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23 August 2012

Ms Caroline Taylor  
Project Leader  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

Dear Ms Taylor

**Response to AEMC questions – AER rule change proposal – Market Operator Service (MOS) and Bulletin Board (BB) pipeline operator cost recovery processes**

Thank you for your email of 16 August 2012 setting out three questions about the AER's rule change proposal on MOS and BB pipeline operator cost recovery processes.

Please find responses to those questions attached to this letter.

This material does not contain any confidential information so I would not object to the AEMC publishing this response if it wishes to do so.

If you have any further queries on these matters or on the rule change proposal more generally please do not hesitate to contact me on 03 9290 1890 or Adrian Russell on 02 6243 1032.

Yours sincerely



Tom Leuner  
General Manager  
AER Markets Branch

## **Response to AEMC questions on the MOS and BB pipeline operator cost recovery processes rule change request**

*Q1. Can you provide additional information on the AER's process leading up to providing advice to AEMO during the 2010-11 assessment of invoices for MOS allocation service costs? For example:*

- a) In seeking your advice, what information did AEMO provide to you? In particular, what was the nature of evidence provided by pipeline operators to AEMO under rule 424(5) of the National Gas Rules (NGR)?*

The information provided by AEMO was the information received by AEMO which it published on the [AEMO website](#). That is, the original cost estimates (in 2010) and invoices following the end of the 2010/11 financial year containing a summary of labour hours, IT costs, legal costs. In some cases there was some description of a project which was undertaken for STTM for which costs were claimed. Importantly information provided did not contain verifiable information as to costs—including an apportionment of labour hours, invoices for third party services. Overall, this brief information did not clearly identify that costs claimed were MOS allocation service costs related.

- b) Can you explain what is involved in the AER's process for exercising your formal information gathering powers under s. 42 of the National Gas Law?*

A section 42 notice can be issued when the AER forms the view that a person is capable of providing information or producing a document that the AER requires for the performance of a function or a power. The notice is signed by the AER's chairman. The AER specifies a time for compliance with the notice. Failure to comply with the notice is a breach of the rules and can result in a civil penalty.

- c) What additional information did you ask for and then receive from pipeline operators (that was not included in the evidence provided to AEMO under rule 424(5) of the NGR) in order to prepare advice for AEMO on the amount payable for these invoices?*

The AER asked for more information in relation to the estimates and the invoices published on the AEMO website. Copies of section 42 notices to businesses have been attached. These indicate the AER sought documents and information to verify costs claimed were MOS service costs. Specific questions asked businesses to provide invoices, break down labour hours, justify specific projects as being MOS allocation service cost related.

- d) In finalising advice to AEMO on this matter, can you explain in greater detail the reasons why the AER was able to provide advice to AEMO on the amount payment for three of the four invoices but was unable to provide advice on the fourth invoice?*

The AER was not, in the time available, able to form a view as to whether the APA Group's proposed costs – both in its tax invoice to AEMO and in its responses to the AER's requests – were all MOS allocation service costs. Specifically, in the time available, and following a number of meetings and responses to further information requests from APA Group, the AER could not determine whether:

- the pre-STTM commencement costs reflected the reasonable costs involved, for example, in setting up a MOS allocation process within a system for the provision of the MOS allocation service; and
- the post-STTM commencement costs reasonably reflect the costs incurred for the provision of the MOS allocation service
- the proposed costs included any costs for STTM facility allocations which cannot be included as MOS allocation service costs.

***Q2. Can you explain how the application of the ‘efficiency test’ would differ from the ‘reasonableness test’ in terms of both the evidence that a pipeline operator would be required to provide to AEMO under rule 424(5) of the NGR and also how the AER would assess these invoices (if an objection is raised) under rule 425(4) of the proposed rule?***

The application of the ‘efficiency test’ is not expected to make a large practical difference to the way that the AER would assess invoices in this case. The difference between assessing whether costs are ‘reasonable’ or ‘efficient’ should not be overstated as, in the context of MOS and Bulletin Board costs, reasonable costs could typically be argued to be efficient and prudently incurred.

However, there are a number of reasons why the proposed rule should be implemented. The proposed test allows the AER to reject costs that do not reflect efficient costs that would have been incurred by a prudent operator. This is preferable to the current assessment on the basis of ‘reasonableness’ as it is unclear why, in some circumstances, STTM shippers would be expected to pay costs that are not efficiently or prudently incurred. Ensuring that pipeline operators have an incentive to incur costs efficiently, and reducing the likelihood that STTM shippers will pay costs that are above efficient levels, is consistent with promoting the efficient operation and use of natural gas services for the long term interests of consumers as outlined in the National Gas Objective. Further, the use of a common terminology, such as efficient costs, provides a consistent assessment approach under the Rules whereas the use of terms like “reasonably incurred” may introduce different considerations and a level of ambiguity in the way the regulator is meant to assess these claims.

The proposed rule does not imply that the efficient costs of one pipeline operator are necessarily the same as those of another pipeline operator – the relevant circumstances of the pipeline operator would be taken into account in each case.

The most substantive change from adopting the ‘efficiency test’ in the proposed rule is that the onus would be on the pipeline operator to provide supporting evidence to show that its invoiced costs are efficient. As noted in the response to question 1, under the current Rules little information is provided to AEMO (and passed on to the AER) in support of cost invoices. This means the AER must request various information for its assessment.

The combined effect of proposed rules 424(5) and 425(4) is to provide an appropriate incentive for pipeline operators to provide information to justify their cost invoice. This would take the form of a description of the costs that are being claimed as well as why those costs reflect efficient costs that would have been incurred by a prudent operator. It has been the AER’s experience that assessment processes work more smoothly and effectively when there is an incentive for service providers to provide appropriate information at the outset in

support of their proposals – rather than an onus on the AER to request specific pieces of information it needs to complete its assessment.

Under the proposed rule, the AER must have regard to the evidence provided by the pipeline operator. The AER may also request additional information from the pipeline operator if necessary, but this may not be required in every case. The AER would follow the process outlined in proposed rule 425(4) when assessing the invoice. It would be open to the AER to use a range of techniques when determining whether the proposed costs reflect the efficient costs of a prudent operator. However, it is difficult in the abstract to explain this assessment process in more detail as it would be dependent on the relevant circumstances and the information available at the time.

***Q3. Can you provide additional information on the issues with the current Bulletin Board (BB) rules, including the rationale for the proposed changes to the BB rules and how the proposed rule would, or is likely to, promote the National Gas Objective?***

The rationale for the changes to the BB rules and the reasons why the proposed BB rules are likely to promote the National Gas Objective are essentially the same as outlined in the rule change proposal for the proposed MOS rules. For convenience, the rule change proposal largely focuses on the MOS allocation service cost process instead of outlining the same issues again for the BB aggregation and information services cost process.

That said, we are happy to provide some additional information in regards to why the proposed changes should apply to the BB process.

As the AER's rule change proposal noted, we do feel there are benefits in retaining a consistent assessment process between the BB process and the MOS allocation service cost process. We understand that AEMO also shares this view. AEMO also noted in its letter of support (attached to the AER's proposal) that when this rule change proposal was raised in the STTM consultative forum it was generally agreed that there would be benefits in retaining consistency.

However, it is worth more clearly explaining that a key reason that the changes outlined in the AER's rule change proposal should apply to the BB process (in addition to simply providing consistency), is the fact that there is the potential for identical problems (identical to those that the rule change proposal identifies for the MOS process) to occur in the BB process. This is because the existing relevant cost recovery processes in the Rules are substantively identical for both MOS and BB costs.

That is, under the MOS process the problems outlined in the rule change proposal occurred as soon as the assessment process was triggered (invoices were submitted and an objection was received). In our view the only reason similar problems have not yet occurred in the BB process is that to date the process has never been triggered (i.e. no invoices have been submitted to date by pipeline operators seeking to recover bulletin board aggregation and information services costs). However, as soon as an invoice for BB costs is lodged and an objection is received, the AER expects that the same problems experienced by the AER and AEMO in relation to the MOS process will arise in relation to the BB process.

In terms of why no BB invoices have been submitted to date, we understand this is simply because no pipeline operators have sought to do so at this stage – the activities for which cost

recovery can be sought are narrower in the BB rules than for MOS so it is likely that any costs involved would be smaller. But this is not to say that pipeline operations will not seek to recover those BB costs in future. We consider that BB cost recovery proposals are possible and should be planned for – if there were no chance of the assessment process ever being activated there would be no need for the Rules at all. In either case the rationale for retaining the status quo — Rules that are likely to cause administrative difficulties if the BB process is used — is not clear.

Given the potential problems with the BB process should it be triggered are clear, we would recommend addressing these at the same time as the problems with the MOS process are addressed. The appropriate solutions should be identical to any solutions adopted for the MOS process. We note that once an objection is raised, at that stage the AER would be required to apply the process as outlined in the Rules – there would not be sufficient time to submit/consider a rule change proposal to address the issues at the time they actually arise.

Addressing the potential BB issues as part of this rule change proposal is an appropriate way of preventing those problems from occurring. If this does not occur then the AER (and AEMO) will be faced with the same administrative problems that occurred in the 2010-11 MOS process as soon as the BB process is activated.