



Transformation of the gas transmission system

**Response to the Australian Energy Market
Commission's pipeline access discussion paper**

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Kristal Burry, Policy Officer

Energy + Water Consumers' Advocacy Program

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade and Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumer's Advocacy Program

This Program was established at PIAC as the Utilities Consumer's Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council of NSW;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW; and
- Good Shepherd Microfinance.

Introduction

PIAC welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) *Pipeline Access Discussion Paper*.¹ The discussion paper arises from recommendations in the *Stage 2 Draft Report: East Coast Wholesale Gas Market and Pipeline Frameworks Review*² (the Stage 2 report) to reform the contract carriage model of gas transportation in the east coast market outside of the Victorian declared transmission system.³

The review intends to improve the level of capacity trading in the market by:

- reducing search and transaction costs involved in trades,
- enabling shippers to obtain competitively priced un-nominated capacity;
- improving the incentives for shippers to trade capacity;
- reducing actual or perceived discriminatory access to capacity; and
- improving the information on which decisions in the sector are made.⁴

The discussion paper seeks feedback on:

- governance arrangements for the implementation;
- terms and conditions of primary and secondary capacity contracts and standardisation to ensure effective trading;
- operation of the capacity trading platform(s)
- operation of the auction for un-nominated capacity
- information on primary and secondary capacity trades that would be published.⁵

The discussion paper and PIAC's response are part of an on-going process to create a more effective gas market on the east coast of Australia in the long-term interests of consumers. This objective should be at the forefront in any decisions with regard to the development and implementation of market changes.

Governance arrangements

The AEMC has sought feedback on the level of regulation required to ensure the effective implementation of the suite of recommendations in the Stage 2 report. It considers that the pipeline owners have limited incentive to release un-used capacity and that regulation is required to facilitate trading. Submissions to the Stage 2 report indicated that an industry-led approach would be preferable, as industry is best placed to be able to determine the optimal design of the auction and capacity trading platforms. In addition, these submissions argued that an industry-led approach would be faster to implement, because a regulatory approach would require rule and law changes, and that a regulatory approach would 'stifle innovation and investment'.⁶

In response to this, the AEMC stated:

¹ AEMC, *Pipeline access discussion paper, east coast gas market and pipelines frameworks review*. 2016.

² AEMC, *Stage 2 Draft report. East coast gas market and pipeline frameworks review*, 2015.

³ AEMC see above no 1, i.

⁴ Ibid, i.

⁵ Ibid, 2.

⁶ Ibid 5.

... given that there have been few barriers to date to industry-led initiatives in this space, and these have not progressed, the Commission remains concerned that an approach absent sufficient regulatory oversight may not lead to efficient or timely outcomes.

PIAC shares the AEMC's concerns about an industry-led approach and urges AEMC to implement effective regulation to ensure this process proceeds with the long-term interest of the consumers at the forefront of decision-making, as opposed to adopting an industry-focus. This would ensure that the process is in line with the National Gas Objective, which is to:

...promote efficient investment in, and efficient operation and use of natural gas services for the **long term interest of consumers of natural gas** with respect to price, quality, safety, reliability and security of supply of natural gas. [emphasis added]

The chairman of the Australian Competition and Consumer Commission (ACCC) has recently indicated concern that current regulation of the gas pipeline is insufficient, and that the threat of regulation is not enough to ensure effective operation of this system. In addition, he raised concerns that the market is dominated by only a handful of pipeline owners and that in these market conditions regulation is required.⁷

The AEMC has outlined a spectrum of possible governance arrangements, from no regulation through to the standard law and rule change process. One option within that spectrum is the development of an Industry Council to coordinate and determine the standards and implementation of the reform agenda. The AEMC states that a process with more industry involvement would provide an opportunity for industry members to be involved in the decision making.⁸ PIAC is of the view that industry already has a voice in decision making through the consultation process during a rule change or market review.⁹

Further, the AEMC, and possibly other government departments, would potentially participate in and have the role of an 'observer' in the council.¹⁰ PIAC is cautious of this approach, as this still relies on the 'threat' of regulation as observed by the AEMC in the discussion paper, rather than actual regulation. In addition, the AEMC notes that if rules and laws do require changes within the industry-led approach, this may slow the process beyond what would have taken place if a regulation-led approach had been adopted.

Overall, while it is not PIAC's preferred approach, it is PIAC's view that, if the option of an Industry Council is adopted, there should be consumer representatives on the council in order to counter the potential for imbalance and industry bias.

The AEMC has also requested feedback on how to weigh the benefits and disadvantages of the different approaches. PIAC reiterates that a regulation-led approach would provide greater benefit and certainty for consumers and recommends that the AEMC weigh these approaches based on the long-term interests of consumers.

⁷ Mr Rod Sims, Chairman ACCC, speech at Australian Domestic Gas Outlook Conference, Sydney, 9 March 2016.

⁸ AEMC, n 1, 9.

⁹ PIAC, *From complex fragments to competitive consumer-focused markets. Submission in response to Review of governance arrangements for Australian Energy Markets: Issues Paper*, 2015,16.

¹⁰ AEMC n 1, 8.

Recommendation 1

PIAC recommends that the AEMC adopt a regulatory-led approach to the reform of capacity trading within the east coast gas market.

Recommendation 2

PIAC recommends that consumer representatives should be members of the Industry Council if the AEMC establishes an Industry Council to develop and implement the recommendations.

Standardisation of capacity products and contract terms

The AEMC recommends adopting standard products and contract terms, where applicable, to enhance trading and provide flexibility for delivery and receipt points. This will contribute to the aim of reducing search and transaction costs and increase the number of market participants.¹¹ There are a number of contract and product terms that AEMC is seeking feedback on, and PIAC will not comment on each individual item, but rather will focus on the high-level issues and its concerns about regulation and monitoring.

In general, PIAC is of the view that it is better to develop standard terms and conditions for hub services at the same time as developing them for primary and secondary trading, in order to ensure they are complementary and that there are no conflicts. This will ensure that the development and implementation of this recommendation is not unnecessarily delayed.¹²

PIAC supports the adoption of a range of standards for each term, rather than a strict set of standards, to allow some flexibility for the different conditions and variations in the market. However, this range should not be so wide as to be ineffective. In PIAC's view, this is preferable to allowing individual shippers and pipelines to negotiate alternatives to the standards, as this seems counter to the aims of standardisation and transparency.¹³

Currently pipeline operators are able to reject a change in delivery point requested by primary capacity holders for non-technical reasons. PIAC is of the view that pipeline operators should be able to reject changes in delivery receipt points on technical grounds only. This will facilitate fair access and use of pipelines, not only for firm capacity holders, but those trading capacity.¹⁴

Recommendation 3

PIAC recommends that standardisation for hub services are developed at the same time as both primary and secondary trading to ensure consistency across these services and reduce the potential for delays.

Recommendation 4

PIAC recommends that pipeline owners not be allowed to reject changes in receipt delivery points for non-technical reasons.

¹¹ Ibid, 11 & 20-21.

¹² Ibid, 13.

¹³ Ibid, 13-14.

¹⁴ Ibid 15.

Capacity trading platform

The AEMC has recommended developing the capacity trading platform to sell services such as forward, backhaul and bi-directional transportation services, hub and storage services.¹⁵ The standardisation of terms and conditions will help facilitate this. However, there remain challenges in developing an appropriate platform and governance arrangements for the platform and auction.

A key design question is whether there should be a single trading platform jointly operated by the pipeline owners across the market, or multiple platforms operated by individual pipeline owners. PIAC has reservations about pipeline owners operating the trading platforms, as there is greater potential for conflict of interest. The Australian Energy Market Operator (AEMO) was established to manage the operational aspects of the National Energy Market (NEM) and as such should be the one to manage the trading platform as well. The AEMC notes in the discussion paper that it is open to a third option, which would expand the role of the trading hub at Wallumbilla, Queensland, to include a capacity-trading platform. AEMO already operates this trading hub and would expand its role to manage the capacity trading platform.¹⁶ PIAC supports this alternative arrangement and considers a single trading platform to be more appropriate and in line with the goals of the review, which is to create a more liquid and active market across the east coast.

A final point of possible concern is the potential for bilateral trades outside of the trading platforms. PIAC has concerns about allowing trades outside of the trading platform, as this reduces the transparency of the system and reduces price discovery, and also does not guarantee non-discriminatory access, as raised by the AEMC.¹⁷ The discussion paper lists several concerns that may mean trades outside of the platform remain necessary; particularly the fee-to-use the trading platform may be prohibitive for one-off trades.¹⁸ Trading outside of the trading platform is allowed in some circumstances as long as the details of these trades is published on the trading platform prior to the finalisation of the trade to allow time for a third party to outbid the current trade details.¹⁹ PIAC is of the view that there is potential to develop a fee structure that would cover one-off trades and be flexible enough to cover the different trading options.

Recommendation 5

PIAC recommends that a single trading platform for the east coast market be adopted, as this will better facilitate trading across the market.

Recommendation 6

PIAC recommends that AEMO be responsible for operating the capacity trading platform.

¹⁵ Ibid 24.

¹⁶ Ibid 29.

¹⁷ Ibid 33.

¹⁸ Ibid 33.

¹⁹ Ibid 33.

Recommendation 7

PIAC recommends that bilateral trading outside of the platforms not be allowed, unless sufficient measures are taken to allow third parties to compete for the capacity and that the price and contract details be published on the platform, in a manner similar to the US model.²⁰

Capacity auction design

The capacity auction will be used to trade contracted but un-nominated capacity across the system. The final design of the auction is to be determined, however the AEMC has developed a series of options and preferences. PIAC supports the AEMC's preliminary preferences as outlined in the discussion paper²¹ but has concerns about the method for determining the winning combination of bids. The AEMC has indicated that its preference is to select bids that maximise profit. However, it is not clear for whom the profit is supposed to be maximised.²² PIAC supports a method that maximises utilisation of the system rather than one that maximises profit. Consumers will benefit from a system that maximises utilisation of capacity at an efficient price, and maximising use of capacity and the system benefits pipeline owners, by signalling when and where investment may be needed in the system.

AEMC has not indicated who it prefers as the auction manager/operator, selecting from pipeline owners acting collectively, individual pipeline owners or AEMO. PIAC recommends that AEMO is the preferred auction operator as it is an independent operator and, as previously stated, is the designated market operator across the NEM. PIAC has previously stated that AEMO would be best placed to run the trading platforms in combination with its role as auction operator.

Recommendation 8

PIAC recommends that the selection of the winning combination of bids is done to maximise utilisation of capacity and the system, rather than profit.

Recommendation 9

PIAC recommends that AEMO is nominated as the auction operator in addition to its role as trading platform operator and its existing capacities as market operator.

Information provision

The level of information provision has yet to be determined, although the AEMC has previously indicated that price and key terms and conditions for trades should be published to ensure that actual or perceived discriminatory access to capacity does not occur. In addition, PIAC considers that all information that is not confidential should be made public to ensure full transparency within the system and this should apply equally to all primary and secondary trades.

Recommendation 10

PIAC recommends that a policy of full transparency be adopted when it comes to information provision of trades and auctions.

²⁰ Ibid 33.

²¹ Ibid 57.

²² Ibid 51 and 57.

Conclusion

PIAC supports the moves to improve trading, however PIAC has concerns about the level of regulation of this system and remain cautious about the effectiveness of these measures in improving the affordability and supply of gas to residential customers. PIAC recommends that the development and adoption of the suite of recommendations to facilitate trading and capacity utilisation in the pipeline transmission be undertaken on the basis of a regulatory-led approach. In addition, PIAC recommends that AEMO be the responsible market operator for the trading platform and auction.