best achieve this and deliver a market facility that is well equipped for the designated purpose. A pipeline run platform would allow for the most effective and maximum utilisation of available pipeline capacity on the east coast of Australia. This is because pipeline operators best know the limits and capabilities of their pipeline assets, meaning they are best placed to respond really quickly to a direction around changing requirements in the market.

In Mar 17, the Federal Government met with representatives from the gas industry to secure gas supply for the east coast of Australia. From these meetings, a raft of key public assurances were announced including for gas producers guaranteeing to make more gas available, and pipeliners agreeing to having any necessary arrangements in place to meet peak demand periods in the NEM. Meeting these public assurances to maintain energy supply during peak demand periods will necessitate having the maximum amount of pipeline capacity

available to ensure gas can be delivered to the NEM's gas-fired generation portfolio. Consideration needs to be given to broader energy market implications when making market design decisions.

The pipeline operator option would also represent the lowest cost option for the industry in aggregate as there would be a lower level of costs to be incurred by the businesses during establishment. This is primarily due to the fact that currently, pipeline operators communicate many times each day with their shippers in the provision of schedules and reporting as part of maintaining the supply balance within the pipeline transmission system. Further, pipeline operators also communicate many times each day with AEMO in the provision of regulatory data and regulatory reporting. The pipeline operator auction platforms, to a large extent, will utilise these existing processes and procedures where possible, including shipper interfaces and AEMO interfaces. These existing procedures will be expanded and modified to include the auction process requirements. This approach will assist with cost management.

Regarding the preference for AEMO on the grounds of its independence, the concerns raised in the Paper in relation to the independence of pipeline operators seems to be concentrated on two matters:

1. In the case of the CTP, some market participants appear to be concerned that pipeline operators having full insight into bidding activity will provide them an opportunity to undercut the prices being offered on the trading platform.
2. In the case of the D-AA, some market participants appear to be concerned pipeline operators will withhold capacity from the auction to drive prices higher.

Which party operates and administers the service has no correlation with these concerns and they are mitigated through transparency and effective oversight.

1. Bids and offers will be visible to pipeline operators on the CTP regardless of who operates it and pipeline operators will see the market value of secondary capacity.
2. Pipeline operators will determine how much capacity is available for the D-AA (based on nominations on contracted capacity on any day) regardless of who operates it. Transparency and regulatory monitoring is appropriate to assure the market the correct amount is being released.

The assessment framework in Chapter 2 of the Paper also gives AEMO a tick and pipeline operators a cross for the need to establish a robust governance framework. Jemena does not consider this assessment to be reasonable. The governance framework accredited to AEMO is effectively the National Gas Rules (the **NGR**). Changes to the NGR will be required to give effect to the trading platform and the auction regardless of who runs them, with associated changes required.

Jemena is concerned whether AEMO has any incentive to deliver a fit-for-purpose market platform given it operates on a cost pass-through basis and that it may deliver an overly complex market platform for a small number of participants. When considering AEMO's previous projects, there is a history of costly operation of markets and pushing complexity onto market participants. AEMO's ongoing fees for operating the Victorian Declared Wholesale Gas Market (\$22.9 million p.a.) and the Short-Term Trading Markets (\$6.8 million p.a.) are not insignificant for a market with a small number of participants.

The Paper does not touch on the governance process that AEMO intends to use to ensure that it is in a position to recover costs associated with implementation. Given the detailed design of the CTP and D-AA are still under active consideration, any assessment of the cost of implementation is extremely high level as the requirements are yet to be properly defined. Making these assumptions has enabled AEMO to present a cheap and easy auction proposal that leverages an existing auction engine. Therefore, if any changes are made during detailed design, it is highly unlikely AEMO will be able to meet its low-cost estimate.

On this basis we question the effectiveness of industry and the GMRG to make an informed decision about the entity best placed to operate the CTP and D-AA while these are still being designed.

1.4 DAY-AHEAD AUCTION

The Paper's introduction to Chapter 4, covering the D-AA, states the AEMC's objectives in recommending the D-AA were to address contractual congestion and market power. Neither of these objectives are mentioned in the assessment framework presented in Chapter 2 and aspects of each proposal are assessed without reference to them. For example, the AEMO proposal for auctions receives a tick on the co-ordination criterion because it enables contingent bidding across pipelines, but questions not asked include:

- Is contingent bidding necessary to address contractual congestion or market power?
- Does contingent bidding in the auction reduce incentives for buyers to participate in the secondary capacity market?

Jemena is concerned about what is proposed in relation to the D-AA, in particular, the assertions within the Paper on the entity best placed to handle the operatorship of the D-AA. Due to the limited time and operational complexity, pipeline operators would be best placed to run the auction for the following reasons.

1. Auction Timing

Gas markets currently operate on a daily basis with many intra-day deadlines and obligations. This means there is very little room to manoeuvre for participants (shippers and pipeliners) to manage their nominations and gas demand profiles. With respect to what is proposed for the D-AA, whether it is pipeliners developing their own platforms or AEMO running a centralised platform, both will increase the length of the market day.

However, the Paper appears to do little more than assess the AEMO option as superior because it proposed to house the CTP and the D-AA in the same web portal. This does not seem to be particularly relevant as they will not be delivered as an integrated service. More relevant to the co-ordination of trade is the timing of the D-AA, particularly the time at which bidders are informed of the auction results. As suggested by the APGA in the Paper, it will be necessary to allow one hour for the data transfer from each pipeline operator to the AEMO platform detailing the available capacity, plus an additional one hour for the data transfer from AEMO to the successful shippers and the pipeline operators. For comparative purposes, the daily pipeline schedule is available currently by 1700 hours and the revised times under each option would be:

- If the pipeline operators are to provide the auction platform, an additional hour will be required before the daily schedule can be run and completed by 1800 hours.
- If AEMO is to provide the auction platform, an additional three hours will be required before the daily schedule can be run and completed by 2000 hours.

The earlier timing outcome is unquestionable if pipeline operators run the auctions. The earlier delivery of auctions is arguably far more important to the co-ordination of trades across platforms and hubs yet has been given no value in the assessment framework. The further this time horizon is pushed out, the less likely participants are to use this product or be able to realise the associated benefit of the auction. Adopting the option that results in earlier settlement will ensure that the product is relevant and utilised by all shippers.

Another important consideration is that the current process for renominations for producers/shippers to manage their gas requirements over the day are largely inflexible as well as the current market day/timing of gas market hubs (e.g. Short Term Trading Markets, the Victorian Declared Wholesale Gas Market). This means that many shippers will not be in a position to fully utilise the service. The only participants that will be able to respond on short-term notice are those with access to flexible gas arrangements or control of production facilities will be in a position. This naturally favours gas producers or those with market power.

Favouring a particular market participant will seriously undermine the objective of liquidity, as a successful and fair auction process would require all participants to be treated equally. A pipeline run auction with earlier settlement time is best placed to meet this objective giving more time for all users to organise their gas supply arrangements therefore in the interest of all shippers and the market as a whole.

2. Security of Supply

There are also security of supply issues that need to be considered. Adopting the option that allows for the earliest settlement will have a greater contribution to maintaining security of supply within the system. Due to the natural physical constraints that occur within a long and interconnected pipeline transmission system (e.g. long distances, travel time etc.), pipeline operators need time to ensure that the appropriate conditions exist on the pipeline to balance the level of gas supply relative to demand to maintain security.

In addition, pipeline operators can take advantage of un-nominated capacity to schedule maintenance activities for the following day whilst minimising market interruption. The later settlement proposed under the AEMO option will impede the pipelines ability to opportunistically schedule such maintenance activities. With this comes an increased level of risk to the shipper in terms of having access to reliable gas supply if maintenance for pipelines is compromised. For these reasons, a pipeline run auction with earlier settlement is best placed to meet the objective of maintaining secure and reliable gas supply.

With respect to pushing out the completion of the market day schedule for an extra two hours (relative to the pipeline option) under the AEMO operatorship model, reducing the time available for pipelines to establish the appropriate conditions increases risks associated with security of supply. This reduces the time and flexibility for pipeline operators to adequately balance gas supply with the pipeline to meet its customers demand profiles safely.

3. Capability of pipeline operators

Jemena considers the Paper unfairly represents the capabilities of pipeline operators to operate an auction. Jemena has \$9 billion in gas infrastructure assets across the east coast of Australia and has a proven track record of operating these complex assets successfully. The tables contained in the Paper have made subjective assumptions that bring into question this capability and are unable to be backed up by any supporting information.

Pipeline operators have to work closely with their customers to not only maintain security of supply on their assets but also to ensure they are able to receive gas that provides for flexibility in how they operate. As such, pipelines are always eager to provide additional functionality and new and innovative products. A pipeline run auction is more likely to result in innovation as the barriers of entry to change will be lower than when an additional party (AEMO) is involved. There is also a built-in incentive for pipelines under the pipeline auction - as users of the D-AA will be customers of the pipeline, there is a reputational incentive to be responsive to changing customer needs. This in turn further emphasises the prospects of innovation and investment as opposed to the AEMO option.

1.5 CAPACITY TRADING PLATFORM

In responding to the request for feedback Jemena considers that many of the points above in the D-AA would also apply to the CTP, particularly around the application of the assessment framework in Chapter 2, the cost and capability concerns.

Jemena already operates a trading platform which has been available over 18 months. With that in mind, we have difficulty understanding the assertions in the Paper that questions our track record as we feel that the Paper unfairly misrepresents the capability. The aforementioned issues associated with AEMO's cost-pass through funding model would be present in AEMO developing and operating the CTP – i.e. what incentives are in place for AEMO to minimise costs.

It should be noted that the AEMC's *Eastern Australian Wholesale Gas Market and Pipelines Framework Review: Stage 2 Final Report* recommended that the CTP include electronic, anonymous exchange based trading. Jemena notes that AEMO is suggesting that consideration should be given to a partially anonymous option. Whilst this may reduce AEMO's implementation costs it's unclear from the Paper whether this would add additional costs to shippers and pipeline operators. On this basis it is difficult to comment on the preferred approach. What we can say is that it will be important to quickly reconcile traded capacity to both verify that capacity traded is legitimate and to ensure that shippers are correctly assigned the correct maximum daily quantity following the outcome of a trade. This seamless verification will become increasingly important should liquidity in the gas market develop.

Jemena considers that the Paper is also lacking in detail in relation to the design of the CTP. As a non-market participant in the Wallumbilla hub, Jemena does not have direct exposure to the operations of the Trayport exchange trading platform. We are therefore unclear on its suitability to managing secondary trades. On this basis we find it extremely difficult to comment. Jemena is also concerned around the process for selecting a preferred operator as AEMO is already presenting details of the systems it would require to operate the platforms, while the CTP and D-AA are being designed.

1.6 CONCLUDING COMMENT

Both the single trading platform and individual pipeline operator platform options will promote the National Gas Objective. However, Jemena considers the Paper is heavily skewed towards the AEMO operatorship model for of the CTP and D-AA based on a series of high level assumptions of how these platforms will work due to the fact that they are still under design. This has made it very difficult for Jemena to adequately assess the suitability of which entity would be best placed to operate the CTP(s) and D-AA.

Notwithstanding this, based on the limited amount of information furnished for consideration, the pipeline operatorship solution would represent the lowest cost option for the industry in aggregate due to the lower level of costs to be incurred by the businesses. Pipeliners have an incentive to keep to costs down and deliver products for their customers that meet their needs. Further, the pipeline operated platform represents an easily implementable approach for the CTP and D-AA.

Jemena would also recommend that consideration is given to broader gas market issues, chiefly the Federal Government's commitment to ensure there is adequate gas supply to meet peak demand periods in the NEM. This will require having the maximum amount of pipeline capacity available to deliver gas to the NEM's gas-fired generation portfolio and the pipeline operator solution is best suited to meet this requirement.

Jemena questions whether AEMO will deliver a fit-for-purpose market platform given it operates on a cost pass-through basis and that it may end up delivering an overly complex market platform for a small number of participants. Further, given the detail of the proposed CTP(s) and D-AA design are still being worked through, the costings provided by AEMO are based on a series of high level assumptions around the market design. Should these assumptions change during the detailed design phase to account for additional complexity in the market design, the associated cost will also increase.

With respect to the above, Jemena does not support the GMRG making a recommendation on the entity responsible for the operatorship of the CTP and D-AA while the details of how the design of these platforms is under active consideration.