



RULE CHANGE

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Gas Amendment (Various Hedging Instruments in the Declared Wholesale Gas Market) Rule 2011

Rule Proponent

Australian Energy Market Operator

Commissioners

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2 June 2011

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About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. The AEMC has two principal functions. We make and amend the national electricity and gas rules, and we conduct independent reviews of the energy markets for the MCE.

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Summary of draft Rule determination

The Commission has made this draft Rule determination for the Various Hedging Instruments in the Declared Wholesale Gas Market Rule Change Request (Rule Change Request). This Rule Change Request was submitted by the Australian Energy Market Operator (AEMO) on 18 November 2010.

In this Rule Change Request, AEMO seeks to enable participants in the Declared Wholesale Gas Market (DWGM) to use their market hedging instruments more effectively and therefore more efficiently manage their trading risks. AEMO states that this should lead to a decrease in their costs to the benefit of gas consumers.

Commission's decision

The Commission has decided to make a draft Rule reflecting AEMO's proposed Rule.

Reasons for the Commission's decision

The Commission decided to make a draft Rule reflecting AEMO's proposed Rule as it considered that the proposal was likely to contribute to the achievement of the National Gas Objective (NGO). In particular, the Commission considered that the proposal was likely to lead to price benefits as:

- it would enhance the ability of DWGM participants (MPs) holding authorised MDQ and AMDQ credits (collectively called AMDQ) to manage their financial risks, potentially lowering their risk management costs and ultimately leading to lower costs for end-use consumers. This is because it would provide these participants with greater scope to manage their imbalance and congestion uplift charges by:
 - increasing the flexibility with which they can use their AMDQ;
 - allowing them to better optimise the use of their Authorised Maximum Interval Quantity (AMIQ) profiles; and
 - increasing the flexibility with which they can offer Agency Injection Hedge Nominations (AIHNS) to other participants.
- it may enhance competition among MPs holding AMDQ to inject gas into the DWGM, potentially leading to more efficient operation for MPs, reduced wholesale prices in the DWGM and ultimately lower costs for end-use consumers.

Invitation for public submissions

The Commission invites public submissions on this draft Rule determination by Thursday 14 July 2011. See section 1.6 for details on how to make a submission and how to request a public hearing on this draft Rule determination.

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1 AEMO's Rule Change Request

1.1 The Rule Change Request

On 18 November 2010, AEMO (Rule Proponent) made a request to the Australian Energy Market Commission (Commission) to make a Rule regarding market hedging instruments in the DWGM.

1.2 Rationale for Rule Change Request

In this Rule Change Request the Rule Proponent raised the following issues that it seeks to resolve:

- MPs are unable to reallocate their AMDQ amongst System Injection Points (SIPs) at Close Proximity Injection Points (CPPs) within a gas day. This presents financial risks to MPs if a SIP fails and they are unable to inject gas into the DWGM;
- the need for MPs to make Injection Hedge Nominations (IHNs) and AIHNs to SIPs rather than collectively to CPPs has led to MPs overnominating IHNs and has reduced their ability to offer AIHNs to other MPs;
- MPs are unable to optimise the use of their daily uplift AMIQ hedge against congestion charges as they are unable to modify their AMIQ profile within the gas day; and
- the definition of CPPs¹ should be amended as it is not possible for any collection of SIPs to meet the existing definition. In particular, it is not possible for a collection of SIPs to be regarded as a single SIP for the purposes of scheduling as physical flow constraints, which affect scheduling, differ between SIPs.

1.3 Solution proposed in the Rule Change Request

The Rule Proponent proposes to resolve the issues discussed above by making a Rule amending the National Gas Rules (NGR or Rules) seeking to:

- permit MPs to update their nominations of AMDQ at SIPs during the gas day, including renominating AMDQ between SIPs that are CPPs. However, AMDQ could only be renominated away from a SIP to the extent that gas injections had not been scheduled at that SIP;²

¹ Rule 200 of the National Gas Rules.

² For example, if an MP has nominated more than 10 TJ AMDQ to a SIP for the current gas day and has been scheduled to inject 10 TJ at that SIP to the end of the current scheduling interval, 10 TJ AMDQ must remain nominated to that SIP to the end of the current gas day. In addition, if an MP has nominated less than 10 TJ AMDQ to that SIP for the current gas day but has been scheduled to

- provide for MPs to nominate IHNs and AIHNs collectively to CPPs rather than to individual SIPs;
- allow MPs to update their AMIQ profiles for future scheduling intervals during the gas day;
- allow AEMO to classify a collection of SIPs to be CPPs if those SIPs can be regarded as a single SIP for the purposes of calculating an MP's uplift hedge. This would remove the current additional requirement that a collection of SIPs can only be classified as CPPs if they can also be regarded as a single SIP for the purposes of scheduling; and
- allow MPs to have the option of submitting IHNs, AIHNs and AMIQ profiles to AEMO up to one hour before a gas day starts. Currently MPs have the option of submitting this information to AEMO up to 11:00am on the day that is two days before the day on which a gas day commences.³

1.4 Relevant background

1.4.1 AEMO's ability to submit this Rule Change Request

Under section 295(3)(a) of the National Gas Law (NGL) a request for a Rule regulating a declared wholesale gas market can only be made by AEMO or the Minister of an adoptive jurisdiction. The Rule Change Request is a request to regulate a declared wholesale gas market as it would affect the use of market hedging instruments (AMDQ, AMIQ profiles, IHNs and AIHNs) in the DWGM. The Rule Change Request was made by AEMO, satisfying section 295(3)(a) of the NGL.

1.4.2 Consideration by AEMO's Gas Wholesale Consultative Forum

AEMO's Gas Wholesale Consultative Forum (GWCF) discussed drafts of the Proposed Rule before the Rule Proponent publically consulted on an exposure draft of the Proposed Rule (see section 1.4.3).⁴ The GWCF documents relating to those discussions

inject 10 TJ at that SIP to the end of the current scheduling interval, all of the AMDQ nominated to that SIP must remain nominated to it to the end of the current gas day.

³ See Rule 211. The gas day in the DWGM starts at 6:00am Australian Eastern Standard Time.

⁴ The GWCF is an open AEMO forum consisting of representatives of registered participants, end-user groups, interested members of the public and AEMO representatives. The objective of the GWCF (in part) is to provide effective consultation between AEMO and stakeholders for the development of changes to the National Gas Rules. The functions of the GWCF include: providing feedback to AEMO on proposals made in relation to the DWGM, advising the AEMO board on the development of the DWGM, and formally recording the positions and views of each participant organisation and other interested stakeholders on matters relating to the DWGM. The Terms of Reference of the GWCF are outlined in the AEMO document *Gas Wholesale Consultative Forum - Victoria (GWCF-V) Terms of Reference and Operational Procedure*. See www.aemo.com.au.

and the minutes of the relevant GWCF meetings (and of its predecessor the Gas Market Consultative Committee (GMCC)) are published on AEMO's website.⁵

1.4.3 Public consultation undertaken by AEMO

AEMO consulted with the public on the nature and content of the Rule Change Request before submitting it to the AEMC. This was achieved by AEMO publishing a consultation paper on 19 May 2010 and inviting public submissions.⁶ This paper included an exposure draft of the Rule proposed in the Rule Change Request.

AEMO received no public submissions during its public consultation.

1.5 Commencement of Rule making process

On 24 February 2011, the Commission published a notice under section 303 of the NGL advising of its intention to commence the Rule making process and the first round of consultation in respect of the Rule Change Request. A consultation paper prepared by AEMC staff identifying specific issues or questions for consultation was also published with the Rule Change Request. Submissions on the Rule Change Request closed on 24 March 2011.

The Commission received one submission as part of the first round of consultation. It is available on the AEMC website. A summary of the issues raised in that submission and the Commission's response to those issues is contained in Appendix A.

1.6 Consultation on draft Rule determination

In accordance with the notice published under section 308 of the NGL, the Commission invites submissions on this draft Rule determination, including the draft Rule, by Thursday 14 July 2011.

In accordance with section 310(2) of the NGL, any person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a hearing must be made in writing and must be received no later than Thursday 9 June 2011.

Submissions and requests for a hearing should quote project number "GRC0004" and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

⁵ The relevant GMCC/GWCF meetings were held on 17 February 2009, 17 March 2009, 19 May 2009, 23 June 2009, 18 August 2009, 20 October 2009 and 17 November 2009.

⁶ AEMO, *Consultation: Rule change proposal for AMDQ, IHN & AMIQ nominations and renominations*, 19 May 2010. See www.aemo.com.au.

2 Draft Rule Determination

2.1 Commission's draft determination

In accordance with section 308 of the NGL, this draft Rule determination has been made in relation to the Rule proposed by AEMO. The Commission has determined it should make, with amendments, the Rule proposed by the Rule Proponent (Proposed Rule).⁷

The Commission's reasons for making this draft Rule determination are set out in section 3.1

A draft of the proposed Rule that the Commission proposes to be made (Draft Rule) is attached to and published with this draft Rule determination. The Draft Rule is the same as the Proposed Rule with minor amendments. Its key features are described in section 3.2.

2.2 Commission's considerations

In assessing the Rule Change Request the Commission considered:

- its powers under the NGL to make the Rule;
- the Rule Change Request;
- the public consultation the Rule Proponent conducted on an exposure draft of the Proposed Rule, and the consultation conducted with the GWCF and the GMCC on the substance of the Rule Change Request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;⁸
- submissions received during first round consultation; and
- the ways in which the Proposed Rule will, or is likely to, contribute to the NGO.

2.3 Commission's power to make the Rule

The Commission is satisfied that the Draft Rule falls within the subject matter about which the Commission may make Rules.⁹ The Draft Rule falls within section 74 of the

⁷ Under section 308(4a) of the NGL the draft of the Rule to be made need not be the same as the draft of the proposed Rule to which the notice under section 303 relates.

⁸ Under section 73 of the NGL the AEMC must have regard to any relevant MCE statement of policy principles in making a Rule.

NGL as it relates to AEMO's declared system functions and the operation of a declared wholesale gas market. Further, the Draft Rule falls within the matters set out in schedule 1 to the NGL as it relates to clause 55B because it regulates the operation and administration of a regulated gas market.

2.4 Rule making test

Under section 291(1) of the NGL the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NGO. This is the decision-making framework that the Commission must apply.

The NGO is set out in section 23 of the NGL as follows:

The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

Under section 291(2) of the NGL, for the purposes of section 291(1) of the NGL the AEMC may give such weight to any aspect of the NGO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.¹⁰

For the Rule Change Request, the Commission considers that the relevant aspect of the NGO is efficient operation and use of natural gas services for the long term interests of consumers of natural gas with respect to price.

The Commission is satisfied that the Draft Rule will, or is likely to, contribute to the achievement of the NGO because it is likely to lead to improved operational efficiencies for MPs which may, ultimately, result in price benefits for consumers of natural gas. In particular, the Draft Rule:

- will enhance the ability of MPs holding AMDQ to manage their financial risks, potentially lowering their risk management costs and ultimately leading to lower costs for end-use consumers. This is because it will provide these participants with greater scope to manage their imbalance and congestion uplift charges by:
 - increasing the flexibility with which they can use their AMDQ;
 - allowing them to better optimise the use of their AMIQ profiles;
 - increasing the flexibility with which they can offer AIHNs to other participants.

⁹ The Draft Rule does not apply in Western Australia as the Draft Rule does not fall within the subject matters about which the Commission may make Rules under the Western Australian Application Act (the *National Gas Access (WA) Act 2009*).

¹⁰ For the Commission's consideration of the Rule Change Request, there is no relevant MCE statement of policy principles.

- may enhance competition among MPs holding AMDQ to inject gas into the DWGM, potentially leading to more efficient operation for MPs, reduced wholesale prices in the DWGM and ultimately lower costs for end-use consumers.

See Chapter 3 for further discussion about how the Draft Rule will or is likely to contribute to the achievement of the NGO.

2.5 Other requirements under the NGL

2.5.1 Compatibility of the Draft Rule with the proper performance of AEMO's declared system functions

Under section 295(4) of the NGL the Commission may only make a Rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed Rule is compatible with the proper performance of AEMO's declared system functions.¹¹

The Draft Rule will impact on AEMO's declared system functions of operating and administering the DWGM. This is because MPs would have more flexibility in how they can use AMDQ and AMIQ profiles and it would change the way in which IHNs and AIHNs are nominated.

The Commission considers that the Draft Rule is compatible with the proper performance of AEMO's declared system functions because AEMO would, following changes to its systems to incorporate the amended rules, continue to be able to operate and administer the DWGM.

2.5.2 Section 295(5) of the NGL

Under section 295(5) of the NGL, the AEMC may only make a Rule that affects the allocation of powers, functions and duties between AEMO and a service provider for a declared transmission system¹² if AEMO consents to the making of the Rule or the Rule is requested by the Minister of the relevant adoptive jurisdiction.

In relation to this Rule Change Request, there is no requirement under section 295(5) of the NGL for AEMO to consent to the AEMC making this Draft Rule. This is because the Draft Rule does not affect the allocation of powers, functions and duties between AEMO and a service provider for a declared transmission system. The Draft Rule only impacts the nature and/or timing of the nominations MPs can make to AEMO regarding their AMDQ, AMIQ profiles, IHNs and AIHNs, and it relaxes the definition of CPPs.

¹¹ AEMO's declared system functions are specified in section 91BA of the NGL.

¹² The declared transmission system is the transmission pipeline for the DWGM.

2.6 Participating jurisdictions

Although the Draft Rule applies in each participating jurisdiction except Western Australia,¹³ it amends Part 19 of the Rules which currently only relates to the operation of the wholesale gas market, transmission system and distribution systems in Victoria (as declared under the *National Gas (Victoria) Act 2008*).

¹³ Under section 21 of the NGL, the participating jurisdictions are the States, the Commonwealth, the Australian Capital Territory and the Northern Territory. The Draft Rule does not apply in Western Australia as it does not fall within the subject matters about which the Commission may make Rules under the Western Australian Application Act.

3 Commission's reasons

The Commission has analysed the Rule Change Request and assessed the issues arising from it. For the reasons set out below, the Commission has determined that a Draft Rule should be made. Its analysis of the Proposed Rule is also set out in this chapter.

3.1 Assessment of issues

In submitting the Rule Change Request, AEMO sought to:

- reduce the stranding of AMDQ at a SIP that is also a CPP when that SIP becomes unavailable for injections;
- allow MPs to better optimise the use of their AMIQ hedges against congestion uplift charges; and
- enhance the opportunity for MPs to trade uplift hedges by offering AIHNs.

AEMO submitted that the proposed changes would enable MPs to more efficiently manage their trading risks, potentially decreasing their market transaction costs to the benefit of gas consumers.

After analysing the issues arising from the Rule Change Request and considering submissions on the Rule Change Request, the Commission is satisfied that the Proposed Rule will or is likely to contribute to the achievement of the NGO as it is likely to result in price benefits.

The current arrangements in the DWGM relevant to this Rule Change Request and the issues considered by the Commission in making this draft Rule determination are set out below.

3.1.1 Current arrangements

Authorised MDQ and AMDQ credits

AMDQ are instruments conferring limited rights on parties that inject and/or withdraw gas from or into the DWGM. These rights are allocated to MPs at injection and withdrawal points on the declared transmission system.

AMDQ units are tradable to some extent and provide their holders with benefits:

- their holders receive priority in having their injection and withdrawal bids scheduled in the event of there being 'equally-beneficial' bids if the AMDQ has been nominated to the relevant injection or withdrawal points;
- they can be used to generate AMIQ to act as an uplift hedge against congestion uplift charges; and

- their holders are entitled to preferential curtailment treatment.

Most of the existing authorised MDQ for withdrawals totalling 990 TJ was allocated to customers or their retailers for the 1999 start of the Victorian wholesale gas market. AMDQ credits have been created since market start following the build of new transmission pipeline or expansions of transmission pipeline capacity.

Injection hedge nominations and agency injection hedge nominations

MPs holding AMDQ can generate AMIQ on a daily basis to hedge against congestion uplift charges. To do this, they must submit IHNs for each SIP to AEMO before the start of a gas day. They must then be scheduled to inject gas at those SIPs.

An MP's daily scheduled injections at a SIP, capped at its IHN at that SIP, will be allocated towards its AMIQ. The collective contribution of an MP's scheduled injections from a group of SIPs that are CPPs will then be capped at the MP's AMDQ held collectively at those CPPs. Currently, IHNs cannot be renominated during a gas day.

MPs can also allocate their scheduled injections at a SIP to another MP's AMIQ by making an AIHN to AEMO. An MP's scheduled injections at a SIP will be allocated firstly to its IHN before being allocated to any AIHNs.

The Rules provide for MPs to nominate IHNs and AIHNs to AEMO before 11:00am on the day that is two days before the day on which a gas day commences. MPs can update their IHNs and AIHNs up to 5:00am on the day on which a gas day commences.

AMIQ profiles

To use its AMIQ to hedge against congestion uplift charges, MPs must nominate an AMIQ profile to AEMO before the start of each gas day. This profile consists of five percentages summing to 100 per cent which AEMO uses to allocate the MP's AMIQ over the gas day's five scheduling intervals.

The Rules provide for MPs to nominate an AMIQ profile to AEMO before 11:00am on the day that is two days before the day on which a gas day commences. MPs can update their AMIQ profiles up to 5:00am on the day on which a gas day commences. Currently, an MP's AMIQ profile cannot be renominated during a gas day.

Ancillary payments and uplift charges

The Rules lay out a framework for ancillary payments and uplift charges, providing for AEMO to make procedures determining the precise allocation of these payments and charges. The core elements of the framework relating to uplift charges are described below.

The Rules

Rule 240 requires AEMO to make uplift payment procedures governing the way in which the following matters are determined:

- an estimate of the portion of any ancillary payments in respect of a gas day attributable to daily and within-day transmission constraints;
- an estimate of the total size of the daily and within-day transmission constraints (if any) giving rise to ancillary payments; and
- the uplift payments payable by or to each MP and declared transmission system service provider.

Under rule 240(2), in making the uplift payment procedures AEMO must, among other things, apply the principles that:

- uplift charges are to be allocated so far as practicable to the cause; and
- AEMO must take into account the extent to which an MP's AMIQ is exceeded by the sum of its forecast demand and scheduled withdrawals when allocating uplift charges relating to daily transmission constraints.

AEMO procedures

Version 2.0 of the *Wholesale Market Uplift Payment Procedures (Victoria)*, which came into effect 15 January 2011, are the uplift payment procedures made by AEMO under rule 240. These procedures specify, among other things, that there are three categories of uplift charges: congestion uplift, surprise uplift and common uplift.¹⁴ They are allocated as follows:¹⁵

- Congestion uplift charges are allocated to:
 - MPs, where the sum of their scheduled controllable withdrawals and forecast demand in a scheduling interval exceeds their AMIQ allocated to that scheduling interval; and
 - the service provider for a declared transmission system if the service provider fails to provide the agreed system capacity under its service envelope agreement with AEMO;
- Surprise uplift charges are allocated to MPs which do not inject or withdraw gas in accordance with their scheduled injections or withdrawals in the previous schedule, or where their demand forecasts or scheduled controllable withdrawals increase or decrease between the current and previous schedules; and

¹⁴ The uplift payment procedures also anticipate that there can be uplift payments to MPs as well as uplift charges on MPs.

¹⁵ AEMO, *Wholesale Market Uplift Payment Procedures (Victoria)*, pp. 2-3.

- Common uplift charges are allocated to all MPs withdrawing gas:
 - where AEMO overrides and increases the total demand forecasts from all MPs but the actual uncontrollable demand is less;
 - where the service envelope agreement with AEMO limits the extent to which the service provider for a declared transmission system can be charged uplift charges; or
 - where uplift payments are payable but there is no basis for categorising them as congestion uplift or surprise payments.

Close Proximity Injection Points

Currently, rule 200 provides for AEMO to be able to classify a collection of SIPs as CPPs if AEMO considers they can be regarded as the same SIP for the purpose of scheduling and for determining AMIQ under rule 240.

3.1.2 AEMO's Proposed Rule

In relation to the current arrangements set out above, AEMO proposes a Rule that seeks to:

- permit MPs to update their nominations of AMDQ at SIPs during the gas day, including renominating AMDQ between SIPs that are CPPs. However, an MP would only be permitted to renominate AMDQ away from a SIP to the extent that it had not been scheduled to inject gas at that SIP;
- provide for MPs to nominate IHNs and AIHNs collectively to CPPs rather than to individual SIPs;
- permit MPs to update their AMIQ profiles for future scheduling intervals within the gas day;
- allow AEMO to classify a collection of SIPs to be CPPs if those SIPs can be regarded as a single SIP for the purposes of calculating an MP's uplift hedge; and
- provide for MPs to have the option of submitting IHNs, AIHNs and AMIQ profiles to AEMO up to one hour before a gas day starts.

3.1.3 Impact and assessment of Proposed Rule

This section summarises the Commission's assessment of the impact of the Proposed Rule. These matters are discussed in more detail in Chapters 5-7.

Impact on risk management

The Commission considers that the Proposed Rule is likely to allow MPs to use their hedging instruments more effectively. This may improve MPs' ability to manage the financial risks of operating in the DWGM. This is because:

- allowing MPs to renominate unused AMDQ between SIPs that are CPPs is likely to enhance their ability to manage imbalance and congestion charges;
- providing for MPs to nominate IHNs and AIHNs collectively to CPPs rather than to individual SIPs is likely to reduce the incentives on them to overnominate IHNs and thereby increase their potential likelihood of offering AIHNs;
- allowing MPs to update their AMIQ profiles during a gas day is likely to improve their ability to hedge against congestion uplift payments;
- changing the definition of CPPs is likely to allow AEMO to define new CPPs, allowing MPs to nominate IHNs and AIHNs to those CPPs and improving the likelihood of those MPs offering AIHNs; and
- providing greater flexibility to MPs in the timeframes for submitting IHNs, AIHNs and AMIQ profiles to AEMO may enhance their ability to manage risk.

These impacts may reduce the costs to MPs of managing their financial risks in the DWGM, improving their operational efficiency and ultimately benefitting end-use consumers through reduced prices.

Impact on competition

The Commission considers that the Proposed Rule may promote competition among MPs to inject gas into the DWGM. This is because it would allow MPs to renominate unused AMDQ between SIPs that are CPPs. This would likely improve their opportunities to be scheduled to inject gas, relative to the existing arrangements.

Enhanced competition to inject gas into the DWGM at a SIP has the potential to lead to reduced imbalance prices and, in the long term, ultimately lower prices for end-use consumers.

Impact on ancillary costs and uplift charges

The Commission considers that allowing MPs to renominate their AMIQ profiles during a gas day may, in principle, provide them with greater scope to avoid uplift charges arising from ancillary payments that are generated by their actions. In turn, this may impact the incentives on MPs to minimise their actions generating ancillary payments.

The Commission notes that AEMO may review the *Wholesale Market Uplift Payment Procedures (Victoria)* if the AEMC makes a final Rule reflecting the Draft Rule to ensure

the procedures are consistent with the Rules. The Commission notes the rules principle to be followed in making the procedures that uplift charges are to be allocated so far as practicable to the cause.¹⁶

3.1.4 Commission's conclusion

On balance, the Commission is satisfied that the Proposed Rule will, or is likely to, contribute to the achievement of the NGO. This is because it is likely to lead to improved operational efficiency for MPs, which may, ultimately, result in price benefits for consumers of natural gas.

3.2 The Draft Rule

The Draft Rule implements the proposal set out in the Rule Change Request with minor changes. These changes are:

- the Draft Rule deletes rule 211(1)(b) and does not renumber rule 211(1)(a)(i)-(ii). This is because existing rule 211(1)(a) is a conduct provision; and
- minor drafting changes for purposes of clarification.

3.3 Civil penalties

The Draft Rule amends rules 200 and 211, neither of which are classified as civil penalties. The Commission will not recommend to the Victorian Minister that these Rules be prescribed as civil penalties. This is because it would be disproportionate for civil penalties to apply in respect of breaches of these rules.

3.4 Conduct provisions

Conduct provisions are rules or provisions of the NGL for which any person (including the Australian Energy Regulator (AER)) may institute civil proceedings in respect of a breach.¹⁷ A person (other than the AER) who suffers loss or damage by conduct of another person in breach of a conduct provision may recover their loss or damage by action against the other person in a court.¹⁸

The Draft Rule amends rules 200 and 211. Rules 211(1)(a) and 211(2) are conduct provisions.¹⁹ The Commission will not recommend to the Victorian Minister that any further rules be prescribed as conduct provisions. This is because it would be disproportionate for conduct provisions to apply in respect of breaches of those rules.

¹⁶ Rule 240(2)(a).

¹⁷ Under section 229(3) of the NGL.

¹⁸ Under section 233 of the NGL.

¹⁹ The conduct provisions are prescribed in the *National Gas (Victoria) (Declared System Provisions) Regulations 2009* and the *National Gas (South Australia) Regulations*.

4 Commission's assessment approach

This chapter describes the Commission's approach to assessing the Rule Change Request in accordance with the requirements set out in the NGL (and explained in Chapter 2).

In assessing any Rule Change Request against the NGL criteria, the first step is to consider the counterfactual arrangements against which the Rule change is being compared. In the present case the counterfactual arrangements are as laid out in Chapter 3.

In assessing this Rule Change Request, the Commission has considered the likely impact of the proposal:

- on the ability of MPs to manage their financial risks in the DWGM;
- on the level of competition amongst MPs to inject gas into the DWGM; and
- on the allocation of uplift charges among MPs and the total level of ancillary payments in the DWGM.

The Commission has focused on this set of issues because:

- the Rule Proponent claimed that the Proposed Rule would enable MPs to utilise their market hedging instruments more effectively and therefore more efficiently manage their trading risks;
- it considers the Proposed Rule could enhance competition amongst MPs to inject gas into the DWGM; and
- it considers the Proposed Rule could impact on the allocation of uplift charges to the parties whose actions generated the relevant ancillary payments. Furthermore, it could impact on the total level of ancillary payments in the DWGM.

The Commission has also:

- reviewed the public consultation the Rule Proponent conducted on an exposure draft of the Proposed Rule and the development of the Proposed Rule through the GWCF; and
- held bilateral discussions with AEMO (as Rule Proponent and DWGM operator) to clarify the Rule Change Request.

5 Risk management

Participants in the DWGM face financial risks. These include imbalance charges from being scheduled to withdraw more gas than they inject, deviation charges from not complying with the injection and withdrawal schedules, and uplift charges to cover the costs of ancillary payments. These financial risks may be heightened by any failure of the supply of gas to a SIP and a failure to be scheduled to inject gas.

Participants may seek to manage these risks by using hedging instruments. The DWGM's instruments include AMDQ, AMIQ profiles, IHNs and AIHNs. Reducing the costs to MPs of managing their financial risks in the DWGM would reduce their costs to operate in the market. These cost reductions may, through competitive processes, ultimately lead to price benefits for end-use consumers.

5.1 Rule Proponent's view

The Rule Proponent has stated that:

- The inability of MPs to renominate AMDQ between SIPs during a gas day increases their risks if supply to a SIP fails.²⁰ Allowing participants to renominate unused AMDQ between SIPs that are CPPs during the gas day would enable them to mitigate the risks of imbalance payments and exposure to congestion costs.²¹
- Applying IHNs collectively to CPPs rather than to SIPs would remove the need for DWGM participants to overnominate IHNs, enabling trade of AIHNs between participants.²²
- MPs are currently prevented from optimising the use of their uplift hedge against congestion charges if they become aware of a change in their forecast demand profile as their AMIQ profiles cannot be changed during the gas day.²³ Allowing MPs to renominate their AMIQ profiles would better allow them to optimise the use of their uplift hedge.

5.2 Stakeholder views

Origin Energy has stated that the Rule Change Request could allow MPs to better mitigate the risk of imbalance and uplift payments as it would provide them with greater flexibility to optimise their scheduled injections and uplift hedge.²⁴

²⁰ AEMO, Rule Change Request, p. 5.

²¹ AEMO, Rule Change Request, p. 6.

²² AEMO, Rule Change Request, p. 6.

²³ AEMO, Rule Change Request, p. 7.

²⁴ Origin Energy submission, 24 March 2011, p. 1.

5.3 Commission's analysis

The Commission considers that there are five aspects of the Rule Change Request which may impact the ability of MPs to manage their financial risks arising from operating in the DWGM. These are:

- allowing MPs to renominate unused AMDQ between SIPs that are CPPs during the gas day;
- providing for injection hedge nominations and agency injection hedge nominations to apply collectively to CPPs instead of to individual SIPs;
- allowing MPs to renominate AMIQ profiles during the gas day;
- redefining CPPs; and
- providing more flexibility to MPs in the timing of their submission of nominations relating to scheduling and hedging to AEMO.

The Commission's assessment of the impacts of each of these is discussed below.

5.3.1 Renominating AMDQ between SIPs

Current arrangements

Under the current arrangements, MPs do not directly nominate AMDQ to SIPs at CPPs. Instead, they nominate injection hedges to each SIP and their AMDQ held at the CPP level is then allocated to SIPs according to the MP's relative injection hedges. Participants are effectively unable to renominate AMDQ between SIPs during the gas day as they are unable to renominate injection hedges to SIPs during the gas day.

An MP may seek to optimise its nomination of AMDQ to SIPs over an entire gas day as it is unable to renominate AMDQ between SIPs during the gas day. This may include allocating AMDQ to a range of SIPs to manage the risk of being unable to inject at a particular SIP.

Analysis

The Commission considers that allowing MPs to renominate unused AMDQ between SIPs that are CPPs during the gas day is likely to have the following impacts:

- for MPs that do not nominate AMDQ to a SIP under the current arrangements, it would provide opportunities for them to renominate AMDQ to that SIP during a gas day and potentially be prioritised in the scheduling of injections at that SIP;
- for MPs nominating AMDQ to a SIP under the current arrangements, it would allow them to renominate greater or lesser quantities of AMDQ at that SIP during the gas day.

In the first case, the MP renominating AMDQ to the SIP will gain the potential to have tie-breaking rights in the scheduling of injection bids at that SIP that they would not otherwise have. In the second case, the MP may have greater or lesser amounts of gas scheduled for injection at that SIP.

These impacts are likely to incrementally enhance the ability of those MPs to manage their imbalance and congestion uplift charges. This is because they would have greater certainty about their scheduled gas injections into the DWGM.

In the next subsection we discuss the proposed restriction for renominations of AMDQ between SIPs to unused AMDQ.

Retaining used AMDQ at SIPs

AEMO proposes that MPs be allowed to only renominate unused AMDQ between SIPs.²⁵ This means that an MP could renominate AMDQ away from a SIP only to the extent that it had not been scheduled to inject gas at that SIP for the current and preceding scheduling intervals in the current gas day.²⁶ Any AMDQ stranded at a SIP would continue to provide the relevant MP with tie-breaking rights for injection bids at that SIP for the remainder of the gas day.

The Commission observes that, in the context of tie-breaking, there is currently no concept in the Rules of AMDQ being used. In particular, AMDQ nominated to a SIP provides tie-breaking rights regardless of the quantity of gas the MP has been scheduled to inject or has actually injected.²⁷ AEMO's proposal would introduce the concept of AMDQ being used in the context of renominating AMDQ between SIPs but not more broadly.

The rights associated with holding AMDQ are one element of the investment regime for the declared transmission system. The Commission notes that the AEMO GWCF is currently considering transmission capacity issues in the declared transmission system.²⁸ It is appropriate for questions about the rights associated with holding AMDQ to be considered as part of a holistic review of the regime for efficient investment in transmission capacity.

²⁵ AEMO, Rule Change Request, p. 6.

²⁶ For example, an MP that had nominated 20 TJ AMDQ to a SIP for the current gas day could only renominate 15 TJ AMDQ to another SIP if it had already been scheduled to inject 5 TJ of gas in the current and preceding scheduling intervals at that SIP. The 5 TJ AMDQ would have to remain nominated to that SIP until the end of the current gas day.

²⁷ For example, under the current arrangements, an MP nominating 10 TJ AMDQ to a SIP for the current gas day continues holding tie-breaking rights for injection bids at that SIP if the MP has already been scheduled to inject more than 10 TJ at that SIP in the current and previous scheduling intervals of the current gas day.

²⁸ AEMO, *Transmission Capacity Issues in the DWGM*, paper presented to the 24 May 2011 DWGM meeting.

5.3.2 Injection Hedge Nominations and Agency Injection Hedge Nominations

Current arrangements

Under the current arrangements, the level of an MP's injection hedge nomination at a SIP caps the extent to which its scheduled gas injections at that SIP contributes to its uplift hedge for that gas day. MPs are unable to renominate their IHNs during a gas day.

Analysis

The Commission considers that the current arrangements may result in incentives on MPs to overnominate injection hedges at SIPs that are CPPs to mitigate the risk of not obtaining an uplift AMIQ hedge. This risk may be heightened if supply to a SIP fails during a gas day. Any overnomination of IHNs will likely lead to a commensurate reduction in the potential offer and use of AIHNs.

Providing for MPs to nominate IHNs and AIHNs collectively to CPPs, rather than individually to SIPs, is likely to result in MPs having a greater propensity to offer AIHNs. This may increase the options for MPs to obtain uplift hedges and thereby manage the risk of being subject to congestion uplift charges.²⁹ This may improve their ability to manage their risks, and therefore reduce their operating costs. This could, through competitive processes, ultimately lead to price benefits for end-use consumers.

5.3.3 Renominating AMIQ profiles

Current arrangements

As discussed in Chapter 3, MPs can use AMIQ and AMIQ profiles to hedge against congestion uplift charges. MPs can nominate an AMIQ profile before the start of the gas day and cannot renominate it during the gas day.

The Rules lay out a framework for making ancillary payments to, and levying uplift charges on, MPs and declared transmission system service providers. Ancillary payments are made to MPs scheduled to inject or withdraw gas out of merit order³⁰ and uplift charges are levied on MPs and declared transmission system service providers to recover the costs of ancillary payments. The *Wholesale Market Uplift Payment Procedures (Victoria)* specify the precise determination of the uplift charges in the DWGM.

²⁹ The Commission observes that amending the existing arrangements to allow MPs to renominate IHNs and AIHNs at SIPs during the gas day may also lead to the more efficient use of AIHNs, relative to the existing arrangements. However, the Commission considers that providing for IHNs and AIHNs to be nominated collectively to CPPs is likely to result in the more efficient use of AIHNs. This is because it would not require MPs to predict and renominate their IHNs and AIHNs at individual SIPs throughout the gas day.

³⁰ In particular, rule 239(3) provides for constrained-on payments to MPs. Rule 239(6) in effect states that constrained-off payments are not made.

Given this division of matters between the Rules and the procedures, the scope of the Commission's assessment has been restricted to the matters specified in the Rules as discussed below.

The Rules provide for AEMO to make uplift payment procedures governing the determination of uplift payments payable to, or by, each MP and transmission system service provider. The Rules specify the high-level principles that must be applied when AEMO makes the uplift payment procedures:³¹

- uplift payments are to be allocated so far as practicable to the cause;
- AEMO must take into account the extent to which an MP's AMIQ is exceeded by the sum of its forecast demand and scheduled withdrawals in allocating uplift payments arising from events occasioning daily transmission constraints; and
- operational gas is excluded from the allocation of uplift charges.

Assessment

The Rules provide for MPs to use AMIQ to hedge against congestion uplift charges. In terms of the Rules framework, allowing an MP to update its AMIQ profile during a gas day would provide for congestion costs to be allocated to MPs in accordance with their most recent AMIQ profile. This would be likely to allow MPs to better optimise the use of their AMIQ hedge to avoid congestion costs.

This would be expected to incrementally reduce risk management costs for those MPs.

Impact of proposal on matters under AEMO procedures

The Commission has not considered the impact of allowing MPs to renominate their AMIQ profiles on the precise allocation of uplift charges among MPs and declared transmission system service providers in making this draft Rule determination. This is because these charges are determined pursuant to the *Wholesale Market Uplift Payment Procedures (Victoria)* and therefore fall outside the scope of the Commission's assessment.

However, the Commission observes that, in line with the principles in the Rules, allowing MPs to renominate their AMIQ profiles is likely to promote the ability of those MPs to hedge against congestion uplift charges. This is because MPs are only subject to congestion uplift charges to the extent that the sum of their scheduled controllable withdrawals and forecast demand exceeds their AMIQ. The proposal would allow MPs to vary their AMIQ over the gas day to better match their scheduled controllable withdrawals and forecast demand.

³¹ Rule 240.

5.3.4 Definition of close proximity injection points

Current arrangements

Rule 200 defines close proximity injection points to be:

system injection points as determined by AEMO that can be regarded as the same system injection point for the purpose of scheduling under Division 2, Subdivisions 1 and 2 and the determination of AMIQ under rule 240.

Analysis

AEMO proposes to amend the definition of close proximity injection points to be:³²

a group of system injection points that AEMO has determined can be regarded as the same injection point for the purposes of determining AMIQ under rule 240.

In support of this change, AEMO states that SIPs can not be equal from a scheduling perspective as physical flow constraints, response times, ramp rates, and minimum and maximum flow rates in general vary between SIPs.³³

The Commission agrees with AEMO that different SIPs cannot be treated as a single SIP for the purposes of scheduling as different SIPs will, in general, have different constraints associated with the injection of gas.

It also considers that amending the definition of CPPs may enhance the ability of MPs to manage their risks as it may allow AEMO to define new CPPs. Subsequent to the AEMC amending the definition of CPPs, AEMO would likely review its list of CPPs. Under other aspects of this draft Rule determination, this would then allow MPs to nominate IHNs to CPPs, removing the incentive on MPs to overnominate IHNs. This, in turn, would likely increase the chance of MPs offering AIHNs to other MPs.

5.3.5 Timing for submission of data to AEMO

Current arrangements

Under the current arrangements, MPs have the option of submitting IHNs, AIHNs and AMIQ profiles in respect of a gas day by 11:00am on the day that is two days before the start of the relevant gas day.³⁴ Any updates to these nominations must be made to AEMO by whichever of the following is the next to occur:³⁵

- 7:00am on the day before the day on which the gas day commences;
- 5:00am on the day on which the gas day commences.

³² AEMO, Rule Change Request, p. 15.

³³ AEMO, Rule Change Request, pp. 8-9.

³⁴ Rule 211(1).

³⁵ Rule 211(2).

Analysis

AEMO proposes to push back the timeframes for MPs to submit IHNs, AIHNs and AMIQ profiles to it so that they can submit that information by 5:00am on the day on which the gas day commences.

Allowing MPs to submit IHNs, AIHNs and AMIQ profiles to AEMO closer to the start of the gas day would allow MPs to incorporate more up-to-date information about their likely gas demands into their submissions. It may also result in them making fewer updates to their submissions. These changes may incrementally reduce the costs for MPs to use these tools.

5.4 Conclusion

The Commission considers that the Proposed Rule is likely to allow MPs to use their hedging instruments more effectively. This may improve MPs ability to manage financial risks of operating in the DWGM. This is because:

- allowing MPs to renominate unused AMDQ between SIPs that are CPPs is likely to enhance their ability to manage imbalance and congestion charges;
- providing for MPs to nominate IHNs and AIHNs collectively to CPPs rather than to individual SIPs is likely to reduce the incentives on them to overnominate IHNs and thereby increase their potential likelihood of offering AIHNs;
- allowing MPs to update their AMIQ profiles during a gas day is likely to improve their ability to hedge against congestion uplift payments;
- changing the definition of CPPs is likely to allow AEMO to define new CPPs, allowing MPs to nominate IHNs and AIHNs to those CPPs and improving the likelihood of those MPs offering AIHNs; and
- providing greater flexibility to MPs in the timeframes for submitting IHNs, AIHNs and AMIQ profiles to AEMO may enhance their ability to manage risk.

These impacts may reduce the costs to MPs of managing their financial risks in the DWGM, improving their operational efficiency and ultimately benefitting end-use consumers through reduced prices.

6 Competition to inject gas

Market participants compete to inject gas into the DWGM. Increasing the level of competition among MPs to inject gas has the potential to lead to lower wholesale prices and ultimately lower costs for end-use consumers.

6.1 Rule Proponent's view

The Rule Proponent did not address this issue in the Rule Change Request.

6.2 Stakeholder views

Origin Energy did not address this issue in its submission on the Rule Change Request.

6.3 Commission's analysis

The Commission considers that the proposal has the potential to increase competition among MPs to inject gas into the DWGM. This is because MPs would be able to renominate AMDQ between SIPs that are CPPs during a gas day, providing them with greater opportunities to be scheduled to inject gas into the DWGM at that SIP. The reasons for this assessment are below.

Current arrangements

Under the current arrangements, an MP's nomination of AMDQ to a SIP is fixed during a gas day. In relation to that nomination, MPs have tie-breaking rights at that SIP. This means they receive scheduling priority for injection bids at that SIP if there are equally-beneficial injection and/or withdrawal bids in the DWGM:

- MPs nominating AMDQ to a SIP may have their injection bids scheduled in preference to MPs not holding AMDQ at that SIP, even though both MPs bid at the same price to inject gas; and
- multiple MPs nominating AMDQ to a SIP and bidding to each inject gas at the same price will be scheduled to inject quantities of gas proportional to the quantities of AMDQ they nominated to the SIP.

Analysis

Allowing MPs to renominate unused AMDQ between SIPs during the gas day would provide them with greater opportunities to be scheduled to inject gas. This is because MPs currently lose the tie-breaking benefits of AMDQ nominated to a SIP if they are unable to inject at that SIP as AMDQ cannot be renominated away from a SIP.

This greater opportunity for MPs to inject gas at a SIP would likely promote competition to inject at that SIP, which may lead to reduced imbalance prices in the DWGM, everything else being equal.

6.4 Conclusion

The Commission considers that allowing MPs to renominate AMDQ between SIPs that are CPPs is likely to enhance competition among MPs to inject gas into the DWGM. This may result in reduced imbalance prices and ultimately lower costs for end-use consumers.

7 Ancillary payments and uplift charges

MPs scheduled to inject or withdraw gas out of merit order may be compensated by ancillary payments. As discussed previously, the total costs of ancillary payments are recovered from MPs and declared transmission network service providers through uplift charges.

Targeting uplift charges to the parties whose actions generated the relevant ancillary payments may create incentives for those parties to act in a way that reduces the total level of ancillary payments. Decreases in the total level of ancillary payments in the DWGM may ultimately lead to reduced costs to end-use consumers.

7.1 Rule Proponent's view

The Proponent did not address this issue in its Rule Change Request.

7.2 Stakeholder views

Origin Energy did not address this issue in its submission on the Rule Change Request.

7.3 Commission's analysis

7.3.1 Impact on how uplift charges are allocated

Current arrangements

As previously discussed, the Rules provide the framework for MPs and declared transmission system service providers to be levied uplift charges. The quanta of these uplift charges are determined pursuant to the *Wholesale Market Uplift Payment Procedures (Victoria)*. In making these procedures, AEMO is required by the Rules to apply the principles that uplift payments are to be allocated to the cause as far as practicable and that MPs can use AMIQ as a hedge against congestion uplift charges.

Assessment

The Rules include the principle that MPs can use their AMIQ to hedge against congestion uplift charges. This may allow an MP to avoid congestion uplift charges even if its actions generated the relevant ancillary payments.

The Commission considers that, in principle, the proposal may provide greater scope for MPs to avoid uplift charges resulting from ancillary payments generated by their actions. This is because it may allow them to renominate their AMIQ to future scheduling intervals in which their actions will generate ancillary payments. However, no party has raised this risk and it does not appear material.

Impact of proposal on matters under AEMO procedures

While the Commission's assessment of the proposal's impact has been limited to the matters specified in the Rules, it has also considered the proposal's impact on how uplift charges are allocated to MPs and declared transmission system service providers, which is undertaken pursuant to the *Wholesale Market Uplift Payment Procedures (Victoria)*. These observations have not played a role in the Commission's decision to make the draft Rule determination.

Allowing MPs to renominate their AMIQ profiles during a gas day would likely impact the relative levels of congestion, surprise and common uplift charges as:

- an MP will only be exposed to congestion uplift charges to the extent that its total scheduled withdrawals in a scheduling interval exceeds the MP's AMIQ allocated to that scheduling interval; and
- the sum of congestion, surprise and common uplift charges for a scheduling interval equals the total ancillary payments for that scheduling interval.

Allowing an MP to renominate its AMIQ profile could effectively redistribute uplift charges from that MP to other MPs, relative to the existing arrangements. This may weaken how uplift charges are targeted to the parties whose actions generated the relevant ancillary payments.

The Commission notes that AEMO may review the uplift payment procedures if the AEMC makes a final Rule reflecting the Draft Rule. In doing so it notes the rules principle to be followed in making the procedures that uplift charges are to be allocated so far as practicable to the cause.³⁶

7.4 Conclusion

The Commission considers that allowing MPs to renominate AMIQ profiles during the gas day has the potential to impact the allocation of uplift charges to the parties whose actions generated the relevant ancillary payments. This may impact the total level of ancillary payments in the DWGM.

It notes that AEMO may review the *Wholesale Market Uplift Payment Procedures (Victoria)* if the AEMC makes a final Rule reflecting the Draft Rule to ensure the procedures are consistent with the Rules. It further notes the rules principle to be followed in making the procedures that uplift charges are to be allocated so far as practicable to the cause.³⁷

³⁶ Rule 240(2)(a).

³⁷ Rule 240(2)(a).

Abbreviations

AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AIHN	Agency Injection Hedge Nomination
AMDQ	authorised MDQ and AMDQ credits
AMIQ	Authorised Maximum Interval Quantity
Commission	Australian Energy Market Commission
CPP	Close Proximity Injection Point
DWGM	Declared Wholesale Gas Market
GMCC	Gas Market Consultative Committee
GWCF	Gas Wholesale Consultative Forum
IHN	Injection Hedge Nomination
MCE	Ministerial Council on Energy
MP	DWGM participant
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Rule Change Request	Various Hedging Instruments in the Declared Wholesale Gas Market Rule Change Request
Rules	See NGR
SIP	System Injection Point

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC Response
Origin Energy	Supports the Rule Change Request as it would provide market participants with the ability to better manage the risks of imbalance and uplift payments.	The AEMC agrees and has made a Draft Rule reflecting AEMO's Rule Change Request.