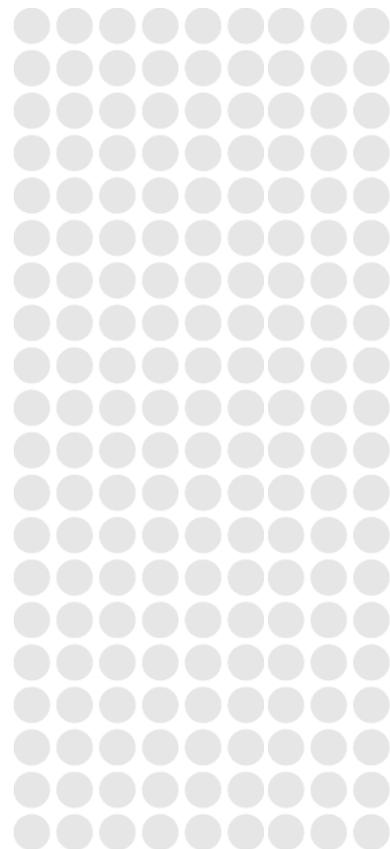




November 2017

# day-ahead auction of contracted but un-nominated capacity & reporting framework

**apa response to consultation paper**



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## **1. Submission overview**

In this submission, APA Group (APA) provides responses to the questions raised in the Gas Market Reform Group (GMRG) Consultation Paper *Day-Ahead Auction of Contracted but Un-nominated Capacity & Reporting Framework*. It also sets out below some of the policy issues raised by the proposed auction design that are not uncovered through the questions asked by the GMRG in its Consultation Paper.

The GMRG is proposing a type of day ahead auction that is completely untested and has never been implemented anywhere in the world. APA considers that the proposed design will undermine future investment, is risky, and is unnecessary: it is a solution in search of a problem, and GMRG's proposal fails to acknowledge the parallel efforts to improve the functioning of the secondary market.

APA believes that the proposed auction design will:

- Undermine electricity system security;
- Undermine development of the secondary capacity market;
- Negatively impact investment in pipeline capacity;
- Create sovereign risk; and
- Does not adequately take account of the costs of auction implementation, against likely benefits.

Many of these risks/outcomes can be avoided by an alternative auction design. Further, the proposals for a day ahead auction are not needed for promoting an effective secondary capacity trading market, as is shown by the US gas market experience. The premise for applying the auction broadly is fundamentally flawed, leading to incorrect conclusions being drawn as to the risks, costs and possible benefits to be derived from the auction.

### ***The proposed auction design will undermine electricity system security***

The GMRG proposed auction product priority will mean that shippers that have essential (and socially important) needs that emerge during the day, such as gas-powered generators, may not be able to access pipeline capacity.

Many gas-powered generators currently use interruptible capacity products to meet their within-day pipeline capacity needs. These needs arise because of signals in the electricity market from high prices brought about by scarcity.

The auction will effectively allocate all potential interruptible capacity before the gas day, at prices close to zero. As the proposed auction product priority will be higher than any product procured on the day, it will block gas-powered generators from accessing necessary capacity to generate. This outcome will have very significant negative effects on the Australian economy, the costs of which are never

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recognised by the GMRG. A lower priority auction product is more appropriate as it ensures that gas-powered generators can access available capacity when it is needed.

### ***APA supports the development of a strong and vibrant secondary capacity trading market***

APA continues to support the development of a market for the secondary trading of pipeline capacity. A strong secondary trading market delivers benefits for shippers and for pipeline service providers by increasing confidence in the primary capacity market through the provision of opportunities for shippers to manage pipeline capacity flexibly. Shipper ability to flexibly manage capacity commitments reinforces the value of primary capacity, the provision of which is the principal business of pipeline service providers.

It is critical that the auction design supports, rather than undermines, the development of the secondary capacity trading market. APA does not consider that the GMRG has yet got this balance right, leading it to recommend the introduction of an auction product that will undermine the value of firm services provided in both the primary and secondary markets.

### ***The current proposals for design of the auction will create sovereign risk and negatively impact investment***

APA is concerned that the concurrent proposal for development of a day-ahead auction for contracted but un-nominated (CBU) capacity:

- is an unjustified and unwarranted intrusion by governments into the contractual arrangements of users of pipeline capacity;
- will, if extended to pipelines in which the capacity is not fully contracted to shippers, create a disincentive for pipeline investment.

The proposed design of the day-ahead auction, as set out in the GMRG 'preliminary view', will require the COAG Energy Council to legislate to change contracts. This has not been explicitly articulated in the GMRG's Consultation Paper.

One view, expressed at the recently held public forum on this matter, is that all options for implementation of the day-ahead auction of CBU capacity will involve some changes to existing contracts, including changes to the rights therein.

This is not the case.

Implementation of an auction design with a lower priority product, such as second priority interruptible, would not require changes to existing contracts, and would not require the removal of shippers' existing rights.

The impact on the overall confidence of the gas market, as well as investors' confidence in the gas industry and industries which use gas, of changing existing

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contractual rights for shippers, must be a key consideration in the development of the auction. Sovereign risk issues are real; they impact investment decisions and increase costs.

The specific proposals of the GMRG reinforce APA's concern that incentives for investment in transmission pipelines are being weakened at a time when they should be strengthened.

### ***GMRG's conclusions on the market impacts of the proposed auction design are flawed***

The GMRG bases its conclusions as to the coverage of the auction on a report – *Expert Advice on Coverage of the Day-ahead Auction for Contracted but Un-nominated Capacity* – which it commissioned from NERA (NERA Report).

In that report, NERA were asked to consider the efficiency outcomes expected from applying the auction to pipelines that are not fully contracted. APA observes that the report was theoretical, took no account of the actual users of pipeline capacity and their needs, and assumed that the priority of the auction product proposed by the GMRG (second priority firm) was 'just right' in the sense that it is firm enough to be useful and to encourage shippers to sell in the secondary market, but not so firm that it undermines the value of primary and secondary capacity.

In effect, to reach the conclusions that it did, NERA assumed (and did not test) that the GMRG's design of the auction product was perfect. It then looked at the effects on allocative and dynamic efficiency that the auction, selling the specified perfect product, would have on pipelines that are fully contacted, and those that are not fully contracted.

Even with the heroic assumption of a perfectly designed auction product, NERA found that the auction:

- Will only improve allocative efficiency on pipelines that are not physically congested.<sup>1</sup> This outcome is unsurprising – a pipeline that is physically congested will not have capacity to reallocate via an auction.
- There is only a weak improvement in allocative efficiency from applying the auction to pipelines that are not physically congested.<sup>2</sup> This outcome is contrary to the statements made throughout the GMRG Consultation Paper that suggest that the increases in allocative efficiency arising from the auction are high. The NERA modelling in fact concludes otherwise, using the most favourable assumptions around the product definition possible.

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<sup>1</sup> NERA 2017, *Expert Advice on Coverage of the Day-ahead Auction for Contracted but Un-nominated Capacity: Prepared for the Gas Market Reform Group*, October, p 38

<sup>2</sup> NERA 2017, *Expert Advice*, p 39

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- Will result in some de-contracting from current levels, and, by assumption, less investment in new capacity.<sup>3</sup> This outcome is underplayed by the GMRG – in fact the GMRG goes so far as to suggest that the outcome of less investment in new capacity may be efficient.<sup>4</sup>

GMRG and its advisers justify the auction on the grounds that it will help prevent future over-investment in pipeline capacity. They say that the current system is over-invested. This astonishing claim contradicts the conclusions of year-long investigations by the Australian Energy Market Commission (AEMC) and the Australian Competition and Consumer Commission (ACCC) which did not identify over investment as a feature of the east coast gas market.

The conclusion that there should be less investment in pipeline capacity is untenable.

The GMRG's attitude to the auction, and its effects on allocative and dynamic efficiency, can be seen in the following statement in the Consultation Paper:

The GMRG understands a broader application of the auction to assets that are not contractually congested may result in some de-contracting on individual assets as shippers fine-tune their capacity requirements. It is important to recognise that there are limits as to how much de-contracting can occur (i.e. if all shippers de-contract there will be no capacity available in the auction). It is also important to recognise that de-contracting is not synonymous with inefficiency. Rather, de-contracting may be efficient if it prevents or reduces overinvestment in capacity.

That is not to say there is no risk that extending the auction to assets that are not contractually congested will result in dynamic inefficiencies. However, this risk must be weighed up against the efficiencies that would arise from the broader application of the auction, which in the GMRG's view are likely to be significant. On balance and having regard to NERA's finding that the impact of the auction on dynamic efficiency is inconclusive, the GMRG is of the view that the allocative efficiency gains will outweigh the possible dynamic inefficiencies and therefore promote the NGO, the Energy Council's Vision and the broader objective of the capacity trading reforms.<sup>5</sup>

The GMRG's view that allocative efficiency gains will outweigh possible dynamic inefficiencies rests on hypothetical modelling by NERA which, as set out above, found only weak allocative efficiency gains and certain dynamic efficiency losses. NERA was only able to conclude that the allocative gains are larger than the dynamic losses because of the assumptions in its model, and in particular the

<sup>3</sup> NERA 2017, *Expert Advice*, p 39

<sup>4</sup> Gas Market Reform Group 2017, *Day-ahead Auction of Contracted but Un-nominated Capacity & Reporting Framework: Consultation Paper*, October, p 84

<sup>5</sup> GMRG 2017, *Consultation Paper*, pp 84-85

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assumption<sup>6</sup> that there are no external benefits (ie, benefits not captured by shippers) associated with a secure gas supply. It is abundantly clear, for example from the events of February 2017 when there was a state-wide blackout in South Australia, that there are external costs from inadequate gas supply security.

Importantly, NERA concluded that the auction would definitely reduce long term contracting; on the assumptions in NERA's work, a reduction in long-term contracting means less investment in new capacity. APA's view is that the impact of reduced long term contracting on investment is obvious and negative, and that Australia's energy system needs more reliability not less.

It is critical that the auction be limited to contractually congested pipelines. If it recommends otherwise, the GMRG will be deliberately undermining investment in new pipeline capacity at a time when reliability of energy supply needs to be increased and new investment is critically needed to get more gas to market.

### ***The GMRG does not adequately take account of the costs of auction implementation, against likely benefits***

The proposed auction design, with tight timeframes for information development and exchange between AEMO and shippers, as well as a combinatorial auction, drives significant costs for both AEMO and pipeline service providers.

Under the current proposal for the auction priority being secondary priority firm, pipeline service providers will need to redesign existing processes for scheduling, curtailment and billing, and will need to rebuild systems around the redesigned processes. This will be a costly exercise for a product that is expected to be allocated, in most circumstances, at prices close to zero.

Further, the proposed timeline for providing information to AEMO for the daily operation of the market is insufficient, and will drive additional compliance costs and risks for pipeline businesses. Ninety minutes is insufficient time for pipeliners to receive nominations, run each pipeline schedule, determine un-nominated capacities, validate that information, and transmit it to AEMO. To do so will require considerable investment in highly reliable instantaneous data flows between service providers and AEMO, which have not been necessary for the operation for the STTM or the Bulletin Board. These will be new investments required to meet a higher (more immediate) reporting standard.

As information production and transmittal moves towards real time requirements, the costs for provision increase exponentially. The implications for doing so are never acknowledged by the GRMG in its design of the auction and the auction product.

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<sup>6</sup> NERA Report, *Expert Advice*, Appendix C: "Note that it is reasonable to assume that social welfare is equal to the sum of shippers' payoffs if v adequately captures society's value for gas transportation."

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A lower priority auction product would place lesser burdens on system development to support the auction and would not require a redesign existing processes for scheduling, curtailment and billing to accommodate a new auction priority. Given the expected efficiency benefits of the auction are expected to be low (and may be negative) investments in a more complex auction design appear unwarranted.

### ***The proposals for a day ahead auction are not needed for promoting an effective secondary capacity trading market***

The US is widely regarded as having a well-functioning natural gas market, including a liquid and effective market in pipeline capacity. As NERA says: "To date, a workably competitive "Coasian" gas transportation market has only emerged in the United States, for at least three reasons:

- First, market power in wholesale gas markets creates an additional incentive for capacity hoarding in many international jurisdictions. In principle at least, shippers may abuse market power by over-contracting and refusing to trade secondary capacity in order to foreclose competitors from the upstream or downstream markets;
- Secondly, in most international jurisdictions, property rights are incomplete. Makhholm (2012) notes that "competitive gas pipeline transport arose in the US once the value of the intangible contract right to point-to-point pipeline transport became so well defined and predictable that it rose to the level of private property"; and
- Thirdly, transactions costs can be high relative to the cost of tradable capacity in international regimes."

NERA does not mention auctions as a factor behind the success of the US gas transportation market. NERA fails to mention auctions in the US context for good reason: **there are none**. US pipelines are permitted to make interruptible and as available capacity available to shippers, but they are not required to sell such capacity at any price. Pipelines must accept shipper offers for short term capacity that are at the maximum rate for interruptible capacity – typically equivalent to the firm forward haul rate divided by the pipeline load factor – and are permitted to accept discounted offers, but are not required to do so.

## 2. APA recommendations

APA continues to support the development of a market for the secondary trading of pipeline capacity. A strong secondary trading market delivers benefits for shippers and for pipeline service providers by increasing confidence in the primary capacity market through the provision of opportunities for shippers to manage pipeline capacity flexibly.

APA has identified considerable risks associated with the current proposal for the design of the CBU capacity auction.

### ***Auction coverage must be limited to contractually congested pipelines***

APA considers that the auction should only apply to pipelines that are contractually congested. The NERA report identifies (and the GMRG agrees) that the auction will lead to less long term contracting and less pipeline capacity being built than under current arrangements. In return, the NERA report identifies only weak improvements in allocative efficiency arising from the auction. This trade-off does not appear justified.

Given the rapidly changing gas and electricity market conditions, and the need for new gas supplies to be developed to meet Australia's energy needs, it does not appear sensible to introduce a mechanism that will lead to *reduced* incentives to invest in critically necessary pipeline capacity.

To limit this risk, APA considers that the auction should only apply to fully contracted pipelines. The Consultation Paper suggests that 'fully contracted' should be defined at a level less than 100% contracted, for example at 90% contracted. APA notes that for a large pipeline, for example one with 400TJ/day of capacity, this leaves a very significant amount of capacity uncontracted and the auction still applying. This is not appropriate and will undermine incentives to invest.

APA considers that a better threshold for 'fully contracted' should be the lesser of 10% of pipeline capacity or 10TJ. This means that for a 400TJ/day capacity pipeline, the minimum level of uncontracted capacity before the auction applies would be 10TJ, and for a 40TJ/day capacity pipeline, the minimum level would be 4TJ.

As limiting auction coverage to contractually congested pipelines will mean that the auction will apply to some pipelines but not others, the combinatorial auction design, and the complexity that comes with it, is not necessary and can be replaced with a simpler auction design.

### ***Auction priority must be lower; the current proposal will block essential gas-powered generation from accessing within day pipeline capacity***

APA believes that the proposed auction priority is too high, leading to auctioned capacity effectively blocking access to pipeline capacity from shippers that have

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essential (and socially important) needs that emerge during the day, such as gas-powered generators.

The auction allocates capacity on a day-ahead basis. Because of the amount of capacity available, and a lack of shipper ability to predict needs that may emerge during the day, the price paid for auction capacity is expected to be low. APA observes that this opinion is shared by the vast majority of stakeholders that have been involved in the auction development process and consultation to date.

Shippers that have capacity needs that emerge during the day, such as gas-powered generators, currently use interruptible services to meet those needs. Gas-powered generator nominations can occur long after the gas day has started, and are made in response to signals of scarcity in the electricity market. Under current arrangements, once scheduled, within day interruptible services are highly reliable. They are rarely, if ever, interrupted.

APA foresees considerable risk that gas-powered generators will not be able to access the interruptible capacity products that they currently use to meet emergency electricity market demand if the auction priority remains as proposed by the GMRG. The proposed auction product priority will mean that low value opportunistic gas movements, such as minor arbitrage between markets using auction capacity purchased at prices near zero, will be prioritised above capacity needs that emerge during the day for high value purposes such as gas-powered generation. This is not in the long term interests of consumers.

APA believes that a more appropriate auction product priority is second priority interruptible. This priority would mean that shippers with needs that emerge during the day, such as gas-powered generators, would be able to secure that capacity ahead of auctioned capacity that may have been allocated at prices close to zero. Ensuring that renomination rights for firm shippers also rank above auction capacity is also critical.

### ***Auction should be targeted at incentivising trade of capacity in circumstances where trade may not otherwise emerge***

The AEMC's principal rationale for recommending the auction of CBU capacity was to provide an incentive for primary shippers to trade capacity in circumstances where there may be hoarding.

APA believes that an auction applying to contractually congested pipelines, with an interruptible auction product, is more consistent with the AEMC's recommendations. An interruptible product will address hoarding as it will provide capacity to shippers in conditions of contractual congestion with little risk of interruption. By definition, a shipper is hoarding capacity where it holds capacity that it does not likely need, for the purpose of ensuring another shipper cannot access that capacity. Hoarding is not a problem for pipelines with available spare capacity, as a contracted shipper

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cannot successfully block a competitor from gaining access where there is spare capacity that the second shipper can secure from the pipeline service provider.

### ***Auction product will undermine the secondary market***

APA believes that the proposed auction priority and product design will undermine the secondary capacity trading market as it creates a product that is not available in the primary or secondary market.

The auction product is proposed as a combinatorial product, where the auction delivers a high priority product that also manages scheduling and curtailment risk across multiple pipelines and pipeline owners for the auction shipper.

The proposed product does not create the right balance between the auction and the primary and secondary market, with the outcome that the auction product will replace, rather than incentivise, the secondary market. The GMRG and NERA never test their assumption that a second priority firm auction product strikes the right balance between firmness and interruptibility so as to not undermine the primary and secondary markets – this is a key question that must be resolved before the auction is implemented.

In line with APA's recommendation that the auction only apply to fully contracted pipelines, APA believes that the auction product should be defined on a pipeline-by-pipeline basis. Combinatorial products can be developed in the primary or secondary capacity markets should shippers desire such a product.

### ***Backhaul should not be included as an auction product***

Backhaul services are not contracted on a firm basis, so the proposal that an interruptible backhaul service be made available via a day-ahead auction goes beyond the remit of the AEMC recommendations for the auctioning of CBU capacity.

Backhaul capacity is not scarce: a significant amount of backhaul capacity is potentially available on most single-direction pipelines and the allocation of backhaul capacity will likely be at prices close to zero.

APA notes that backhaul is effectively a pipeline-facilitated gas swap. Providing backhaul to the market at prices close to zero will undermine the market for swaps on the gas trading hub, limiting potential liquidity that may be achieved in that market.

The approach also means that forward haul shippers cover the cost of the pipeline through the prices they pay for service, leaving backhaul shippers to pay little or nothing for essentially the same service of transporting gas. Backhaul shippers will free-ride on those shippers with forward haul contracts. A mechanism that institutionalises free-riding is not in the long-term interests of shippers; nor is it in the long-term interests of the end-users of the gas they transport.

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### *Timing of auction commencement*

The Capacity Trading Platform and the CBU auction both aim to increase market liquidity by providing improved access to CBU capacity.

The necessary system changes to implement the CBU auction are vastly more complex than those required for the Capacity Trading Platform. Also, the market governance and other structures are already in place for the capacity trading market, leveraging those in place for the gas supply hub. For these reasons, APA sees potential for the implementation of the capacity trading platform in a shorter timeframe than for the CBU auction.

The CBU auction will require a rebuild of existing pipeline systems and processes for scheduling, curtailment and billing to accommodate the auction product and derive the necessary data for the auction to run each day. This work will take time, and can only begin once the market rules and AEMO procedures are finalised and the build pack has been developed and released. Significant market testing will also be required as the CBU auction involves new systems and concepts for service providers, AEMO and shippers.

APA proposes that the following timetable for implementation of each market would be achievable, and deliver benefits to shippers from the implementation of at least one of these mechanisms as early as possible.

- Oct 18 – partially anonymous capacity trading platform up and running
- Oct 19 – CBU auction up and running, and potential move to fully anonymous capacity trading platform if this is considered desirable at that time.

Delaying the implementation of the auction will also allow for the important reforms to support secondary market trading, such as the standardisation of the capacity product, to be tested before the CBU auction is implemented.

This testing may lead to further refinements to the design and application of the auction such that it further stimulates (or does not undermine) the capacity trading market.



## PART A Day-Ahead Auction of Contracted but Un-Nominated Capacity

	Questions	Feedback
<b>3.1</b>	<b>Transportation products auctioned</b>	
1.	<p>Do you agree with the proposal to include the following products in the auction:</p> <ul style="list-style-type: none"> <li>o forward haul transportation services (with separate products offered in both directions on bi-directional pipelines)? If not, please explain why.</li> <li>o compression services? If not, please explain why.</li> </ul>	<p><b>Transportation services</b></p> <p>Yes – where the auction applies, it should relate to contracted but un-nominated firm forward haul transportation services.</p> <p>Where contracted firm services are offered in both directions (that is the pipeline in question offers firm bidirectional capacity for primary shippers to contract) then, subject to other restrictions on whether the auction will apply to those services, it should apply to contracted but un-nominated firm capacity in both directions.</p> <p>The auction should only apply for contracted but unutilised capacity, as set out in section 2.</p> <p><b>Compression services</b></p> <p>Yes – subject to establishing shipper demand for a day-ahead compression service made available via auction.</p> <p>Developing a compression capacity product for auction will be complex, and implementation will be costly. That there is sufficient demand for a day-ahead compression service made available via auction must be established before proceeding down this path.</p>
2.	<p>Do you agree with the proposal to include an interruptible backhaul service in the auction for single direction pipelines? If not, please explain why.</p>	<p>No – the proposal to include an interruptible backhaul service in the auction is ill-conceived, as follows:</p> <ul style="list-style-type: none"> <li>• Backhaul is not a contracted service and therefore its inclusion goes beyond the scope of the AEMC's recommendation.</li> <li>• Backhaul is a pipeline facilitate gas swap. To the extent it is provided through the auction, it will remove potential liquidity from the gas supply hub. This does not appear to be consistent with the Gas Market Vision.</li> </ul>

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		<ul style="list-style-type: none"> <li>• The inclusion of backhaul capacity creates profound free-rider effects that are not in the long term interests of consumers.</li> <li>• Contrary to the statement in the Consultation Paper, backhaul is not “simply” an accounting adjustment on forward haul. It requires dynamic monitoring in respect of forward haul capacity, and is only possible because of the existence of the physical asset in the first place.</li> <li>• Contrary to suggestions in the Consultation Paper, the ACCC found no evidence that pipeliners were pricing backhaul capacity above benchmark levels, and the auction is likely to provide backhaul capacity to the market at prices lower than the ACCC-identified benchmarks, which may be inefficient. This will be of particular concern if, as discussed in the public consultation forum, winners of auctioned capacity simply nominate for the full amount they win so as to preserve the option right of that capacity without any real intent to flow.</li> <li>• The benefits of making more gas available to the market are highly overstated, as no producer will develop gas in reliance on non-firm capacity.</li> </ul> <p><b>Inclusion of backhaul goes beyond the AEMC’s recommendation</b></p> <p>Backhaul services are not contracted on a firm basis, and a proposal that an interruptible backhaul service be made available via a day-ahead auction goes beyond the remit of the AEMC recommendation to limit auction capacity to contracted but un-nominated capacity.</p> <p><b>Auctioned backhaul will reduce gas market liquidity</b></p> <p>APA notes that backhaul is effectively a pipeline-facilitated gas swap. Providing backhaul to the market at prices close to zero will undermine the market for swaps on the gas trading hub, limiting potential liquidity that may be achieved in that market. This does not appear consistent with the COAG Gas Market Vision.</p> <p><b>Inclusion of backhaul creates significant free-rider problems</b></p> <p>Backhaul capacity is not scarce: the potential exists to make available significant amounts of backhaul capacity on most single-direction pipelines. The result will be the allocation of backhaul capacity at prices close to zero. The result of this is that forward haul shippers cover the cost of the pipeline through the prices they pay for service, leaving backhaul shippers to pay little or nothing for what is essentially the same service</p>
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		<p>of transporting gas. Backhaul shippers will free-ride on those shippers with forward haul contracts. This is not in the long-term interests of shippers; nor is it in the long-term interests of the end-users of the gas they transport.</p> <p><b>Backhaul is not just an accounting adjustment</b></p> <p>There is a perception held by some shippers and others that the provision of backhaul service is no more than an accounting exercise. This is not correct. Operationally, the provision of backhaul service is little different to the provision of forward haul service. Compression and linepack must be planned recognising any obligations to deliver backhaul service, and flows and pressures must be dynamically monitored, in the same way as they are for forward haul services, to ensure that the service provider meets the contractual obligations it has in respect of both the forward haul and back haul services. The service provider cannot rely on the back haul shipper's nomination in order to satisfy delivery to a firm forward haul shipper because if the backhaul shipper does not provide gas at the forward haul shipper's delivery point as nominated, the service provider will fail to meet its forward haul service obligations. As such, the service provider must always remain operationally capable of delivering to the firm forward haul shipper and must continuously balance the delivery of the forward and back haul services.</p> <p>Backhaul service provision is neither costless nor risk-free. Accordingly, the service provider's costs and risks associated with providing the service should be offset by commensurate compensation through prices set at an appropriate level. It is not at all obvious that the auction of potentially large quantities of backhaul service at a reserve price of zero is likely to compensate for the costs and risks of service provision.</p> <p><b>ACCC found no evidence that pipeliners were pricing backhaul capacity above benchmark levels</b></p> <p>The ACCC Inquiry found no evidence that backhaul services were being priced above the benchmarks that they themselves identified in their Inquiry Report.<sup>7</sup></p> <p>The GMRG's rationale for including backhaul in the auction is that it will increase efficiency as it provides low cost access to backhaul capacity. Embedded in this</p>
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<sup>7</sup> ACCC 2016, Inquiry into the east coast gas market, April, pp 109-110

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		<p>rationale is an assumption that the current backhaul price is inefficient. However, this is not correct and is an inaccurate representation of the evidence of actual pipeline service provider charges compared to ACCC benchmark prices.</p> <p>In comparison to benchmark prices, the auction is in fact likely to provide access to backhaul capacity at levels below the benchmark market prices as identified by the ACCC. It is likely that this will be an inefficient outcome where shippers are not contributing to the costs of providing the service, including a contribution to the asset that makes the service possible.</p> <p><b>The benefits available are highly overstated</b></p> <p>The Consultation Paper states that access to low cost backhaul capacity may mean that otherwise uncommercial gas is developed and provided to market. The suggestion that gas supplies will be developed on the basis of access to backhaul capacity is commercially and technically untenable.</p> <p>Therefore, the GMRG is wrong to assume that this will support uncommercial field development.</p> <p>Any producer investment decision around developing new gas supplies based on non-firm transportation arrangements is unlikely to ever get financial investment approval.</p>
<p><b>3.2</b></p>	<p><b>Priority of the auction product</b></p>	
<p>3.</p>	<p>Do you agree with the proposal to adopt a second priority firm auction product? If not:</p> <ul style="list-style-type: none"> <li>o please explain why you think this option should not be selected; and</li> <li>o please set out the option you think should be adopted and why you think it is more consistent with the AEMC's recommendations and the assessment framework set out in section 2.3 than the second priority firm auction product.</li> </ul>	<p>No, APA does not agree with the proposal to set the auction capacity priority as second priority firm. APA believes the proposed priority is too high. Applying this priority level will usurp existing shipper capacity rights, and will require the crown to legislate to unilaterally amend existing contracts to confiscate those rights.</p> <p>The priority should instead be set as the lowest priority service, reflecting the price most likely paid by auction shippers (\$zero), and the importance of ensuring that shippers with needs that emerge during the day (such as for gas-powered generation) and which value capacity at a rate higher than \$zero, can be accommodated. This approach is also more consistent with the AEMC's recommendations, which focused on addressing inefficient contractual congestion ('hoarding'), than the GMRG's focus, which appears to be price regulation for day-ahead capacity. It also does not require existing contractual rights to be changed.</p>

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		<p>In summary, APA does not consider that the auction priority proposed by the GMRG appropriately balances:</p> <ul style="list-style-type: none"> <li>• The needs of primary shippers, in particular gas-powered generators and industrial users that have needs that emerge during the day;</li> <li>• Incentives for investment in new capacity, including significant first mover disadvantages that arise for shippers contracting to support new investments;</li> <li>• The risks faced by pipeline operators in providing capacity, and the likely compensation for doing so;</li> <li>• The relative pricing of capacity products, and how they relate to firm services;</li> <li>• The gaming risks that the proposed priority creates (and the associated regulatory arrangements needed to manage that risk) compared with offering a fully interruptible product; and</li> <li>• Sovereign risk considerations, as the proposed priority requires changing existing contractual arrangements for capacity to insert the auction capacity in the scheduling and curtailment schedules at a higher priority than existing services available on each pipeline, and potentially under individual contracts.</li> </ul> <p>An interruptible auction product definition is more consistent with the AEMC's recommendations. An interruptible product will address hoarding as it will provide capacity to shippers in conditions of contractual congestion with little risk of interruption. By definition, a shipper is hoarding capacity where it holds capacity that it does not likely need, for the purpose of ensuring another shipper cannot access that capacity. It should also be recognised that in these circumstances, CBU capacity is highly unlikely to be interrupted by primary shipper needs – its purpose for contracting was different.</p> <p>Hoarding is not a problem for pipelines with available spare capacity, as a competitor can secure capacity from the pipeline service provider. Holding excess capacity therefore does not block access to the pipeline for a competitor.</p> <p>Therefore, to address hoarding there is only a case for applying the auction to fully contracted pipelines. In those circumstances the auction product priority can be interruptible – it will still remove incentives to hoard by providing access to 'over-contracted' capacity with high levels of reliability.</p>
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		<p><b>Needs of primary shippers, in particular gas-powered generators</b></p> <p>Currently, the only capacity that can be purchased on a ‘within day’ basis is interruptible capacity. This is because within day capacity is always subject to firm shipper requirements and the physical conditions on the pipeline for that day. Within day interruptible capacity is used to a high degree by gas-powered generators and some industrial customers who rely on this service to access capacity at very short notice in response to electricity market shortages or price signals.</p> <p>Note that for these types of gas users a firm contract is not financially viable due to the unpredictable (and usually short lived) nature of their opportunities.</p> <p>Under the GMRG proposal, the proposed auction priority would be higher than any capacity requirement that emerged within the day, regardless of shipper willingness to pay or reason the capacity is needed (such as an electricity market shortfall or emergency). APA does not consider this is an appropriate outcome where it is expected that in most circumstances auction capacity will be allocated at prices close to zero. This outcome is very likely to undermine security and reliability in the electricity market at a time when the market is becoming more reliant of gas-powered generation to meet electricity peaks.</p> <p><b>Incentives for investment in new capacity</b></p> <p>Contrary to statements made by the GMRG and NERA in respect of investment incentives, APA maintains its view that a higher priority auction product will increase the likelihood that it will replace firm primary capacity contracting, as well as secondary market trades. Both of these outcomes would undermine incentives to invest (dynamic efficiency) as:</p> <ul style="list-style-type: none"> <li>• Shippers are less likely to contract for firm capacity to support new investment because of the obvious free-rider effects that give competitors access to low cost, high value capacity; and</li> <li>• The benefits of a strong secondary market for shippers to allow them to manage their contracting risks by selling in the secondary market (therefore making long term commitments in new capacity less risky for them) will be lost.</li> </ul> <p><b>Risks faced by pipeline operators in providing capacity</b></p> <p>The proposed priority creates a right for shippers to gain access to a relatively high priority</p>
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		<p>product at very low cost. This creates a disconnect between the risks and incentives faced by the pipeliner in providing the service (as it is subject to liabilities in circumstances where it does not provide the capacity) without commensurate compensation through tariffs. The pipeliner's potential risks and liability in providing the service should be offset by commensurate compensation through tariffs, and it is not clear that the auction proceeds are likely to be sufficient.</p> <p><b>The relative pricing of capacity products, and how they relate to firm services</b></p> <p>The proposed auction product priority inserts a new product within the suite of services currently offered by pipeliners that is priced by an entirely different mechanism to other services.</p> <p>Contrary to suggestions in the Consultation Paper, efficient pricing of CBU capacity is not independent of firm and other capacity – its pricing by pipeliners in fact reflects consideration of pipeline utilisation rates and provides incentives to shippers contracting for firm capacity. This was recognised by the ACCC in its Inquiry Report where it calculated appropriate benchmarks for interruptible and as available capacity by reference to pipeline utilisation rates to deliver a 'firm equivalent price' for short term capacity.<sup>8</sup></p> <p>The premise of the auction, and statements in the Consultation Paper, instead treat CBU capacity pricing as independent of other prices by setting those prices in a separate market with zero reserve. This is best demonstrated by the statement in the Consultation Paper that the auction will:</p> <p style="padding-left: 40px;">'Pose a constraint on the ability of service providers to sell day-ahead capacity at prices in excess of what would prevail in a workably competitive market by adopting a zero reserve price and allowing the market to determine the value'.</p> <p>The assumption in this statement is that a workably competitive market price for CBU capacity is independent of other pipeline prices. It is not.</p> <p>It is not the case that an efficient price for high priority (and therefore high value) auction capacity is zero where there are no physical pipeline constraints. This approach, by</p>
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<sup>8</sup> ACCC 2016, Inquiry into the east coast gas market, April, pp 109-110

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		<p>NERA's admission, will lead to lower contracting levels. Lower expected contracting levels over the life of an asset has flow on effects for investment.</p> <p>The financing structure that delivers efficient pipeline investment (with lower costs for shippers) assumes long term contracts with low risk counterparties. The pipeline service provider model is successful because it delivers lower risk long term revenue streams that allows the recovery of sunk capital over a very long term (in excess of 50 years). Because of this, most pipeliners have a lower cost of capital than the shippers that use their services, so shippers can reduce their overall costs by contracting for pipeline services with a specialist pipeline company rather than building and owning pipelines themselves. Where the auction undermines this structure, the costs of pipeline investment will increase, and fewer pipeline and gas supply projects will be viable. This is not at all understood or discussed by the GMRG or NERA. NERA's experience appears based in European markets where regulation and centralised planning attempts to address the investment question in sub-optimal ways.</p> <p><b>Gaming risks and associated regulatory interventions</b></p> <p>The Consultation Paper discusses potential gaming risks associated with the activities of the pipeliner (in respect of notifying un-nominated capacity) and firm shippers (amongst other things, in terms of nominations and renominations). It does not consider gaming risk for auction participants arising from a high priority product, for example where an auction participants bids for capacity at low cost without an intention to use that capacity. A shipper could block access to within day capacity altogether by nominating for the full auctioned amount to preserve the option value of the auctioned capacity. This type of behaviour will have disastrous effect on pipeline operations as well, for example where this behaviour relates to backhaul capacity.</p> <p>Even without this type of nominating behaviour, the perceived risk that the auction capacity will be nominated late in the day reduces the confidence that other shippers will have in lower priority 'within day' products being able to meet their needs. These shippers may be excluded from using a within day product because of the risk of interruption from allocated auction capacity, even where the holder of that capacity does not intend to use that capacity on that day.</p> <p>An auction participant may also be using auction capacity for low value activities, such as taking minor arbitrage opportunities between markets. In doing so, this capacity is</p>
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		<p>being 'used' on the day, and would not be available to other shippers for higher value uses, such as ensuring adequate generation capacity in the electricity market. This does not appear to be an efficient or acceptable outcome.</p> <p>The Consultation Paper notes that regulatory rules need to manage the identified gaming risks, but contains no detail of what this may entail in respect of administrative and regulatory oversight (and intervention) to ensure compliance. Many of these risks of gaming are created by the proposed auction priority of second priority firm (for example in respect of renomination risks for firm shippers), and would be significantly less where a lower priority product is sold through auction.</p> <p>A lower priority auction product would remove much of the incentive for shippers to seek to protect contracted capacity, as well as the ability for an auction participant to hoard capacity at low cost. The proposed auction therefore introduces a hoarding risk – the very risk that it was meant to eliminate.</p> <p>The regulatory intervention and oversight costs can also be expected to be lower with a lower priority auction product, as it does not create the same incentives for un-competitive behaviour.</p> <p><b>Sovereign risk considerations</b></p> <p>At no stage does the Consultation Paper make clear that their proposed approach to auction priority requires changes to existing contractual priorities for current contracted shippers. This gives rise to significant sovereign risk, as the government is changing existing contractual rights for shippers.</p> <p>An alternative approach, and one that does not change existing rights, is to set the auction priority as the lower priority service. This will not change existing rights, and will alleviate some of the risks associated with investment outlined above. It will also allow shippers with needs that emerge during the day, such as gas-powered generators, to access capacity above auctioned capacity that may have been allocated for \$zero.</p> <p><b>Renomination rights</b></p> <p>The Consultation Paper is unclear as to which renomination rights are intended to be accommodated under the auction product. While discussing the range of renomination rights available, the Consultation Paper notes that some shippers have 'firm'</p>
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		<p>renomination rights. This means that renominations up to their contracted firm capacity must be accommodated by the pipeliner during the gas day. Other shippers have 'best endeavours' or 'reasonable endeavours' renomination rights, which are subject only to physical (operational) delivery limitations. The AEMC was clear that it intended the auction to accommodate both firm and 'best/reasonable endeavours' renomination rights. In contrast, the Consultation Paper is not clear whether best/reasonable endeavours renominations rights would rank above auction capacity, and instead refers exclusively to 'renomination rights' or 'firm renomination rights'.</p> <p>In the public consultation forum, the GMRG clarified the intent that both firm and best/reasonable endeavours renominations rights of firm shippers would rank above the proposed auction priority.</p> <p>APA notes that, if the auction product were to rank above best/reasonable endeavours renomination rights, the result would be that, in respect of APA pipelines, no renominations would rank above auction capacity. This would have very serious detrimental effects to the operation of the gas market, as well as the electricity market in respect of gas-powered generation, and would substantially undermine the value of firm capacity.</p>
4.	Are there any other tools that you think should be available to auction participants to manage curtailment risk?	No. Curtailment risk is a critical requirement if the auction is to be expected to incentivise, rather than replace, secondary capacity trading. APA considers that the proposed auction product and auction design already involves a product that is of too high a quality to meet these aims.
<b>3.3</b>	<b>Other elements of the auction product</b>	
5.	<p>Do you think the auction product should have:</p> <ul style="list-style-type: none"> <li>o the same MHQ factor as that specified in the service provider's operational GTA? If not, please explain why.</li> <li>o a 'reasonable endeavours' renomination right? If not, please</li> </ul>	<p><b>MHQ factor</b></p> <p>Yes. The auction capacity should have the same MHQ factor as that set out in the operational GTA.</p> <p><b>Auction renomination rights</b></p> <p>Yes. The auction capacity can have a reasonable endeavours renomination right subject to priority and operational capability to deliver. It is key that firm service shippers be able to re-nominate up to their full firm MDQ without limitation from auctioned capacity.</p>

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	explain why.	
6.	<p>Do you think the auction product should have an imbalance allowance equivalent to that specified in the service provider's operational GTA?</p> <ul style="list-style-type: none"> <li>o What, if any, effect do you think this would have on a MOS provider's ability to provide balancing services in the STTM? If you think it will be problematic, are there any measures that you think could be employed to address this issue, while also providing auction winners with some level of an imbalance allowance?</li> <li>o Are there any other issues that the GMRG should be aware of in relation to this proposal?</li> </ul>	<p>No.</p> <p>The auction capacity cannot have an imbalance allowance. The auction capacity is a resale of existing firm capacity which itself includes an imbalance allowance (which in many cases is expressed as a fixed amount, rather than a percentage of firm MDQ, and therefore does not automatically reduce when CBU capacity is transferred through the auction). Where the firm shipper can renominate (and be in imbalance for that capacity), having an imbalance also relate to auction capacity will effectively multiply the imbalance allowance for the same capacity. The rights for an imbalance allowance must rest with the firm shipper who often uses this to provide market services such as MOS in the STTM.</p> <p>Pipeline cannot create additional imbalance services for non-firm capacity for this reason.</p> <p>Auction shippers can manage imbalances by trading imbalances through in pipeline trade points and potentially other services to facilitate trading.</p>
<b>3.4</b>	<b>Contract path specification</b>	
7.	<p>Do you think a zonal or point-to-point contract path approach should be employed in the auction?</p>	<p>The point-to-point approach (with limited, high demand routes) would be much simpler and lower cost to implement, and gives rise to lower risks for pipeliners and shippers in respect of interruption of capacity. This approach matches the proposal put forward by AEMO to use the SRA engine to manage the auction.</p> <p>A zonal approach would require significant system modifications by pipeliners to provide this functionality.</p>
8.	<p>If you think a point-to-point approach should be employed, do you have any concerns with:</p> <ul style="list-style-type: none"> <li>o the proposal to use different approaches for the trading platform</li> </ul>	<p><b>Use of different approaches</b></p> <p>No. The trading platform and the auction are trading/selling different products so this difference in approach should not give rise to issues.</p> <p><b>Competition in the NEM</b></p>

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	<p>and auction? If so, please explain why.</p> <ul style="list-style-type: none"> <li>o the potential for the publication of information on contracted but un-nominated capacity at delivery points servicing market generating units to adversely affect competition in the NEM? If so, please explain why and how you think this could be addressed.</li> </ul>	<p>APA does not have a view on the question of competition.</p> <p>APA notes that gas-powered generators frequently make use of interruptible services to meet their capacity needs. To the extent that the auction removes this ability, these generators may have an option to secure firm capacity where it is available, or perhaps seek to participate in the daily auction on the possibility that they will need the capacity during the day.</p> <p>The firm service option is likely to increase costs for gas-powered generators for their intermittent needs, which will be reflected in the prices they bid. The proposed auction approach is likely to distort auction outcomes and create a new source of 'capacity sitting' to ensure opportunities for market responses are not lost. In doing so, generators would not be gaming the auction, but may block the flow of gas for other shippers. The GMRG proposed auction design and product priority would encourage this behaviour.</p>
9.	<p>Are there any other complexities associated with the point-to-point approach or technical requirements the GMRG should factor into its consideration of this issue?</p>	<p>Yes.</p> <p>The implementation of the auction will be highly complex given the final proposed design, specifically if the priority of service ends up somewhere in the existing contractual priority stack for current contracts. The approach requires a rebuild of existing systems and processes for scheduling, curtailment and billing to accommodate this auction. The effort and costs for pipeline service providers to implement these changes will be significant and has been grossly underestimated and devalued by the GMRG when pipeliners raise these issues. APA notes that the GMRG has failed to consider implementation and ongoing compliance costs for the auction as a relevant consideration in the design of the auction.<sup>9</sup></p> <p>The AEMO model for auction operation presented to the GMRG working group, where AEMO would operate the market, was based on costing for a much simpler approach. These considerations appear to be ignored in an effort to deliver the most elaborate auction platform and product possible. The original objective of the auction to manage contractual hoarding has clearly been lost.</p>
<b>4.1</b>	<b>Calculation of auction quantity</b>	

<sup>9</sup> GMRG 2017, Day-ahead Auction of contracted but un-nominated capacity & reporting framework, October, pp17-18

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<p>10.</p>	<p>Do you agree that the calculation of the contracted but un-nominated capacity will simply involve deducting the actual nominations from the reserved capacity for each product (e.g. at receipt points, delivery points, pipeline segments and compression), or are there other complexities that service providers will need to deal with that have not yet been identified?</p>	<p>No.</p> <p>In practice, this will be a complex calculation given the number of individual pipeline segments that will require analysis.</p> <p>As above, this task has been grossly underestimated by the GMRG. APA comments on the daily timetable are set out in response to question 33.</p> <p>Establishing systems to accommodate the auction will require a significant investment in time and resources to achieve in practice. An implementation date in late 2018 would be unachievable given the amount of work required to develop detailed auction arrangements and procedures, which will then need to be finalised before pipeliners can implement them in their own systems and processes. The importance of appropriate systems testing between pipeliners and AEMO, as well as with market participants is also prudent in any new market arrangements. Adequate time for these important steps, as well as training, to be completed does not appear to have been contemplated in the current implementation timeline.</p>
<p>11.</p>	<p>Given your view on product design, do you think as available or interruptible nominations received prior to nomination cut-off should be included in the calculation of contracted but un-nominated capacity?</p>	<p>Yes.</p> <p>Shippers have existing contractual rights to nominate As Available or Interruptible capacity and have it scheduled at or after nomination cut-off. The auction should not remove these rights.</p> <p>Further, these rights, both before and after nomination cut-off, are critical for the operation of the electricity market for gas-powered generators. This is a key feature of existing contractual arrangements that is used by a number of parties – they should have the choice to continue exercising these rights or use the auction process instead if they desire.</p>
<p>12.</p>	<p>If the auction product is defined as a second priority as available or interruptible product, do you think service providers should be required to employ a top down approach to scheduling these services, or are there technical reasons why this approach can't be employed?</p>	<p>This question presupposes that the auction will apply to pipelines that are not fully contracted. As discussed in sections 1 and 2 of this submission, APA does not consider that this is appropriate.</p> <p>Notwithstanding this position, APA considers that a top down approach may have theoretical appeal, however the costs of implementation will be very high for pipeliners as it involves a wholesale change to systems involved in pipeline scheduling and curtailment.</p>

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		<p>APA further notes that the prioritisation of auction capacity over As Available and Interruptible capacity also means that these products may not be able to be used by shippers for within day flows such as gas-powered generation in response to market/reliability signals.</p> <p>In this regard, APA notes that the capacity analysis released by the GMRG shows that there is little risk of not getting capacity through auction, and therefore this capacity is likely to be allocated at prices close to zero. Where a shipper is willing to pay an As Available or Interruptible rate to ensure access to capacity, then it would appear that this shipper is valuing that capacity most highly, and ought to have priority over the auction capacity.</p>
13.	Are there any other factors that service providers would need to take into account when calculating the auction quantity for each product?	<p>Operational capacity constraints will be relevant to the determination of capacity available on each day.</p> <p>In addition, varying receipt point pressure (i.e. the pressure supplied by an interconnecting pipeline) directly affects the available capacity on a day. Some primary firm capacity contracts acknowledge this variability and incorporate a 'floating' MDQ that is tied to the pressure provided.</p>
14.	Are there any specific calculation issues that the GMRG would need to consider if the point-to-point approach is used?	<p>As discussed above, this calculation is likely to be complex and difficult to systematise. Time will be required to develop, implement and test the necessary systems to deliver this, and to calculate these values for each pipeline on a daily basis. The process for developing this value each day will require validation which in turn will add to the timeline for data development and transfer.</p> <p>APA does not consider that the GMRG has adequately recognised these timing issues in the proposed implementation schedule, or the daily timeline for release of capacity values to AEMO following scheduling. A study should be undertaken in the early scoping period to ensure all scenarios are considered and business logic is agreed (particularly for priority of service and scheduling-back).</p>
15.	Do you think the method service providers are to use when calculating the auction quantity should be specified in the NGR, or do you think service providers should be able to develop their own method	<p>No. The methodology for calculating the capacity should not be set out in the NGR as it is likely to be very detailed, and may require some specific arrangements for some pipelines/situations.</p> <p>APA considers that the most appropriate approach is for pipeliners to develop relevant</p>

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	and have it approved by the AER?	methodologies (potentially in line with some high level principles set out in the rules), that can be assessed by AEMO or potentially the AER. Compliance with an agreed methodology can be a regulatory obligation. This allows pipeliners to develop approaches that meet the objectives of the auction at less cost than if a rigid approach is mandated.
<b>4.2</b>	<b>Auction format</b>	
16.	Do you agree with the proposal to utilise a partial combinatorial auction? If not, please explain why?	<p>No.</p> <p>APA does not agree that the auction should apply to all pipelines between markets. Coverage should be limited to pipelines that are fully contracted. For these reasons, a combinatorial auction of any description is not needed.</p> <p>Further, APA considers that the proposed combinatorial auction design is highly complex and will be hard for smaller shippers to use.</p> <p>APA considers that a simple pipeline-by-pipeline auction is more appropriate to achieve the policy intent to address hoarding, and will deliver a simpler approach that can be utilised by smaller, less sophisticated shippers to gain capacity. As it is, the proposed combinatorial approach will only be decipherable to large 'portfolio' shippers with sophisticated trading desks and therefore will only benefit those shippers to the detriment of others.</p> <p><b>Delivering the policy intent</b></p> <p>The desire to deliver a combinatorial auction (in whatever form) appears to be driving the decision to apply the auction to all pipelines (regardless of contractual position) in an effort to deliver a market-to-market solution to shippers. The rationale for pursuing this approach for the auction capacity (as opposed, for instance, to developing market-to-market products for the capacity trading platform) is never explained.</p> <p>A combinatorial auction is not necessary to address potential hoarding issues. In fact, as set out below, the complex auction design will further benefit large incumbent portfolio shippers and means that smaller shippers may not be able to confidently engage in the auction at low cost.</p> <p><b>Combinatorial auction design is complex and will benefit large incumbents</b></p> <p>The proposed combinatorial auction creates a highly complex auction design that will</p>

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		<p>benefit only the larger portfolio gas participants.</p> <p>A combinatorial auction approach requires a shipper that only wants capacity on one pipeline (for example an industrial shipper or gas-powered generator) to understand the potential for prices to be set and capacity to be allocated on the basis of constraints on all other pipelines in the auction round. This requires a sophisticated knowledge of the market, bids and trading on other pipelines and in respect of other shippers, which is only likely to be available to large sophisticated portfolio shippers.</p> <p>For a small shipper, auction capacity under a combinatorial format will be no better than a lottery, however it can be manipulated by large sophisticated shippers to great effect.</p> <p>A pipeline-by-pipeline non-combinatorial auction approach would be far simpler to implement as well as to understand, and would be more accessible to smaller shippers. Aggregation risks can be managed for shippers by agents and aggregators that have emerged in other markets, and do not need to be managed through the auction process.</p>
17.	<p>Do you think there is value in including the minimum requirement optional feature from market start, or do you think this could be added over time if required?</p> <ul style="list-style-type: none"> <li>o If you think it should be included from market start, please outline the benefits you think bidders will derive from its inclusion and if you think these benefits will outweigh the costs and complexities of including this in the auction solver?</li> <li>o If a minimum requirement is adopted (either from market start or later), which combination of minimum requirement (global or bid-specific) and allocation mechanism (option 1 or 2) do you prefer and why? The</li> </ul>	<p>APA does not have a view on this matter.</p>

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	GMRG is particularly interested in stakeholders' views on the impact on bidders and efficiency as well as potential gaming opportunities with any of these combinations	
18.	Do you think there is sufficient demand for substitutable routes to warrant the inclusion of the XOR set optional feature? If so, please explain why.	No. As described in the Consultation Paper, inclusion of substitutable routes appears to add considerable complexity, and it is not clear that this is warranted given its limited relevance for auctioned capacity.
19.	Do you agree with the proposal to include the static backhaul optional feature? If not, please explain why.	No. Providing access to backhaul capacity via the auction process, in the way proposed, is ill-conceived. APA's reasons for this are set out in its response to Question 2.
<b>4.3</b>	<b>Reserve price</b>	
20.	If compressor fuel is provided by a service provider, do you think the reserve price should be adjusted to reflect these costs, or do you think the costs should be recovered through the operational GTA?	The principal variable cost which might be incurred by a pipeline operator is the cost of gas used as compressor fuel. However, pipeline operators, including APA, often do not purchase fuel gas. Instead, they allow shippers to provide the fuel needed for the transportation gas using contracted capacity. Individual shippers on a pipeline often transport quantities of gas larger than the total quantity compressor fuel required for operation of the pipeline, and can purchase gas at prices lower than the prices at which gas can be purchased by the operator.  This is reflected in an auction design which incorporates a reserve price of zero on the assumption that a pipeline operator will not incur any additional costs in making available to a shipper capacity which for which the shipper has successfully bid at auction. The auction design assumes that the compressor fuel required to transport gas using capacity which for which a shipper has successfully bid at auction will be provided by the shipper. In these circumstances, the reserve price should not be adjusted for compressor fuel costs. Those costs are a matter for the shipper.
<b>4.4</b>	<b>Pricing rule</b>	
21.	Do you agree with the proposal to adopt	No. APA considers that a far simpler approach for shippers and for system development is

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	<p>a pay-as cleared pricing rule? If not, please explain why.</p>	<p>a pay as bid model. APA notes that under a pipeline-by-pipeline approach (that APA recommends), a pay as bid model makes it far less complex for shippers to calibrate their bids to maximise value as the allocation parameters are far simpler to understand.</p> <p>Further, a pay as bid model provides direct signals of constraint, and the value of capacity, to shippers and pipeliners which will support investment. This is because a gradual increase to constraint price is likely to be observed rather than the potential for an abrupt jump once all capacity is allocated.</p>
22.	<p>If you propose an alternative pricing rule, please provide details on how this rule could be implemented and whether or not the inclusion of minimum requirements and/or XOR sets would be problematic under this alternative rule.</p>	<p>APA does not have a view on this matter.</p>
23.	<p>Do you agree with the proposal to set the price at the lowest accepted bid if the lowest accepted bid is fully cleared? If not, please explain why.</p> <ul style="list-style-type: none"> <li>o If you propose an alternative pricing rule, please provide details on how this rule could be implemented and whether or not the inclusion of minimum requirements and/or XOR sets would be problematic under this alternative rule.</li> </ul>	<p>No. As set out above, APA believes that shippers should pay as bid.</p>
24.	<p>Do you agree with the proposal to use a random tie-break mechanism in those cases where there are more than one set of prices that satisfy the pricing constraints imposed by the lowest accepted bids? If not, please explain why.</p>	<p>No. As set out above, APA believes that shippers should pay as bid, and be allocated capacity on a pro rata basis in event of a tie (which will be unlikely if bids are to 4 decimal places).</p>

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4.5	Method for determining winning bidders	
25.	Do you agree with the proposal to determine winning bidders through the use of a profit maximising algorithm, which in this case reduces to a revenue maximising algorithm? If not, please explain why.	No. As set out above, APA believes that capacity should be allocated, and shippers should pay, as bid. On a pipeline-by-pipeline non-combinatorial auction basis, this approach is far simpler to manage, and allows smaller shippers to understand and secure capacity.
26.	Do you agree with the proposal to use a random tie-break rule to determine winning bidders? If not, please explain why.	No. As set out above, APA believes that shippers should pay as bid, and be allocated capacity on a pro rata basis in event of a tie. This is the approach for capacity under contract that has the same priority and is well understood by shippers.
4.6	Curtailment on the gas day	
27.	Do you agree that auction winners should be able to try and procure primary capacity from the service provider if the curtailment arises as a result of a renomination and there is spare primary capacity available? If not, please explain why.	Yes. This question suggests that the GMRG is considering limiting the ability for pipeliners to contract with shippers for available spare capacity. It is hard to conceive how the GMRG could consider it appropriate to prevent such a transaction.
28.	Do you think that auction winners should be able to choose whether they are only curtailed on the product for which there is insufficient capacity or across all products? If not, please explain why.	No. The proposed combinatorial auction design delivers a highly valuable product that manages for the shipper (at zero reserve) capacity procurement and curtailment across multiple pipelines and potentially multiple pipeline owners. As a single product, this is not available in the primary or secondary market.  There is a risk that managing this curtailment risk for shippers through the auction product will create a product that is more desirable than a firm product. The assumption that this product is less desirable than firm capacity is key to NERA's view that the auction will not undermine firm contracting or dynamic efficiency, but is never actually tested in NERA's analysis.
29.	Do you think that the pro-rating with	In principle, where curtailment occurs, money back compensation should be available

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	<p>compensation curtailment option should be employed as the project team has suggested, or do you think the pipeline wide valuation with or without compensation option should be employed? In addressing this question, please outline how significant you think the risks of curtailment are.</p>	<p>on a pipeline-by-pipeline basis in relation to the amount of capacity actually curtailed. The costs of delivering this outcome through both pipeliner operator and AEMO systems, however, will be high. The benefit of doing so, where the auction capacity is likely to be allocated at prices close to zero, is questionable.</p> <p>APA further notes that it is unclear why the GMRG considers that a risk which is currently managed by shippers under contractual arrangements should be managed for shippers under the auction where shippers are likely to have paid close to \$0 for their capacity.</p>
<b>4.7</b>	<b>Allocation of the auction residue</b>	
30.	<p>Do you agree with the proposal to allocate the auction residue to service providers based on the revenue achieved by individual products? If not, please explain why and set out what alternative approach you think should be employed.</p>	<p>Yes. APA notes that this is a far simpler calculation in a pipeline-by-pipeline pay as bid auction design.</p>
<b>4.8</b>	<b>Information to be provided to auction participants</b>	
31.	<p>Do you agree with the proposal to:</p> <ul style="list-style-type: none"> <li>o provide auction participants with information on the products to be auctioned and the auction quantities prior to the auction?</li> <li>o provide auction winners with information on their own winning bids and the clearing price for all the products sold through the auction?</li> <li>o publish information on auction quantities and the clearing prices on the BB website?</li> </ul>	<p>As noted in response to question 16 above, this information will not give shippers information on the bidding outcomes that led to particular pricing and allocation outcomes in all circumstances. Smaller shippers are unlikely to have the resources to understand complex combinatorial auction outcomes, their drivers and then develop strategies to manage these risks. The proposed information here would be insufficient for them to conduct this analysis.</p>

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32.	Do you agree with the proposal not to publish the bid-stack in the initial stages of the auction's operation? If not, please explain why you think the gaming issues identified by NERA are unlikely to affect the robustness of the auction.	The complexity of the auction design effectively limits participation by smaller shippers. Publication of bid stack information is unlikely to address this issue, and, as suggested in the Consultation Paper, may exacerbate the ability of larger incumbent shippers to manipulate auction outcomes.
<b>4.9</b>	<b>Auction timing</b>	
33.	Do you agree with the proposed timing offsets for the auction related D-1 activities? If not, how long do you think should be allowed for each activity?	<p>No.</p> <p>1.5 hours is not sufficient time for pipeliners to receive nominations, run each pipeline schedule, determine un-nominated capacities, validate that information, and transmit it to AEMO.</p> <p>Under the STTM rules, pipelines have 4.5 hours to derive and send similar information, and this has proved to be a difficult and costly obligation to fulfil. No consideration or weight has been given to the system costs associated with the short and strict timeline set out in the Consultation Paper. These costs increase exponentially as the time available for their production, validation and transmittal are reduced.</p> <p>Ensuring systems are sufficiently resilient to meet this obligation is costly and does not allow room for any issues that may need to be resolved in the scheduling process.</p>
34.	<p>What do you think should occur if:</p> <ul style="list-style-type: none"> <li>o a service provider is unable to provide AEMO with the auction quantity within the required timeframe?</li> <li>o AEMO experiences a system failure and is unable to conduct the auction within the required timeframe?</li> </ul>	In the event that information is not provided to AEMO by any party or that for any other reason AEMO is unable to run the auction, then for that day the auction should be suspended and shippers revert to existing arrangements to secure capacity. It is not possible to make any assumptions about allocating capacity in an auction without real information.
<b>5.2</b>	<b>Coverage of the auction</b>	
35.	Do you agree with the proposal to apply	No. A detailed discussion of APA's concerns with the NERA report is set out in section 1 of

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	<p>the auction to all the transmission pipelines (excluding the Declared Transmission System) linking major demand centres and supply sources in the east coast and contractually congested pipelines in regional areas? If not, please explain why.</p>	<p>this submission.</p> <p>Applying to auction to pipelines are that not contractually congested will lead to decreased long term contracting which it assumes will lead to less investment in new capacity. Both of these outcomes were confirmed by the NERA report.</p> <p>In addition finding these impacts on investment, the NERA report found only 'weak' potential gains in allocative efficiency from applying the auction across all markets, and found these only by assuming that the costs of determining which pipelines were contractually congested would be difficult and costly, and therefore it was better to apply the auction more broadly. This is untenable.</p> <p>The GMRG's view that allocative efficiency gains will outweigh possible dynamic inefficiencies rests on hypothetical modelling by NERA which, as set out above, found only weak allocative efficiency gains and dynamic efficiency losses. NERA was only able to conclude that the allocative gains are larger than the dynamic losses because of the assumptions in its model, and in particular the assumption that there are no external benefits (ie, benefits not captured by shippers) associated with a secure gas supply. It is abundantly clear, for example from the events of February 2017, that there are external costs from inadequate gas supply security. Importantly, NERA concluded that the auction would definitely reduce long term contracting; on the assumptions in NERA's work, a reduction in long-term contracting means less investment in new capacity. APA's view is that the impact of reduced long term contracting on investment is obvious and negative, and that Australia's energy system needs more reliability not less.</p> <p>It is critical that the auction be limited to contractually congested pipelines. If it recommends otherwise, GMRG will be deliberately undermining investment in new pipeline capacity at a time when reliability of energy supply needs to be increased and new investment is critically needed to get more gas to market.</p>
36.	<p>Are there any other pipelines or compressors that you think should be added to the list of pipelines and compressors that could be subject to the auction in Table 5.2?</p>	<p>APA does not have a view on this matter.</p>
37.	<p>Do you think that the efficiencies</p>	<p>No.</p>

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	associated with a broader application of the auction will outweigh some of the dynamic efficiency losses that could occur on individual pipelines? If not, are there any other measures that you think could be employed to ameliorate the effect of any such losses?	No net efficiencies, which might outweigh the loss of dynamic efficiency, have been identified with the broader application of the auction. This is explained in section 1 of this submission.
38.	Do you agree that exemptions should be available to: <ul style="list-style-type: none"> <li>o transportation assets that are not providing third party access? If not, please explain why.</li> <li>o transportation assets that service a single facility? If not, please explain why?</li> </ul>	<i>Exemption of transportation assets not providing third party access</i> Yes. <i>Exemption of transportation assets servicing a single facility</i> Yes. Further exemptions are required for pipelines that are not fully contracted, and in respect of new pipelines/capacity to avoid significant free-rider effects that will undermine contracting shippers' incentives to invest.
39.	Do you think an exemption should be available to pipelines that fall below a minimum size threshold if they are not contractually congested? Please explain your response.	Yes. The costs of auction implementation are likely to outweigh any possible benefits.
40.	Are there any other exemptions that you think should be provided for? If so, please explain what they are and why they are required.	New pipeline capacity should be exempt from the auction to address free-rider problems that will deter shippers from contracting new capacity.
<b>6.1</b>	<b>Auction platform and systems</b>	
41.	Do you agree with AEMO's proposal to use existing systems and a modified version of the SRA algorithm? If not, please explain why.	Yes. AEMO presented this option as a low implementation cost option that would support a simple auction design. The auction design and complexity contemplated by the GMRG appear to go far beyond that which would be available using the SRA algorithm. APA considers that the

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		auction design should be significantly simplified and use this lower cost option.
42.	Will service providers need to put any new systems in to calculate auction quantities or to deal with information transfers between itself and AEMO? If so, how long do service providers think this is likely to take?	<p>Yes - new systems will be required, as well as significant reconfiguration of existing systems. Pipeline service providers will need to redesign existing processes for scheduling, curtailment and billing, and will need to rebuild systems around the redesigned processes.</p> <p>Detailed design of the auction arrangements and procedures will need to be completed by AEMO before pipeline service providers can begin work on their processes and systems.</p> <p>Once AEMO and service providers have completed required new systems and the rebuilding of existing systems, a period of testing will be required. That testing will involve not only AEMO and the service providers; market participants who will use the systems will also have to be involved. The process of testing will be both extensive and intensive as will be prudent for any new market arrangement.</p> <p>Adequate time for these important steps to be completed does not appear contemplated when setting the current implementation target of September 2018.</p> <p>APA is of the view that, assuming the auction design, detailed procedures, and build packs are finalised by Q4 2018, system development might be completed by Q2 2019. Allowing adequate time for market testing, an auction start date of late-2019 may be appropriate.</p>
<b>6.2.2</b>	<b>Settlement arrangements</b>	
43.	Do you agree with AEMO's proposal to combine the settlement amounts for the GSH and day-ahead auctions? If not, please explain why.	APA does not have a view on this matter.
<b>6.2.3</b>	<b>Credit risk management</b>	
44.	Do you agree with AEMO's proposal to combine the credit risk management arrangements for the GSH and auction products? If not, please explain why.	<p>APA has concerns about the amount of payment security shippers will provide to AEMO and the suggestion that any "residual credit risk" should be borne by service providers.</p> <p>It is not clear when or how "the risk that payment security for some reason fails" would arise. If this risk were to materialise because AEMO did not properly administer the security</p>

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		<p>payments, it is not appropriate or reasonable that service providers bear the consequences. Understanding when and how this risk may arise should inform the amount of security sought and maintained by AEMO.</p> <p>In APA's view, creditworthiness should be assessed on a shipper by shipper basis with credit support to be provided as determined appropriate by the pipeliner. There cannot be a one size fits all approach.</p> <p>The security should reflect the external credit rating of the Shipper (i.e. S&amp;P or Moody's), with those shippers with higher ratings being required to post a lower amount of security. At a minimum, the amount of security should be the equivalent of four months expected revenue, with a floor of \$100,000, where the shipper has a credit rating the below BBB- (S&amp;P) or Baa3 (Moody's). This will allow the pipeliner sufficient time to attempt to remedy the non-payment issues (if at all) and notify the non-paying shipper of cessation of service.</p> <p>In addition, service providers will want to ensure that any residual credit risk is factored into the credit support provisions of the operational GTA with a shipper to cover the service provider's counterparty risk and provide recourse to sufficient security to cover any shortfall in proceeds due to the service provider through the auction process.</p>
<b>6.2.4</b>	<b>Cost recovery</b>	
45.	Do you agree with the proposal to recover AEMO's costs of implementing and conducting the day-ahead auction from auction and GSH participants? If not, please explain why.	<p>Yes. This approach is fair and means that the beneficiaries of the auction will pay for its operation.</p> <p>APA does not support any proposal that service providers should pay for AEMO's costs in auction establishment or operation. The auction has not been developed for the benefit of pipeliners – the shippers that use the facility are the beneficiaries of the auction and they should pay for its costs.</p> <p>Further, and as set out in APA's submission on the Standardisation and Capacity Trading reforms, service provider system implementation and ongoing administrative costs must be able to be recovered from auction participants through a fee or tariff. As noted above, service providers will incur significant costs in preparing for the auction that they will need to recover. These costs should be recovered from users of the auction product.</p>
46.	Do you agree with the proposal to allow	Yes.

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	AEMO to determine, in consultation with auction and GSH participants, the fee structure that would apply to the day-ahead auction and secondary capacity trades? If not, please explain why.	
47.	Do you think the cost recovery provisions should be specified in the NGR?	APA does not have a view on this matter.
<b>6.25</b>	<b>Other contractual arrangements required by auction winners</b>	
48.	What changes do you think will need to be made to the Operational Code that was released for public comment in the <i>Standardisation Related Reforms and the Capacity Trading Platform Consultation Paper</i> to accommodate the auction product?	<p>Necessary changes to the operational code are considerable and need to be determined as part of a separate consultation process once the auction priority has been determined.</p> <p>At a minimum, the necessary changes to the Operation Code should include:</p> <ul style="list-style-type: none"> <li>• Addition of services to cover auction products with different service priorities and curtailment provisions</li> <li>• Point to Point contract paths, instead of points within a zone</li> <li>• Different nominations cut-off times and procedures</li> <li>• Renomination rights for auction product versus bilaterally or exchange traded firm (and park) services</li> <li>• Credit support – calculation of quantum and service provider’s recourse in the event of shortfall in credit held by AEMO for purchase of auctioned capacity.</li> </ul>
<b>7.2</b>	<b>Legal and governance framework for the day-ahead auction</b>	
49.	Are there any other changes that you think will be required to the legal and governance framework to give effect to the day-ahead auction that have not been identified in Table 7.1?	<p>Yes.</p> <p>The legal and governance framework changes described do not acknowledge that the proposed approach involves a change to existing contractual rights of shippers to insert a new priority of capacity into existing contractual scheduling and curtailment schedules.</p>

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		<p>Changing existing contracts and the removal of property rights creates significant sovereign risk. The Consultation Paper fails to acknowledge this, or weigh it against the supposed benefits of introducing an auction with the proposed priority of product.</p> <p>APA considers that changing existing contractual rights is a fundamental flaw in the proposed auction design which cannot be ignored. It must be clearly and transparently discussed with market participants and government stakeholders.</p> <p>An alternative approach that does not undermine existing shipper contractual rights or require extensive changes to existing contracts is available by specifying an interruptible auction product, however the GMRG has not at this stage chosen to adopt this approach.</p>
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### **PART B – Reporting Framework for Secondary Trades**

Part B of the Consultation Paper sets out:

- a scheme of reporting requirements for secondary trades; and
- governance arrangements for that scheme of reporting requirements.

If implemented, the reporting requirements will place obligations on users of pipeline capacity to disclose the details of their trading of capacity within defined time frames.

APA notes that the scheme of reporting requirements for secondary trades does not anticipate a role for pipeline service providers and, indeed, APA would not expect that, as providers of primary capacity, pipeline service providers would have any role in the disclosure of information on those trades.

The governance arrangements for this scheme of reporting requirements for secondary trades do not anticipate changes to the NGL and the NGR which have implications for service providers.

On this understanding, APA has no comments to make on Part B of the Consultation Paper.