Jemena Gas Networks
(NSW) Ltd
ABN 87 003 004 322

Level 20
111 Pacific Highway
North Sydney NSW 2060
PO Box 1220
North Sydney NSW 2059
T +61 2 9455 1500
F +61 2 9455 1589
www.jemena.com.au

29 January 2015

Via online submission

Ms Electra Papas
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Ms Papas

Rule change proposal—Matched allocation process in the STTM (GRC0030)

Jemena Gas Networks (NSW) Ltd (**JGN**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**) consultation paper on the matched allocation process rule change request, which JGN submitted on 15 September 2014.

JGN understands from the consultation paper that the AEMC is particularly interested in obtaining stakeholder feedback on the following questions:

1. Is it appropriate to subject unaccounted for gas (**UAG**) to the risks of deviation pricing in the Short Term Trading Market (**STTM**)?
2. Are there any benefits to requiring JGN to procure UAG through the STTM rather than allowing it to use the matched allocation process?
3. Would a permanent rule act as a barrier to harmonising UAG arrangements across retail markets and, if so, would a five year extension of the transitional rules to 30 June 2020 be more appropriate?

The first of these questions was addressed in some detail in JGN's rule change request.[1] The remainder of this submission therefore focuses on the latter two questions.

Question 2: Are there any benefits to requiring JGN to procure UAG in the STTM?

Under the transitional provisions set out in clauses 26 and 27 of Schedule 1 of the National Gas Rules (**NGR**), gas purchased by JGN to meet the operational requirements of its distribution system at the Sydney STTM hub can be excluded from the operation of the STTM through the matched allocation process. If these transitional provisions are allowed to lapse on 30 June 2015 then, as noted in JGN's original rule change request, it will give rise to the following costs and risks:[2]

- JGN will be required to pay the following STTM-related fees and charges:
  - STTM market participation fees.

[1] JGN, Rule change proposal – National Gas Rules – Matched Allocation Process, 15 September 2014, pp. 11-12.

[2] Ibid.

- Any costs associated with meeting AEMO's STTM prudential requirements.
- Deviation and/or market schedule variation charges to the extent operational gas requirements on a particular day deviate from the *ex-ante* schedule.
- Any other STTM-related administrative costs.

- JGN will incur additional costs setting up the systems and making other operational changes to either directly or indirectly participate in the STTM.
- JGN will be exposed to a range of STTM related risks because it is not possible to hedge against all of the risks associated with operating in the STTM.

While this aspect of JGN's rule change request appears to be well understood by the AEMC, it has queried whether requiring JGN to procure UAG through the STTM would give rise to any:

1. improvement in the efficiency of the operation of the Sydney STTM's price discovery mechanism (i.e. because of the increased liquidity in the STTM); and/or
2. other benefits for STTM users, such as a reduction in the STTM market participation fees.

JGN's views on these two matters are set out below.

Impact on liquidity and the efficient operation of the STTM

Over the last five years UAG has accounted for around 2.24% of the total volume of gas transported in the NSW Gas Network.[3] Given the relatively small volume of gas in question, it is difficult to see how requiring JGN to procure UAG through the STTM would result in a *material* improvement in the liquidity of the Sydney STTM, or the efficiency of the STTM's price discovery mechanism.

That is not to say that the additional liquidity wouldn't give rise to a small efficiency improvement. However, in JGN's view the scale of the improvement would *not* be sufficient to offset all of the costs and risks outlined above. STTM users and other end-users of gas would therefore be worse off overall, if this was the only reason that JGN was required to procure UAG through the STTM.

Impact on market participation fees and STTM users

STTM market participation fees[4] are currently determined by AEMO on an annual basis having regard to the costs it expects to incur in operating the STTM, the volume of gas that is expected to be traded through the STTM and the number of participants[5] that are expected to use the STTM.[6]

Depending on the nature of the costs that AEMO incurs in operating the STTM, the market participation fees may either fall or remain unchanged if JGN is required to procure UAG through the STTM. For example:

---

[3] JGN, 2015-20 Access Arrangement Information (AAI) - Appendix 7.5 UAG methodology and justification, p. 5.

[4] These fees include an activity fee ($/GJ withdrawn) and a fixed fee ($/day per hub per ABN).

[5] Measured on an ABN basis.

[6] AEMO, STTM Gas Final Budget and Fees: 2014-2015, May 2014.

(a) if the costs of operating the STTM are totally fixed[7] then market participation fees will **fall** because the fixed costs will be spread across a greater volume of gas;

(b) if AEMO incurs both fixed and variable costs when operating the STTM then market participation fees will **fall**, but to a lesser extent than what would occur if the costs were completely fixed because the additional volumes of gas traded through the STTM would give rise to higher variable costs; and

(c) if the costs of operating the STTM are totally variable (i.e. they move directly in line with changes in the volume of gas traded through the STTM) then market participation fees will be **unchanged**.

Irrespective of what happens to the fees payable by other STTM users, if JGN is required to procure UAG through the STTM then any market participation fees it incurs will be included in its network tariffs and passed directly through to network users operating in the Sydney STTM hub, which are all STTM users. The implications that this will have for the overall price that STTM users have to pay for gas are set out in Table 1.

As the final row of Table 1 reveals, if the costs of operating the STTM are completely fixed and the other costs and risks associated with operating in the STTM are ignored, then other STTM users would be **no better off** if JGN was required to procure UAG through the STTM, because any reduction in market participation fees would be completely offset by an increase in JGN's network tariffs.

If, on the other hand, AEMO incurs some variable costs in operating the STTM then other STTM users would be **worse off** because the inclusion of the UAG volumes in the STTM would give rise to higher STTM operating costs, which AEMO would recover from JGN through market participation fees and JGN would then recover from network users (STTM users) through network tariffs. This point can be seen more clearly in the following example, which assumes the fixed costs of operating the STTM are $2 million p.a., variable costs are $0.05 per GJ and the volume of gas traded through the STTM is 100 PJ without UAG and 102 PJ with UAG. In this example, the costs to be recovered from STTM users through market participation fees would be:

- $7 million if JGN was *not* required to procure its gas through the STTM; and
- $7.1 million if JGN was required to procure its gas through the STTM.

The additional $0.1 million in this example would, in the first instance, be recovered by AEMO through JGN's market participation fees. JGN would then pass the fees through to network users (STTM users) in its network tariffs. The overall cost to STTM users (i.e. market participation fees plus network tariffs), would therefore be $0.1 million higher in this example if JGN was required to procure UAG through the STTM than what it would be if JGN could use the matched allocation process.

---

[7] The term 'fixed costs' is used in this context to refer to costs that don't vary with the volume of gas traded through the STTM.

Table 1: Impact of requiring JGN to procure UAG through the STTM on market participation fees, network tariffs and the price paid for gas

<table>
<tr><th>STTM operating costs</th><th>100% fixed costs</th><th>Mix of fixed and variable costs</th><th>100% variable costs</th></tr>
<tr><td>Effect on AEMO’s STTM operating costs</td><td>The costs of operating the STTM would be unchanged if JGN was required to procure UAG through the STTM.</td><td>The variable costs of operating the STTM would increase but the fixed costs would be unchanged if JGN was required to procure UAG through the STTM.</td><td>The costs of operating the STTM would increase in line with the additional volumes of UAG that would have to be procured through the STTM.</td></tr>
<tr><td>Effect on market participation fees</td><td>Market participation fees would fall because the fixed operating costs would be spread across a greater volume of gas.</td><td>Market participation fees would fall, but to a lesser extent than if AEMO’s costs were completely fixed, because while the fixed costs would be spread across a greater volume of gas AEMO’s variable costs would increase.</td><td>Market participation fees would be unchanged because the higher variable costs would be spread across a greater volume of gas.</td></tr>
<tr><td rowspan="2">Effect on network tariffs</td><td colspan="3">The market participation fees payable by JGN would be passed directly through to network users in the form of higher network tariffs.</td></tr>
<tr><td>The increase in network tariffs would completely offset the fall in market participation fees.</td><td>The increase in network tariffs (which would reflect JGN’s share of both the fixed and variable costs of operating the STTM) would exceed the fall in the fixed cost component of the market participation fees.</td><td>Network tariffs would increase to reflect JGN’s share of the variable costs of operating the STTM, but in this case there would be no reduction in market participation fees to offset some of the increase in higher network tariffs.</td></tr>
<tr><td>Net effect on STTM users (Δ in market participation fees + Δ in network tariffs)</td><td>The overall cost to STTM users would be no different to what it would be if JGN was able to continue to use the matched allocation process.</td><td colspan="2">The overall cost to STTM users would be higher than what it would be if JGN was able to continue to use the matched allocation process.</td></tr>
</table>

While it is difficult to know what the precise composition of AEMO's cost base is, it would be reasonable to expect it to consist of a mix of both fixed and variable costs. On that basis, STTM users can be expected to be worse off if JGN is required to procure UAG through the STTM.

The implications that this will have for end-users of gas, will depend on whether the STTM user is:

- An end-user (e.g. large industrial customers) – In this case the costs will be borne directly by the end-user.
- A retailer – In this case the decision to pass the higher costs onto end-users will rest with the retailer. However, given that all retailers operating in the Sydney STTM hub will face higher network tariffs, it is reasonable to expect that they will all pass these costs directly through to end-users. Further support for this view can be found in the fact that:
  - the Independent Pricing and Regulatory Tribunal (IPART) allows changes in network tariffs to be automatically passed through to the Standard Retailer's[8] standing offers to small gas customers;[9] and
  - in the NSW gas retail market, the standing offer typically acts as the reference point for other market offers to small gas customers.[10]

  Any increase in network tariffs can therefore be expected to flow directly through to the Standard Retailer's standing offer and other retailers' market offers.

Summary

As the preceding discussion highlights, end-users located in the Sydney hub would be **worse off** if JGN was no longer able to use the matched allocation process and had to procure UAG through the STTM because:

- any improvement in the efficiency of the price discovery mechanism would be more than offset by the additional costs and risks JGN would face when procuring gas in the STTM, which would be passed on to network users through network tariffs; and
- any reduction in the fixed cost component of the STTM market participation fees would be more than offset by an increase in network tariffs because:
  - the variable costs of operating the Sydney STTM will increase; and
  - any market participation fees that JGN incurs will be passed directly through to network users through network tariffs.

These observations reinforce the conclusion that JGN reached in its rule change proposal, which is that allowing it to continue to use the matched allocation process will ensure that customers continue to benefit from the least cost procurement option.

---

8 The Standard Retailer in the Sydney STTM hub region is AGL.

9 IPART, Changes in regulated retail gas prices from 1 July 2014, p. 23.

10 AEMC, Final Report – Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, 3 October 2013, p. 25.

Question 3: Would a permanent rule act as a barrier to the harmonisation of UAG arrangements?

The final question that the AEMC has asked is whether making the matched allocation process a permanent rule would act as a barrier to harmonising UAG arrangements across retail markets and, if so, whether a five year extension of the transitional rules to 30 June 2020 would be more appropriate? One example that the AEMC has cited in this context is Australian Gas Networks Limited's (**AGNL**) proposal to bring the UAG arrangements in South Australia and Queensland into line with the arrangements in Victoria, but it is possible there may be other proposals to harmonise these arrangements in the future.

JGN's view on whether a permanent rule would act as a barrier to harmonisation is set out below, along with its understanding of AGNL's current harmonisation proposal.

AGNL's harmonisation proposal

JGN is aware that the Gas Retail Consultative Forum (**GRCF**) is currently considering a proposal by AGNL to bring the UAG arrangements in Queensland and South Australia into line with the arrangements that are currently in place in Victoria. In simple terms, this proposal would require:

(i) the responsibility for supplying UAG in the South Australian and Queensland retail markets to be transferred from the distribution networks to retailers;

(ii) a regulatory benchmark for UAG to be established for the South Australian and Queensland gas distribution networks;

(iii) an incentive regime to be implemented, which rewards (penalises) the distribution network if actual UAG volumes are lower (higher) than the benchmark; and

(iv) a large number of changes to be made to the South Australian and Queensland Retail Market Procedures (RMP) and the distribution networks' access arrangements to give effect to (i)-(iii).

While AGNL's proposal was submitted to the GRCF in mid-2014, the costs and benefits of implementing the proposed arrangements are yet to be quantified. AEMO is also yet to consider whether the proposed amendments to the RMP would satisfy rule 135EB(1) of the NGR. It is unclear therefore at this stage whether AGNL's proposal will be implemented and, if so, when it will be implemented.

Will the proposed rule impede harmonisation in the NSW/ACT retail market?

If AGNL's proposal (or any other harmonisation proposal) is implemented in South Australia and Queensland, then it is *possible* that there may be a push to implement the arrangements in the NSW/ACT retail market even though this market was not identified in AGNL's proposal. Before this could occur, AEMO would be required by rule 135EB(1) of the NGR to satisfy itself that making the necessary amendments to the NSW/ACT Retail Market Procedures (**RMP**) jurisdictions is: [11]

- consistent with the National Gas Law and the NGR; and

[11] Rule 135EB(1) of the NGR.

- appropriate having regard to the NGO, the compliance costs that are likely to be incurred by AEMO and market participants and any principles in the NGR applicable to the procedures.

Given the framework established by rule 135EB(1), the only way in which JGN's proposed rule could really impede the harmonisation of UAG arrangements in the manner proposed by AGNL (or any other potential harmonisation proposal) is if it:[12]

- prevented (either explicitly or implicitly) any other parties from procuring UAG or imposed an obligation on JGN to procure UAG;
- precluded a regulatory benchmark for UAG being set or a UAG incentive regime being implemented;
- prohibited any changes being made to the way in which UAG is dealt with in the NSW/ACT RMP; and/or
- mandated the use of the matched allocation process for UAG purchases.

As the AEMC will be aware, the proposed rule simply puts in place a process that allows (but does not require) JGN to use the matched allocation process for gas that it purchases to meet the operational requirements of the distribution system at the Sydney STTM hub. Importantly, the proposed rule does **not** impose any obligation on JGN to procure UAG,[13] so if a decision was made to transfer this responsibility to retailers then the proposed rule would not prevent this from occurring. Nor would the proposed rule prevent a regulatory benchmark or UAG incentive regime from being implemented, or otherwise prevent changes being made to the UAG arrangements in the NSW/ACT RMP. The other important point to note about the proposed rule is that the matched allocation process can only be used by JGN, so if retailers were to become responsible for acquiring UAG then the gas would have to be traded through the STTM as would be the case in other jurisdictions.

While JGN is satisfied that its proposed rule change will **not** act as a barrier to harmonisation, it would be happy to discuss this further if the AEMC has any specific concerns about the way in which the proposed rule is drafted.

Should a permanent rule be made or the transitional rules extended by 5 years?

For the reasons set out below, JGN is of the view that the matched allocation process should be given effect through a permanent rule rather than through a five year extension of the transitional rules:

(i) It is unclear at this stage whether harmonisation will occur and, if it does occur, what jurisdictions will be harmonised and when harmonisation will occur.

(ii) JGN's proposed rule will *not* prevent harmonisation from occurring in the NSW/ACT retail market if, following relevant consultations with market participants as provided

---

[12] If any of these conditions was met then harmonising the UAG arrangements in the manner proposed by AGNL could be considered inconsistent with the NGR (contrary to rule 135EB(1)(a)), and could therefore act as a barrier to harmonisation.

[13] This obligation is instead given effect through JGN's Access Arrangement (**AA**). While AEMO is required by rule 135EB(2) to have regard to any applicable AA, it is allowed under rule 135EB(3) of the NGR to make retail market procedures that are inconsistent with an applicable AA. The fact that this obligation is sitting in JGN's AA will not therefore impede harmonisation.

for under Part 15B of the NGR, AEMO considers it appropriate having regard to the NGO and the other matters it is required to consider under rule 135EB of the NGR.

(iii) If harmonisation does not occur within the five year extension period then JGN will have to submit another rule change request towards the end of that period, which will impose additional costs on JGN, the AEMC and other stakeholders.

The importance of the latter of these points cannot be understated, because the costs and time involved in preparing and assessing rule change requests are not inconsequential. JGN would therefore expect the AEMC to carefully consider this impost if, notwithstanding the fact that the proposed rule will not prevent harmonisation occurring, the AEMC is minded to just extend the transitional rules by five years.

Concluding remarks

As noted in the original rule change request, JGN's decision to submit this rule change is *not* being driven by the prospect of financial gain, because irrespective of the procurement option that is used, the costs will be passed directly on to customers. Nor is it being driven by a desire to try and circumvent any attempt to harmonise the UAG arrangements. JGN's decision to submit the rule change is instead simply being driven by its desire for its customers to continue to benefit from the least cost (and lowest risk) procurement option for operational gas, consistent with the NGO.

If you wish to discuss any aspect of this submission, please contact Alex McPherson on (02) 9455 1504 or at alex.mcpherson@jemena.com.au.

Yours sincerely

Robert McMillan

General Manager Regulation

Jemena Limited