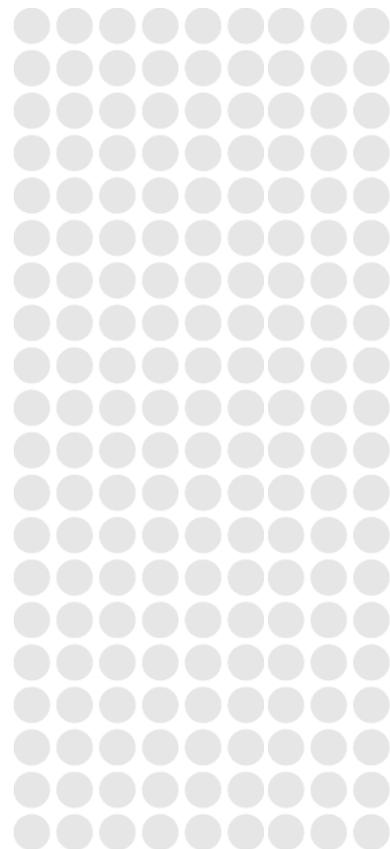




June 2017

# operation and administration of the capacity trading platform(s) and day-ahead auctions

**apa response to consultation paper**



**energy. connected.**

## Submission summary

APA considers that there are significant issues with the process being run by the Gas Market Reform Group (GMRG) to develop implementation details of the capacity trading platform and the contracted but un-nominated capacity auctions. It is clear that the process is operating under an unrealistic timetable for decision making, and is front-ending key design decisions without consideration or understanding of the design elements that critically influence those decisions. The likely outcome from this hurried and ill-considered process is poorly designed and targeted market interventions that will not achieve the Gas Market Vision, and will undermine the National Gas Objective to promote the long term interests of consumers.

The critical element that is missing is the *policy context* for these reforms, and what that means for how the capacity trading platform and the contracted but un-nominated capacity auctions interact. The lack of context and clear policy direction has led to the market development process being dominated by a small number of Working Group participants with a vested interest in the particular outcome, to the exclusion of engagement of other parties.

To be clear, APA supports efforts to increase the liquidity of the gas market, in particular in relation to the development of a strong and vibrant secondary trading market. There are significant market benefits to be had from a strong secondary capacity trading market that are not available through the contracted but un-nominated capacity auction.

The path being undertaken by the GMRG has been to consider the capacity trading platform separately from the contracted but un-nominated capacity auctions. In doing so, the GMRG is not recognising that they are effectively two different mechanisms for the allocation of the same capacity. They both relate to contracted capacity that is not used by the primary contracting party. Viewed in this way, it is important to consider how one mechanism may influence the other, particularly in respect of market liquidity, and to decide where, from a policy perspective, it is best to seek to concentrate liquidity.

Attempting to maximise transactions in both the capacity platform and auction mechanism is an effective zero-sum game, splitting liquidity between the mechanisms or pushing shippers to prefer the auction mechanism, which cannot deliver the other market benefits available through a liquid secondary trading market.

### **APA support for a centralised capacity trading platform**

APA supports a centralised capacity trading platform as providing the best opportunity for a vibrant and liquid secondary trading market to develop.

A strong secondary trading market for capacity delivers benefits for shippers and pipeliners by increasing confidence in the market, and opportunities for shippers to

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manage pipeline capacity flexibly. This reinforces the value of primary contracts to the benefit of pipeliners as well.

For this reason, APA considers that the capacity trading platform would apply to all pipelines as a platform for shippers with firm capacity rights to offer capacity for sale, and for other shippers to secure that capacity on the secondary market. Put simply, the capacity trading platform should be the 'platform of choice' for policy makers and shippers.

The decision as to who runs the capacity trading platform must be informed by product and market design elements that are yet to be resolved within the Working Group. A decision on this matter at this stage of product and market design is premature.

### ***APA support for pipeliner-run auctions***

APA believes that auctions should be incorporated and run within individual pipeline operator systems so as to achieve an effective access mechanism to contractually congested pipelines, whilst providing firm capacity holders the appropriate incentive mechanism to trade on the secondary platform. These two issues represent the primary intent of the COAG proposal and careful consideration should be given so as to not 'over design' the auction mechanism.

## Introduction

### ***GMRG process will not deliver outcomes that will support market development***

APA considers that the process being undertaken by the Gas Market Reform Group (GMRG) to develop details of the capacity trading platform and the contracted but un-nominated capacity auctions is being jeopardised by an unrealistic timetable that has front-ended key design decisions without consideration or understanding of the design elements that critically influence those decisions. The likely outcome from this hurried and ill-considered process is poorly designed and targeted market interventions that will not achieve the Gas Market Vision, and will undermine the National Gas Objective to promote the long term interests of consumers.

The critical element that is missing is the *policy context* for these reforms, and what that means for how the capacity trading platform and the contracted but un-nominated capacity auctions interact. The lack of context and clear policy direction has led to the market development process being dominated by a small number of Working Group participants with a vested interest in the particular outcome, to the exclusion of engagement of other parties.

This has been exacerbated by the selection of members by the GMRG for the various Working Groups. In respect of the Day Ahead Auction Group, membership is heavily weighted towards participants without firm contracting positions on pipelines. This has led to important elements such as investment and its relationship to long term contracting and the allocation of price risk being ignored or downplayed in a rush to maximise the scope of the auction to enable businesses with representatives on the Working Group to get free access to capacity through a poorly designed and untargeted auction.

### ***Market development work must be undertaken within an integrated policy framework***

APA supports efforts to increase the liquidity of the gas market, in particular in relation to the development of a strong and vibrant secondary trading market. APA, and the pipeline sector more generally, has a history of investing to support the secondary trading market, and wants to see it grow and prosper. A strong secondary trading market for capacity delivers benefits for shippers and pipeliners by increasing confidence in the market, and opportunities for shippers to manage pipeline capacity flexibly. This reinforces the value of primary contracts to the benefit of pipeliners as well.

The path being undertaken by the GMRG has been to consider the capacity trading platform separately from the contracted but un-nominated capacity auctions. In doing so, the GMRG is not recognising that they are effectively two different mechanisms for the allocation of the same capacity. They both relate to contracted capacity that is not used by the primary contracting party. This is demonstrated by the application of an identical 'platform of choice' assessment criteria to each,

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without any consideration or understanding of the policy overlay as to what each mechanism should be targeted to achieve, within an integrated policy framework.

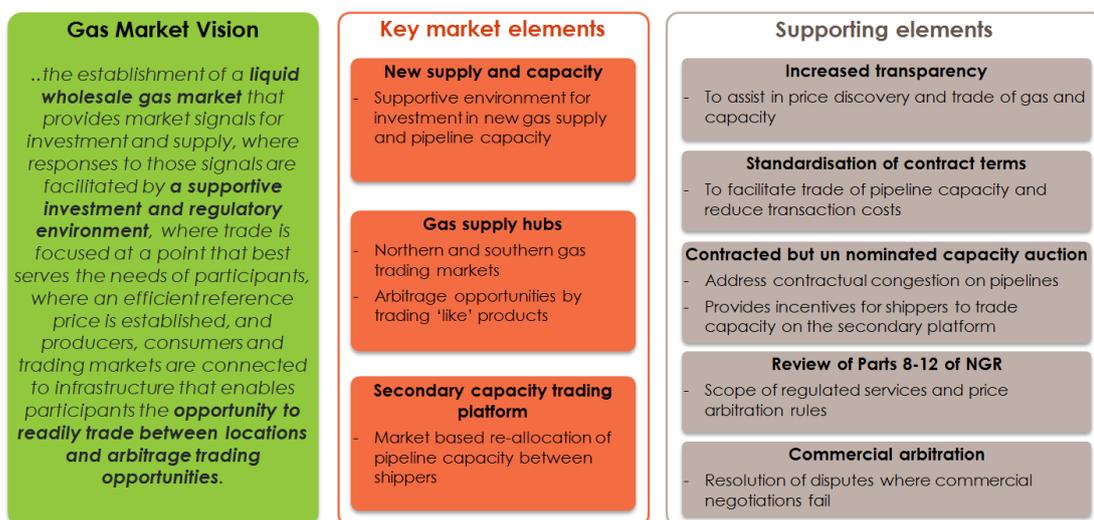
Viewed as effectively competing market mechanisms, it is important to consider how one mechanism may influence the other, particularly in respect of market liquidity, and to decide where, from the policy perspective, it is appropriate to seek to concentrate liquidity.

As it is, seeking to maximise the attractiveness of both mechanisms will ensure the success of neither in facilitating shippers and pipeliners to access the benefits of a robust secondary trading market.

**An integrated policy framework that will achieve the Gas Market Vision**

APA's view of the integrated policy framework for the achievement of the COAG Energy Council Gas Markets Vision is set out at Figure 1 below. APA believes that an integrated policy approach that is consistent with the National Gas Objective and the COAG Energy Council Gas Market Vision would focus on developing secondary trading markets for gas and capacity, while at the same time ensuring that incentives for investment are maintained.

**Figure 1 – Achieving the Gas Market Vision – integrated policy framework for further development of the gas market**



Achieving this outcome involves understanding the relationships between the auction and platform in respect of their impacts on market liquidity, and incentives to trade and invest. As discussed above, these are two market mechanisms for the allocation of the same capacity. Emphasising both mechanisms will split liquidity in a market that is already thin and needing development.

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Understanding this point leads to the conclusion that policy and market design should emphasise development of the secondary capacity trading platform because of the contributions that a liquid secondary trading market can bring to the gas market as a whole. The desire to concentrate liquidity within the secondary trading market then leads to a targeted role for contracted but un-nominated capacity auctions to incentivise contracted shippers to trade, rather than positioning the auctions as a competitor to the platform.

When designing the mechanisms to implement this balance, the key questions that must be resolved include the scope of the capacity trading platform and auction (which pipelines they each appropriately cover to ensure that they complement each other), the nature of the products sold, and the arrangements for trade including legal responsibilities and relationships between contracting parties. It is only once these elements are understood that decisions can begin to be made on market design, including the most appropriate body or group to operate these markets.

Under the current rushed timeline, these elements have not been resolved, and work is proceeding without an attempt to understand the policy framework in which it sits.

## Capacity Trading Platform

### **APA supports a centralised capacity trading platform**

1. Do you think:
  - a. a single capacity trading platform should be developed? or
  - b. each pipeline operator should develop its own capacity trading platform?

In answering this question, please explain why you think the option you have selected will promote the NGO and achieve the Council's Vision.

APA supports a centralised capacity trading platform as providing the best opportunity for a vibrant and liquid secondary trading market to develop. This is consistent with a policy framework that seeks to maximise liquidity, and the attractiveness of products, in the capacity trading market.

High levels of liquidity in this market will give shippers the opportunity to trade capacity across multiple pipelines and create market-to-market capacity services without the involvement of pipeliners. For this reason, APA considers that the capacity trading platform would apply to all pipelines as a platform for shippers with firm capacity rights to offer capacity for sale, and for other shippers to secure that capacity on the secondary market.

### **Locking in a decision on who should run the platform is premature**

2. If you think a single capacity trading platform should be developed, do you think it should be:
  - a. operated by AEMO as part of the Gas Supply Hub? or
  - b. operated on a stand-alone basis by a joint venture of pipeline operators, or another party with relevant experience?

In answering this question, please explain why you believe the relevant party should be selected and what the benefits to the market would be from the selection of this operator.

APA considers that there is insufficient detail known on the design of the platform at this stage to make an informed decision as to the appropriate party to run the platform. Any decision made today is likely to close off design options that may be determined to be preferable once more detail of the preferred design is known.

For example, AEMO as part of a centralised trading platform design, have raised the possibility of a 'fully anonymous' capacity trading option, where AEMO would be responsible for shipper nominations for traded capacity. The *Consultation Paper* has sought stakeholder comments on this option.

Consideration of the benefits or otherwise of a fully anonymous trading option is an important and appropriate matter for the Working Group to consider, and for the GMRG to seek feedback on. APA does not consider, however, that stakeholders

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currently have sufficient information available to make an informed decision on this matter, and on its relevance to the question of who runs the platform.

The issue relates to costs and risk allocation related to the market design, should stakeholders prefer a fully anonymous trading option.

First, a fully anonymous market design option would involve a move away from the currently posited 'operational capacity transfer' model that delivers a relatively low cost implementation option, to one that involves far deeper links between the capacity trading platform and pipeliner systems. The implications of these links, including cost implications, have not been explored, such that stakeholders can assess the relative cost/functionality trade-offs involved. The same integration issues and associated costs arise in relation to AEMO's proposal for locational swaps through the capacity trading platform, which would be another departure from the originally proposed operational capacity transfer model.

The second implication is arguably more critical. It is important to understand how liabilities would flow where AEMO takes responsibility for shipper capacity nominations. The key question would be how liabilities would flow in circumstances where AEMO failed to make appropriate nominations.

AEMO's legal structure means that it cannot accept or manage these kinds of market liabilities. This means that, if AEMO runs the platform providing a fully anonymous trading service, trading participants would carry the costs of error or system failure if AEMO failed to provide, or provided the wrong, data to the relevant pipeliner. This may be a key issue for trading participants in determining who should run the platform, as a private company or joint venture between pipeliners could manage this liability. In fact, locking in the party to run the platform before these issues have been explored could take the 'fully anonymous' trading option off the table for shippers.

The fact that issues have already arisen in the detailed design process in respect of two developments<sup>1</sup> on the original product design assumptions, and which have a fundamental bearing on the appropriate party to run the platform, shows misguided nature of the GMRG process where it is rushing to lock in decisions in line with a self-imposed deadline.

APA maintains that the decision on who will operate the capacity trading platform is premature given the current stage of the policy, service, and market design and development process. This decision must be deferred until after further work has been undertaken on the role of the capacity trading platform in respect of other policy initiatives, the nature of services that should be offered through the platform, and the high level arrangements around governance processes and systems have been established.

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<sup>1</sup> The other element is AEMO's proposal for locational swaps

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Only after these aspects are known, can pipeliners and AEMO develop meaningful proposals as to the costs of implementation options, which would include the potential for the pipeliner operated joint venture to propose an option that operates across all pipelines. APA notes that the predominant model overseas is that secondary trading markets are operated by individual, or a joint venture, of pipeline businesses.

### ***Fully anonymous trading option***

3. If the capacity trading platform is to be operated as part of the Gas Supply Hub, do you think that once the trade has been executed:

- a. the anonymity of trading parties should be maintained by AEMO informing the pipeline operator of the trade (i.e. the fully anonymous option)? or
- b. the identity of the trading parties can be revealed and the communication of the trade to the pipeline operator left to the trading parties (i.e. the partially anonymous option)?

In considering this issue, it is worth noting that pipeline operators have not provided an estimate of how much it would cost to set up the fully anonymous option.

APA considers that should the trading platform be operated as part of the Gas Supply Hub, then the simplest way to implement the platform would be through option (b) subject to AEMO carrying out any appropriate netting of trades. This methodology would be entirely consistent with the current Gas Supply Hub market for gas commodity.

No consideration has been given to the additional cost for legal and system changes, including liability flows, to accommodate option (a) for either AEMO or pipeline operators.

Option (b) could easily be implemented as a first 'no regrets' step with the suggested implementation of option (a) occurring at a later date but only after a thorough and rigorous cost benefit analysis proved it necessary and appropriate.

## Contracted but Un-nominated Capacity Auction

1. Do you think:

- a. a single auction platform should be developed? or
- b. each pipeline operator that is to be subject to the auction should develop its own auction platform?

In answering this question, please explain why you think the option you have selected will promote the NGO and achieve the Council's Vision.

APA believes that auctions should be incorporated and run within individual pipeline operator systems so as to achieve an effective access mechanism to contractually congested pipelines, whilst providing firm capacity holders the appropriate incentive mechanism to trade on the secondary platform. These two issues represent the primary intent of the COAG proposal and careful consideration should be given so as to not 'over design' the auction mechanism.

The Capacity Trading Platform and the Contracted but Un-nominated Capacity Auction are effectively two different mechanisms for the allocation of the same capacity. Attempting to maximise transactions in both the capacity platform and auction mechanism is an effective zero-sum game, splitting liquidity between the mechanisms or pushing shippers to prefer the auction mechanism, which cannot deliver the other market benefits available through a liquid secondary trading market.

This push towards the contracted but un-nominated capacity auction is a result of the incentives created for purchasing shippers to wait and secure capacity at auction rather than purchase capacity on the secondary trading market. This will occur in circumstances where auctioned capacity is not scarce, such that total demand at auction does not push the price for capacity meaningfully above the floor price of zero, and the risk of interruption is low. In these circumstances, a purchasing shipper will choose not to secure capacity in the secondary market (where presumably capacity is offered at a price above zero), but will instead wait to secure capacity through the auction at a much lower price.

While a firm contracted shipper on a pipeline subject to an auction may be incentivised to offer capacity through the secondary trading market, the buying shipper is not incentivised to buy, as they have an alternative, lower cost option available immediately following nomination cut off. This incentive effect will be further exacerbated if the auctioned product is firm, as there would be no risk of interruption for auctioned capacity.

APA considers that the appropriate targeting of the auction is towards contractually congested pipelines, in line with the original AEMC recommendation. It is in these circumstances the auction can be expected to incentivise secondary trade (as there is some level of scarcity driving auction price outcomes) and address potential hoarding issues, which only arise on contractually congested pipelines.

APA believes that this targeted approach lends itself to choosing the lower cost (while still effective) implementation option offered by pipeliners operating individual auction platforms that are integrated into their respective nominations systems.

***Overview of pipeline-sector proposal***

The pipeline sector proposed auctions for contracted but un-nominated capacity would naturally fit within the pipeline scheduling systems, given the requirement that the auction occur after scheduling of existing contractual nominations. Regardless of the auction operator, Shippers will be required to nominate for the actual usage of capacity into these individual systems and will require a Gas Transportation Agreement with each pipeline operator. In simple terms, it would seem logical that the party responsible for determining and scheduling the capacity should also run the auction. The key advantages of pipeline-operated auctions are:

- Simpler & more effective implementation (less data transfer risk)
- Lower Industry costs
- Auction can be held much sooner after nomination deadline
- Greater options for more flexible future products
- One GTA to cover auction and transportation
- One system for auction and nominations

These benefits were recognised by Working Group participants, as shown in the transcription of the Whiteboard photo (figure 2 below) included in the Working Group minutes when the proposal was discussed. The weight of 'pros' suggests that the pipeliner-run option delivers a superior auction to that proposed by AEMO, and one that delivers an attractive option that is suitable to apply in targeted situations where there is contractual congestion.

**Figure 2 – Working Group analysis of ‘pros and cons’ of pipeliner-run auction proposal<sup>2</sup>**

Pros	Unknowns	Cons
<ul style="list-style-type: none"> <li>• Pipelines would absorb the costs to them (implementation and ongoing)</li> <li>• Less deal time data transfer                             <ul style="list-style-type: none"> <li>○ Sooner execution of auction</li> </ul> </li> <li>• Ease of curtailment</li> <li>• No new prudential with pipeline</li> <li>• Auction eligibility is clear</li> <li>• No additional data interface</li> <li>• Reduces costs/complexities to pipelines</li> <li>• Ease of multiple auctions</li> <li>• Individual pipes leads to higher innovation</li> <li>• Doesn't impose costs on AEMO/participants</li> </ul>	<ul style="list-style-type: none"> <li>• Regulatory timeframes</li> <li>• Clear cost of implementation/ongoing costs</li> <li>• Timeframes – relative                             <ul style="list-style-type: none"> <li>○ Needs to be teased out in more detail</li> </ul> </li> <li>• Governance of rules?                             <ul style="list-style-type: none"> <li>○ GTAs</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Potential for conflict of interest                             <ul style="list-style-type: none"> <li>○ Governance</li> </ul> </li> <li>• Separation from the capacity trading platform                             <ul style="list-style-type: none"> <li>○ Needs aggregation platform</li> </ul> </li> <li>• Not AEMC's preferred outcome of a single auction</li> </ul>

**No policy or market case for a centralised auction**

2. If you think a single auction platform should be developed, do you think it should be:

a. operated by AEMO? or

b. operated on a stand-alone basis by a joint venture of pipeline operators, or another party with relevant experience?

In answering this question, please explain why you believe the relevant party should be selected and what the benefits to the market would be from the selection of this operator.

*Auction must be targeted to achieve policy aims*

APA does not consider there is a policy or market case to support a centralised auction mechanism, regardless of the party that operates it. This is because the auctions must be targeted to apply only to contractually congested pipelines, making any integration opportunities across pipeline legs potentially transient. This

<sup>2</sup> GMRG 2017, Day Ahead Auction and Capacity Trading Platform Project Teams Meeting No. 4 minutes, pp 2-3 and Appendix B

does not suggest that there are significant benefits to be achieved from coordination across auctions.

*Co-ordination benefits available with secondary market are overstated*

APA does not consider that hypothesised 'co-ordination' benefits with secondary market products (capacity or gas commodity) are realistic. APA notes that the Assessment Criteria focus on co-ordination opportunities in the secondary market (for gas and capacity) rather than those available in the primary pipeline capacity market.

It is unclear how a shipper could co-ordinate trades between the Gas Supply Hub, capacity trading platform and the contracted but un-nominated capacity auction. Co-ordination in respect of contingent bids or purchases between the Gas Supply Hub, the capacity trading platform and contracted but un-nominated capacity auction would not be available due to the different timing of these mechanisms. The auction would happen long after trades through the Gas Supply Hub and Capacity Trading Platform are closed.

In contrast, pipeliner run auctions give the opportunity for extension (by the pipeliner) into systems for allocating spare (uncontracted) capacity after the nomination cut-off time. This provides scope for shippers to secure contracted but un-nominated capacity or spare capacity suited to their needs. This is likely to be more useful to shippers due to the timing of the auction (which will be after nominations for the next gas day) compared to the potential for co-ordination with secondary market transactions, which need to be completed considerably before this time.

*Timing of auction and flexibility of mechanism*

Another key difference between the pipeliner option and the AEMO option involves how soon after the nomination cut off time an auction could be conducted. Most participants at the Working Group valued an earlier auction as provided under the pipeliner proposal as it provided more time to confirm supply and demand arrangements for usage of the auctioned capacity.<sup>3</sup> In response to this, the *Consultation Paper* reports the views of some Working Group members that timeframes for data collection, validation and transfer associated with the AEMO option could be reduced from the proposed one hour.

It is unclear on what basis Working Group participants reached these conclusions, and APA notes that none of the members that expressed this view had any existing experience with AEMO/service provider data interfaces for market purposes. In fact, a one hour data transfer window represents a highly compressed window that transfers considerable risks and costs to the pipeliner in relation to data verification

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<sup>3</sup> GMRG 2017, *Day Ahead Auction and Capacity Trading Platform Project Teams Meeting No. 4 minutes*, pp 2-3 and Appendix B

and transfer protocols, and any reduction in that timing window would have an exponential impact on implementation costs and risks.

Any attempt to reduce the timeframe for these market-critical data transfers will give rise to considerably increased costs and risks for the pipeliner, adding to the burden on pipeliners should AEMO be chosen to run the auctions. These elements are relevant to the consideration of who should run the auction, however they are still to be discussed and resolved within the Working Group. The decisions put before stakeholders in the *Consultation Paper* are premature as these timing issues have not been resolved.

#### *Implementation and transaction costs*

Compared to the AEMO proposal, the pipeliner proposal will be lower cost to implement, as it will not drive the substantial system integration and data exchange costs that are required (but never disclosed) as part of the AEMO proposal.

The *Consultation Paper* notes that the AEMC recommendation was that, regardless of the option chosen, pipeliners bear all the costs as the costs of the auction will be paid out of auction proceeds.

If this proposal is implemented, in addition to bearing these costs, pipeliners will face a reduction in revenues associated with this auction mechanism as it will likely displace current As Available, Authorised Overrun and Interruptible capacity contracts, and if applied indiscriminately, could also displace some firm contracting over time. Importantly, pipeliners do not expect to derive additional revenue from the sale of capacity from this auction mechanism. As the AEMO-operated option drives significantly higher integration and other costs for pipeliners, pipeliners will bear these higher costs, as well as AEMO's development costs under the AEMO-operated option.

Where both options presented for the auction involve zero transaction costs for the shipper (as both involve absorption of costs by the pipeliners), the key point of difference in respect of costs between the options is the varying implementation costs. In a robust policy development process these are an important decision-making factor. The pipeliner proposal involves a significantly lower cost implementation option and therefore should be preferred.

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|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ol style="list-style-type: none"><li>3. Are there any other elements of:<ol style="list-style-type: none"><li>a. AEMO's proposal that you would like to comment on?</li><li>b. APGA's proposal that you would like to comment on?</li></ol></li></ol> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

APA considers that AEMO's cost estimates for establishing an auction mechanism are not credible. In addition the considerable scope creep that the auction design has already suffered from that originally conceived and costed by AEMO, AEMO's track record in market development suggests that its costs are likely to be at least an order of magnitude higher than those quoted.

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In addition, AEMO has historically shown limited concern over the costs and risks that it imposes on pipeliners and other market participants through its facilitated markets. As an example, AEMO was a key advocate of a 'low cost' implementation of a new trading hub at Moomba that, like its proposal for the capacity trading platform and contracted but un-nominated capacity auction, utilised existing AEMO systems. The hidden costs from this decision are the substantial implementation and integration costs incurred by APA, and undoubtedly also by Epic Energy in relation to the Moomba to Adelaide Pipeline, associated with this policy.

To date, not a single trade has been executed through the Moomba gas supply hub, however APA has incurred in excess of \$300K in system and contract changes to support that hub. APA has no expectation of ever recovering these costs through increased pipeline utilisation driven by trading activity for the Hub. APA has similar expectations in relation to the contracted but un-nominated capacity auction.