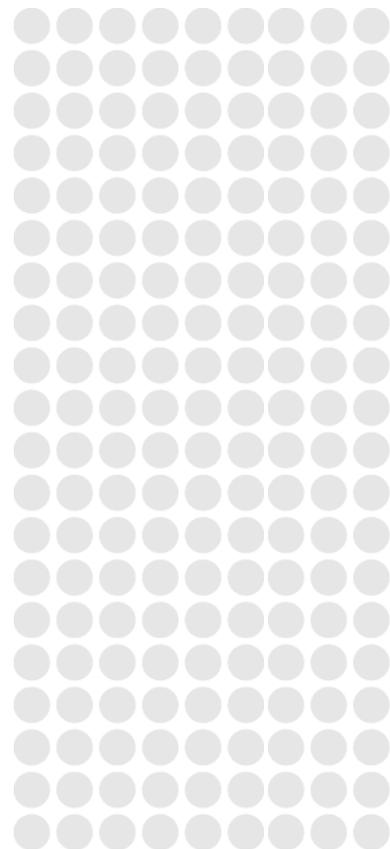




April 2018

# capacity trading reform package: draft legal and regulatory framework

## apa response to consultation paper



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### Executive summary

APA reiterates its support for 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.

In order to achieve the objectives of the Capacity Trading Reform Package, it is important that, in developing the legal and regulatory framework, the scope of all aspects of the reform is clear; service providers are provided with the legislative protection required to comply with the reforms; and consequences for non-compliance with the provisions are appropriate.

APA's key concerns with the proposed legal and regulatory framework are set out below. These, and APA's other comments, are described more fully in APA's detailed response to Gas Market Reform Group's (GMRG's) specific queries and proposed amendments to National Gas Law (NGL), Regulations and Rules in the attached GMRG template.

It is important to note that APA's comments, concerns and recommendations have been prepared in the context of the proposed legal and regulatory framework as it is currently drafted. To the extent that aspects of the framework are amended to address comments received from other interested parties, APA's comments and recommendations need to be considered in the context that they were provided and may need to be amended to reflect the framework as it stands at that stage. APA would appreciate the opportunity to engage with the GMRG in this regard.

### Introduction of sub-objectives in the Rules

Reforms to support the secondary market need to be assessed for their impact on the pipeline transportation market as a whole, including on investment in new pipeline capacity and primary market contracting. APA is concerned that the use of narrow, secondary market focused sub-objectives in respect of these reforms undermines the importance of the broader National Gas Objective, which APA argues should be the objective applied for all aspects of the NGL and the Rules.

### Scope of the capacity auction provisions

The intention behind the reforms was that the capacity auction provisions were limited to AEMO-run auctions of contracted, but unominated capacity. The way in which 'capacity auction' has been defined in section 2(1) of the proposed amendments to NGL does not clearly limit the scope of the capacity auction provisions in the NGL and the Rules to:

- an auction run by AEMO as contemplated in Parts 24 and 25 of the Rules;
- contracted, but **unominated** capacity.

This is clearly problematic and not what was intended in the Capacity Trading Reform Package. Both the Capacity Trading Reform Package Final Recommendation dated November 2017 as well as this Consultation Paper clearly intended for the scope of the capacity auction to be limited to capacity that is **both** contracted and unominated. Any extension of scope beyond contracted, but unominated capacity would have the

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consequence of service providers being required to commit the same capacity to both the primary shipper under its contractual obligations, and to a secondary shipper who buys the capacity at auction. This puts compliance with existing contracts at risk. Appropriate amendments must be made to ensure that the scope of this reform is clear – that it is to apply only to auctions run by AEMO, for contracted, but unominated, capacity.

### **Legislative protections provided to service providers**

In APA's view, the proposed amendments to the NGL, Regulations and the Rules do not go far enough to ensure that transportation service providers are not forced to breach their existing contractual obligations through compliance with the NGL and the Rules.

For example, APA's contracts provide that it must schedule and curtail in a certain sequence and the priority lists do not contemplate an auction product, which will sit above as available, authorised overrun, interruptible etc. A nomination from an auction winner is not a current contractual excuse to curtail those services.

APA is of the view that it is necessary to include a generic clause in Part 24 of the Rules, which provides service providers with relief from pre-existing contractual liability to the extent that the failure to provide the services in accordance with the terms of the primary contract was due to an obligation imposed on service providers under the Rules relating to the capacity auction.

Furthermore, APA expects that there will be a high volume of requests to transportation service providers to vary agreements to include operational transportation service in contracts soon after the capacity trading rules come into effect. APA considers that an additional transitional provision that extends the allowable time to make these changes is required in light of the workload this may create in transition. In particular, APA suggests a minimum of 60 business days to apply during a transition period following commencement of the reforms to provide additional time to deal with the initial demand.

### **Introduction of 'unbundling'**

The principle of 'unbundling' contemplated in proposed Rule 642(2)(a) is new and has not previously been consulted upon as part of the consultation process.

APA's understanding of the intention of capacity trading reforms is that:

- if a service is sold by a transportation service provider as a standalone service, then that service is capable of being on-traded by the primary shipper; but
- if a transportation service provider sells a single service which is comprised of parts, those individual parts are not capable of being 'unbundled' and on-traded separately by primary shippers.

APA is concerned that a shipper can 'infer' a standalone service that is not specified in the contract because it is sold as part of a single service, and separate that inferred service ('unbundle it') and sell it separately. This is described in more detail by way of an example in APA's detailed comments on the proposed Rule 642(a) in the attached template. This goes beyond the sale of existing contractual rights (that is rights specified in contract), and was at no stage discussed, much less agreed, in working groups engaged in advising on the capacity trading reforms. The creation of a new right for shippers to unbundle services

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sold as a single service could inadvertently create new capacity rights for shippers, not specified in contract, which, if unbundled and traded separately from otherwise 'bundled' services could lead to the sale of firm capacity in excess of existing contractual rights, and facility capacity.

This requirement is inappropriate, not practical of implementation and goes beyond the scope of the capacity trading and auction reforms that has been discussed and consulted on to date. APA recommends that Rule 642(2)(a) be deleted.

### **Changes to pipeline service points**

APA considers that there has not been adequate consideration of the implications on the primary market, and in particular investment, of shippers having broad rights to change receipt and delivery points under contract.

Investments underpinned by long-term gas transportation agreements are often made for individual shippers at particular locations, where there is no alternative use for capacity if that shipper ceases to take capacity at that site. If a shipper has the ability to transfer capacity that has been the subject of an investment for that shipper, prior to the end of that foundation contract, then the base investment underpinned by long-term contracts is undermined. This is exacerbated in the case of a fully regulated pipeline, where a now disused lateral or compression facility can be removed from the capital base, thereby reducing tariffs for all shippers (including the foundation shipper for that investment), and the service provider cannot recover their investment at all.

While a service provider can ensure that it continues to receive the same revenue under the contract, if a receipt or delivery point is changed, such a change can sterilise additional pipeline capacity, meaning that that the shipper cannot sell that capacity to other shippers and be compensated accordingly.

APA considers that the right to change receipt and delivery points must be subject to technical and commercial considerations. The Rules may provide for a shipper to refer a service provider's decision not to accept a change in receipt or delivery point to the AER for review. APA does not consider this is appropriate, however, as shippers can (and do) seek this flexibility within their contracts.

### **Expanded powers for auction shippers to nominate in excess of their auction capacity**

APA is concerned that the ability for auction shippers to submit renominations for capacity in excess of their allocated auction capacity under proposed Rule 651(d) will undermine the market drivers for the auction.

One of the stated aims in introducing the capacity auction for contracted but un-nominated capacity is to ensure that this capacity is allocated to those that value it most. Allowing auction shippers (including, potentially, shippers that have not even bid for particular capacity in the auction) to nominate for unallocated capacity after the auction is completed, fundamentally undermines this outcome and opens clear opportunities for gaming as it incentivises shippers not to participate in the auction to ensure that the clearing price is zero.

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This can have follow on impacts on the operation of the pipeline as shipper bids may not reflect their actual intent to use the pipeline, which would undermine operational stability. APA considers that auction shipper renomination rights should be capped at the capacity won in the auction by that shipper. This mirrors a firm shipper's renomination rights, which do not exceed their firm capacity under contract.

### **Broad scope of AEMO's powers**

APA has concerns about the broad scope of the powers conferred on AEMO by the proposed changes to the NGL and the Rules. In particular:

- Proposed section 8(3) of the NGL appears to contemplate circumstances in which AEMO controls or operates a compression service facility. It is not at all clear from the proposed changes to the NGL and the Rules in what circumstances AEMO would be required to control or operate a compression service facility. This section should be deleted.
- Proposed section 91BRM(2) provides that AEMO may trade in transportation capacity to the extent necessary or desirable for the efficient operation of a capacity auction. It is not clear why AEMO would require the power to trade capacity in the context of an auction. This section should be deleted.
- There are a number of circumstances discussed in more detail in response to specific provisions in the NGL and the Rules where APA considers that an additional stage of consideration, or level of oversight is appropriate. These mostly arise in respect to AEMO's broad powers to develop and amend the Capacity Transfer and Auction Procedures, measures related to the election of the OTS Code Panel and the operating manual which sets out how the Panel functions, and to impose other obligations on service providers. While APA assumes that AEMO will develop the Procedures in accordance with Part 15B of the Rules, it notes that Part 15B does not specifically provide for a similar process to be followed when amendments are made to the Procedures. This is a clear oversight in the Rules that needs to be corrected.

### **Civil penalty and conduct provisions**

APA has concerns that a number of proposed Rules, which require a degree of judgement, or which apply a subjective test in respect of compliance, are subject to civil penalty and conduct provisions. APA is particularly concerned in relation to Rules 632(2), 632(3), 634(2) and 634(5), which are not appropriate to designate as civil penalties.

APA is also concerned that the time provided for transportation service providers to undertake some tasks is inadequate, thereby placing service providers at increased risk of breaching civil penalty provisions. These circumstances are highlighted in APA's comments on the NGL and Rules.

### **Reforms would benefit from further detailed consultation**

APA recognises that the legislative changes required to implement the capacity trading platform, contracted but un-nominated capacity auction, gas day harmonisation and secondary trades reporting requirements are complex and far reaching. The legislative

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package released by the GMRG is comprehensive, and impacts many aspects of the NGL and the Rules. It is critical to the broader energy market that these reforms are appropriate and effective, and unintended consequences arising from drafting issues are avoided.

APA believes that the consultation process on the NGL and Rules would benefit from drafting workshops where a small number of representatives from each sector can work through the detailed drafting points with the drafters to ensure the reforms are implemented appropriately. These sessions are not intended to revisit policy questions. Instead they are to ensure that the intended policy outcomes are achieved. A similar approach was adopted during the development of the original NGL and Rules, which proved very effective in refining those instruments before implementation.