

HSBC Building
Level 19
580 George Street
Sydney NSW 2000
PO Box R41
Royal Exchange NSW 1225

Phone 61 2 9693 0000
Fax 61 2 9693 0093
www.apa.com.au

APA Group



Australian Pipeline Ltd
ACN 091 344 704

Australian Pipeline Trust
ARSN 091 678 778

APT Investment Trust
ARSN 115 585 441

1 April 2016

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Reference: GPR0003

Dear Mr Pierce

**APA Group submission to the AEMC Discussion Paper:
East Coast Wholesale Gas Market and Pipeline Frameworks Review**

APA Group (APA) welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) discussion paper on the East Coast Wholesale Gas Market and Pipeline Frameworks Review.

The Discussion Paper and the additional consultation has raised a number of complex and inter-related issues, which require careful consideration. APA appreciates the short extension to the deadline for lodgement of its submission on this discussion paper.

Please call Peter Bolding, General Manager Regulatory and Strategy, on 02 9693 0053, if you would like any further information.

Yours sincerely

Ross Gersbach
Chief Executive Strategy & Development



**Submission to the Australian Energy Market
Commission**

***East Coast Wholesale Gas Market and Pipeline
Frameworks Review***

Pipeline Access Discussion Paper

1 April 2016



Contents

1	Introduction	1
2	Preliminary comments	3
3	Capacity trading platforms and information provision	4
3.1	A single trading platform or multiple platforms	4
3.2	Services traded	5
3.3	Exchange based trading	5
3.4	Bilateral trades off-platform	6
4	Standardisation of capacity products and reporting	7
4.1	Standardisation of primary capacity contracts	7
4.2	Receipt and delivery point flexibility	9
4.3	Reporting on primary capacity contracts	10
4.4	Standardisation of secondary market contracts	11
4.5	Secondary market reporting requirements	11
5	Auctioning of contracted but un-nominated capacity	12
5.1	Auctioning of multiple segments	12
5.2	Individual or combinatorial allocation	13
5.3	Number of rounds	13
5.4	Determining the amount of capacity to be auctioned	13
5.5	Auction scope	14
5.6	Institutional setting and auction residue allocation	14
5.7	Auction limited to fully contracted pipelines	15
5.8	Setting the reserve price	16
5.9	Interaction with existing rights	16
5.10	Auction with price cap on reference services	17
5.11	Auctions on lateral pipelines	18



1 Introduction

In this submission, APA Group (APA) responds to the issues raised in the Pipeline Access Discussion Paper prepared by Australian Energy Market Commission (AEMC) as part of its East Coast Wholesale Gas Market and Pipeline Frameworks Review.

APA's responses to the more specific issues about pipeline access raised in the Discussion Paper are framed by its earlier response to the AEMC's Stage 2 Draft Report. In its response to that report, APA:

- supported the Council of Australian Governments (COAG) Energy Council vision for a liquid wholesale gas market in eastern Australia, and the efforts being made to structure the gas market so that the vision can be realised;
- strongly advocated further gas market development by market participants, and not by regulatory intervention; only the participants themselves can make the investments in pipeline infrastructure which can facilitate that market development and, for that, investment incentives must be preserved;
- indicated its willingness and intention to continue to lead the development of a market for non-discriminatory access to primary and secondary pipeline capacity;
- committed to further develop and operate a capacity trading platform in an efficient manner to minimise the costs to shippers, and to encourage other pipeline operators to similarly develop and operate low cost trading platforms;
- committed to pursue arrangements for the auctioning of contracted but un-nominated capacity on those pipelines where pipeline capacity is fully contracted; and
- undertook to further develop Wallumbilla as a northern hub by investing to increase compression availability.

APA remains of the view that market development is best pursued by market participants (in this case, by pipeline operators).

APA believes that the early and low cost development of trading platforms, and implementation of the auctioning of contracted but un-nominated capacity, supported by standardisation of capacity products and contract terms, can be achieved through the creation of an industry council to oversee the process.

APA has been an active participant in work undertaken by the Australian Pipelines and Gas Association (APGA) to define the structure and functions of an industry council on behalf of pipeline operators. Further details about the proposed structure and functions of the council are provided in APGA's submission responding to the AEMC's Pipeline Access Discussion Paper. They are not repeated in APA's submission.

The Discussion Paper raises issues which can be expected to arise in the implementation of the proposals for pipeline access canvassed in the AEMC's Stage 2 Draft Report. APA has contributed to the responses to those issues (in addition to the proposal for an industry council) in the APGA submission, and concurs with the views advanced in that submission.



APA's response begins, in section 2, with some preliminary comments on a number of general issues raised in the opening parts of the AEMC's Discussion Paper. Section 3 then addresses the issues which the AEMC has raised on capacity trading platforms and information provision. APA considers, in section 4, the issues raised on the standardisation of capacity products and contract terms, and addresses, in section 5, the AEMC's issues on the auctioning of contracted but un-nominated capacity.



2 Preliminary comments

In continuing to pursue an industry-led approach to gas market development, APA emphatically rejects the AEMC's view that industry-led initiatives to facilitate access to pipeline capacity have not been progressed, despite there being few "barriers to entry".

As the Stage 2 Draft Report notes, the East Coast gas market is in a period of growth and change driven largely by the establishment of a Queensland-based LNG export industry, which is triggering unprecedented shifts in supply and demand, and changes to patterns of gas flows.

The first production of LNG for export was in December 2014 with the first shipment from Gladstone on 5 January 2015. In the months preceding these events, APA had completed work to permit reverse flow in the Berwyndale to Wallumbilla Pipeline, allowing gas to be delivered into the QGC liquefaction plant at Curtis Island, and had negotiated arrangements with QGC for the transportation and storage of gas in its pipeline system during plant commissioning. During the next 12 months, APA completed work to permit reverse flow on the Moomba to Sydney Pipeline, on the basis of arrangements negotiated with one of its shippers, for the transportation of gas from Victoria into Queensland. These arrangements may not have been of the type that the AEMC now believes is required for further development of the gas market on the East Coast. They were, however, a direct and immediate response to shippers' needs in a changing marketplace.

APA's investments in pipeline flow reversals have introduced a degree of flexibility into the gas transportation network serving the East Coast which will physically support, and make economically valuable, the trading in pipeline capacity which the AEMC now sees as important to achieving the COAG Energy Council's vision of a liquid wholesale gas market.

In light of these clear demonstrations of APA's responsiveness, APA finds as unsustainable the AEMC's view that industry-led initiatives to facilitate access to pipeline capacity have not been progressed, despite there being few "barriers to entry".

The trading of capacity in a secondary capacity market facilitated by more developed trading platforms, and the daily auctioning of contracted but un-nominated capacity, should increase pipeline utilisation and create new commercial opportunities for pipeline operators. Those opportunities should, in turn, provide the direct financial incentives for the pipeline operators to more fully develop their trading platforms, and to implement systems and procedures for the auctioning of contracted but un-nominated capacity. APA submits that pipeline operators have strong financial incentives to facilitate access to pipeline capacity contrary to the assertions of the AEMC.



3 Capacity trading platforms and information provision

APA and other pipeline operators have already begun the development of capacity trading platforms. If pipeline capacity is to be made available to meet the immediate needs of participants in the rapidly changing gas market identified by the AEMC, that process of development must continue.

3.1 A single trading platform or multiple platforms

One approach to trading platform development, an approach which seems to find favour at various points in the Discussion Paper, is to try to anticipate all of the possibilities, and to design and implement, using the command of legislation and regulation, a centralised and administered capacity trading platform and auction process for the East Coast gas market. That has been the response in the electricity sector, where it has been driven by the need to coordinate dispersed decisions to generate and use energy which have near-instantaneous effects throughout the supply network.

Responding, in this way, to growth and change in the gas market will be costly and unnecessary. Even if it were feasible, anticipating all of the possibilities, and designing and implementing a centralised trading platform and auction process, would significantly lengthen the response time. A centrally administered and extensive consultation process, and legislation and regulations, would also be required, introducing further uncertainty as to timing. Substantial and unnecessary costs would be imposed on shippers.

If the benefits of the enhanced opportunities to trade gas which now seem to be emerging are to be realised, flexible access to pipeline capacity must be available to meet those opportunities. This will best be achieved by pipeline operators continuing to develop multiple trading platforms through which the maximum capacity on individual pipelines, and in the pipeline systems of individual operators, can be made available to shippers day by day.

APA is of the view that much of what the AEMC is seeking to achieve through the proposals of the Stage 2 Draft Report can be achieved through the concerted efforts of the pipeline operators within a period of about 18 months.

In the United States, the implementation of pipeline capacity trading arrangements has been successfully decentralised, to individual pipeline operators, on a scale much larger than would be required for the East Coast gas market. As the Discussion Paper notes, this has been assisted by the development of industry standards and protocols by, initially, the Gas Industry Standards Board and, more recently, by its successor, the North American Energy Standards Board. The role of the North American Energy Standards Board is essentially the coordination of industry requirements. It is not a regulatory body, although regulatory agencies may participate in its activities.

The AEMC's Discussion Paper asks:

Is a single trading platform likely to be the most effective and efficient way for shippers to trade capacity, or should further consideration be given to the multiple trading platforms option?



APA strongly supports the continued development of multiple trading platforms. The question of operational responsibility for the trading platforms is then easily answered: efficient low cost operation will be achieved by continuing the current practice of individual pipeline operators having responsibility for the operation of their own platforms.

3.2 Services traded

The Discussion Paper asks:

Should the capacity trading platform(s) be developed to enable:

- *transportation, hub and pipeline storage services to be sold, or should it only provide for a sub-set of these services?*
- *services to be sold on a firm, as available and interruptible basis, or should it only provide for firm services to be sold?*
- *primary capacity holders and pipeline operators to sell these services, or should it only provide for primary capacity holders to sell on the platform(s)?*

A more developed APA capacity trading platform would facilitate the trading of rights to firm service where that service could be a firm gas transportation service, a firm hub service, or a firm pipeline storage service. APA does not see any requirement at present to facilitate the trading of services which are provided on an as-available or interruptible basis.

3.3 Exchange based trading

A capacity trading platform could, the Discussion Paper advises, support an electronic exchange which would allow shippers to anonymously submit buy and sell orders for capacity, and for those orders to be matched by the exchange. Alternatively, the platform could support a listing service: shippers would list offers to buy and sell capacity, and the prices at which they would transact. Trades would then take place through negotiation, and information on the executed “deals” would be posted on the platform.

The Discussion Paper asks:

- *Is there likely to be sufficient demand to introduce exchange based trading from day one, or should a staged approach be implemented as suggested in some submissions? If a staged approach is considered more appropriate, please explain why and outline how the staged approach could work in practice.*
- *How long is it likely to take to develop standardised services and should industry take the lead on this?*

APA’s capacity trading platform currently supports a listing service and, in consequence, identifies potential sellers and buyers of capacity. APA understands that this identification of individual buyers and sellers is seen as deterring parties from trading capacity in the secondary market. The scale of trading may be increased by ensuring seller and buyer anonymity.



To further facilitate capacity trading in the shortest possible time APA is proposing to redevelop its existing platform to incorporate systems which will allow shippers to anonymously submit buy and sell orders for capacity, and which will match those orders.

3.4 Bilateral trades off-platform

The Discussion Paper advises that the AEMC is concerned that allowing bilateral capacity trades “off platform” will not guarantee non-discriminatory access to pipeline capacity. In particular, bilateral trading may favour incumbents and prevent the entry of smaller participants that the proposals of the Stage 2 Draft Report are intended to achieve.

The Discussion Paper asks:

- *Is the issue of discriminatory access to secondary capacity likely to be problematic if bilateral trades continue to occur?*
- *Should prospective bilateral trades arranged outside of the capacity trading platform be required to publish information on the prospective terms and conditions of that trade, to enable other prospective buyers or sellers to compete for that capacity?*

Precluding the bilateral trading of capacity “off-platform” would remove a channel through which the secondary market trading of capacity could take place on terms and conditions which reflected the specific circumstances and requirements of buyer and seller. It would be a restriction on the extent of the secondary market, for which there is no real justification, at a time when the intention is to ensure development of that market in the pursuit of a liquid wholesale gas market.

The transaction costs incurred in off-platform bilateral trading are likely to mean that it would be restricted to larger incumbents, but that does not prevent other market participants offering capacity for trade, and smaller participants accessing the capacity offered for the purpose of entering the market.

APA is of the view that there is no reason to expect that bilateral trading of capacity “off-platform” will be discriminatory, and to preclude it at the present time.

As part of providing the market with information for price discovery, information on *completed* off-platform bilateral trades might be published. APA sees no reason for *prospective* terms and conditions to be published. Prospective terms and conditions are likely to have little relevance to either the sellers or buyers of capacity. The terms and conditions which might be of relevance to them are those that support actual transactions.



4 Standardisation of capacity products and reporting

In APA's view, some standardisation of capacity products and contract terms across the pipeline systems of individual operators, and across the pipeline systems of all operators serving the East Coast gas market, will be necessary to facilitate capacity trading which can meet the needs of buyers and sellers of gas.

APA has already begun the process of standardisation, and has developed and published a standard form Gas Transportation Agreement (GTA), setting out a standard set of terms and conditions for all of its East Coast pipelines. (The GTA is available under "Standard T&Cs" tab on <http://capacitytrading.apa.com.au/capacitytrading.aspx>.)

APA's standard GTA sets out terms and conditions applying to primary capacity, and to capacity purchased in the secondary market regardless of the original terms and conditions in the GTA of the shipper selling that capacity. The standard terms and conditions were developed as part of implementation of APA's Operational Transfer service for capacity trading, and effectively allow the transfer of contracted firm capacity between shippers on a commodity-like basis, the unit of commodity traded being 1 GJ of MDQ per day between a specified receipt point and a specified delivery point.

The terms and conditions of the GTA for primary capacity between APA and the seller are not disclosed to a shipper buying capacity in the secondary market. The terms and conditions relevant to the buyer, including imbalance limits, variance limits and associated charges, are set out in the terms and conditions of a GTA which the buyer has with APA. That GTA may be a previously negotiated GTA for primary capacity, or a standard "zero MDQ" contract which sets the buyer up to trade in the secondary market without any initial purchase of capacity in the primary market.

Under the Operational Transfer service, a holder of primary capacity (Contracted MDQ) can sell its capacity to another shipper as operational capacity (Operational MDQ), which is firm service in the hands of the buyer, and the buyer then has the right to nominate up to its Operational MDQ. The holder of primary capacity remains responsible for payment, to APA, of the capacity charges for its Contracted MDQ. A separate agreement provides for the payment of the holder of the primary capacity by the shipper buying Operational MDQ at the price agreed between the parties.

4.1 Standardisation of primary capacity contracts

The Discussion Paper asks, in respect of primary capacity contracts:

- *Is the list of operational, prudential and other contractual provisions that could be standardised appropriate? Or are there others that could be added, or should some be removed? What may not be suitable for standardisation?*
- *To what extent will changes need to be made to allocation agreements between shippers at delivery points to facilitate more trade?*
- *Is there value in also developing standard terms and conditions for hub services at the same time the terms and conditions are developed for transportation services?*



- *Is it feasible to develop a single standard for each term and condition or is a range of standards more appropriate for some provisions?*
- *Would it be possible to implement the standardised terms and conditions in GTAs that are already on foot?*
- *Should shippers and pipelines be able to negotiate alternatives to any of the standardised provisions? If so, in what cases would this be relevant?*
- *How long is it likely to take to develop standardised provisions?*

Conceivably, all of the terms and conditions of the contracts for capacity sold in the primary market could be standardised. However, comprehensive standardisation would be inconsistent with the access regulatory regime of the National Gas Law and the National Gas Rules, which facilitates the negotiation of terms and conditions by the operator of a covered pipeline and a prospective shipper. In the event of those negotiations not proceeding, the regulatory regime provides the prospective shipper with a right of access to a prescribed reference service. The terms and conditions of that reference service are set and amended from time to time through a regulatory process. In APA's view, comprehensive standardisation would be difficult to achieve, and would be a lengthy process. It is not necessary. In the context of the AEMC's proposals, what is required is the standardisation of only those terms and conditions which have the effect of reducing transaction times, and lowering transaction costs, so that a buyer can quickly match up pipeline capacity with the commodity that may also have been purchased in a secondary market for gas. What is required is the standardisation of product definition and key commercial terms sufficient to ensure that capacity can be easily traded.

Pipeline operators should have flexibility to design services which meet the requirements of prospective shippers sourcing capacity in the primary market. Those prospective shippers support the investment in pipeline capacity which underpins the gas market itself. The terms and conditions on which they contract should not be unnecessarily constrained by requirements for the trading of capacity in a secondary market which is, essentially, a market for transactions which are incremental to the transactions in the primary market for pipeline capacity.

Furthermore, different operating conditions on different pipelines will preclude the standardisation of all terms and conditions. The terms and conditions which govern imbalances, for example, although common in gas transportation agreements, are likely to be different in terms of their detail across the agreements for different pipelines.

In its standard form GTA, APA has sought to achieve a balance between the need to standardise to facilitate the trading of capacity in a secondary market, and the need to be able to offer individual shippers terms and conditions which meet their specific requirements.

If the standardisation of primary capacity contracts has the desired effect of facilitating the trading of pipeline capacity, changes to the allocation agreements between shippers at delivery points will also be required to maximise the opportunities for, and the benefits from, capacity trading. APA does not see the changes required as being major; the allocation agreements themselves have, by their very nature, a high degree of standardisation.



4.2 Receipt and delivery point flexibility

Greater receipt and delivery point flexibility has the potential to facilitate capacity trading.

The Discussion Paper examines two general approaches to receipt and delivery point flexibility, one from the United States and the other from New Zealand.

The discussion of the “US approach” highlights a key issue: a shipper may have a right to capacity to deliver gas to a range of delivery points on a pipeline, but the facilities at the delivery points themselves have capacity limits. This is not an issue where primary capacity is point to point, and where capacity traded is simply the same point to point capacity. However, once receipt and delivery point flexibility is introduced, a shipper buying capacity in the secondary market may be able to transport gas to a delivery point other than the delivery point used by the primary capacity holder, but find that capacity is not available in the delivery point facilities themselves. The provision of greater receipt and delivery point flexibility requires an accompanying mechanism for the allocation of the available capacities in receipt and delivery point facilities. In the example given in the Discussion Paper, this is achieved by recognising, in gas transportation agreements (which, in the US, allow the trading of firm capacity), secondary receipt points, and the right to deliver to those points on a less-than-firm basis.

The New Zealand example illustrates the need for the pipeline operator’s revenues to be maintained where, in a regime with receipt and delivery point flexibility, a shipper with traded capacity uses a delivery point upstream of the delivery point used by the holder of the primary capacity.

The Discussion Paper asks:

- *Would it be feasible to implement the approaches that have been used in either the US or New Zealand, or is there a better alternative?*
- *If greater receipt and delivery point flexibility can be achieved, will allocation agreements need to change? If so, how significant are these changes likely to be?*

APA acknowledges the value of greater receipt point flexibility, but questions the wisdom of focusing on approaches which been developed in other contexts. The extent to which greater receipt and delivery point flexibility can be provided depends on the specific circumstances of a pipeline, and on the commercial arrangements which the pipeline operator has with shippers. It also depends on the allocation agreements in effect at many receipt and delivery points.

Pipeline operators should be able to modify their gas transportation agreements to provide greater receipt and delivery point flexibility, but shipper use of that greater flexibility will require changes to allocation agreements. APA notes that the provision of flexibility at a particular receipt point or delivery point will not change the physical capacity available for allocation at that point and, in the case of a delivery point, should not constrain existing users of gas located downstream of the delivery point. The capacity of the delivery point should be sufficient for the delivery of gas to those downstream users in quantities consistent with their current contractual entitlements.



The changes required to allocation agreements to give effect to greater receipt point and delivery point flexibility should not be significant. The agreements themselves are relatively simple and effectively standardised. Difficulties could, however, arise, and need to be resolved, where a receipt point or delivery point has been paid for by a single user, and that user seeks partial reimbursement of the cost from shippers proposing to deliver gas through the point under newly arranged flexibility. APA sees this as being resolved through commercial negotiation, although the delay introduced by the requirement to negotiate may extend the time required to give effect to receipt or delivery point flexibility.

APA is of the view that, in the longer term, all gas transportation agreements will be structured to facilitate receipt and delivery point flexibility. In the short term, the rights in some transportation agreements to nominate and renominate at particular delivery points may limit a pipeline operator's ability to provide flexibility in respect of those delivery points.

The Discussion Paper asks:

Should a pipeline operator's ability to reject a change be restricted to technical reasons only? If so, how should the criteria for rejection be developed?

APA is of the view that, in the short term, a pipeline operator must be able to reject proposed changes to receipt and delivery points for both technical and commercial reasons. The operator must be able to reject proposed changes which, if effected, would put it in breach of an existing gas transportation agreement.

4.3 Reporting on primary capacity contracts

In its Stage 2 Draft Report, the AEMC proposed that information on the prices in all primary capacity contracts be published together with information on the terms and conditions of contract which may have had direct effects on those prices.

In its response to the Draft Report, APA supported transparency in both primary and secondary markets for gas commodity and pipeline capacity.

APA continues to be of the view that, only where there are equivalent requirements for transparency applicable to commodity and transport, can there be a meaningful advancement towards the a liquid wholesale market for gas, and continues to support a legislative package that provides for the publishing of the prices of all primary sales of gas and pipeline capacity, and of the terms and conditions of those sales which directly relate to price.

Furthermore, the publication of information on trades in the secondary market should not be limited to the publication of information on the trades in standardised products. Information on bespoke arrangements will also assist the process of price discovery.

The publication of prices and contracts will assist the process of price discovery and the emergence of a more liquid gas market. The publication of the identities of the contracting parties is unlikely to further those outcomes, and may adversely impact competitive positions in markets other than markets for gas and gas transportation.

APA does not support the publication of the identities of contracting parties.



Ensuring that the identities of contracting parties will remain confidential will, in APA's view, be a challenge. Aggregation of traded capacities to "zonal level" is unlikely to be sufficient if contracts are published and, even if it were, aggregation obscures the details which can assist price discovery.

If information on capacity trades in the primary capacity market is to be published, it should be published as soon as possible after the trades have been executed. Only current information will assist buyers and sellers form views about the prices at which they should transact.

As hub services and storage services become more important to shippers managing gas supply operations, the process of price discovery and the emergence of a more liquid gas market will be assisted by the reporting of information on transactions in these services.

4.4 Standardisation of secondary market contracts

APA agrees that the trading of capacity in a secondary market should be facilitated by some standardisation of the terms and conditions for the trades in question, and has already given effect to this view through its implementation of Operational Transfers.

To the extent feasible, APA has already:

- standardised the terms and conditions for secondary market trading so that they mirror its standard terms and conditions for primary capacity provision; and
- standardised the terms and conditions for secondary market trading across its pipelines serving the East Coast gas market.

APA is of the view that some standardisation of terms and conditions could assist the development of secondary markets for hub services.

4.5 Secondary market reporting requirements

APA's views on secondary market reporting requirements are essentially the same as its views on the reporting of primary capacity contracts. Those views – on reporting on primary capacity contracts – were set out in section 4.3 above.



5 Auctioning of contracted but un-nominated capacity

APA has committed, in its response to the AEMC's Stage 2 Draft Report, to pursue arrangements for the auctioning of contracted but un-nominated capacity on those pipelines where pipeline capacity is fully contracted.

APA is strongly of the view that, at this stage in the evolution of a secondary market for the trading of pipeline capacity, a simple scheme for the auctioning of contracted but un-nominated capacity should be implemented. If the further development of trading platforms has the intended effect of facilitating capacity trading, the quantity of contracted but un-nominated capacity potentially available to gas market participants should fall. Buyers should be active in the secondary market, and primary capacity holders should have the incentive to sell spare capacity to those buyers rather than allow it to be sold at auction for the benefit of pipeline operators.

A simple auction design will, as the Pipeline Access Discussion Paper recognises, require some standardisation of the key elements of the "product" for which bids are sought.

5.1 Auctioning of multiple segments

The Discussion Paper asks:

- *How frequently do shippers require capacity for the entire length of a pipeline?*
- *How frequently do shippers require capacity for subdivided segments of a pipeline?*
- *Does this vary between pipelines?*

Shippers using the pipelines serving the East Coast gas market generally require capacity for the entire length of pipelines which have been designed and constructed to link particular gas fields with major demand centres. They are less likely to require capacity on segments of existing pipelines. There are, in consequence, usually only a small number of receipt points and delivery points on a pipeline.

At the present time, only small numbers of buyers are likely to seek capacity via the auctioning of contracted but un-nominated capacity, and that capacity will be for small numbers of receipt and delivery point combinations on any pipeline. Rather than attempt the a priori subdivision of pipelines into segments, and implement a process which would auction multiple segments, the auction process can structured around bids from buyers which would specify:

- a receipt point and a delivery point between which pipeline capacity is sought;
- the quantity of capacity sought; and
- the price the buyer is prepared to pay for that capacity.



5.2 Individual or combinatorial allocation

Structuring the bids in this way would eliminate the need for some form of complex combinatorial auction process.

Combinatorial auctions might have been implemented in a number of settings in Australia and overseas, and might be implementable for the auctioning of pipeline capacity. However, they would introduce a degree of complexity which would be unnecessary and costly to shippers given the likely scale of auctions for contracted but un-nominated capacity.

As the secondary market for capacity matures, more complex auction schemes might be introduced, but only if buyers are prepared to pay the additional costs.

5.3 Number of rounds

As the Discussion Paper notes, an auction may proceed through a single round, or it may proceed through multiple rounds.

A single round auction has the advantage of simplicity. Multiple round auctions allow bidders to gain information about their competitors' valuations of the product being auctioned during successive rounds.

Since an auction of contracted but un-nominated capacity must take place after nominations cut-off for the day ahead, it will have to be completed within a relatively short timeframe. Holding more than one round may make the process complicated and costly to administer. Although restriction to one round would, in other circumstances, preclude price discovery, the daily auctioning of contracted by un-nominated capacity should assist the price discovery process.

The Discussion Paper asks:

Is a single round appropriate for the auctioning of contracted but un-nominated capacity?

APA concurs with the assessment of the Discussion Paper, and concludes that a single round auction is appropriate.

5.4 Determining the amount of capacity to be auctioned

APA addressed the issue of the determination of the amount of capacity to be auctioned in its earlier submission responding to the findings and draft recommendations of the AEMC's Stage 2 Draft Report.

A shipper's un-nominated capacity is a part of its contracted capacity and, other than in exceptional circumstances specified in the shipper's gas transportation agreement, will not vary over time, with the amount of line pack, or with the timing of planned maintenance.

Under the recommendations of the Stage 2 Draft Report, the details of all primary capacity sales are to be published. APA would also expect to publish daily nominations (as it currently does, for key pipelines, on its capacity trading website) to assist the decision



making of all market participants, so that any withholding of capacity by the pipeline operator would be quickly discovered.

In the first instance, the amount of capacity to be auctioned is simply the difference between a shipper's contracted capacity and the total of its nominations on a gas day. This difference should be available from a pipeline operator's gas management system. It represents capacity available at, or upstream of, the delivery point at which there is contracted but un-nominated capacity

The situation of a buyer requiring capacity downstream of a delivery point at which there is contracted but un-nominated capacity is more complex. The physics of pipeline gas flow is such that less capacity is available downstream of the delivery point. How much less will depend on the physical characteristics of the pipeline, and on its daily operating conditions. The pipeline operator may, in these circumstances, have to make determinations of the downstream capacity which may be available for auction. These determinations cannot be made using a simple formula which might be codified in rules, or which might be made subject to prior approval by a third party such as the Australian Energy Regulator.

5.5 Auction scope

A single auction for contracted but un-nominated capacity across the entire East Coast pipeline network might, as the Discussion Paper suggests, permit an optimal allocation of that capacity. But the scale of the auction, both in terms of the number of bidders and the amount of capacity which might be available for auction day by day, will be small. This will certainly be the case if the AEMC's proposals have the desired effect of otherwise enhancing the trading of capacity in the secondary market.

In these circumstances, the management of complementarities between different pipelines and hub services will be best left to shippers rather than it being undertaken within a single complex auction mechanism. Such a mechanism would be difficult and costly to construct.

As APA has noted above, in the United States, the implementation of pipeline capacity trading arrangements has been successfully decentralised, to individual pipeline operators, on a scale much larger than would be required for the East Coast gas market. Experience in the United States indicates that a single complex auction mechanism is unnecessary.

APA notes that the evolution of a highly liquid gas market in the United States has been facilitated by the emergence of a new class of market participants – marketers – who bringing together, day by day, sellers and buyers of gas, and link them through pipelines and across pipeline systems.

5.6 Institutional setting and auction residue allocation

The auctioning of contracted but un-nominated capacity should, in APA's view, be undertaken by individual pipeline operators. They have the knowledge of the operational capabilities of the pipelines required to run the auction processes in a way which can ensure that all of the capacity available on a day is offered to the market on that day.



If the auctioning of contracted but un-nominated capacity is undertaken by individual pipeline operators, there are no issues about the method to be used for the allocation of auction residues, and no need to address the complexities of allocation which would arise if a single auction were to be adopted across the entire East Coast.

5.7 Auction limited to fully contracted pipelines

The proposal to auction contracted but un-nominated capacity is intended to:

- address contractual congestion; and
- undermine what the AEMC perceives as the market power of pipeline operators in the market for day ahead capacity.

The Discussion Paper advises that neither of these rationales for the auctioning of capacity appears to apply in the case of pipelines which are not fully contracted. In principle, then, there should be no requirement for the operators of pipelines which not fully contracted to implement capacity auctions.

APA agrees, and further contends that the auctioning of contracted but un-nominated capacity in pipelines which are not fully contracted is unsustainable because it creates strong incentives for shippers to rely on low-priced capacity from the auction process, and not to reserve firm capacity, thereby undermining financial support for the investment which has been made.

APA has therefore committed to pursue arrangements for the auctioning of contracted but un-nominated capacity, but only on those of its pipelines where capacity is fully contracted.

The AEMC is, however, concerned that restricting the auctioning of contracted but un-nominated capacity to pipelines which are fully contracted will create incentives for pipeline operators to only partially contract capacity to avoid any requirement to implement the auction.

APA finds this difficult to understand.

If a pipeline operator did not fully contract the capacity in its pipeline, it would not incur the costs of auction implementation, but it would continue to incur the costs of financing the unutilised capacity.

If the pipeline operator fully contracted the capacity in its pipeline, it could expect to recover all of its costs of financing the capacity, but would incur the costs of auction implementation.

If the auction process is simple (and APA is of the view that it should be), the costs of implementing the auction are likely to be small relative to the costs of financing pipeline capacity. The incentive for the pipeline operator to only partially contract capacity, and to forgo revenues by leaving some of its capacity unsold, to avoid auction implementation, will not be great.

This, of course, ignores the revenues from the auction which, under the AEMC's proposal, are to accrue to the pipeline operator. Shipper interest in the capacity made available



through the auction may, initially, not be great, but as the AEMC expects that it will increase over time, then the auctioning of contracted but un-nominated capacity will be attractive to pipeline operators. Rather than having an incentive to only partially contract capacity, pipeline operators will have a further incentive to ensure that their pipelines are fully contracted.

5.8 Setting the reserve price

In its Stage 2 Draft Report, the AEMC proposed that the auction for contracted but un-nominated capacity have a reserve price which would be set at short run marginal cost. The principal component of short run marginal cost was expected to be the marginal cost of compressor fuel.

In its submission responding to the Stage 2 Draft Report, APA proposed that the reserve price be set at zero. A separate administrative charge would be required to recover the costs of developing and operating the auction platform.

APA continues to advocate these pricing arrangements.

APA does not purchase gas, and requires that shippers using its pipelines supply the gas to fuel the compressors which provide their transportation service.

5.9 Interaction with existing rights

A number of issues may arise from interaction of the proposed auctioning of contracted but un-nominated capacity with the rights created by existing transportation agreements and other market arrangements. The Discussion Paper summarises these issues in a series of questions, including:

- *How material is the issue of re-nomination rights, and has the Commission accurately characterised the issue?*
- *Has the Commission identified all possible solutions to this issue?*
- *What is your preferred solution to this issue, and why?*
- *How complex and costly would holding more frequent auctions be?*
- *Where should capacity bought in the auction be placed in the curtailment order?*
- *Should contracted as-available rights be permitted in light of the introduction of the auction? If not, how should existing as-available rights be phased out?*

APA is aware that a number of existing gas transportation agreements include shipper rights to renominate on a gas day. Pipeline operator recognition of these renomination rights may be inconsistent with the proposed auctioning of contracted but un-nominated capacity.

The Discussion Paper identifies five possible solutions to this problem of inconsistency. These are:



- withhold some capacity from the auction to allow renominations to have effect;
- designate the capacity made available at auction interruptible capacity, allowing it to be interrupted to accommodate renominations;
- a combination of withholding capacity and designating the capacity made available at auction as interruptible;
- more frequent auctions; and
- designate auctioned capacity firm with a right to curtail after capacity subject to renomination.

APA is of the view that, to the extent existing gas transportation agreements include renomination rights, those rights should be recognised for the remaining terms of those agreements. This would preclude attempting to address the inconsistency by designating auctioned capacity firm with a right to curtail after capacity subject to renomination.

Addressing the inconsistency with the proposed auction process through more frequent auctions would, in APA's view, make the auction process unnecessarily complex and difficult to operate within the short timeframe available.

APA's preferred solution is to designate the capacity made available at auction interruptible capacity, allowing it to be interrupted to accommodate renominations. This will ensure that the maximum amount of (contracted but un-nominated) capacity is made available on each day.

Prospective users may factor the interruptibility of the auctioned capacity into the pricing of their bids, and there may be, as the Discussion Paper suggests, some adverse effect on market liquidity because the auctioned product is perceived to be of "low" quality. However, these are, in APA's view, "second order" effects. If, as APA believes, only a small number of gas transportation agreements include the right to renominate:

- market participants will quickly learn that the likelihood of interruption is low and does not call for significant discounting of bid prices; and
- with low likelihood of interruption, the quality of the product is "high" and its interruptibility will not have much impact on market liquidity.

APA sees no reason to prohibit contracts for as-available capacity rights, and would expect the demand for as-available capacity to diminish as the secondary market trading of capacity and the auctioning of contracted but un-nominated capacity become well established.

5.10 Auction with price cap on reference services

The possibility arises, the Discussion Paper notes, of the service provided by the auctioning of contracted but un-nominated capacity on a covered pipeline being specified, by the Australian Energy Regulator, as a reference service. The regulator would then set a reference tariff for that reference service, which would be inconsistent with the AEMC's proposal for an auction with an uncapped clearing price.



The AEMC advises – and APA agrees – that regulator specification of the service provided by the auction as a reference service is unlikely.

Nevertheless, the AEMC proposes that its preferred method of harmonising the auction with the access regulatory regime of the National Gas Law and the National Gas Rules is to cap the auction clearing price at the reference tariff.

In APA's view this would distort the pricing provided by the auction and lead to an inefficient allocation of pipeline capacity. The purpose of an auction is to elicit otherwise unknown consumer valuations of the product being auctioned, and to allocate the product to those consumers who value it most highly, consistent with the requirements for (constrained) economic efficiency. That the price some consumers are prepared to pay for contracted but un-nominated capacity on a day may be well above a reference tariff for that capacity (which would be calculated from cost) is irrelevant.

If (constrained) efficiency is to be achieved, the auctioned capacity must be allocated to the shippers prepared to pay the highest prices for it. Harmonisation of the auction with the access regulatory regime would require a rule change to explicitly remove the service provided by the auction from the purview of the regulator.

5.11 Auctions on lateral pipelines

Section 6.5 of the Discussion Paper presents the following scenario:

- a retailer supplies a gas consumer using a lateral pipeline;
- the rights to capacity in the lateral pipeline are held by the retailer under a long term gas transportation agreement with the pipeline operator;
- the gas supply agreement between the retailer and the gas consumer is about to terminate, and the consumer is seeking to negotiate a new gas supply agreement not necessarily with the same retailer;
- termination of the retailer's gas transportation agreement is not imminent.

In this scenario, the Discussion Paper advises, the retailer may be able to negotiate a new gas supply agreement with the consumer at a price above that which would be expected in a workably competitive market because it has a monopoly on access to the transportation capacity of the lateral.

The Discussion Paper proposes that the auctioning of capacity may provide some relief because the consumer may be able to secure capacity on a day ahead basis.

The Discussion Paper asks, among other things:

Is the auction likely to provide a sufficient remedy to the issue?

In APA's view, it is unlikely that the auction would provide a sufficient remedy.



But, more importantly, should issues of this type influence assessment of the AEMC's proposal for the auctioning of contracted but un-nominated capacity. That proposal is part of a package targeted at ensuring that all of the pipeline capacity which might be available on a day can be made available to users on that day. It is not about devising solutions to problems of purported monopoly in circumstances which, certainly, might be relevant to the parties affected, but which are of little relevance to the broad issue of developing a liquid wholesale gas market on Australia's East Coast.

APA notes that a great deal more would need to be known about the circumstances of the retailer, the consumer and the pipeline operator in the scenario above before any conclusion could be drawn about whether the retailer was in a position of monopoly.