RULE CHANGE

AEMC

Australian Energy Market Commission

CONSULTATION PAPER

National Gas Amendment (Reference service and rebateable service definitions) Rule 2012

Rule Proponent

The Australian Energy Regulator

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two principle functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

Summary

This consultation paper seeks stakeholders' comments on a proposed variation to the more preferable rule set out in the Australian Energy Market Commission's (AEMC or Commission) draft rule determination relating to the definitions of reference services and rebateable services in the National Gas Rules (NGR). It has been prepared following the Commission's consideration and analysis of extensive stakeholder feedback on its draft determination. The Commission is proposing an amendment to the rebateable service definition in the NGR that only applies to pipeline services provided by means of the Victorian declared transmission system (DTS).

Rule change request

The Australian Energy Regulator (AER) requested a rule change to amend the definitions of reference service and rebateable service in the NGR. The purpose of the rule change request was to provide the AER with the flexibility to determine which pipeline services are reference services, rebateable services or neither.

The AER regarded this discretion as desirable because it considered that under the current reference and rebateable services definitions it could make access arrangement decisions which in some circumstances could lead to outcomes that would not encourage the efficient investment in and use of pipeline services and would not be in the long term interests of consumers.

In addition, the AER also expressed particular concern that it regarded APA GasNet (the Victorian DTS service provider) to be earning revenue in excess of its target regulated revenue. The AER argued that its proposed amendments to the definitions would enable it to take into account any excess revenue when determining reference tariffs for the Victorian DTS.

Draft rule determination

The AEMC made a draft rule determination on the AER’s rule change request to not adopt the proposed rule but rather make a more preferable rule. In doing so, the Commission largely adopted the AER's proposed reference service definition with some amendments limiting the AER's discretion. However, it did not adopt the AER's proposed rebateable service definition.

The reasons that the Commission did not adopt the AER's proposed rebateable service definition were that:

- it was not satisfied that the AER had sufficiently demonstrated that APA GasNet was inappropriately retaining revenue in excess of its target regulated revenue such that an amendment to the NGR was required. This was because the Commission had found that in the current access arrangement period APA GasNet was already rebating the majority of this revenue back to users by the annual updating its price control model. The annual updating of this model is

part of the annual tariff variation process which had been approved by the AER each year as being compliant with the current access arrangement; and

- it considered that any possible benefit of the AER's proposed rule change was outweighed by potential risks to investment on other regulated pipelines. This was because the Commission considered that the AER's proposed rebateable service definition could lead to uncertainty for service providers that would impact on their ability and willingness to invest. This may not be in the long term interests of consumers with respect to security of supply.

Submissions to the draft rule determination

On the whole, submissions to the draft determination supported the draft rule to amend the reference service definition. This will be discussed further in the final determination regarding this rule change process.

However, not all submissions supported the Commission's draft determination position not to amend the current rebateable service definition, and some submissions raised additional material. In particular, the AER's submissions argued that the Commission should implement its proposed rebateable service definition.

The Commission has carefully considered the views of stakeholders on this matter. It notes that:

- the AER remains of the opinion that its proposed rebateable service definition is required for it to take into account the revenue APA GasNet is earning from non-reference services when it is determining reference tariffs;
- while the current 'rebating mechanism' in the APA GasNet price control model (which is part of the annual tariff variation mechanism) has been approved by the AER to date, the AER considers that it is not possible for it to return to users revenue earned from authorised maximum daily quantity credit certificates (AMDQ cc) unless the definition of a rebateable service is amended. This implies that the AER considers that it cannot approve a revised APA GasNet access arrangement that has a 'rebating mechanism' in the price control model equivalent to that in the current APA GasNet access arrangement;
- the uncertainty arising from the AER's views about the regulatory treatment of APA GasNet's non-reference service revenue is undesirable for the AER, APA GasNet, other service providers and consumers;
- that there is an inconsistent outcome in applying the NGR where the regulation of most transmission pipelines includes services that represent the firm transportation of gas. However, in the case of the Victorian DTS, regulation to date has not included services that offer some firmness of supply. This outcome reflects differences in the operation of, and market design relevant to, the pipelines;

- if implemented, the AER's proposed rebateable service definition would create regulatory uncertainty for other regulated pipelines (that is, pipelines other than the Victorian DTS). This uncertainty may diminish service providers' ability and willingness to invest. Any diminution of investment that may jeopardise service providers' ability to meet future demand would not be in the long term interests of consumers of gas; and

- evidence and analysis supporting the application of a revised rebateable service definition to other pipelines has not been persuasive to date.

Having had regard to these matters, the Commission has proposed a rebateable service definition in this consultation paper that applies only to pipeline services provided by means of the Victorian DTS and allows rebateable services to be services in the same market as reference services.

The proposed definition will enable the AER, if it considers appropriate, to require certain non-reference services provided by means of the Victorian DTS to be classified as rebateable services even though they are within the same market as the reference services on offer. The effect of this would be to provide a clear avenue within the access arrangement framework for the revenues from such rebateable services to be taken into account when determining reference tariffs.

Consultation

The Commission welcomes stakeholder comments on its proposed rebateable service definition. It also seeks comment on the need for, and details of, any transitional arrangements for this rule, if made. Submissions are requested by 5 October 2012.

Contents

1 Introduction

1.1 The rule change request

On 5 August 2011, the AER submitted a rule change request to the Commission to amend the NGR definitions of reference service and rebateable service.

The purpose of the AER's rule change request was to provide the AER flexibility for it to determine which pipeline services are reference services, rebateable services or neither.[1]

The reason provided by the AER for its rule change request was that it considered that the current definitions may lead to access arrangement decisions which in some circumstances may lead to outcomes that are not the most efficient with respect to investment in and use of pipeline services and are contrary to the long term interests of consumers.[2]

The AER identifed a specific concern with respect to the Victorian declared transmission system (DTS). This was that APA GasNet (the service provider for the Victorian DTS) was over-recovering on its efficient costs because of revenue earned from the sale of authorised maximum daily quantity credit certificates (AMDQ cc). This over-recovery was claimed to result from the 'volume effect' where APA GasNet receives additional revenue for providing reference services on unused AMDQ cc contracted capacity.[3]

The AER also expressed concern with respect to its inability to set efficient tariffs for other pipeline services such as backhaul and interruptible, which may be offered on other regulated pipelines.[4]

The AER considered that the proposed amendments to the reference service and rebateable service definitions are complementary and are necessarily linked together in order to address these concerns.[5]

1.2 Draft rule determination

The AEMC published its draft rule determination on 15 March 2012. In the draft rule determination the Commission decided not make the AER's proposed rule, but rather

1 AER rule change proposal, cover letter, 5 August 2011, p1.

2 AER rule change proposal, cover letter, 5 August 2011, p2.

3 AER rule change proposal, 5 August 2011, pp6-8, 14-15, 20-22.

4 AER rule change proposal, 5 August 2011, pp8-9, 15-16.

5 AER rule change proposal, cover letter, 5 August 2011, p3.

to make a draft rule that was a more preferable rule. The draft rule made by the Commission:[6]

- largely adopted the reference service definition proposed by the AER, with the addition of the requirement that the AER take into account the revenue and pricing principles when exercising its discretion in making a decision about reference services; and

- did not include a change to the definition of rebateable service.

The Commission considered that the draft rule will, or is likely to, contribute to the achievement of the national gas objective (NGO) because it will promote:[7]

- the efficient use and investment in pipeline services. When significant uncertainty exists as to the revenue and demand for a pipeline service, the draft rule reduces the likelihood that inefficient tariffs are set for that service; and

- the long term interests of consumers with respect to price and security of supply by allowing the AER to decide whether a pipeline service sought by a significant part of the market is a reference service. As a result, the AER will not be required to set a tariff for the relevant service which in certain circumstances may not be reflective of efficient costs.

The reasons why the Commission decided not to make a change to the rebateable service definition were that it:[8]

- was not satisfied that the AER had demonstrated that there was a problem with APA GasNet inappropriately retaining revenue earned from AMDQ cc that was in excess of its regulated target revenue. Specifically, the Commission concluded that APA GasNet was already rebating back to users revenue earned from the 'volume effect' in its price control model. The annual updating of this model was part of the annual tariff variation process which was approved by the AER each year as complying with the current access arrangement;[9] and

- considered that any possible benefit of the AER's proposed rule change was outweighed by potential risks to investment on other regulated pipelines. This was because the Commission considered that the AER's proposed rule change may lead to regulatory uncertainty and inefficient investment in pipeline services which may not be in the long term interests of consumers with respect to security of supply.[10]

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6 AEMC, Draft rule determination: National Gas Amendment (Reference service and rebateable service definitions) Rule 2012, 15 March 2012, p5.

7 AEMC, Draft rule determination, 15 March 2012, p6.

8 AEMC, Draft rule determination, 15 March 2012, p14.

9 AEMC, Draft rule determination, 15 March 2012, pp18-22.

10 AEMC, Draft rule determination, 15 March 2012, pp27-31.

In regard to the AER's inability to set efficient tariffs for pipeline services such as backhaul and interruptible, which may be offered on other regulated pipelines, the Commission considered that the reference service definition as amended by the draft rule would allow the AER (when making an access arrangement decision) to assess whether an emerging or developing pipeline service is likely to be sought by a significant part of the market over the next access arrangement period.[11] However, the draft rule determination did not address the AER's concern with respect to these services which may be offered on other regulated pipelines in the context of the proposed change to the rebateable service definition.

1.3 Submissions in response to the draft rule determination

The Commission received ten submissions in response to the draft rule determination. These included a number of late and supplementary submissions. Submissions from some stakeholders supported the draft rule. However, the AER was not supportive of the draft rule and another stakeholder suggested an alternative reference service definition. Submissions made by the AER and DBNGP (WA) Transmission Pty Ltd (DBP) were accompanied by legal advice. All submissions are available from the AEMC's website and are listed in Appendix A to this consultation paper.

The matters raised in submissions with respect to the rebateable service definition are discussed in the remainder of this consultation paper.

1.4 Scope of this consultation paper

In light of the submissions on the draft rule determination, this consultation paper considers the need to amend the rebateable service definition. In particular, this consultation paper discusses making a change to the rebateable service definition that only relates to the Victorian DTS.

The AER's proposed change to, and the draft rule on, the reference service definition are not discussed further in this consultation paper. The Commission's response to submissions on this matter will be discussed in the final rule determination.

The Commission welcomes stakeholder views on the AEMC's proposed rebateable service definition.

1.5 Timeframes and next steps

The close of submissions on this consultation paper is 5 October 2012.

After considering submissions in response to this consultation paper, as well as submissions received in response to the draft rule determination, the Commission will make a final rule determination. The final rule determination will be published on 1 November 2012.

11 AEMC, Draft rule determination, 15 March 2012, p24.

1.6 Process for making a submission

The Commission invites submissions on this consultation paper by 5 October 2012. Submissions should quote project number "GRC0012" and may be lodged online via the Commission's website, www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

1.7 Structure of this consultation paper

The remainder of this consultation paper is structured as follows:

- Chapter 2 provides a background of the main issues with respect to the proposed change to the rebateable service definition and the Commission's assessment approach;
- Chapter 3 outlines the Commission's assessment approach;
- Chapter 4 discusses the question of over-recovery of revenue from AMDQ cc, how the Commission considered this issue in the draft rule determination, and the AER's concerns that it does not have the ability to address this issue under the current rules; and
- Chapter 5 discusses the AEMC's proposed rebateable service definition.

2 Background

This chapter provides context to the Commission's analysis and consideration of whether the rebateable service definition in the NGR should be amended. In particular, it:

- outlines the different operating arrangements of the Victorian DTS and other regulated transmission pipelines;
- provides an overview of AMDQ cc and revenue earned from the provision of this service; and
- discusses the potential impact of AER's proposed rebateable service definition on service providers.

2.1 AMDQ cc and the Victorian DTS

2.1.1 Differences between contract carriage and market carriage pipeline

The approach used to allocate the capacity of a gas pipeline to users is fundamental to the operation of a transmission pipeline. There are two approaches that may be adopted for the management of capacity on a pipeline. These are:

- the contract carriage approach; or
- the market carriage approach.

Under contract carriage, a service provider manages the pipeline's capacity by entering into bilateral contracts with shippers (users). These contracts are usually made in advance on a long term basis and provide shippers with an exclusive right to an amount of pipeline capacity. However, under the market carriage model an independent system operator manages pipeline capacity through a pool approach. Users of a market carriage pipeline do not reserve capacity on the pipeline.[12]

Contract carriage is used for transmission pipelines in all states and territories except Victoria. The market carriage model is only used for the Victorian DTS where the Australian Energy Market Operator (AEMO) manages the operation of the pipeline which transports gas to distribution networks across the majority of the state. AEMO also operates the Victorian declared wholesale gas market (DWGM) which applies to the Victorian DTS.

The structure of the pipeline system affects which model is more suited to a particular market. Pipelines with a trunkline structure (or point to point) are ideal for the traditional contract carriage capacity management model because network

12 Productivity Commission, *Review of the Gas Access Regime*, 11 June 2004, p315.

externalities[13] are small and bilateral transactions do not take into account load interdependencies. In contrast, a pipeline system structured as a dense network exhibits network externalities because loads in one line affect loads in another. In this case, the market carriage capacity management model is more appropriate because it allows the pipeline operator to determine the optimal gas flow schedule taking into account the anticipated injection and withdrawals of gas by users.[14]

In establishing the Victorian DWGM, the Victorian Government noted that the Victorian DTS had different characteristics from other transmission pipelines in Australia in that:[15]

- the system was relatively small and had limited storage capacity because of limited physical line pack and a single LNG facility; and
- it was expected that there would be additional sources of gas introduced into the Victorian transmission system.

The Victorian DTS is a network system with gas injected and withdrawn at a number of points. It is a meshed pipeline network more like a large regional distribution system rather than a long distance point to point transmission pipeline. At different points on the network gas flows can be bidirectional depending on supply and demand conditions. There is also potential for gas to either flow into or out of the network at different times or flow by different paths within the network.

Accordingly, these network features of the Victorian DTS meant that it was not feasible to base reference services (and consequently, reference tariffs) on point to point capacity rights. This is because capacity rights cannot be meaningfully defined in a network system which has multiple injection and withdrawal points and with the potential for congestion. Determining the capacity available to meet any one user's requirements depends on the total pattern of user injections and withdrawals, and the ability for the pipeline operator to meet the requirements of any one user is affected by the plans of all users.

For the Victorian DTS, APA GasNet makes the pipeline system available to AEMO under contract (the service envelope agreement).[16] It is AEMO that manages the receipt, transportation and delivery of gas. The transportation of gas is provided by the single reference service as included in APA GasNet's access arrangement. It has two key components – injection (gas flows into the Victorian DTS) and withdrawal (gas taken from the Victorian DTS) – and is on a 'non-firm' basis where users cannot reserve capacity. This contrasts with contract carriage, where the reference service is typically a

13 Network externalities are defined as the effects on a user of a service of others using the same or comparable service, http://economics.about.com/cs/economicsglossary/g/network_ex.htm.

14 Productivity Commission, *Review of the Gas Access Regime*, 11 June 2004, p315.

15 Victorian Department of Treasury and Finance, Energy Projects Division, *Victoria's gas industry, implementing a competitive structure*, information paper 3, second edition, April 1998, p67.

16 NGL, s. 91BE.

single bundled right to inject gas and have it transported and delivered on a 'firm' (that is, reserved) basis.

Unlike the previous regulatory regime, the National Gas Law (NGL) and NGR do not recognise the contract carriage or market carriage models.[17] Nevertheless, the Victorian DTS still operates in a manner consistent with that envisaged by the Victorian Government. For this reason, the rationale and design of the market carriage system in Victoria, and how it differs from contract carriage pipelines, remains relevant today and provides context for the Commission's analysis in this consultation paper. In addition, the Commission has had regard to the changes that have occurred in the Victorian DTS over time. Of particular relevance, is the development of AMDQ cc since 2002.

2.1.2 What is AMDQ cc?

The Victorian DTS generally has sufficient capacity to supply all users' gas needs without suffering congestion on the pipeline on all but a few days of the year.[18]

Authorised maximum daily quantity (AMDQ), and subsequently AMDQ cc, were established to prioritise access to the transmission pipeline system at times of congestion and to provide pricing signals to gas users.[19] AMDQ and AMDQ cc provide users with:

- curtailment rights – in the event of transmission constraints, users not holding AMDQ will have their ability to inject gas into the system restrained ahead of users holding AMDQ;
- a hedge against uplift charges – which are incurred in the event of congestion on the transmission system or when demand is significantly different to what was planned; and
- a tie break right when there are competing bids at injection and withdrawal points.

AMDQ were created in 1998 prior to the commencement of the Victorian wholesale market when the primary source of gas supply for the Victorian DTS was from Longford (with the addition of limited peak gas supplied from the Dandenong LNG plant). Total AMDQ was set to equal the peak capacity of the system at that time (that is, 990 TJ/day) and was allocated to existing customers at no charge on the basis of historical usage or pre-existing contractual rights. This was part of the preparations for

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17 Section 3.7 of the National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code) required an access arrangement to include a statement that the covered pipeline was either a contract carriage pipeline or a market carriage pipeline (these terms were defined in the Gas Code). There is no similar requirement in the NGR or NGL.

18 The Victorian DTS is a winter peaking system. Congestion is most likely to occur on the coldest winter days.

19 AEMC, Draft rule determination, 15 March 2012, Appendix A.

creating a market carriage based transmission system and wholesale market for gas in Victoria.[20]

AMDQ cc were first introduced in 2002 to provide similar rights (as noted above) to users on new pipeline capacity to those provided by AMDQ on the Longford pipeline. That is, in the event of a constraint, a user holding AMDQ cc will obtain some degree of 'firmness' of supply (although it is a more limited right than provided by 'firm' contract carriage contracts) compared to users who do not hold AMDQ cc. The amount of capacity made available through either investment in new capacity or through pipeline re-configuration is agreed between APA GasNet and AEMO. Once agreement has occurred, new certificates are created and APA GasNet has the right to allocate those certificates to users.[21] AMDQ cc have been issued for new capacity at the Port Campbell and Culcairn injection points.

Until 2007 there was no significant demand for AMDQ cc, but since that time demand for AMDQ cc has increased significantly as parts of the pipeline system have been expanded. For the 2013–2017 access arrangement period, there is currently 353 TJ/day contracted under AMDQ cc on the South West Pipeline (SWP) and 50 TJ/day contracted for at Culcairn.

Currently AMDQ cc is sold by a tender process in a bundle with the associated transportation (injection) of gas for that location. APA GasNet sets the price and users bid for quantities of daily capacity made available. Where bids total more than the total of new capacity available, APA GasNet allocates the available capacity on a pro-rata basis based on the capacity tendered for by bidders. The operation of the tender process for AMDQ cc is not specified in the NGR, the current APA GasNet access arrangement, or by AEMO.[22]

The price set by APA GasNet could be equal to or higher than the relevant injection reference tariff. The ability of APA GasNet to charge a price that is higher than the reference tariff is related to the demand for AMDQ cc and users' perception of the benefits afforded to them in holding AMDQ cc. That is, users are prepared to pay a premium when the pipeline system is constrained as a hedge against the risks of curtailment and the payment of uplift charges. This was illustrated in 2008, when APA GasNet (after consultation with the ACCC) decided to sell AMDQ cc by an open auction process. This auction attracted bids that were very high compared to the floor price (which was set at the reference tariff) and all available AMDQ cc was fully allocated. Subsequent to this APA GasNet decided not to continue with the open auction process, as it considered that the high prices were not desirable in the longer term and it was cognisant of the requirement that all shippers should have access to

20 AEMC, Draft rule determination, 15 March 2012, Appendix A. Any allocation, re-allocation or transfer of AMDQ is managed by AEMO pursuant to rules 327-332 in the NGR.

21 NGR, rules 329, 331 and 332 relate to the allocation, re-allocation, transfer and relinquishment of AMDQ cc.

22 However, AEMO auctions AMDQ according to Part 19 of the NGR.

scarce resources. As a result, AMDQ cc bundles have since been offered by a tender process as noted above.[23]

APA GasNet has submitted that the demand for AMDQ cc and hence the revenue it receives from these certificates being priced above the reference tariff (see discussion below on the 'price effect') is a feature of the Victorian DWGM and is critical in providing a form of leading capacity signal under the market carriage model.[24] However, AMDQ cc were not intended to create signals for investment when VENCorp (the predecessor of AEMO) proposed the AMDQ cc mechanism. Rather they were intended to create incentives for better utilisation of non-Longford system injection points to relieve constraints on the Longford-Dandenong pipeline, as well as a hedge against uplift costs and to improve transparency.[25]

2.1.3 Over-recovery of revenue earned from AMDQ cc

The specific issue that the AER sought to address through its rule change proposal was what it saw as its inability to regulate revenue earned from AMDQ cc which leads to APA GasNet recovering more than its efficient pipeline costs. That is, because the revenue earned from AMDQ cc is in addition to the revenue earned from reference tariffs, APA GasNet is recovering more than the total regulated target revenue which is approved by the AER.[26]

There are two possible types of over-recovery associated with the AMDQ cc bundled service. These are:

- the 'volume effect' which occurs when APA GasNet is able to earn additional revenue for providing reference services on unused AMDQ cc contracted capacity. This is revenue that APA GasNet would otherwise not have earned if the holder of the AMDQ cc had fully used its contracted capacity; and
- the 'price effect' which occurs when the price paid for AMDQ cc is above the reference tariff, and is the difference between these two prices.

In its rule change request, the AER only identified over-recovery due to the 'volume effect'.[27] However, the AER has subsequently expressed its concern with regard to the over-recovery of revenue due to the 'price effect' and the increase in this revenue that is forecast for the next access arrangement period.[28]

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23 AEMC, Draft determination, 15 March 2012, pp34-35.

24 APA submission, 3 November 2011, p5 and APA submission, 26 April 2012, p2.

25 VENCorp, *Application for minor variation of an authorisation to the Australian Competition and Consumer Commission in respect of amendments to the Market & System Operations Rules (MSO Rules)*, March 2000, pp10-11.

26 AER rule change proposal, 5 August 2011, pp7, 21-22.

27 AER rule change proposal, 5 August 2011, pp6-8, 14-15, 20-22.

28 AER submission, 27 April 2012, p11 and AER supplementary submission, 15 June 2012, p2.

In its draft determination, the Commission concluded that the AER had not clearly demonstrated that APA GasNet was retaining additional revenue earned from AMDQ cc.[29] This was because under the current access arrangement APA GasNet was rebating users for the 'volume effect' of AMDQ cc by annually updating its price control model and that the 'volume effect' represented the majority of revenue generated from AMDQ cc.[30]

In response to the draft rule determination, the AER submitted that revenue derived from the 'volume effect' of the sale of any AMDQ cc bundled service cannot be rebated against the reference tariff as it is not a regulated service – specifically, that it is not a rebateable service – under the current APA GasNet access arrangement. This position was supported by external legal advice obtained by the AER. The AER also noted that APA GasNet had proposed the same reference service, and the same 'rebate mechanism', in its revised access arrangement proposal for 2013–2017.[31] The AER has stated that it is not possible for it to return to users revenue earned from AMDQ cc (either the price or volume effect) unless the AEMC amends the definition of a rebateable service.[32] This implies that the AER considers that it cannot approve a future access arrangement with the 'rebating mechansim' in the price control model that is part of the current APA GasNet access arrangement.

In addition, the AER has commented on the 'price effect' arising from the sale of the AMDQ cc bundled service. It submitted that APA GasNet will receive significant revenue from the AMDQ cc service due to the 'price effect' over the next access arrangement period. The AER estimated that APA GasNet may receive an additional $27.5 million over the period 2013–2017 from the 'price effect' of its AMDQ cc service at Port Campbell.[33]

Conclusion

The Commission has considered the AER's position and its legal advice. It acknowledges that the AER is clearly of the view that it cannot now take into account revenues associated with the AMDQ cc service in the manner proposed in the APA GasNet access arrangement. This raises sufficient doubt about the clarity of the NGR in relation to whether the AER would be able to approve an access arrangement where there is uncertainty about the treatment of the revenue derived from the 'volume effect' of AMDQ cc. In addition, the AER has expressed concern about the 'price effect' revenue. The Commission is aware that as the Victorian DTS expands to meet users' needs, the revenue earned from the 'price effect' of AMDQ cc is likely grow. These are the key reasons why the Commission has reviewed the need for a rule change to address the AER's concerns. This is discussed further in Chapters 4 and 5.

29 AEMC, Draft rule determination, 15 March 2012, p14.

30 AEMC, Draft rule determination, 15 March 2012, p21.

31 AER submission, 27 April 2012, p7.

32 AER submission, 27 April 2012, p11.

33 AER submission, 27 April 2012, p11 and AER supplementary submission, 15 June 2012, p2.

2.2 Impact of the AER's proposed change to the rebateable service definition on other pipelines

2.2.1 Potential costs

In the draft rule determination the Commission identified and discussed two detrimental impacts that the AER's proposed change to the rebateable service definition could have on regulated pipelines other than the Victorian DTS. These were:[34]

- the triggering of most favoured nation clauses in existing bilateral contracts;[35] and
- the potential for the proposed rule to take precedence over the fixed principle in the Dampier to Bunbury Natural Gas Pipeline (DBNGP) access arrangement.[36] The fixed principle prevents the Economic Regulatory Authority (ERA) from 'clawing back' any revenue that DBP might earn from the sale of pipeline services that is in excess of the total revenue set under the access arrangement.[37]

In assessing both of these impacts the Commission considered that the AER's proposed change may alter the risk/reward relationship between users and the service provider and expose the service provider to greater financial and regulatory uncertainty and risk. The Commission concluded that this may lead to an increase in investment risk which could result in inefficient investment in pipeline services and may not be in the long term interests of consumers.[38]

With respect to triggering the most favoured nation clauses in existing contracts, the Commission concluded that the risk and impact of this occurring under the current rule is minimised by the requirement that the market for a rebateable service be substantially different to the market for the reference service. The practical impact of removing this requirement as sought by the AER would be to potentially expose service providers to increased investment risk by allowing rebateable and reference services to be in the same market. Reductions in the reference tariff due to rebateable services being in the same market, may trigger a most favoured nation clause in existing contracts. If this were to happen, then revenues from existing contract customers may be reduced and service providers may be exposed to greater financial and investment risk. This is because the risk/reward relationship arising from the AER's proposed rule would be different (riskier) than what is inherent in existing

34 AEMC, Draft rule determination, 15 March 2012, pp13-14, 27-31.

35 A most favoured nation clause provides that if the tariff for the pipeline service on offer to other users is less than the price for that service agreed to in an existing contract, then the lower tariff will also apply to the contract.

36 A full access arrangement may include a principle declared in the access arrangement to be fixed for a stated period of time extending over two or more access arrangement periods (NGR, rule 99).

37 AEMC, Draft rule determination, 15 March 2012, p29.

38 AEMC, Draft rule determination, 15 March 2012, pp13-14.

contracts under the current rules. This may impact on the ability or willingness of service providers to make new investments in pipeline infrastructure.[39]

On the DBNGP fixed principle, the Commission concluded that if the proposed rule was made then it may be interpreted as taking precedence over the fixed principle and as a result the fixed principle would no longer apply. If this were the case, DBP may be exposed to greater regulatory uncertainty and greater financial risk than it, its users and financiers have taken into account in current contracts. This in turn may impact on the service provider's ability or willingness to invest in the currently anticipated pipeline expansions. This is unlikely to be in the long term interests of consumers if future demand is not met.[40]

In response to the draft rule determination, the AER has disagreed with the Commission's conclusion on both of these issues.[41] However, DBP's submissions have supported the Commission's conclusions and in turn contested the AER's position.[42] The views expressed by both the AER and DBP have been supported by legal advice.

Conclusion

The Commission has considered the differing views expressed. It remains concerned that there is a significant difference of opinion on the potential impact that the AER's proposed rebateable service definition may have on existing contractual arrangements for pipelines other than the Victorian DTS. Despite the differing opinions, there appears to be no new argument to suggest that the decision to not implement the AER's proposed rebateable service definition (as set out in the draft determination) is not appropriate in these circumstances. The Commission remains concerned about the potential impact the AER's proposed change to the rebateable service definition could have on fully regulated pipelines other than the Victorian DTS. Specifically, if the AER's proposed definition was adopted, service providers would be exposed to increased regulatory uncertainty about the treatment of pipeline services each time their access arrangements were reviewed by the regulator. Such uncertainty could also impact on the provision of services that are negotiated with users.

For these reasons, the Commission maintains its view as set out in the draft rule determination that the AER's proposed change to the definition of rebateable services may lead to an increased risk to investment for pipelines other than the Victorian DTS.

2.2.2 Potential benefits

In its rule change request, the AER discussed the benefit of its proposed change to the rebateable service definition in relation to pipeline services such as backhaul and interruptible, which may be offered on pipelines other than the Victorian DTS (that is,

39 AEMC, Draft rule determination, 15 March 2012, pp13, 28.

40 AEMC, Draft rule determination, 15 March 2012, pp13-14.

41 AER submission, 27 April 2012, pp7-11 and AER supplementary submission, 15 June 2012, pp2-5.

42 DBP submission, 26 April 2012, p1, DBP supplementary submission, 11 May 2012, pp1-5 and DBP further supplementary submission, 13 July 2012, pp1-4.

contract carriage pipelines). The AER submitted that the proposed amendments are required to allow revenue to be rebated (if appropriate) when considering services of significant uncertain demand or uncertain revenue such as backhaul and interruptible services. By way of example, the AER cited the ACCC's assessment of the reference service in the 2006 draft decision on the Roma to Brisbane Pipeline (RBP) access arrangement. The AER argued that if the ACCC had made its assessment under the current rules, it may not have been able to define services (such as backhaul) as rebateable services if the ACCC had considered that these services were not in a substantially different market to the forward haul reference service.[43]

In responding to the draft rule determination, the AER submitted that it considered its proposed rule change was necessary to address not just APA GasNet's AMDQ cc service, but also broader issues from other emerging pipeline services on other pipelines (such as backhaul and interruptible) which are likely to become more significant.[44] By way of example, the AER referred to three stakeholder submissions to the RBP 2012–2017 access arrangement proposal which identified issues arising from new pipeline services.[45] That is, a potential benefit of making the proposed amendment to the rebateable service definition would be (according to the AER) that it would allow the AER to take into account emerging or uncertain pipeline services in access arrangements.

As previously noted, the draft rule determination did not discuss the AER's concern with respect to services which may be offered on regulated pipelines other than the Victorian DTS in the context of the proposed change to the rebateable service definition (although the issue was discussed in regard to the proposed reference service definition).

Conclusion

Having considered the views expressed by the AER on the need to apply its proposed rebateable service definition to pipelines other than the Victorian DTS, the Commission considers that insufficient analysis and evidence to support this view has been provided to date. The Commission is not satisfied that the arguments made by the AER for the broader need for its proposed amendment to the rebateable service definition are supported by clear and convincing evidence.

In reaching this conclusion the Commission notes that:

- while a number of pipeline services (such as backhaul, interruptible and park and loan services) could be considered as rebateable services, these services may also be offered as negotiated services. Under the current RBP access arrangement, negotiated services may be offered where a prospective user's requirements and circumstances vary from the conditions of the reference service, including where the prospective user seeks access to capacity other than the existing capacity. In

43 AER rule change proposal, 5 August 2011, pp15-16.

44 AER supplementary submission, 15 June 2012, p1.

45 AER, submission, 27 April 2012, pp4-5.

these circumstances, the prospective user may seek to negotiate different terms and conditions (including tariff), as a negotiated service;[46]

- stakeholder submissions on the proposed RBP access arrangement for 2012–2017 have argued that the AER should consider the pipeline services identified (intra-day nominations, as available and backhaul) as reference services, or that the AER should consider that the revenue from such services be included in the regulated revenue.[47] That is, these stakeholders were not specifically requesting that the services should be rebateable services; and

- the NGR clearly requires total revenue and costs to be allocated between reference services and other services.[48] 'Other services' are not just restricted to rebateable services, but may also include services that are negotiated.

2.2.3 The Commission's proposed position

In order to assess whether a proposed rule change is required and satisfies the NGO, the Commission must weigh up the potential benefits of making the proposed change against the potential costs. In relation to regulated pipelines other than the Victorian DTS, the Commission has weighed up the potential benefits of applying the AER's proposed rebateable service definition against the potential costs of doing so. In terms of the potential benefits:

- the Commission has not been provided with any clear evidence that pipeline users are requesting that certain pipeline services ought to be classified as rebateable services; and

- non-reference services can be specified as negotiated services. The revenue from which must be taken into account when determining the revenue to be allocated to reference services.

In terms of the potential costs, the Commission considers that the application of the AER's proposed rebateable service definition to regulated pipelines other than the Victorian DTS would generate regulatory uncertainty that could deter investment. Specifically, the Commission is concerned that service providers would be exposed to increased regulatory uncertainty about the treatment of pipeline services each time their access arrangements were reviewed by the regulator. Such uncertainty could also impact on the provision of services that are negotiated with users. This may not be conducive to efficient investment in natural gas services and ultimately would not be in the long term interests of consumers.

On balance, the Commission has concluded that to date, the potential benefits of applying the AER's proposed rebateable service definition to regulated pipelines other

46 APT Petroleum Pipelines Limited, *Access arrangement for Roma Brisbane Pipeline*, effective 1 September 2012 – 30 June 2017, August 2012, p8.

47 AER submission, 27 April 2012, pp4-5.

48 NGR, rules 93(1) and 93(2).

than the Victorian DTS have not been demonstrated to outweigh the potential costs. Accordingly, the Commission does not consider that the AER's proposed rebateable service definition should apply to these pipelines.

3 The Commission's assessment approach

In the draft rule determination, the Commission set out its approach to assessing the AER's rule change request.[49] In assessing a rule change request the Commission must consider the relevant NGL requirements. This includes the rule making test: that the Commission must be satisfied that the rule if made will, or is likely to, contribute to the achievement of the NGO.[50]

In assessing the AER's rule change request the Commission considered a number of issues because the definitions of reference service and rebateable service are fundamental to the regulation of covered pipelines under the NGR. The Commission was cognisant that any change to these definitions would have application to all covered pipelines subject to full regulation by the AER and the ERA. The issues that the Commission considered were:[51]

- whether the problem as identified by the AER had been substantiated and justifies a rule change;
- whether the rule change proposal would be likely to address the problem identified by the AER;
- whether the rule change proposal would be likely to contribute to the achievement of the NGO, particularly in respect of promoting efficient investment in, and use of, pipeline services;
- whether there is a more preferable rule that would be likely to better contribute to the achievement of the NGO, particularly in respect of promoting efficient investment in, and use of, pipeline services;
- the likely impact of the rule change proposal on the AER's ability to set efficient tariffs;
- how the rule change proposal may impact on regulated pipelines other than the Victorian DTS;
- other consequences of the rule change (intentional or unintentional) that were not identified by the AER; and
- whether the level of discretion that the rule change proposal provides to the AER would be appropriate.

The Commission has reconsidered its assessment approach to the rule change request. It has done so in light of responses to, and additional material provided following, the publication of its draft determination.

49 AEMC draft rule determination, 15 March 2012, p16.

50 NGL, s. 291(1).

51 AEMC draft rule determination, 15 March 2012, pp16-17.

The focus of the draft rule determination, particularly in regard to the treatment of AMDQ cc in the APA GasNet access arrangement, was the Commission's view that the AER had not clearly demonstrated that there was a problem that required an amendment to the NGR. This conclusion largely reflected the evidence that APA GasNet had been rebating users for revenue earned from the AMDQ cc 'volume effect' through the annual updating of its price control model. The Commission had noted that APA GasNet's updating of its price control model was part of its annual tariff variation process which had been approved by the AER as being compliant with the current access arrangement (and by implication, compliant with the NGR).[52]

It is evident that the AER having considered legal advice, is clearly of the view that for it to effectively account for AMDQ cc revenue in APA GasNet's access arrangement, a change to the NGR is required. In particular, the Commission notes:

- the AER's views on the level of discretion in relation to its decisions on annual tariff variations and the approval of reference tariffs;
- the AER's views on the operation of the APA GasNet access arrangement, its annual tariff variation mechanism, and its compliance with the NGR; and
- the 'price effect' and its potential growth (in revenue terms) in the future.

Accordingly, the assessment approach in relation to the current consideration of the rebateable service definition has included a focus on the nature and extent of the problem identified by the AER. Specifically, the over-recovery of (volume and price effect) revenue from the sale of the AMDQ cc bundled service. This is discussed in the following chapter.

52 AEMC draft rule determination, 15 March 2012, pp12, 14, 17, 21-22.

4 Problem of over-recovery of revenue from AMDQ cc

4.1 Rebating of AMDQ cc revenue through the price control model

4.1.1 The rebating process

In the draft rule determination, the Commission concluded that:[53]

> "On the information available to it, the Commission is not satisfied that the problem identified by the AER exists (that is, that APA GasNet is inappropriately retaining revenue that is in excess of the target regulated revenue). This is because APA GasNet is rebating users for the volume effect of AMDQ cc under the current access arrangement and the volume effect represents the majority of the AMDQ cc generated revenue."

Specifically, the 'volume effect' from AMDQ cc was automatically taken into account when APA GasNet annually updated its price control model by replacing forecast volumes with actual volumes. When actual volumes are above forecast volumes in a given year, the model update has the effect of reducing reference tariffs for the subsequent year. In this way, users do not pay twice for gas injected at these points in the Victorian DTS. This updating of the price control model has occurred as part of APA GasNet's annual tariff variation process.

The price control model was part of APA GasNet's access arrangement proposal[54] which was approved by the ACCC in 2008.[55] The model applies the approved price control formula to calculate revenues and tariffs for each year of the access arrangement period as described in schedule 4 of the current access arrangement.[56]

In accordance with the access arrangement, APA GasNet has submitted an annual tariff variation proposal to adjust tariffs for the following year to the AER each November for approval. Each year this proposal has included APA GasNet's price control model[57] that has been updated with actual and forecast values to demonstrate compliance with the approved price control formula in the derivation of the proposed adjusted tariffs.[58] The updating of actual and forecast volumes, and hence revenues, have occurred in accordance with clause 4.2 of schedule 4 of the current access

53 AEMC, Draft determination, 15 March 2012, p21.

54 ACCC, *Draft decision, Revised access arrangement by GasNet Australia Ltd for the Principal Transmission System*, 14 November 2007, p213.

55 ACCC, *Final approval, Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 25 June 2008.

56 APA Group, *GasNet Australia access arrangement*, approved 25 June 2008, commencement date 1 January 2008, schedule 4, pp35-38.

57 APA GasNet, *Statement of proposed year 2012 transmission tariffs*, 17 November 2011, p6.

58 APA Group letter to the AER, *APA GasNet transmission system year 2012 tariff reset*, 17 November 2011.

arrangement.[59] For example, in approving APA GasNet's annual tariff variation proposal for 2012, the AER stated that the proposal complied with the provisions of the access arrangement and "that the forecasts used by GasNet are acceptable".[60]

As a result of APA GasNet's annual updating of its price control model and the AER's repeated approval of this process, the Commission found that APA GasNet was rebating users for the over-recovery of AMDQ cc revenue due to the 'volume effect'. The Commission considered that this was occurring even though the ACCC had decided not to classify AMDQ cc as a rebateable service in its 2008 final decision on the access arrangement.[61] In fact, nominating AMDQ cc as a rebateable service was not required to achieve this outcome – the rebating was occurring through the application of APA GasNet's approved annual tariff variation process and operation of its price control model.[62]

The Commission's draft determination also noted that if the AER was concerned with the process of rebating users through the updating and operation of APA GasNet's price control model, then under the NGR the AER could propose an amendment to APA GasNet's proposed reference tariff variation mechanism at the next access arrangement review.[63]

On this last point, the Commission does acknowledge that the current rebating process through the price control model is not transparent: it is not described in the current access arrangement or access arrangement information.

4.1.2 The AER's response

In response to the draft rule determination discussion as outlined above, the AER submitted that:[64]

> "unless the AEMC also adopts the AER's proposed change to the rebateable service definition, the AER is not likely to be able to rebate revenue derived from a non-reference service against a reference tariff(s)."

This position was supported by legal advice obtained by the AER.

In addition, the AER stated that if AMDQ cc was a rebateable service, only then could its revenue be rebated against the reference tariff. However, in the AER's opinion AMDQ cc cannot be classified as a rebateable service under the current definition in the NGR due to the requirement that it be in a substantially different market to the

59 APA Group, *GasNet Australia access arrangement*, approved 25 June 2008, commencement date 1 January 2008, schedule 4, p35.

60 AER, Statement of reasons, GasNet tariff reset for 2012, 14 December 2011.

61 ACCC, *Final decision, Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008, pv.

62 AEMC, Draft rule determination, 15 March 2012, pp20-21.

63 AEMC, Draft rule determination, 15 March 2012, p21.

64 AER submission, 27 April 2012, pp1-2.

reference service.[65] Effectively, this implies that the rebating arrangement that occurred through the price control model under the current access arrangement would not be continued (although it has been proposed) into the forthcoming access arrangement period.

4.1.3 Conclusion

In light of the AER's submission in response to the draft rule determination, the Commission has re-considered the matter of rebating revenue earned from the AMDQ cc bundled service. It acknowledges the AER's opinion that under the current NGR and access arrangement, it would not be able to approve the inclusion of the current rebating mechanism in the next revised access arrangement for 2013–2017. This view, which is inconsistent with the Commission's draft determination, has created legal uncertainty about whether the AER is able to approve an access arrangement for the Victorian DTS that includes the current AMDQ cc revenue rebating process under the current provisions of the NGR. This uncertainty is undesirable. As a result, the question for the Commission is now whether an amendment to the NGR could remove any legal doubt about the AER's ability to take into account AMDQ cc related revenue in determining reference tariffs.

4.2 Revenue earned due to the price effect of AMDQ cc

As previously noted, the AER did not identify the over-recovery of revenue due to the 'price effect' of AMDQ cc as an issue in its rule change request.

In the draft rule determination, the Commission noted that the proportion of total AMDQ cc revenue earned by APA GasNet over the current access arrangement period which was due to the 'price effect' was small.[66]

In response to the draft rule determination, the AER submitted that the additional revenue APA GasNet would be likely to receive from the AMDQ cc service over the next access arrangement period (2013–2017) due to the 'price effect' would be significant. It estimated that the amount could be $27.5 million over the five year period. This estimate was based on APA GasNet's proposed injection tariff at Port Campbell ($1.969/GJ) as set out in its proposed access arrangement and the AMDQ cc tender price for the sale of 353TJ/day at Port Campbell for 2013–2017.[67]

In light of the AER's submissions, the Commission has considered the 'price effect' issue further. It notes that the demand for the AMDQ cc service is likely to increase over time as more capacity is added to the Victorian DTS. This means that the share of total revenue (that is, total revenue associated with the operation of the Victorian DTS) from AMDQ cc (which includes revenue from the 'price effect') is likely to increase and become more significant over time. It also notes that the revenue earned from the 'price

65 AER submission, 27 April 2012, p7.

66 AEMC draft rule determination, 15 March 2012, p21.

67 AER submission, 27 April 2012, p11 and AER supplementary submission, 15 June 2012, p2.

effect' has not been included in the price control model rebate mechanism – it has been retained by APA GasNet.

4.3 Regulation of pipeline services

As discussed above, the AER's submissions in response to the draft rule determination have raised legal doubt over its ability to take into account the revenue generated from the AMDQ cc bundled service. In light of this uncertainty, the Commission has considered whether a change to the rebateable service definition could remove the doubt. In doing so, the Commission has examined the fundamental principles of economic regulation of covered gas pipelines (particularly in relation to transmission pipelines). It has also had regard to the impact that market design may have on regulatory outcomes. This is discussed below.

4.3.1 Fundamental principles of economic regulation of gas pipelines

Economic regulation under the NGL is only applied to covered pipelines which exhibit a level of market power where the benefits of regulation outweigh the costs.[68] This is put into effect by the application of the pipeline coverage criteria (set out in s. 15 of the NGL) by the National Competition Council and the relevant government minister.

There are two types of regulation for covered pipelines, light regulation and full regulation. Full regulation pipelines are required to have full access arrangements which set out reference tariffs, services to be offered and terms and conditions. These access arrangements are to be approved by the AER through an access arrangement approval process. In contrast, light regulation pipelines are not required to have a full access arrangement but may submit a limited access arrangement to the AER for approval. Limited access arrangements do not have reference tariffs. Their intent is to give certainty over terms and conditions applicable to the pipeline services offered.[69]

Central to the regulatory framework is the ability of users and service providers of pipelines to negotiate the terms and conditions (including price) of access. The resulting negotiated terms and conditions of access may differ from the access arrangement relevant to the pipeline.[70] The NGL provides for a dispute resolution

68 Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), p12.

69 Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), pp13-17.

70 Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), p17.

process by an arbitrator if a dispute arises between a user or prospective user and a service provider over access to the regulated pipeline service.[71]

Accordingly, in the context of the economic regulation of pipelines under the NGL, reference services and reference tariffs play an important role in providing a point reference for negotiation and dispute resolution. This is because by definition, the reference service is a service that is likely to be sought by a significant part of the market. The policy intent of this definition is clear. That is, to ensure that economic regulation of covered pipelines is effective in promoting the long term interests of consumers, it is necessary that economic regulation applies to services that are sought by a significant part of the market. It should not, for example, exclude material services as a result of an unusual market design.

4.3.2 Impact of market design on pipeline services and revenue

As previously noted, the NGL does not recognise the contract carriage or market carriage models for managing capacity allocation on transmission pipelines. This presents challenges because functionally the regulatory framework appears best suited for contract carriage, not market carriage. For contract carriage pipelines, it is reasonable to expect that the reference service will be a 'firm' (or 'non-interruptible') service and that payment for that service will reflect both the reservation of pipeline capacity as well as the actual flow of gas. This reflects that:

- 'firm' services are demanded by a significant part of the market; and
- most gas pipelines are founded on the basis of long term contractual arrangements based on the right to use a certain reserved amount of pipeline capacity.

The Victorian DTS is a market carriage pipeline where the reference service is a 'non-firm' service. In addition, and to reflect the operation of market carriage, users pay the reference tariff as they use the pipeline system. While users have the advantage of not requiring contracts or reserving capacity to use the Victorian DTS, their usage of the pipeline is not guaranteed. However, users that hold AMDQ or AMDQ cc do have rights that are analogous to some rights that can be found in contracts. Users must pay to hold these rights. For users with AMDQ cc, this means that the total cost paid includes payment of transportation tariffs (equal to the reference tariff) plus a payment for acquiring the AMDQ cc rights. The second of these has, to date, generated unregulated revenue for APA GasNet (that is, revenue earned due to the 'price effect'). However, if the Victorian DTS was operated as a contract carriage pipeline, it would be reasonable to expect that the revenue derived from the sale of those rights would also be regulated as it would be likely that they would be sought by a significant part of the market.

71 Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), pp18-19.

As noted above, when AMDQ cc was first created it played a small role in the market. However, the importance of AMDQ cc has increased in recent years, particularly since 2007. Given this, it could be argued that the AMDQ cc service now meets the underlying policy intent for the definition of a reference service: it is likely to be sought by a significant part of the market. This suggests that there should be some regulatory oversight of providing the service. The first option would be to specify the provision of AMDQ cc as a reference service. This would require the establishment of a reference tariff. If this is not feasible, as stated by the AER, one alternative would be to specify the service as a rebateable service. This does not require the setting of a tariff. However, it would provide for the AER to take into account the revenue generated from the sale of the service in determining reference tariffs. This would be the effect of the AER's proposed rebateable service definition in its application to the Victorian DTS if it were implemented.

4.3.3 The Commission's considerations

In reviewing the regulatory environment applicable to covered pipelines subject to full regulation, the Commission notes that:

- the extent of regulatory oversight employed for various pipeline services should be guided by the degree of importance placed on the services by users of the pipeline. This is illustrated by the requirement that reference services must be those pipeline services sought (or likely to be sought) by a significant part of the market;

- the regulation of pipeline services that represent firm transportation of gas should result in consistent outcomes across pipelines;

- the ability of the regulator to apply a relevant degree of oversight to a pipeline service should not be unnecessarily hindered by unclear provisions in the NGR. Nor should it be hindered by peculiar regulatory requirements or market design features (such as the use of market carriage instead of contract carriage); and

- the NGR should provide a clear framework within which the details of the regulatory arrangements for a pipeline can be established, having regard to its particular circumstances.

The Commission has therefore had regard to these factors in reviewing the rebateable service definition.

5 The Commission's proposed rebateable service definition

5.1 Rationale for the definition

The Commission has considered its conclusions set out in the draft rule determination with respect to the rebateable service definition in relation to the Victorian DTS. The Commission acknowledges that revenue from the sale of AMDQ cc should be accounted for in the APA GasNet access arrangement but that the mechanism for doing so that has been applied previously is unlikely to be approved by the AER.

On the evidence presented to it in the first round of submissions, the Commission understood that the problem identified by the AER's rule change request regarding revenue derived from the 'volume effect' of AMDQ cc was addressed by APA GasNet rebating users through its price control model. However, on the basis of the AER's submissions in response to the draft rule determination the Commission has reconsidered its position. It has found that there is:

- legal uncertainty over whether the AER can approve an access arrangement that includes the current AMDQ cc revenue rebating mechanism in the price control model;
- forecast to be a significant increase in revenue due to the 'price effect' of AMDQ cc for the next access arrangement period;
- likely to be an increase over the long term in the share of APA GasNet's revenue earned from the unregulated AMDQ cc service; and
- an inconsistent regulatory outcome between the Victorian DTS and other fully regulated pipelines arising from differences in the structural conditions of the markets.

As a result, the Commission considers that the AER's proposed change to the rebateable service definition could solve the problem identified with respect to the Victorian DTS: it would provide a clearer avenue for the AER to take into account the revenues generated from AMDQ cc. However, the Commission is not convinced that the change to the definition should be applied more broadly to other regulated pipelines. This is because the Commission considers that:

- it has not been presented with sufficient evidence to support the argument that the rebateable service definition should be changed for regulated pipelines other than the Victorian DTS; and
- the AER's proposed rebateable service definition may result in an increase risk to investment on other regulated pipelines which may not be in the long term interests of consumers with respect to security of gas supply.

As a result, the Commission is not satisfied at this point that the application of the AER's proposed amendment to the rebateable service definition to all pipelines would be consistent with the NGO.

Therefore, the Commission has considered whether the rebateable service definition can be amended in a way that resolves the AER's issues regarding the APA GasNet access arrangement without impacting on other regulated pipelines. The Commission considers that the benefits of this approach will be that it:

- would potentially result in lower prices to Victorian gas consumers by enabling the rebating in part of the revenues generated from AMDQ cc and will better promote the NGO by being in the long term interests of consumers with respect to price;
- would provide increased flexibility (for the AER and APA GasNet) for determining the method for allocating and pricing AMDQ cc, creating scope for improvements in allocative efficiency;
- would provide clarity and certainty to users, APA GasNet and the AER by explicitly including in APA GasNet's access arrangement the approach taking into account AMDQ cc revenue;
- is broad (that is, not specific to AMDQ cc), allowing other services that are either emerging or resulting from a restructure of existing services to be considered as rebateable services and thus be included in the APA GasNet access arrangement; and
- would enhance consistency in the scope of economic regulation between the Victorian DTS and other fully regulated pipelines. That is, there would be a clear framework in the NGR that would result in consistent outcomes being applied to contract and market carriage arrangements (see section 4.3.2 above).

5.2 The Commission's proposed definition

A proposed amended rebateable service definition is set out below (marked to show changes to rule 93(4) of the NGR). The Commission considers that this definition reflects the Commission's proposed policy position as expressed above.

The effect of the Commission's proposed rebateable service definition is to limit the changes proposed by the AER to the Victorian DTS. With respect to pipeline services offered on the Victorian DTS, the proposed change gives the AER flexibility for it consider a service which is in the same market to the reference service, as a rebateable service. Such a circumstance may arise where it is problematic for the AER to set a reference tariff due to uncertainty of demand or revenue or where it is not commercially and technically reasonable to set a reference tariff (which may be the case for the AMDQ cc service). By giving the AER this flexibility, it provides a clear avenue for the AER to take into account revenues from such rebateable services when determining reference tariffs within the framework of the APA GasNet access arrangement.

Stakeholders are invited to comment on the amended definition set out below.

(4) Subject to subclause (5), a~~A~~ pipeline service is a **rebateable service** if:

(a) the service is not a reference service; and

(b) substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; and

(c) the market for the service is substantially different from the market for any reference service.

(5) A pipeline service provided by means of a pipeline forming part of the declared transmission system is a **rebateable service** if:

(a) the service is not a reference service; and

(b) either:

(i) substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; or

(ii) it is not commercially and technically reasonable to set a reference tariff for the service.

5.3 Transitional arrangements

The AER has requested that the Commission consider including a transitional provision in making the final rule that deals with the operation and application of the final rule to access arrangement reviews already in progress.[72]

Stakeholders are invited to comment on the need for, and details of, such transitional arrangements if the final rule was to apply to access arrangements that are currently being assessed by the AER.

72 AER submission, 27 April 2012, p12.

Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMDQ	authorised maximum daily quantity
AMDQ cc	authorised maximum daily quantity credit certificates
APA	APA Group
APA GasNet	APA GasNet Australia (Operations) Pty Limited
APIA	Australian Pipeline Industry Association
Commission	See AEMC
DBP	DBNGP (WA) Transmission Pty Limited
DBNGP	Dampier to Bunbury Natural Gas Pipeline
DTS	declared transmission system
DWGM	declared wholesale gas market
ERA	Economic Regulation Authority of Western Australia
gas	natural gas
Gas Code	National Third Party Access Code for Natural Gas Pipeline Systems
Jemena	Jemena Limited
LNG	liquefied natural gas
MSO rules	Market System Operating rules
NGL	National Gas Law
NGO	national gas objective

NGR	National Gas Rules
Origin	Origin Energy
Proponent	See AER
RBP	Roma to Brisbane Pipeline
SWP	South West Pipeline
TJ	terrajoule
VENCorp	Victorian Energy Networks Corporation

A Submissions in response to the draft rule determination

Submission	Date received
Submissions received by the due date	
APA Group	26 April 2012
Australian Pipeline Industry Association (APIA)	26 April 2012
DBNGP (WA) Transmission Pty Limited	26 April 2012
Origin Energy	26 April 2012
Submissions received after the due date	
Australian Energy Regulator	27 April 2012
Jemena Limited	1 May 2012
APA Group – supplementary submission	10 May 2012
DBNGP (WA) Transmission Pty Limited – supplementary submission	11 May 2012
Australian Energy Regulator – supplementary submission	15 June 2012
DBNGP (WA) Transmission Pty Limited – further supplementary submission	13 July 2012