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Dear Mr Roberts

Australian Energy Regulator Review of Facility Operator Compliance with The Rules Relating to Standard Operational Transportation Service Agreements

AEMO welcomes the opportunity to comment on the Australian Energy Regulator's review of facility operator compliance with the Rules relating to standard Operational Transportation Service Agreements (OTSAs). AEMO is concerned that the pricing structures set out in some OTSAs may be acting as a barrier to participation for the Day Ahead Auction (DAA or the auction) and the Capacity Trading Platform (CTP) on some facilities.

The CTP and DAA were established to enable the development of a liquid secondary market in pipeline capacity which in turn will support the efficient allocation and utilisation of transportation facility capacity across the east coast. The CTP is a secondary market intended to facilitate the trading of unutilised firm contracted pipeline capacity. This market enables excess contracted capacity to be on sold to other participants who value it most. The auction is intended to incentivise firm shippers to offer their unutilised capacity for sale via the CTP as any unsold and unutilised contracted capacity is released to the DAA. In addition, the auction provides a market price for short-term pipeline capacity which has historically been determined by commercial negotiation between facility operators and shippers.

For these reforms to be successful it is important that participants have the ability to utilise both the DAA and CTP as they have interrelated incentives. Firm shippers need to have the opportunity to sell their capacity via the CTP to buyers prior to it being released into the auction. In turn, the auction needs to be accessible to as broad a range of shippers as possible so that firm shippers have an incentive to sell their capacity into the CTP in the first place. An OTSA is required to participate as a buyer in both markets and participation in either market is subject to fees charged by facility operators. Therefore, the fee structure needs to be non-discriminatory between markets and should be structured in a way that enables the broadest level of participation possible by firm and OTSA shippers.

AEMO's views from market establishment

AEMO has been encouraged by the early level of participation in the DAA. As of 22 July 2019, over 12.5 PJ (on average, 85 TJ per day) of capacity has been bought through the auction by 5 registered participants. No capacity trades have been made.

To date, auction participation has largely been concentrated (over 95% of capacity allocated) on pipelines owned by APA Group. Auction participants have frequently used linked bidding across interconnected facilities. The linked bidding functionality allows participants to buy transportation capacity for a pathway across multiple assets simultaneously through a single bid without having the risk of acquiring capacity on only part of the pathway. As an example, participants can use a linked bid to acquire capacity from Wallumbilla to Sydney which requires the purchase of capacity on multiple facilities. Linked bids have been an important enabler for participants in utilising auction capacity as part of their gas portfolio. We do note that there has been no participation on pipelines in South Australia to date, so there has been no linking of bids observed between facilities in Queensland or Victoria and South Australia. The popularity of linked bids highlights the interconnectedness of the pipeline network and the benefit from adopting a consistent approach to the cost recovery structure between facility operators.

Potential issues with the fee structure of OTSAs

Facility operators have taken a range of different approaches to the fee structure of their standard OTSAs using substantially different ratios between fixed and variable fees. AEMO considers that an appropriate and consistent charging structure across facility operators would better promote efficient and broad participation in the new markets.

Some facility operators have elected to recover their costs entirely through fixed charges recovered on either a monthly or annual basis, and also through upfront charges which are charged on top. A high fixed fee weighting may be negatively impacting participation on the CTP in particular. Capacity trades are likely to occur at a lower frequency than commodity trades or auction purchases as the market grows. Such trades may include participants trading capacity to manage maintenance outages or seasonal variations in demand. High fixed costs are likely to act as a deterrent to these types of trades, as the fixed costs may outweigh the value of a single trade even if it is for a substantial volume.

Relatively high fixed or upfront costs are likely to impact auction participation. Given the non-firm nature of auction capacity, participants are likely acquiring auction capacity to arbitrage between markets and/or to supplement their firm capacity. Such activity in the auction is likely to be intermittent in nature and high fixed fees are likely to act as a barrier to participation. In general, high fixed costs disproportionately negatively impact those with smaller gas portfolios (typically new entrants, large users, and small retailers). This may shrink the pool of potential participants for CTP products and the auction.

There are also potential issues if facility operators attempt to recover costs through high variable charges. Given the interdependency of capacity between interconnected pipelines, a high variable fee charged by one facility operator may make an entire capacity pathway uneconomic. As mentioned, in the auction, participants use linked bids to bid for a pathway of capacity. For linked bids, the variable fees charged by facility operators are increasingly important as participants must pay the tariff for each facility that they transit. For example, if a facility operator of a compressor that is required to transport gas between two pipelines charges a high variable cost, a linked bid across the three facilities may not be economic. As access to the compressor's capacity is required to utilise the capacity between the two interconnected pipelines, capacity on the individual pipelines is not useful without also having capacity on the compressor. As such, the high variable cost charged by one facility (the compressor in this case) will likely have flow-on impacts for demand on other facilities and may lead to lower participation in the auction overall.

High variable charges are likely to have similar effects on the CTP. Although orders on the CTP are not linked, the interconnectedness of transportation facilities means that high variable costs charged by some facilities may also undermine demand and participation for a broad range of CTP products.

Ultimately, as the market is voluntary, if participation is low on a facility then the facility operator will not be able to recover their implementation and ongoing costs. As such, the implementation of efficient fee arrangements should be in the best interest of both shippers and facility operators. An exception could be where a facility operator benefits from a lack of auction participation through greater use of as available services that are charged at higher rates.

Rule 634(3)(c)(iii) requires facility operators to recover the standardisation costs over time in a manner that promotes efficient trade in, and utilisation of, transportation capacity. Considering the interrelationship of the incentives for the CTP and DAA and the interconnectivity of transportation facilities, AEMO is supportive of a more balanced and consistent fee approach across facility operators to meet the intent of Rule 634(3)(c)(iii). This may involve facility operators recovering their costs over time through a mix of both fixed and variable charges determined in a similar and consistent ratio. We note that some facility operators have adopted such an approach and we would encourage this model to be adopted more generally. Ultimately, inefficient fee structures have the potential to undermine the policy objective of this reform to support the efficient allocation, utilisation and pricing of transportation facility capacity across the east coast.

If you would like to discuss the contents of this submission further, please do not hesitate to contact Paddy Costigan, Manager Market Design on 03 9609 8407.

Yours sincerely

Peter Geers

Chief Strategy and Markets Officer