



2-3 Parkhaven Court, Healesville, Victoria, 3777

ABN 71 278 859 567

6 June 2017

Gas Market Reform Group
c/o Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: enquiries@gmrg.coagenergycouncil.gov.au

Dear GMRG

**Operation and Administration of the
Capacity Trading Platform(s) and Day-Ahead Auction
Consultation Paper, May 2017**

The Major Energy Users (MEU) welcomes the opportunity to provide its views to the Gas Market Reform Group (GMRG) on the Operation and Administration of the Capacity Trading Platform(s) and Day-Ahead Auction process for the east coast gas market.

The MEU considers that the GMRG has produced a clear and detailed assessment of the “pros and cons” of the various options for implementing pipeline capacity trading and an auction process.

1. Overview

As a result of the ACCC and AEMC reviews of the east coast gas markets, they identified that there were two core issues directly impacting consumers regarding the transportation of gas – viz there was a problem with the rules on coverage allowing monopoly rent taking on many gas transmission pipelines and there were significant issues with hoarding of gas transportation capacity, limiting retail competition for gas consumers. The reviews also identified that there were other changes to the gas market that could be made to increase economic efficiency of the current processes.

It is hoped that the issue with monopoly rent taking on gas pipelines has been addressed through the introduction of commercial arbitration but the aspect of capacity hoarding is still unresolved, although the MEU hopes that this will be addressed through establishing capacity trading platform(s) and day ahead auctions.

In order to identify how the MEU considers the various proposals included in the Consultation paper would provide the greatest benefit to consumers, the MEU asks the basic questions – what is the aim of the proposed changes and how best can they be achieved to deliver the best outcome for consumers, both directly and indirectly.

As an overarching approach, the National Gas Objective (NGO) requires the changes to enhance the long term interests of consumers and this must be the focus of how the changes are to be implemented.

2. Hoarding of capacity must be prevented

The MEU considers that the core aspect for consumers about what these changes are to achieve lies with the ACCC and AEMC assessments that the current east coast gas market structures (outside the Victorian Declared Gas Wholesale market – DWGM) allow pipeline shippers to hoard capacity and by doing so prevent retail competition being available for all downstream gas consumers. The MEU has been very active in the various reviews of the east coast gas markets and structures as its members have seen firsthand how the current structures are gamed by pipeline owners and shippers to increase the costs to gas consumers.

Hoarding of capacity is where a shipper contracts with the pipeline operator for all of the capacity (usually just firm capacity but could also include interruptible capacity) and so prevents any other shipper from using the pipeline. Retailer/shippers particularly do this to prevent other retailers from providing competition in downstream markets. The MEU has noted that capacity hoarding is more prevalent on pipelines which have smaller capacities, especially on laterals off a main gas transportation pipeline.

3. Inefficient investment must be prevented

The MEU has also identified that under contract carriage for gas transportation, there is a real risk of over investment in gas transmission pipelines¹. This is because

¹ During the discussions with AEMC regarding their proposed change to the DWGM, this point was made by a number of shippers concerned that the contract carriage approach proposed by the AEMC of its view of what the Victorian gas market should look like, could well result in unnecessary additional capacity being built.

one shipper may have firm contracts for capacity with a pipeline owner/operator and a new shipper seeking capacity will have to underwrite new capacity in the pipeline if there is insufficient firm capacity available for sale. At the same time, the existing shipper may not be using all of its capacity which could otherwise be used to satisfy the needs of the new shipper. In the absence of any means to trade available capacity, the pipeline operator has an incentive to expand the capacity of its pipeline to meet the needs of the new shipper, even if it is aware that there is unused but contracted capacity available on the pipeline.

To build new but unneeded capacity is not efficient, and so the ability to require unused but contracted capacity to be made available for other shippers will improve the efficiency of the gas transportation market, noting that ultimately it will be consumers that pay for this loss of efficiency and over-supply of capacity.

If applied to ensure there is no ability to “get around” the requirement to offer unused capacity to other shippers, the trading of unused capacity should address the concerns about capacity hoarding and improve the overall efficiency of the gas transportation market.

The MEU sees that there is a risk for consumers that attempts will be made by shippers seeking to game the auction process in order to continue the practice of hoarding capacity. In this regard the MEU points out that where a shipper wants to maintain its ability to hoard capacity, it can still do so even under the approach proposed within the Consultation paper. If the shipper already “owns” all the capacity on a pipeline, it could circumvent the implicit restraint the capacity trading approach applies, by nominating to the trading platform all of the capacity of the pipeline, thereby not allowing the trading platform to auction any capacity because in theory there will be no spare capacity to be traded. What should only be nominated is the amount of gas that is likely to be actually transported.

The MEU considers that there must be a requirement included in the process that all unused capacity must be made available for auction, even if the shipper “owning” all the pipeline capacity puts in spurious nominations for all capacity in an attempt to use this capacity to prevent downstream competition.

4. Contracting pipeline capacity can be challenging

The MEU notes that the AEMC view of the east coast gas market is that it will be based on the implementation of two commodity trading hubs (one at Wallumbilla and the other at the Victorian DWGM) with supplies to the regional centres being based on the hub price plus the cost of transport to each demand point. The implication of this view is that to use (say) the Wallumbilla hub as a source for gas for Port Pirie or Whyalla, the delivered cost would utilize transportation on two APA owned pipelines (SW Queensland pipelines WAL and MOO) and the two Epic Energy owned pipelines (MAP and the Whyalla lateral).

This arrangement needs close coordination of accessing capacity for the total journey as having capacity on one pipeline but not another would prevent the need for capacity on the first. Having a delivery system based on multiple pipelines with different owners and each having their own trading platform and auction process increases the difficulties for such a shipper, especially where the shipper is dependent on accessing unused capacity. Further, each shipper will have “overs and unders” in its usage of capacity over time and the ability to trade these “unders and overs” assists in increasing economic efficiency through minimizing the purchase of firm capacity that is used only occasionally.

To be able to acquire capacity on multiple pipelines requires a standard product and a single entity that can ensure there will be an ability for continuity of flow between different pipelines. The alternative to a standard product and a lack of continuity increases complexity and risk for shippers significantly.

5. Extent of the requirement for capacity trading

The MEU notes there is no discussion on the Consultation paper as to the extent of which pipelines will be subject to the trading platform and the day ahead auction processes. This is a major oversight as the extent of the pipelines to be covered will have a bearing on the costs involved with implementing the change to the market. However, more importantly, the MEU has identified that there would be less ability to hoard capacity if all transmission pipelines were subject to the new requirements.

Importantly for consumers, the MEU considers that the scope of the new processes must include all gas transmission pipelines including laterals. If only main gas transmission pipelines are covered by the new trading processes, the issue of capacity hoarding on the smaller pipelines and laterals will continue to be unresolved and consumers, especially those remote from the capital cities (other than in Victoria) will continue to be limited on their ability to change retailers and so enjoy competition in their gas supplies.

The MEU accepts there is a need for increased capacity trading and a more formal approach to better use capacity on the major pipeline routes. As every transmission pipeline effectively provides a monopoly service², it is important that the available capacity is used more efficiently. However, capacity trading and auctioning of spare capacity is more important on the smaller transmission pipelines and laterals where

² For example, while both EGP and MSP provide for delivery of gas to Sydney, each delivers gas from a different production point, thereby each providing a unique service. As there are no other pipelines delivering gas from Moomba and Longford to Sydney, both pipelines provide a monopoly service and have no competition.

it is possible to acquire all of the capacity for a relatively modest sum and thereby prevent the competition that is fundamental to the delivery of the NGO.

The long term interests of consumers are achieved through ensuring that there is effective competition. If a shipper is able to prevent downstream competition, then the structure provided does not meet the requirements of the NGO.

The MEU considers that all transmission pipelines have to be included in the scope of the capacity trading platform and auctioning process.

6. The service must be simple and lowest cost

Ultimately consumers pay for the infrastructure and services that the gas market provides. This means that the lowest cost and simplest structure possible should be implemented to deliver the most effective trading platform and the auctioning process.

In the development of the electricity market and the gas markets (supply hub at Wallumbilla, STTMs and DWGM) it has been recognised that a central body provides the most efficient approach to operating the trading hubs. As noted in section 4 above, if each pipeline owner operates its own trading platform and auction process, there is potential for inefficiencies, recognising that shippers must use multiple pipelines to transport gas to each of the markets. While the trading hubs are part of the solution for a more efficient east coast gas market, this is only part of the story as for most consumers, the use of gas is remote from the commodity trading hubs and this requires efficient transport of gas to its point of consumption. To require multiple entities to be responsible for different parts of gas supply chain to each point of consumption adds unnecessary layers of complexity.

For example, for the delivery of gas to the gas users at Port Pirie and Whyalla under the AEMC proposed east coast gas market structure, an end user (or its representative) would contract with:

-) A gas producer for its base load gas needs (probably under a firm bilateral contract,
-) AEMO for trading is unders and overs at the Wallumbilla supply hub
-) APA for transport on the two SWQ pipelines (Wallumbilla and Moomba sections)
-) Epic Energy for transport on MAPs and the Whyalla lateral.
-) The distribution network for delivery from the Whyalla lateral to the point of consumption.

The simplest and most convenient approach would be to have all of the capacity trading and ability to acquire or sell transport capacity under “one roof”, and

preferably with an entity that is “disinterested” in the outcomes and already is underpinned by a demonstrable and robust governance framework. In this regard, recognising that each of the pipelines provides a monopoly service, it is clear that if each of the pipelines controls the market for their services, they will have an interest in using the process to maximize their revenues and profitability. If there was active competition on each of the transport sectors, then the pipeline owner would be less able to use control of the pipeline to maximize its benefit, but as noted in section 5 above, all of the gas transmission pipelines in the east coast gas market provide a monopoly service.

The MEU also notes that AEMO already has the capability to expand its existing processes to provide the capacity trading platform and the auctioning process with only minor costs but at the same time provide a service that is independent of pipeline ownership. The MEU notes that the costs estimated by AEMO to provide the auctioning process is higher than that proposed by the pipeline owners via the APGA. The MEU is suspicious of this lower cost proposed by the APGA, as there would be multiple auctions proposed and in theory having more than one auction process must be less expensive than multiples. The MEU considers that the pipeline owners have a vested interest in controlling the auction process as this gives them greater opportunity to maximize their revenues and profitability.

Further, the MEU considers that if the APGA estimate is wrong (ie too low), there will be no ability to test at a later stage if the actual costs are higher than the estimate, and if this occurs then it will be consumers that will pay the higher costs which will not be transparent. In contrast, the AEMO costs will there for all to see and therefore fully transparent. When considered in actual dollar terms, the difference between the AEMO estimate and the APGA estimate is only some \$1.3m of implementation costs. When this amount is considered in context of the total east coast gas market, the saving is modest but provides a transparency and independence that is essential in ensuring that overall, the most efficient outcome is implemented.

The MEU notes the concern that the “fee” for provision of the services for small shippers might prevent a barrier to entry. The MEU points out that this can be addressed in a number of ways (such as a sliding scale where the fee is related to the volumes of gas that are impacted by the trades) but while it is clear that where AEMO provides an independent service there will be a fee for service, other providers including the pipelines themselves will have to charge for the same service but where the basis of the fee charged is not as clear or fair.

Summary

The MEU supports the implementation of a capacity trading platform and considers that all transmission pipelines including laterals should be included in the process.

The MEU considers that AEMO should be initially charged with establishing the capacity trading and auctioning processes as this will ensure that the processes are transparent, independent and scalable, and AEMO already has a demonstrable governance framework in place.

The MEU is concerned that APGA has not provided any demonstration that its estimate for proving a capacity auctioning scheme is robust, but considers that the premium for the AEMO costing is very modest in terms of the total cost of gas used in the market and any premium will be more than offset by the benefits from using the independence of AEMO and a single source for the processes involved.

We appreciate the opportunity to have provided this input to the capacity trading and auction process. Should you wish for amplification of any of the comments provided in this response, please contact our Public Officer (David Headberry) on 03 5962 3225 or at davidheadberry@bigpond.com .

Yours faithfully

A handwritten signature in black ink, appearing to read 'David Headberry', with a checkmark at the end of the signature.

David Headberry
Public Officer

The MEU notes that the responses to the specific questions need to be seen in context with the comments made in the foregoing part of this response to the consultation paper

#	Questions for stakeholders	MEU response
3.1	<p>Do you think:</p> <p>a. a single capacity trading platform should be developed? or</p> <p>b. each pipeline operator should develop its own capacity trading platform?</p> <p>In answering this question, please explain why you think the option you have selected will promote the NGO and achieve the Council's <i>Vision</i>.</p>	<p>See comments above</p> <p>The MEU considers that a single trading platform should be implemented to ensure that there is an easy ability to have continuity of transport across multiple pipelines.</p>
3.2	<p>If you think a single capacity trading platform should be developed, do you think it should be:</p> <p>a. operated by AEMO as part of the Gas Supply Hub? or</p> <p>a. operated on a stand-alone basis by a joint venture of pipeline operators, or another party with relevant experience?</p> <p>In answering this question, please explain why you believe the relevant party should be selected and what the benefits to the market would be from the selection of this operator.</p>	<p>See comments above</p> <p>For transparency, independency and cost reasons, it is preferable for a party independent of pipeline ownership to operate the trading platform. The MEU supports AEMO being the provider of the service and points to the experiences of other operations where the gas market participants provided a common operation (eg gas balancing at a hub); the MEU member experiences in a dealing with a joint venture style arrangement based on gas market participants were not as efficient as when the services were provided by AEMO as an independent operator. AEMO already has provided evidence of its ability to provide some of these new services, and the costs are considered reasonable.</p>
3.3	<p>If the capacity trading platform is to be operated as part of the Gas Supply Hub, do you think that once the trade has been executed:</p>	<p>The MEU is concerned that where the information made public could be identified as providing information about the gas usage by a single user of the gas, then this information must be kept confidential.</p> <p>Where the information is sufficiently aggregated that the gas usage for</p>

	<p>a. the anonymity of trading parties should be maintained by AEMO informing the pipeline operator of the trade (i.e. the fully anonymous option)? or</p> <p>b. the identity of the trading parties can be revealed and the communication of the trade to the pipeline operator left to the trading parties (i.e. the partially anonymous option)?</p> <p>In considering this issue, it is worth noting that pipeline operators have not provided an estimate of how much it would cost to set up the fully anonymous option.</p>	<p>single gas users cannot be identified, then there is value in the information being made more public</p>
<p>3.4</p>	<p>Are there any other elements of AEMO’s proposal that you would like to comment on?</p>	<p>See comments above Table 3.2 shows that using AEMO for this process provides more value to consumers than pipeline controlled options</p>
<p>4.1</p>	<p>Do you think:</p> <p>a. a single auction platform should be developed? or</p> <p>b. each pipeline operator that is to be subject to the auction should develop its own auction platform?</p> <p>In answering this question, please explain why you think the option you have selected will promote the NGO and achieve the Council’s <i>Vision</i>.</p>	<p>See comments above The MEU considers that a single auction platform is all that is necessary and addresses the concerns about multiple trading processes needed if each pipeline implements its own processes</p>
<p>4.2</p>	<p>If you think a single auction platform should be developed, do you think it should be:</p> <p>a. operated by AEMO? or</p> <p>b. operated on a stand-alone basis by a joint venture</p>	<p>See comments above The MEU considers that AEMO should be the operator. Table 4.2 provides clear support for this view other than in terms of cost where the MEU has concerns about the prices estimated by APGA and even if</p>

	<p>of pipeline operators, or another party with relevant experience? In answering this question, please explain why you believe the relevant party should be selected and what the benefits to the market would be from the selection of this operator.</p>	<p>AEMO price is higher, in terms of the overall cost of gas delivered to consumers, the premium is minimal and more than offset by the other advantages of having AEMO provide the service..</p>
4.3	<p>Are there any other elements of: a. AEMO's proposal that you would like to comment on? b. APGA's proposal that you would like to comment on?</p>	

