



Future-orientated design

**Response to the AEMC's wholesale gas market
discussion paper**

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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 Consumers' 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) discussion paper, *Review of the Victorian Declared Wholesale Gas Market*.¹ This discussion paper was written in order to further develop the recommendations made in the AEMC's review of the Victorian declared wholesale gas market (the DWGM).

The AEMC has proposed the development of an entry-exit system within the Declared Transmission System (DTS) to provide greater flexibility, transparency and lower transaction costs within the market. To do this will require the development of new capacity rights, pricing and revenue and balancing mechanisms.²

Managing capacity in the Southern Hub

The reform of the Victorian DWGM will require review of the institutional arrangements between the Australian Pipeline Association (APA), the owner of the DTS, and the Australian Energy Market Operator (AEMO), the system operator. The AEMC has proposed allocating responsibility for selling baseline pipeline capacity to APA in addition to its role as owner of the pipeline. AEMO would be responsible for determining any extra capacity, selling this additional capacity, system operation, managing congestion and residual balancing. These divisions are similar to what occurs now, modified to be appropriate for an entry-exit system. APA would be required to submit its proposed baseline allocations for each entry and exit point to the Australian Energy Regulator (AER) for approval, along with the reserve price for accessing baseline capacity.³

PIAC supports this division of roles within the proposed Southern Hub and supports the regulatory-led approach to setting the baseline capacity and pricing.

Recommendation 1

PIAC recommends the adoption of the proposed allocation of roles between APA and AEMO with regulatory oversight by the AER.

Capacity allocation mechanisms

A key design feature of the new Southern Hub will be the allocation of capacity at both the entry and exit points. This is particularly relevant for when demand for capacity exceeds the system capacity. There are a number of methods available and in use within the European gas market that may be applicable to the Southern Hub:

- auctioning capacity;
- pro-rating capacity;
- first-come-first-serve; and
- capacity tied to end-use customers.⁴

¹ AEMC. *Discussion Paper: Review of Victorian declared wholesale gas market*. 2016.

² Ibid 8.

³ Ibid 18.

⁴ Ibid 26.

The most important of these mechanisms for residential users is the ‘capacity tied to end-use customers’ mechanism, as retailers are unable to predict the amount of gas they require because of the variability of residential use. Capacity is allocated automatically based on the downstream market share of a retailer and works similarly to the current Authorised Maximum Daily Quantity (AMDQ) for Tariff V customers.⁵ If another mechanism was used for this class of market participant it may reduce the ability of small retailers to access capacity as larger users may use their dominance to block smaller users.⁶

To cater for the different types of market participants and different features of the entry/exit points within the system, the AEMC has proposed adopting different allocation mechanisms to best suit these locations. Auctions are proposed for points where parties can control the quantity of gas injected/withdrawn from the system. These are typically production points, interconnection points and storage entry/exit points. Automatic allocation is proposed for distribution points for retailers, as described above. Auctions are proposed for exit points for large users directly connected to the system.⁷

PIAC supports the adoption of a mix of mechanisms for allocating capacity, as this will provide increased flexibility and increase the opportunities for small retailers to enter the market.

The existing system has market certificates (AMDQ and AMDQ cc) that provide the holder certain rights when capacity is scarce. These certificates will require a transition mechanism to provide holders equivalent allocation rights in the Southern Hub. The AEMC is proposing that holders of these certificates are granted firm entry/exit capacity equivalent to their current levels for a defined period, after which the holder would be required to participate in the allocation mechanisms at the specific entry/exit point they are seeking access to.⁸

PIAC considers this to be a transparent and fair process for managing these market rights, however, it cautions against adopting a timeframe that is longer than the length of allocation of capacity in the new system to ensure that as many participants are active in the system as possible.

Recommendation 2

PIAC recommends the adoption of the multiple mechanisms for allocating capacity at entry and exit locations within the Southern Hub.

Recommendation 3

PIAC recommends the proposed transition of AMDQ and AMDQ cc certificates to firm capacity, but recommends that the allowed timeframe that these rights are held for does not decrease participation in the market.

Capacity pricing and revenue

The DTS is a covered pipeline, which means APA is required to submit access arrangements every five years to the AER. The AER is able to determine what services APA is allowed to

⁵ Ibid 29.

⁶ Ibid 28.

⁷ Ibid 37.

⁸ Ibid 42.

charge based on what proportion of the market participants are likely to want to purchase them. The AEMC has indicated there may be challenges in applying the existing regulation framework to the proposed Southern Hub.⁹

The economic regulation of pipelines is of concern to PIAC and, given the changing nature of the DTS and the broader east coast gas market, PIAC considers this to be the ideal time for a full review of the economic regulation and test for coverage of pipelines within the east coast gas market. This will ensure that the Southern Hub, the transition to the development of the proposed Northern Hub, and the gas transmission system as a whole are sufficiently regulated to mitigate the effect of the significant control of the transmission system by just a few pipeline owners.

PIAC notes that others have also called for a review of economic regulation of this system; notably, the Chairman of the Australian Competition and Consumer Committee (ACCC) has indicated that this will be one of the recommendations in the ACCC's review of the east coast gas market, due in April 2016.¹⁰

Recommendation 4

PIAC recommends that AER hold a detailed review of economic regulation of transmission pipelines and the test for coverage of pipelines.

Balancing

The final design question for the Southern Hub is how the balancing of gas within the system is conducted and who would be responsible for the balancing. Injections and withdrawals from the system must be balanced within the system specifications to ensure that pipeline pressure remains within the safe limits. The AEMC has proposed a system that would incentivise shippers to keep the system in balance, with AEMO performing residual balancing activities. After analysis of the European market, AEMC has proposed two options:

- Continuous market-based balancing: this would incentivise shippers to determine when and how to balance the market anytime, as long as the system overall remained in balance. AEMO would only be required to intervene if shippers failed to take corrective steps and would then charge shippers that are out of balance a fee to cover the costs of purchasing gas or operating the system to return it to balance;
- Fixed period market-based balancing: this would require AEMO to settle any shippers out of balance at the end of the 24-hour period. While shippers would be able to make corrective moves within the 24-hour period, AEMO would incur more costs in ensuring that the system remained balanced during the balancing period, as shippers would only have to pay at the end of the 24-hour period.¹¹

According to the AEMC's analysis, the continuous market-based balancing would provide greater flexibility and certainty for shippers to self-balance the system and would reduce barriers for

⁹ Ibid 45.

¹⁰ Mr Rod Sims, Chairman ACCC, speech at Australian Domestic Gas Outlook Conference, Sydney, 9 March 2016.

¹¹ AEMC see above 1, 67-72.

smaller market participants to enter the market.¹² PIAC supports this reasoning and the adoption of this method of balancing the system.

Recommendation 6

PIAC recommends that AEMC adopt the continuous market-based balancing system in the proposed Southern Hub.

Conclusion

PIAC is generally supportive of the proposed design options for the Southern Hub, as they are designed to increase opportunities for small market participants to enter the market. The AEMC has also developed capacity allocations that factor in the different requirements for retailers with residential customers. While PIAC is supportive of these moves, it is difficult for consumers to understand how the proposed design elements will affect them as participants in the market. PIAC requests that the AEMC provide additional consultation for consumers and consumer representatives to facilitate their input into the system design and implementation. Given the changes that are being made not just to the Victorian market, but to the whole east coast market, PIAC recommends that this an ideal time to review the economic regulation of gas transmission pipelines.

¹² Ibid 68 and 72-73