

Day-ahead auction for contracted but unnominated capacity

**Submission to the Gas
Market Reform Group**

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APGA submission to the Day-Ahead Auction of Contracted but Un-Nominated Capacity and Reporting Framework Consultation Paper

Introduction

The Australian Pipelines and Gas Association (APGA) welcomes the opportunity to respond to the Gas Market Reform Group's (GMRG) Day-Ahead Auction of Contracted but Un-Nominated Capacity and Reporting Framework Consultation Paper.

APGA is the peak body representing Australasia's pipeline infrastructure, with a focus on gas transmission, but also including transportation of other products, such as oil, water and slurry. Our members include constructors, owners, operators, advisers, engineering companies and suppliers of pipeline products and services.

APGA's members build, own and operate the gas transmission infrastructure connecting the disparate gas supply basins and demand centres of Australia, offering a wide range of services to gas producers, retailers and users. The replacement value of Australia's gas transmission infrastructure is estimated to be \$50 billion.

APGA is an active participant in the GMRG's process to develop the day-ahead auction of contracted but un-nominated capacity. There are a number of instances where the preferred approach set out by the GMRG in the consultation paper raise concern for APGA:

- The combinatorial mechanism put forward is complex. It appears to favour long-distance, multi-pipeline bids over higher value bids on single pipelines. This creates disadvantages for those market participants seeking simpler routes through auction. In some instances, it may penalise shippers that have firm transport across some of the multi-pipeline route they wish to use on a day-ahead basis.
- The GMRG does not seem to have a clear understanding of the role of as available and interruptible services in the market. In introducing such a significant reform, it is vital that a comprehensive view of existing market arrangements informs decisions. Introducing auctioned capacity to the market with a higher priority than existing flexible services introduces risk for some market participants.
- Introducing an auction will lead to later scheduling of pipelines. The more complex the auction is, the later this will be. Later scheduling introduces additional cost, complexity and deliverability risk for pipelines.

APGA would like to see a risk register prepared for this reform, to ensure that the risks associated with such a large change to the market are adequately understood and mitigated.

Key Issues

Combinatorial nature of the auction

Questions 16-18

The proposed combinatorial nature of the auction adds complexity, and cost, to the entire process. It also appears to have the, presumably unintended, consequence of prioritising multi-pipeline bids over single pipeline bids.

An auction that is complex and favours long-distance transportation is most likely to best suited to large, sophisticated entities with high levels of flexible gas supply seeking opportunistic transactions rather than small entities looking to acquire gas reliably.

Further, the proposed combinatorial process does not give any weight to shippers that have firm capacity on one or more legs of the desired transportation route. As currently proposed, the auction engine would give more weight to a combinatorial bid across two pipelines of 20c/GJ on each pipeline than a bid of 30c/GJ on just one of those pipelines. The later bid may be made by a shipper than has firm capacity on the second pipeline. The later bid represents shipper that places the highest value on the capacity, the shipper has firm capacity on one pipeline and has made a higher bid on the second pipeline. Even if the shipper doesn't have firm capacity on one pipeline, it clearly values the capacity more highly.

That such an outcome is possible under the proposed approach should give the GMRG pause.

Many of the characteristics set out in the GMRG's preferred approach stem from the desire to achieve the combinatorial mechanism in the consultation paper. It is difficult to treat each section separately, there are inter-relations across them all.

Priority of the auction product

Questions 3 and 4

APGA does not agree with the proposal to adopt a second priority firm auction product.

The GMRG should consider very carefully the implications on introducing a new priority to existing pipeline arrangements. They have been proven to work well for all shippers, ensuring gas is delivered as required.

'As available' and 'interruptible' services provide reliable and understood flexibility, either as an extension, or as an alternative, to firm services. They are of benefit to gas fired power generators, who regularly request and use such services **on the day they are required**.

Currently, gas fired power generators can use these flexible services to secure transportation capacity at short notice and avoid a need to pay firm reservation charges for capacity that is used only a few days a year, but necessary to meet peak electricity demand. If these arrangements are no longer suitable in all circumstances, there may be some generators that choose to mitigate any capacity access risk by acquiring firm contracts. This could place upward pressure on peak electricity prices.

By proposing that auctioned capacity should have the new priority of 'second priority firm', the GMRG is limiting, if not removing, the ability of pipeline operators to offer secure, flexible services that are clearly valuable to some sectors. The impact that auctioned capacity will have on same day services appears to be being overlooked in the consultation paper.

Before reaching a decision on the priority of the auction product. APGA recommends that the GMRG develop a detailed understanding of the use of as available and interruptible service. Without this understanding, it is not possible to assess the impact to the market of diminishing the priority of these services.

Throughout the auction reform process, much has been made of ensuring that 'gas should be transported to where it is valued most highly' and that 'shippers that value the capacity most highly should have access to it'. Paradoxically, if auctioned capacity is to be a higher priority than 'as available' and 'interruptible', there will be many days where those that are willing to pay a pipeline operator directly for secure flexibility may be prevented from, or limited in their ability to do so by parties that have acquired capacity through auction for the auction floor price of \$0.00.

APGA considers it is unnecessary to create a new priority level for the auctioned capacity, it should be considered interruptible. If curtailment is to occur, the curtailment stack will be determined by price paid for interruptible capacity, with those paying least being curtailed first.

Management of curtailment risk

APGA considers there is another paradox introduced by the GMRG in its consideration of curtailment risk. By proposing the auctioned capacity be second priority firm, the GMRG is limiting the ability of shippers to manage curtailment risk through authorised overruns or by acquiring 'as available' capacity.

If auctioned capacity was to have the lowest priority, then curtailment risk could be managed by 'upgrading' any capacity acquired through auction to 'as available' if there appears to be a risk of curtailment. In this way, those that value the capacity most will be able to ensure they are prioritised.

Any concerns regarding the pricing of 'as available' service can be addressed through the arbitration mechanism.

Hoarding risk

The GMRG cursorily considers curtailment risk and the risk of nomination gaming in its analysis. It includes no consideration of hoarding risk. The higher priority given to auctioned capacity, the greater the ability of some parties to acquire large tranches of capacity through auction at very low cost and prevent it being otherwise used. A service provider will be limited in their ability to sell 'on the day' flexible services if all available capacity has been acquired cheaply through auction.

The risk that hoarding of auctioned capacity will occur is real given that the GMRG informed the Auction Forum on Tuesday 31 October that nomination conduct provisions are being considered for firm capacity holders but not for those that acquire capacity through auction.

Renomination rights

On occasion the consultation paper refers to '*all renominations (including firm and implied rights)*' and other times to just '*renomination rights*'. The GMRG should clarify if the terms mean the same thing or if the term '*renomination rights*' excludes implied rights.

Backhaul

Questions 2 and 19

APGA does not agree with the proposal to include an interruptible backhaul service in the auction for single direction pipelines.

Backhaul is not a firm service offered on a 'take or pay' basis. There is no 'contracted but unnominated' capacity to be auctioned.

The analysis provided by the GMRG on page 24 and 25 is cursory and unconvincing. If the GMRG or other stakeholders believes there are issues with the pricing of backhaul services, these can be addressed through the arbitration mechanism.

The GMRG contends it is a simple administrative matter to schedule backhaul yet offers no evidence of this. The presentation of scheduling as a simple task occurs throughout the consultation paper – demonstrating there is little appreciation for the complexities in ensuring that all nominations are met as efficiently as possible. The impact of backhaul on scheduling is discussed further below in the section on scheduling and deliverability.

To include backhaul in an auction for contracted but unnominated capacity is clearly outside the scope of the reform.

Coverage of the auction

Questions 35-40

APGA does not agree with the proposal to apply the auction to pipelines that are not fully contracted.

APGA reminds the GMRG that the initial decision to have a floor price of zero was based on the conclusion that fully contracted pipelines recover all their long-term costs through contracts. Firstly, this is simply not true. Long-term contracts are used to secure investment in pipelines, but pipeline service providers always take some risk on the durability of demand. Foundation contracts typically expire after 10 to 15 years (less in recent pipeline investment) and capital costs are recovered over longer timeframes.

Pipelines that are not fully contracted are very likely to be pipelines that are not currently recovering their long-term costs and are thus exposed to new and damaging risk through the imposition of capacity auctions. It is insufficient to produce a report by NERA that says the auction has little or no implications for primary capacity markets and therefore there is no risk of their introduction. Every molecule of gas transported by capacity acquired through auction is a molecule that is not transported by capacity acquired through primary or secondary markets. Auctions will clearly have an impact on primary and secondary markets.

APGA notes that capacity auctions in Europe have been implemented on contractually congested interconnect points only. The introduction of auctions on pipelines that are not fully contracted is unique. APGA is concerned that the GMRG seems confident in readily dismissing the risks associated with such an introduction.

Impact of auction on variable components of tariffs

Many firm services include a capacity reservation charge and a throughput charge. There is no discussion in the consultation paper of how a pipeline will recover the throughput component of its tariff when it is transporting capacity acquired through auction.

This is a critical issue. Pipeline services are offered with an expectation of certain capacity utilisation, and associated revenue from throughput charges, by each customer. If each customer's unused capacity is made available to the market through auction, a pipeline operator may find itself transporting more gas than anticipated and failing to recover costs that were agreed with contracted customers to be covered through throughput charges.

Impact of auction on scheduling and deliverability

Scheduling of a pipeline is not a simple administrative task. It is a complex modelling undertaking that must be carefully managed to ensure that gas can be delivered across the pipeline as required and that the pipeline will be adequately prepared to deliver gas over coming days.

The introduction of a day ahead auction will impact pipeline scheduling. There is little appreciation of this in the consultation paper. Indeed, scheduling is treated as a simple administrative task. Importantly, scheduling leads to the physical movement of gas across long distances.

The additional nominations for capacity acquired through auction will require an entire re-scheduling of the pipeline, resulting in final preparations for a gas day being completed several hours later (probably at least five) than they currently are.

This is not a minor administrative matter. If pipeline compressors and systems are not properly calibrated for the day's nominations, gas may not be distributed across the pipeline in a manner that will ensure all deliveries occur. Gas does not move instantaneously. A delay of five or more hours before the schedule is finalised will be problematic in some circumstances.

This is exacerbated if backhaul is included in the auction. Without backhaul, a pipeline operator can be confident in the auction resulting only in more gas being required to be transported on the pipeline. With backhaul, it may be that less gas is required to be

transported. This means a pipeline will lose all the hours between the initial schedule and the final schedule – it could not start moving gas until the demand for backhaul is known as it is highly inefficient to start moving gas if some of it ultimately does not need to be transported.

The risk of non-delivery will be further increased if nominations for auctioned capacity either change over the course of the day or simply fail to be followed. APGA's considers this has some likelihood, the auctioned capacity is best suited to short-term portfolio management decisions and short-term decisions are subject to rapid change as circumstances change over a day.

APGA also notes that many pipeline operators have removed or minimised variation charges due to market power concerns. Variation charges have always been primarily concerned with managing shipper behaviour rather than revenue raising. With the implementation of the auction, ensuring correct shipper behaviour on nominations is of increased importance.

Later scheduling will mean that where errors do occur in either AEMO's auction systems or pipeline scheduling systems, there will be less time available to address them before the commencement of the gas day.

Later scheduling means pipeline operators will need to ensure key staff are available later than current practice, which will add to overall costs. It is likely that many pipeline companies will have to increase resources and restructure control room operations entirely to manage late evening day ahead scheduling, which is not a minor cost at all.

Auction platform and systems

Questions 41 & 42

These questions cannot be answered now. The original proposal to use AEMO systems for the auctions has been superseded by the current design approach being put forward.

AEMO's original proposal included costs of under \$200,000, a simple repurposing of an existing engine and approximately 6 months for implementation.

The currently proposed implementation time frame for the auction set out in the consultation paper has auctions commencing in March 2019. Obviously AEMO's original proposal, on which the decision to have AEMO operate the auction platform was made, was inadequate.

The auction set out in the consultation paper will have completely different system requirements for AEMO and pipeline service providers that are still unknown.