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Mr John Pierce
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Australian Energy Market Commission
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Dear Mr Pierce

Australian Energy Market Commission Wholesale Markets Paper

AEMO welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Pipeline Regulation and Capacity Trading Discussion Paper, which forms part of the AEMC's East Coast Wholesale Gas Market and Pipeline Frameworks Review.

Effective pipeline capacity trading arrangements are essential to achieving the COAG energy council's vision for a liquid wholesale gas market as well as providing the ability to trade between hubs and arbitrage trading opportunities. AEMO supports consideration of the mechanisms proposed by the AEMC to improve pipeline capacity trading. Arrangements put in place to date have not been effective and as such it is now time to consider more substantial reform of pipeline arrangements.

Measures to facilitate the trading of pipeline services (as outlined in approach A) are important in addressing concerns associated with a participant's ability to efficiently search and match secondary capacity transactions. However, these measures alone are unlikely to drive the active trading of unused, contracted pipeline capacity. AEMO believes it is important to consider a package of initiatives from all three approaches outlined in the discussion paper (facilitating trade, shipper incentives and pipeline operator incentives).

AEMO looks forward to engaging further with you during the course of this Review. If you would like to discuss the contents of this submission further, please do not hesitate to contact Paddy Costigan on 03 9609 8407.

Yours sincerely,

Peter Geers
Executive General Manager, Markets

cc:

Attachments: AEMO submission on Pipeline Capacity

Attachment: AEMO submission on Pipeline Regulation and Capacity Trading

This attachment outlines AEMO's view on approaches to incentivise pipeline capacity trading as set out in the *Pipeline Regulation and Capacity Trading* discussion paper (section 4).

A comment that is common to all approaches is that storage facilities, hub services (e.g. compression) and other pipeline services (e.g. renominations, backhaul) should be specifically included in the discussion of regulation and trading arrangements.

Approach A

Measures to facilitate the trading of pipeline services between shippers are important in addressing inefficiencies associated with a participant's ability to search for, and match, short-term pipeline capacity transactions. However, these measures alone are unlikely to resolve issues associated with pipeline congestion and utilisation as they do not address incentives to trade, or make available, unused contracted pipeline capacity.

Section 4.1 of the discussion paper considers that approach A could be applied in the first instance, with more significant regulatory changes (such as approaches B and C) being applied upon further review. Initiatives implemented in recent years to facilitate the trading of pipeline services between shippers, including standardisation and matching, have not been effective in developing secondary trading of pipeline capacity. As such, AEMO believes further reform should be considered now rather than in the future. While standardisation and other initiatives outlined in approach A are important, to be effective they will need to be combined with reforms outlined in approach B and C.

Standardisation of pipeline service contracts

Standardised arrangements to assist in the facilitation of secondary trading should focus on the operational aspects of a Gas Transportation Agreement (GTA), including delivery point flexibility, nominations, allocations and fees for associated administrative services. Standardisation of terms and conditions should assist in the facilitation of secondary trading in pipeline capacity, benefits include:

- Assisting in the valuing and benchmarking of offers in pipeline capacity, allowing trading participants to compare recent transactions and aiding in the search process.
- Reduce legal costs and approval processes for multiple counterparties potentially reducing the entry hurdle for participants.
- May simplify credit and prudential requirements and market risk management.
- Allow for harmonized development across the market.

Bespoke terms and conditions for primary capacity between pipeline owners and shippers under existing GTAs may be able to be maintained subject to them not restricting the secondary trading of capacity. Capacity traded in the secondary market would require a higher degree of standardisation. While a transition to standardisation of terms and conditions should aim to minimise the impact and commercial risk on contract holding shippers, a degree of market risk should be anticipated in secondary market transactions.

Standardisation in the form of minimum service requirements would also be beneficial for the trading of pipeline capacity trading. Standard services could include on-the-day renominations, title transfer services and allocation arrangements. Standardisation of contracts would also be integral to the capacity release mechanisms outlined in approach B.

The discussion paper considers whether regulation is required to achieve standardisation across pipelines. AEMO understands that work to standardise GTAs (applicable to both primary and secondary trading) has been carried out by individual pipeline operators. AEMO is not aware of work to standardise pipeline services across pipelines. As such, standardisation across pipelines is likely to require greater coordination or regulation.

Auction of spare pipeline capacity

The paper outlines the potential for pipeline operators to auction uncontracted pipeline capacity. The auctioning of primary capacity is likely to be a good initiative for managing scarcity and enhancing transparency. However, on its own the auctioning of uncontracted capacity is not likely to be effective in managing congestion on the east coast where there is a high level of contracting of primary capacity on key pipelines. An auction of uncontracted firm capacity could be combined with any capacity that is surrendered (voluntarily or otherwise) by shippers.

Within the current investment and regulatory framework, the auction of capacity in combination with an open season could be used to provide non-discriminatory access to new developable capacity or the re-contracting of capacity (of which a portion could be reserved for auction).

Transaction efficiency

Improvements can be made to the mechanisms available to shippers for the trading and settlement of capacity transactions. A central trading platform that allows transactions to be formed, settled and reported could reduce transaction costs for participants. The central trading platform could also make direct notifications to pipeline operators that automatically transfer traded capacity from a seller to a buyer. These improvements could be considered alongside initiatives outlined in approach B & C.

Approach B

AEMO supports the consideration of incentives for shippers to trade unutilised, contracted pipeline capacity. While they may be covered implicitly, AEMO believes it is important to specifically include storage and hub services (like compression) in the discussion of a shipper's incentive to trade unused, contracted capacity.

Capacity release

AEMO agrees with the pros and cons of the different release mechanisms, and their application in the east coast gas market, as presented in the discussion paper.

The discussion paper notes the implementation of a capacity release mechanism could be complicated and could impact upon the use of pipeline services by contract holders. If designed to encourage the efficient, short-term utilisation of unused contracted pipeline capacity then there should not be a material impact on the effective use of capacity by contract holders. The design of a release mechanism could be guided by experience in international markets to minimise complexity, cost and impact on contract holders.

The discussion paper also outlines concern over capacity release and the potential for a free-rider problem. A free-rider problem could occur if the wholesale gas market or the capacity release mechanism provide a non-contract holding shipper equal (or close to equivalent) access to firm pipeline capacity (or market access) as contract holding shippers. Effective design of this mechanism with a view to maintaining long term incentives should alleviate free-rider concerns. Physical congestion (actual or forecast) should continue to provide the necessary signal to shippers to make efficient long-term infrastructure investments.

An active secondary market for the trading of pipeline capacity would reduce the risk associated with, and provide a signal for, long-term infrastructure investment.

GTA contract provisions

The discussion paper considers prohibitive contractual provisions in GTAs which limit capacity trading. If there are GTAs that have contractual provisions that limit capacity trading then they should be addressed before designing arrangements for managing congestion (including release mechanism and revenue distribution) – such arrangements should not be designed around GTAs.

Reserving capacity for short-term trades

Reserving newly developed capacity for short-term trading is likely to help resolve scarcity with capacity being allocated to the users that value it the most. However, such arrangements are not compatible with the contract carriage arrangements as long term contracts underwrite the development and expansion of pipeline assets.

Approach C

It is important to consider pipeline operator incentives as part of a package of initiatives to improve access to pipeline capacity.

Coverage

AEMO has observed that, in general, the reference services on covered pipelines on the east coast have a relatively narrow definition that excludes many of the services (e.g. renominations, backhaul) that shippers require to participate effectively in retail and wholesale gas markets. The discussion paper appears to focus on the trigger for pipeline regulation, AEMO suggests that the scope of the review should be broadened to consider pipeline regulation more holistically.

AEMO also believes the consideration of regulatory arrangements should be expanded to include other gas facilities (e.g. storage facilities).

Prohibitive contract provisions

To alleviate concerns over prohibitive clauses, pipeline service contracts could be submitted to the AER for review. This approach would allow the issue to be regularly monitored. A move towards standardisation of pipeline service contracts across the east coast should reduce the administrative burden associated with this type of oversight.

Pipeline Services

Consideration of pipeline operator incentives could be expanded to include minimum pipeline service levels. Pipeline services could include standards in relation to renominations, delivery point flexibility, allocations and title transfers. Such services are important to support trading of gas and in turn are important in achieving the council's vision of a liquid wholesale gas market.

AEMO is not a party to pipeline contracts but has received feedback on pipeline services during market development activities with stakeholders. Feedback from trading participants suggests that pipeline contractual arrangements can act as a hurdle to efficient short-term trading, some common concerns include:

- On-the-day renominations are not possible on some pipelines and on others the prices are relatively high making many short-term trading opportunities uneconomic.
- Commercial terms of pipeline services (e.g. park and loan, backhaul services) impact upon participation in mandatory markets.
- Title transfer services are not available on all pipelines¹.
- On some pipelines trading participants lack confidence in the allocation processes (i.e. there is uncertainty over what and how gas deliveries are allocated to shippers) and as a consequence do not have confidence in the reliability of gas transactions. This lack of confidence can deter trading participants from entering into economic transaction opportunities.

¹ Title transfer services are an accounting service that facilitate on-selling of natural gas on a pipeline.