

14 November 2012

Mr John Pierce
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Australian Energy Market Commission
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FROM THE OFFICE
OF THE CHAIRMAN

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Dear Mr. Pierce

Market Operator Service Timing and Eligibility in the Short Term Trading Market

AEMO submitted a rule change request on 22 June 2012 to make an amendment to the National Gas Rules (NGR) to:

- move certain provisions dealing with timing aspects of the Market Operator Service (MOS) offering process from the NGR to the Short Term Trading Market (STTM) Procedures; and
- broaden the eligibility for MOS provision in the STTM from eligible contract holders to any STTM Shipper, provided there is an underlying agreement that allows this to occur.

The Australian Energy Market Commission (AEMC) published a consultation paper to facilitate stakeholder submissions on the proposed rule change and received submissions from Stanwell Corporation, Origin Energy and Alinta Energy. AEMO has prepared a response to the issues raised by stakeholders in their submissions.

AEMO would be pleased to have these responses considered by the AEMC. For further details, please do not hesitate to contact Arlyne Yuliana on 03 9609 8477 or Roger Shaw on 03 9609 8585.

Yours sincerely



Terry Grimwade
Group Manager Market Development

Attachment: STTM MOS Timing and Eligibility – AEMO Response to Stakeholder Submissions for AEMC Consultation

STTM MOS TIMING AND ELIGIBILITY – AEMO RESPONSE TO STAKEHOLDER SUBMISSIONS FOR AEMC CONSULTATION

PREPARED BY: Market Development

DATE: 14 November 2012

FINAL

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1 Summary

AEMO undertook an extensive public consultation into the operation of the Short Term Trading Market (STTM) between August 2011 and March 2012, making a number of recommendations including changes to the operation of Market Operator Service (MOS) to improve competition in the STTM¹.

AEMO developed the rule change request in consultation with STTM Consultative Forum (STTM-CF), and submitted the rule change request to the Australian Energy Market Commission (AEMC) on 22 June 2012 to:

- reduce the MOS period,
- alter the associated timings for MOS offers and the publication of MOS stacks, and
- extend the eligibility to offer MOS in the market to any STTM shipper.

On 13 September 2012, the AEMC published a consultation paper, inviting submissions from stakeholders regarding the proposed rule change request. Three submissions have been published on the AEMC website (from Stanwell Corporation, Origin Energy and Alinta Energy) and this paper outlines AEMO's responses to each issue raised by the stakeholders in their submissions.

2 AEMO's Responses to Issues Raised by Stakeholders

2.1. Length of MOS Period

Stanwell Corporation and Alinta Energy support reducing the MOS period from 3 months to 1 month. However, both companies stated that consideration should be given to further reduce the MOS period to daily, or at the most, weekly.

In the initial discussion paper titled *STTM Reviews Phase 1 – Discussion Paper* dated 16 August 2011, AEMO raised concerns with competition in the provision of MOS and discussed whether the MOS period might impact this. Stakeholders' submissions to the discussion paper presented views ranging from a daily MOS period to no change to the MOS period (3 months).

AEMO then discussed three options for the MOS period (i.e. daily, weekly and monthly) in the draft report titled *STTM Design and Demand Hub* dated 19 December 2011, and expressed a preference for a monthly MOS period. Stakeholders' submissions to the draft report again expressed views ranging from daily MOS to no change to the MOS period, as summarised below:

- Adelaide Brighton Cement (ABC) and the Major Energy Users (MEU) considered that it was premature to reduce the MOS period, given the low numbers of MOS providers in the

¹ The notes and information for the consultation papers and workshops have been published on AEMO's website on the STTM Reviews page: <http://aemo.com.au/Gas/Market-Operations/Short-Term-Trading-Market/Review-of-Short-Term-Trading-Market>

market at present and the potential for exerting market power that a shorter MOS period might have.

- Origin Energy did not consider the changes to the MOS period were required and questioned where the additional capacity to offer MOS would come from.
- AGL, Alinta Energy, Australian Power and Gas (APG), BP, Infratil, and Energy Australia (previously TRUenergy) supported a shorter MOS period, ranging between one week and one month.
- International Power (IP) was in favour of a daily MOS period so that those who participate in the National Electricity Market (NEM) could enter and exit MOS market on daily basis.

As noted in AEMO's final report titled *Review of the STTM Operations and Demand Hubs* dated 30 March 2012, AEMO has considered all stakeholders' feedback and recommended reducing the MOS period to one month and automating the offer process to reduce lead times for offer submission.

The rationale for choosing a monthly MOS period over a weekly MOS period is to provide balance between price certainty for the market and the ability for shippers to enter and exit the MOS market. A monthly MOS period should allow MOS providers the flexibility to make more MOS offers that align with seasonal demand changes and their capacity holdings. A move to daily MOS may require more fundamental changes to the way MOS operates and would require significant consideration.

Furthermore, consultation with stakeholders has shown that a staged approach to reduce the MOS period is preferred to minimise risk to the market, with the potential to further reduce the MOS period when the market has matured and gained more experience with a shorter MOS period. Therefore, AEMO proposes that any further changes to the MOS period should be considered and evaluated through the STTM-CF, prior to formal consultation on a change to the STTM Procedures.

2.2. Maintain Some MOS Timings in the National Gas Rules (NGR)

Alinta Energy argues against moving rules provisions for MOS period and MOS process timings to STTM Procedures, preferring to have these in the hands of the AEMC.

As mentioned in AEMO's rule change request, AEMO has considered maintaining the approach whereby the timings for when MOS offers are due and when MOS stacks are published are prescribed in the NGR. However, specifying the timings in the STTM Procedures will provide greater flexibility to make subsequent amendments when the market is ready to move to a shorter MOS period. This will reduce the implementation time for the changes but still retains the prescribed consultation and change management process.

AEMO notes Alinta Energy's preference to have maximum MOS period and MOS process timings being prescribed in the NGR for regulatory certainty. Therefore, should the final rule determination introduce this; AEMO proposes that the maximum thresholds are:

- a MOS period of no greater than one month
- the closing time to make or update MOS offers for a MOS period shall be no more than 5 days prior to the start of the MOS period
- the MOS stack to be published within 24 hours of the close of submissions
- where the MOS period is one month, AEMO must publish a notice inviting MOS offers in accordance with STTM Procedures

Furthermore, AEMO recommends that if there is a rule requirement to publish a notice inviting MOS offers; the period of notice should be covered in the STTM Procedures so a shorter period can be adopted if required.

2.3. Notice to Invite MOS Offers

Stanwell Corporation does not support the removal of the requirement for AEMO to publish a notice inviting MOS offers.

Rule 398 the NGR requires AEMO to issue a notice 40 business days prior to each MOS period requesting MOS offers and specifying submission dates, the relevant MOS period, a statement that an eligible contract holder must comply with the requirements of rules 399 and 400, and any other matter reasonably required as specified in the STTM Procedures.

AEMO proposed removing the obligation to publish a notice inviting MOS offers on the basis that it was envisaged that the MOS period would reduce over time. Should the AEMC decide to retain the requirement to publish a notice in the rule, AEMO proposes that the approach noted in section 2.2 is adopted.

2.4. Net Market Benefit on MOS Eligibility Changes

Origin Energy recommends AEMC to consider the net market benefit on broadening the eligibility to supply MOS.

There are two separate components associated with the proposed rule change, which will require changes to AEMO's market systems. These components and details of the cost and benefit are further described below.

2.4.1. Reducing MOS period

AEMO’s systems are able to handle shorter (or longer) MOS period. Therefore, there is no associated cost to change the system. However, currently the MOS offer and validation process is done as a manual process (every 3 months), which carries a risk of error.

AEMO’s proposal is to automate the MOS offer submission and validation process at the same time as reducing the MOS period to monthly, to allow validation of MOS offers and the publication of the MOS stack in a shorter period. This is expected to benefit the market as it allows MOS providers to respond to market, operational and seasonal conditions closer to the MOS period leading to more efficient prices for MOS offers. Furthermore, as the market is transitioning to a shorter MOS period, the automation process is necessary to eliminate the risk of mistakes caused by more frequent manual processes.

STTM shippers offering MOS will need to make changes to their own business processes and systems to submit MOS offers via the STTM Web Exchanger (S-WEX) or the STTM Web Exchanger Interface Engine (S-WEXIE), rather than via email. This will incur some cost to trading participants, and this cost is not included in AEMO’s cost estimates. The design of the automated transactions will be based on the current format and manual validations to minimise the impact on trading participants that have developed systems or automated process to generate MOS offers. Ultimately, the cost of entering MOS offers is voluntary and should be considered as part of the cost of making MOS offers.

2.4.2. Supply of MOS by Trading Right Holders

Allowing trading right holders to supply MOS is expected to increase the competition for the supply of MOS at the hub. As a result, it is expected that the market will see a decrease in the cost of MOS.

Observation of MOS pricing curves in the STTM to date shows that an increase in the number of MOS providers generally results in lower MOS prices, as shown in figure 1 and 2 below.

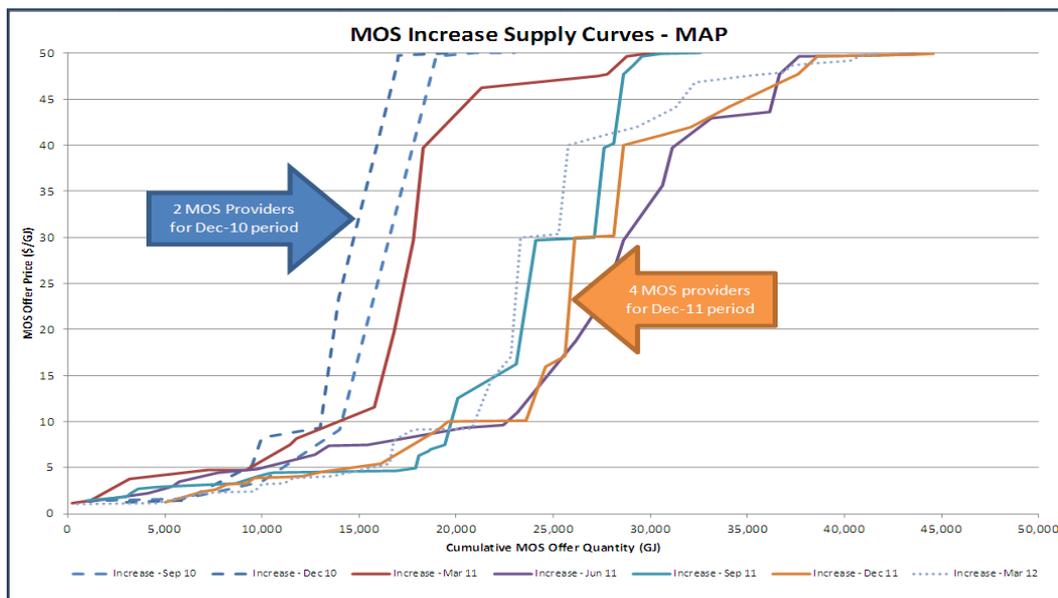


Figure 1: MOS Increase Supply Curve for MAP Pipeline

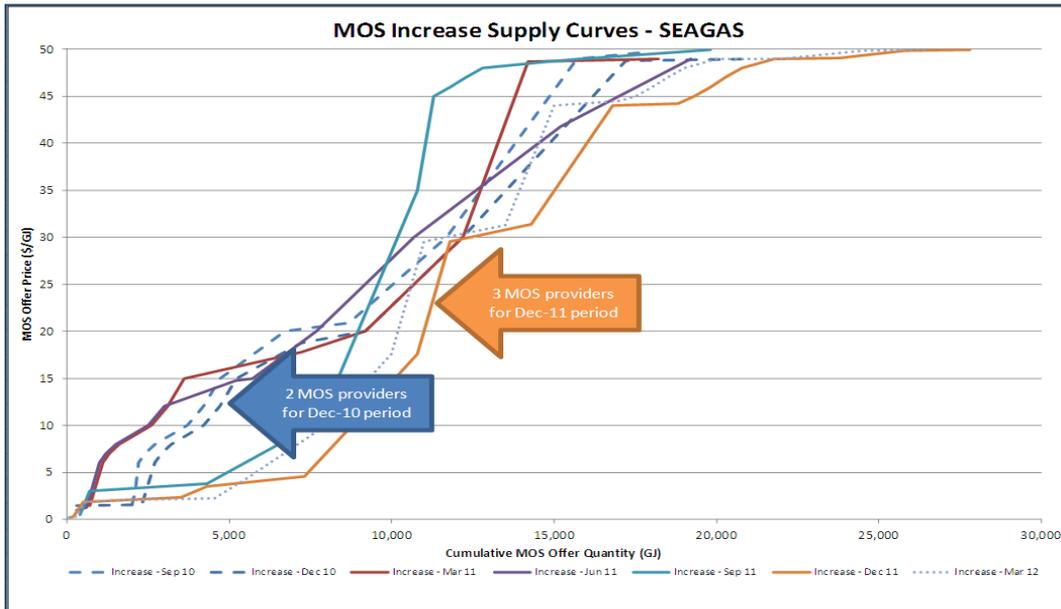


Figure 2: MOS Increase Supply Curve for SEAGAS Pipeline

Conversely, a decrease in the number of MOS providers generally results in an increase of MOS prices, as shown in figure 3.

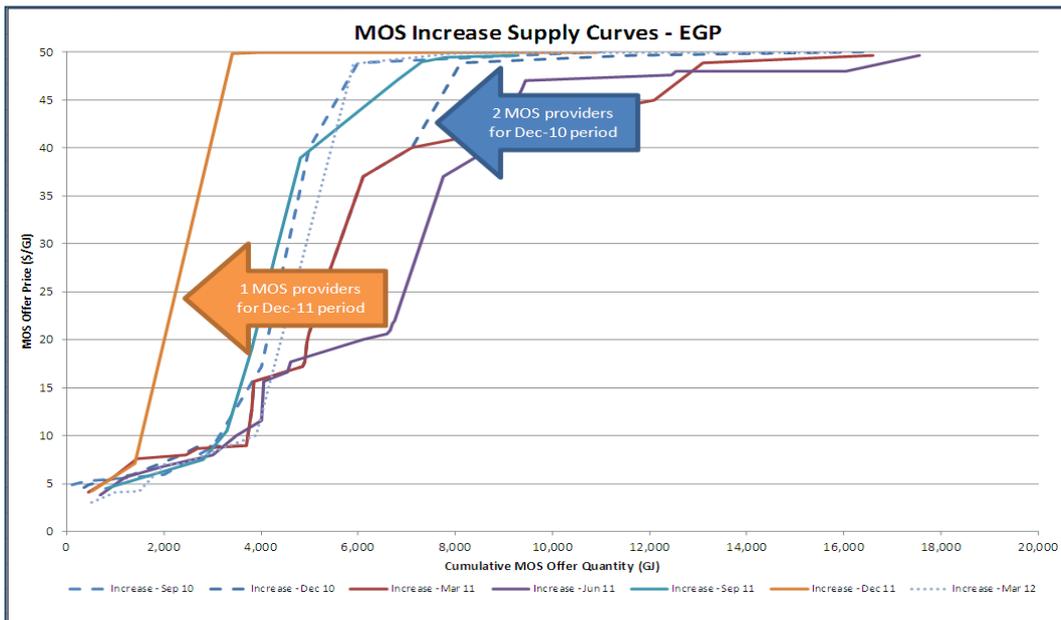


Figure 3: MOS Increase Supply Curve for Eastern Gas Pipeline

Furthermore, the implementation of the proposal would give the contract holder the potential benefit to earn a return on their contract holding by entering into a commercial arrangement with another shipper to transfer the right to supply MOS. This is similar to the current process of transferring rights to capacity via trading rights that is allowed in the ex ante market scheduling process.

As outlined in AEMO’s final report titled *Review of the STTM Operations and Demand Hubs*², the proposed implementation is expected to be designed so that there are no changes to participants’ systems for the preparation and submission of STTM facility allocations, MOS step allocation or registered facility service allocations.

² Section 6.1 for MOS Period and 6.2 for Supply of MOS by Trading Right Holder

2.4.3. Additional Information on Cost and Benefit

As there are synergies of work between automation of MOS offers process and provision of MOS by trading right holders, AEMO has proposed to implement these two components together, with total estimated cost of \$200,000. The table below represents the estimated increased cost should AEMO implements the proposed changes.

	AEMO's costs over 5 year period		AEMO's Total Cost
	System Cost	Labour Cost	
CURRENT :			
- Quarterly MOS period			
- Manual process of validating MOS offer and compiling the MOS stack	\$ -	\$ 120,000	\$ 120,000
PROPOSED:			
- Monthly MOS period			
- Automation of MOS offer and MOS stack generation process	\$ 200,000	\$ 60,000	\$ 260,000
- Allow MOS provision at the trading right level			
Increase cost due to implementing the proposed changes			\$ 140,000
Approximate cost of MOS services over 5 year period³			\$100,000,000

The cost benefit analysis suggests that the market only needs to see 0.14% reduction in the cost of MOS over a 5 year period to fully recover the cost of implementing the proposed changes.

2.5. Balance between the NGR and STTM Procedures

Origin Energy argued that there should be balance between what is in the NGR and the Procedures. Therefore, Origin Energy proposed AEMC and AEMO to overlap their respective consultations prior to the close of submissions to the AEMC's draft determination.

As mentioned in AEMO's final report titled *Review of the STTM Operations and Demand Hubs* (under the proposed implementation plan section) and the rule change request, below is the high level summary of the required STTM Procedures changes:

- STTM Procedures would be amended to reduce the MOS period to one month and to include the timing for the submission of MOS offers and the publication of MOS stacks, as well as other technical details currently described in rules 398 and 400.
- The change to the definition and application of *MOS provider* in the rules must be extended to the STTM procedures.
- New obligations will be created for contract holders, where they have transferred their MOS eligibility to a third party, to designate a trading right as being eligible to supply MOS.

³ Based on 2011-2012 financial year data (with STTM Brisbane hub only started on 1 December 2011), the current cost of MOS provision to the market is approximately \$20 million per annum.

AEMO intends to start the proposed procedure change consultation process once AEMC publishes the draft determination for the MOS rule change request, as it would be premature to start developing the STTM Procedures ahead of this.