

Terms of Reference:

Standardisation of contract terms project team

1. Background

The Gas Market Reform Group (GMRG) was established by the COAG Energy Council in the latter half of 2016 to lead the design, development and implementation of a number of reforms set out in the Gas Market Reform Package, including the development of:

- a number of pipeline and hub services (jointly referred to as ‘transportation’) capacity trading related reforms;
- a new commercial arbitration framework for pipelines that will be underpinned by greater transparency of prices and contract terms, as well as pricing principles;
- the market transparency reforms, which for GMRG involves the development of terms of reference for the biennial review on the growth in liquidity in wholesale gas and pipeline capacity trading markets; and
- the wholesale gas market related reforms, which primarily relate to the Southern Hub and Declared Wholesale Gas Market (DWGM) that the AEMC is currently working on.

These interlinked suite of reforms, which were proposed by the AEMC in its *East Coast Wholesale Gas Markets and Pipeline Frameworks Review Stage 2 Final Report* and by Dr Vertigan in his *Examination of the Current Test for the Regulation of Gas Pipelines*, are designed to promote:

- the National Gas Objective, which is to:

...promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

- the Energy Council’s Vision for the Australian Gas Market, which is for.

...the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities.

To carry out the work listed above, the GMRG has established the following work streams:

- the transportation (pipeline and hub services) capacity trading work stream;
- the disclosure and commercial arbitration framework work stream;
- the information and market transparency work stream; and
- the wholesale markets work stream.

Work on the first three of these work streams will commence in early 2017, while work on the fourth work stream will commence when the AEMC finalises its recommendations.

Further detail on the transportation capacity trading work stream is provided below, while Appendix A provides an overview of the GMRG's governance structure, its work streams and relationships with stakeholders.

2. Transportation capacity trading work stream

The transportation capacity trading work stream will be responsible for progressing the capacity trading related reforms identified in the Energy Council's Gas Market Reform Package in response to the AEMC's Stage 2 Final Report. These reforms, which have been endorsed by the Energy Council, are expected to foster the development of a more liquid market for secondary capacity by:¹

- enabling capacity to be allocated on a non-discriminatory basis to those that value it most highly through market based processes and, in so doing, improve the efficiency with which capacity is used on pipelines;
- reducing search and transaction costs;
- aiding the price discovery process by reducing information asymmetries and, in so doing reduce search and transaction costs and enable more informed decision making; and
- providing capacity holders with a greater incentive to trade capacity.

The proposed reforms include the development of:

- standards for key operational, prudential and other contract terms that govern the relationship between the parties and their contractual obligations ('other contract terms') in primary, secondary, operational transfer and trading exchange agreements;
- a day-ahead auction of contracted but un-nominated pipeline and hub services capacity;
- a capacity trading platform(s) that provides for exchange based trading of commonly traded transportation services and a listing facility for other services; and
- a reporting framework for secondary capacity trades that provides for the publication of the price and other related information on secondary trades.

Further detail on the scope of these reforms can be found in Table 2.1, which contains a summary of the recommendations contained in the AEMC's Stage 2 Final Report which have been categorised by the AEMC as follows:

- **required outcomes** – these recommendations were described by the AEMC as outcomes that must be progressed by the GMRG and are necessary to the implementation of the reforms;
- **preferred outcomes** – these recommendations were described by the AEMC as outcomes that should be pursued by the GMRG unless it is clear there are greater benefits in alternative approaches; and
- **suggested outcomes** – these recommendations were described by the AEMC as outcomes that have in-principle benefits but need to be considered further by the GMRG.

¹ AEMC, Stage 2 Final Report, 23 May 2016, p. 69.

Table 2.1: AEMC Recommendations

Recommendation	Required outcomes	Preferred outcomes	Suggested outcomes
Standardisation of key primary and secondary capacity contractual terms	<ul style="list-style-type: none"> ▪ Standardisation of key primary and secondary capacity contractual terms for pipeline and for hub services. ▪ Where possible and appropriate apply across the eastern Australian gas market. ▪ Standards to be developed are for key operational, prudential and other contractual provisions in GTAs, CTAs and Operational GTAs, and provisions in contracts used for exchange based trading on the capacity trading platform. ▪ Counterparties to existing contracts should not be materially disadvantaged through the standardisation process 	<ul style="list-style-type: none"> ▪ Shippers provided greater flexibility to change their receipt and delivery points 	
Auction for contracted but un-nominated capacity	<ul style="list-style-type: none"> ▪ A daily, day-ahead capacity auction for contracted but un-nominated pipeline capacity and hub services. ▪ Auction happens shortly after nomination cut-off time. ▪ Reserve price of zero dollars, with compressor fuel provided by shippers in-kind. ▪ At least all contracted but un-nominated capacity placed for sale through auction. ▪ Accommodate nominations or renominations by incumbent shippers after the auction is conducted. 	<ul style="list-style-type: none"> ▪ Combinatorial auction where multiple buyers and sellers can simultaneously coordinate trades, managing the complementarities between different pipeline segments. ▪ Single round auction to reduce complexity and opportunities for anti-competitive behaviour between participants. ▪ Bidders pay the value of their winning bids ("first-price" rule) to reduce complexity. ▪ Algorithm determines the winning combination of bids by maximising profit (constrained by requirement that at least all contracted but un-nominated capacity is put on sale in auction). ▪ Capacity purchased in the auction curtailed before (ie, earlier than) firm capacity. ▪ Single auction across the east coast market, in order to optimise allocation across as many products as possible. ▪ Exemption from the auction for pipelines serving a single user. 	<ul style="list-style-type: none"> ▪ As available rights in current GTAs to be phased out to avoid them competing with rights allocated in the auction. ▪ Exempting on a case-by-case basis pipelines that are not fully contracted from needing to conduct the auction. ▪ The auction to be run by the same instruction(s) which run the capacity trading platform.
Capacity trading platform(s)	<ul style="list-style-type: none"> ▪ Creation of capacity trading platform(s) which include electronic anonymous exchange based trading for commonly traded products in addition to a capacity listing service typical on current capacity trading platforms. ▪ Trades carried out through the capacity trading platform to be given effect through an operational transfer. ▪ Bare transfers will be allowed but the seller will be required to offer the buyer the option to use an operational transfer. 	<ul style="list-style-type: none"> ▪ Single capacity trading platform operating across the east coast. ▪ As many services as possible capable of being traded on the platform (eg, transportation services, hub services and pipeline storage services), recognising the need to avoid unnecessary complexities. ▪ Trades conducted outside the capacity trading platform to be advertised ahead of time on the capacity trading platform listing service. 	
Publication of information on secondary capacity trades	<ul style="list-style-type: none"> ▪ Publication of information on all secondary trades of pipeline capacity and hub services. ▪ The information to be published is the price of the trade and any other information that might reasonably influence that price, taking into account measures to protect anonymity. ▪ Publication should occur at or shortly after the time the transaction is entered into 		

To progress the reform measures identified by the Energy Council (including consideration of the AEMC's required, preferred and suggested outcomes), the GMRG has established the following project teams:

- the standardisation of contract terms project team;²
- the capacity trading platform project team; and
- the auction project team.

The project teams consist of members from a range of different backgrounds and are expected to have the technical expertise that will be required to contribute to the design and development work in the project team meetings. The project teams will be facilitated by the GMRG Strategic Program Director and assisted by the GMRG senior technical advisor, a secondee analyst from one of the market bodies and, where relevant, by other legal, economic and/or market design experts, including from the market bodies.

The GMRG has also sought nominations for the development of an advisory panel, which will be made up of senior representatives from industry (including consumers and users of gas) and will provide strategic perspective and advice to the GMRG.

The GMRG will also be carrying out an extensive program of engagement on the recommendations emerging from the project teams with other stakeholders and the market bodies (i.e. the AEMC, AEMO and AER). The Gas Market Project Implementation Team (GMPIT), Standing Committee of Officials (SCO) and the Energy Council will also be provided with regular updates on the progress of this work stream.

Further detail on the work that the standardisation of contract terms project team will be expected to carry out is provided in the following section.

3. Standardisation of contract terms project team

The Standardisation of contract terms project team will be responsible for progressing the reforms set out in the first row of Table 2.1 and making recommendations to the GMRG, which will then be consulted on with other stakeholders before the final recommendations are made to SCO and the Energy Council.

Before setting out the specific matters that will need to be considered by this project team, it is worth taking the time to set out what is intended to be achieved through these reforms.

3.1 AEMC recommendations on standardisation

In its Stage 2 Final Report, the AEMC made it clear that, with the exception of the exchange based capacity trading and auction products, it did not expect the service related provisions in transportation contracts to be standardised. It did, however, consider that there would be value in making capacity more fungible by:³

- standardising the operational, prudential and other contractual provisions governing the relationship between the contracting parties and their contractual obligations (see Box 3.1 for an explanation of how these differ from service related provisions) in the following contracts and, where possible and appropriate, across pipelines:
 - primary gas transportation (pipeline or hub services) agreements (GTAs) entered into between pipeline operators and shippers;

² Given the parallels between the work to be carried out on standardisation and reporting, this project team may take on the reporting of secondary trading information work towards the end of the program.

³ AEMC, Stage 2 Final Report, 23 May 2016, pp. 85-86.

- secondary capacity transportation (pipeline or hub services) agreements (CTAs) entered into between primary capacity holders and other shippers;
- operational transfers entered into between pipeline operators and buyers of secondary capacity, which the AEMC recommended be used to give effect to trades on the capacity trading platform(s)
- auctioned capacity agreements entered into between pipeline operators and the purchasers of auctioned capacity; and
- the exchange agreements to be used on the capacity trading platform(s); and
- providing shippers with greater flexibility to change receipt and delivery points.

Box 3.1: Service, operational, prudential and other contract terms

A capacity holder's right to access pipeline or compression capacity will usually be defined by reference to the service related elements, which include:

- the type of service that the capacity is to be used for (e.g. transportation services (forward haul, backhaul or bi-directional), hub services or storage services);
- the firmness of the seller's obligation to provide the service (e.g. firm, as available or interruptible) and the priority in scheduling and curtailment;
- the receipt and delivery points (or zones) that services are provided between and any technical restrictions at those points (e.g. operating pressures); and
- the maximum capacity the shipper can nominate to be supplied at receipt and delivery points, which is usually measured on a daily and hourly basis and renomination rights.

The contracts will also contain:

- operational terms and conditions, such as
 - (a) start of gas day and nomination cut-off times;
 - (b) gas specification, gas quality and metering provisions;
 - (c) service definition and the priority accorded to firm, as available and interruptible services in the scheduling and curtailment processes;
 - (d) nomination, scheduling, curtailment and allocation procedures;
 - (e) imbalance, daily variance and overrun tolerance levels and penalties;
 - (f) the process for making changes to receipt and delivery points; and
 - (g) provisions relating to transfers, assignments and novations of capacity;
- prudential requirements; and
- other contract provisions governing the relationships and contractual obligations between parties, such as warranties, representations, possession, responsibility, title, control, liability and indemnities, default, force majeure, confidentiality and dispute resolution provisions.

Standardisation of contract terms

In section 5.3.2 of its Stage 2 Final Report, the AEMC noted that at a minimum, it would expect common standards to be developed for the prudential provisions, other contract provisions, and many of the operational provisions. It acknowledged, however, that it may be more difficult to develop common standards for provisions that are more technical in nature (e.g. imbalance and overrun tolerance levels), because these provisions can depend on the physical characteristics and operating conditions of the pipeline.

The AEMC also noted that while such standardisation was regarded as a 'required outcome', the form of such standardisation and the manner in which it is implemented (including whether common standards can be developed for all pipelines, or if pipeline specific standards are required) are matters for the GMRG to consider.

Some of the other matters that the AEMC recommended the GMRG consider in this context include whether:⁴

- a single standard can be developed for each term and condition or if a range of standards may be more appropriate in some circumstances;
- a credit support mechanism should be developed to manage the risk to one counterparty when the other counterparty has low credit worthiness because this would no longer be managed through bespoke prudential requirements;
- changes needed to be made to the allocation agreements¹⁵⁴ that shippers have entered into at some delivery points to enable capacity to be traded; and
- the adoption of these standardised provisions should be compulsory, or if shippers and pipelines should be able to negotiate around any provisions.

Receipt and delivery point flexibility

In section 5.3.3 of the Stage 2 Final Report, the AEMC noted that there were a number of measures that could be implemented to provide shippers with greater receipt and delivery point flexibility, including:⁵

- developing zones that cover multiple receipt and delivery points and allowing changes to occur relatively easily within these zones and putting in place rules that clearly define how changes across zones will be dealt with;
- only allowing pipeline operators to reject changes to receipt and delivery points on technical and operational (e.g. if the transfer would affect delivery to another shipper with firm rights) grounds, as opposed to commercial grounds; and
- requiring pipeline operators to respond to a request to change a receipt or delivery point within a specified time.

The AEMC acknowledged, however, that there may be other measures that could achieve a similar outcome more efficiently and noted that the GMRG should not limit its consideration to the measures listed above.

Energy Council's response to the AEMC's recommendations

In its response to the AEMC's recommendations, the Energy Council noted the following:⁶

"The Energy Council notes the findings of the ACCC and AEMC of the benefits of standardising GTAs, CTAs and Operational GTAs, which included reducing search and transaction costs and allowing trades to be executed faster.

The Energy Council agrees to the standardisation of key primary and secondary capacity contractual terms for pipeline and for hub services (Reform Measure 8).

The Energy Council notes that having market participants involved in determining the appropriate level of standardisation and how to achieve greater receipt and delivery point flexibility is important because they ultimately will have to operate under these terms and conditions.

The Gas Market Reform Group will lead the development of detailed design work for any required changes to the NGL and NGR and other relevant instruments that are necessary to

⁴ AEMC, Stage 2 Final Report, 23 May 2016, p. 90.

⁵ AEMC, Stage 2 Final Report, 23 May 2016, pp. 91-92.

⁶ Energy Council, Gas Market Reform Package Appendix A – Energy Council response to ACCC and AEMC's reports, August 2016.

support the standardisation process. This work will consider the AEMC's required and preferred outcomes for contract standardisation in further detail when evaluating options for the capacity standardisation initiative."

3.2 Matters to be considered by the Standardisation of contracts terms project team

In keeping with the recommendations set out in the AEMC's Stage 2 Final Report, the Standardisation of contract terms project team will be responsible for:

1. Developing common standards for the operational, prudential and other contractual provisions in the following types of pipeline and hub service contracts (in order of priority):
 - operational transfers;
 - auction capacity trade agreements;
 - CTAs;
 - capacity trading platform exchange agreements; and
 - if considered necessary, GTAs.

As noted by the AEMC, the GMRG is responsible for recommending whether the standards should, to the extent it is possible and appropriate, be common across pipelines and the different types of contracts. If relevant, the project team will also draft contract templates.

2. Identifying and evaluating the options for providing shippers with greater receipt and delivery point flexibility and considering how any changes in this area will be given effect.
3. Providing advice on how the standards should be implemented (i.e. a compulsory requirement in the National Gas Law (NGL)/National Gas Rules (NGR)/Procedures or a voluntary standard/code) and maintained over time. If the standards are to be compulsory, then consideration will need to be given to whether:
 - the standards should be set out in the NGR or Procedures or some other instrument; and
 - the standards should apply retrospectively to existing contracts.
4. Considering a number of the other matters identified by the AEMC, including whether:
 - a credit support mechanism should be developed; and
 - changes need to be made to allocation agreements to facilitate trade.

This project team will also be responsible for advising the GMRG of any changes that would need to be made to the functions and powers of the AEMC, AER or AEMO and/or the NGL, the NGR or subordinate instruments, to give effect to any of its recommendations.

In considering these issues and developing its advice to the GMRG, the project team will be expected to have regard to the AEMC's recommendations, as well as the National Gas Objective and the Energy Council's Vision for the Australian Gas Market. The recommendations made by the project team will be subject to further consultation by the GMRG.

While the tasks to be carried out by this project team are relatively discrete, there are some interdependencies with the other project teams. For example:

- the work that the Standardisation of contract terms project team will be carrying out on standardising the operational, prudential and other contract terms in the operational transfer agreements will be required by the capacity trading and auction teams;
- the work that the capacity trading and auction teams will be carrying out on the products to be sold through the exchange and auction could have a bearing on the work the Standardisation of contract terms project team is to carry out on developing standards for the operational, prudential and other contract terms; and
- the work that the Standardisation of contract terms project team will be carrying out on delivery and receipt point flexibility will have a bearing on the capacity products to be sold through the exchange and the auction.

Given these interdependencies, it will be important for the work carried out by this project team to be appropriately sequenced and for the team to communicate effectively with the other project teams. For example, given the AEMC's recommendation that operational transfers be used to give effect to trades carried out through the capacity trading platform and equivalent standardised terms be used for the auction, there may be value in prioritising the development of the standardised terms for the operational transfers.

3.3 Deliverables

Any advice provided by the project team to the GMRG on the issues identified in the preceding section should be in written form and of a standard that can be consulted upon with other stakeholders.

3.4 Proposed project plan

The table on the following page provides further detail on the proposed project plan for this project team and the other project teams. It should be noted that the dates in this table are indicative only and may change over course of the project.

While not shown in this table, many of the reforms are expected to require changes to the NGL, NGR and/or other subordinate instruments, so additional time will likely be required to accommodate these changes. The indicative implementation schedule published in August 2016 indicated that it could take up to three years to implement these changes with the reforms to take effect in mid-2021. The GMRG is committed to implementing the reforms as soon as possible without jeopardising the design process.

Appendix A: GMRG Governance Structure

