31 October 2013

FROM THE OFFICE OF THE
CHIEF EXECUTIVE OFFICER

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Mr John Pierce
Chairman
Australian Energy Market Commission
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Dear Mr Pierce

Rule Change Request – STTM settlement surplus and shortfall

AEMO is proposing that the National Gas Rules (NGR) be modified to require AEMO to make Short Term Trading Market (STTM) Procedures that will allow for fair and efficient allocation of settlement surplus payments and settlement shortfall charges.

Rule 464(2A) sets out a principle for allocating any settlement shortfall or settlement surplus on the basis of a trading participant's total deviation quantity at a hub for a billing period. The total deviation quantity may not be the most efficient or fairest way to allocate both settlement surpluses and shortfalls. AEMO's analysis indicates that allocation in this manner will, under some circumstances, disadvantage participants, particularly smaller trading participants, who have incurred deviations – imposing inequitable costs over and above deviation charges or payments required to recover the market costs of their deviation.

AEMO proposes that the NGR be amended to provide a principle which will enable equitable allocation of these settlement surplus payments and shortfall charges. AEMO requests that the AEMC consider this rule change as urgent under section 304 of the National Gas Law. AEMO considers that the proposed Rule be considered as an urgent Rule change because the additional time taken for a normal Rule change threatens the effective operation and administration of the STTM.

AEMO is concerned that failure to expedite the proposed Rule under section 304 of the NGL is likely to prejudice smaller trading participants by increasing barriers to entry by and creating inefficient wealth transfers in the STTM, once changes to deviation pricing are made in accordance with amending rule 2013 No. 4 – STTM deviations and the settlement surplus and shortfall (STTM deviations rule), commencing 1 May 2014.

A description and drafting of the proposed Rule, a statement of the issues concerning the existing NGR, and how the proposed Rule contributes to the achievement of the National Gas Objective is provided at Attachment A.

If made, AEMO would seek for this rule to commence at the same time as the STTM deviations rule, on 1 May 2014. AEMO also requests that a transitional rule be included to delay the effective date of both rules until 1 November to allow time for procedures and systems to be finalised in response to the outcomes of this rule change request. However, as circumstances sometimes change, we may need to amend the commencement date of this proposed rule change at any time prior to a final decision being made.

AEMO would be pleased if you could have these matters considered by the AEMC. For further details, please do not hesitate to contact Sandra McLaren, Acting Group Manager—Market Development, on (03) 9609 8355 or Sarah McKelvie, Senior Market Analyst – Market Development on (03) 9609 8438.

Yours sincerely

Mike Cleary
Chief Operating Officer

Attachments:

A: Rule Change Proposal

Attachment A: Rule Change Proposal

This Rule Change Proposal is structured as follows:

1. Summary

AEMO is proposing that the National Gas Rules (NGR) be modified to require AEMO to make Short Term Trading Market (STTM) Procedures that will allow for fair and efficient allocation of settlement surplus payments and settlement shortfall charges.

Rule 464(2A) sets out a principle for allocating any settlement shortfall or settlement surplus on the basis of a trading participant's total deviation quantity at a hub for a billing period. The total deviation quantity may not be the most efficient or fairest way to allocate both settlement surpluses and shortfalls. AEMO's analysis indicates that allocation in this manner will, under some circumstances, disadvantage participants, particularly smaller trading participants, who have incurred deviations – imposing inequitable costs over and above deviation charges or payments required to recover the market costs of their deviation.

2. Background

2.1 STTM

The STTM is a day-ahead market for natural gas at defined hubs. The STTM currently operates in Adelaide, Brisbane and Sydney.

STTM shippers make offers to supply gas to the hub, while STTM users and STTM shippers make bids to withdraw gas at or from the hub. Bids and offers are submitted on the day before the relevant gas day (i.e. ex-ante), at which time AEMO determines the market price and the quantity of gas traded by STTM shippers and STTM users for that gas day. This schedule is published approximately 18 hours ahead of the gas day so that shippers can use this information as an input to their shipping nominations to the relevant facility operators, a process which occurs outside the STTM. Shippers are able to renominate expected changes to their forecasts to facility operators during the gas day. The STTM has a market schedule variation (MSV) mechanism which allows these renominations to be recognised in the market.

Actual gas flows (or allocations) in the STTM are provided by the facility operators after the end of the gas day. The difference between final pipeline nominations and the actual flow on the pipeline is allocated as Market Operator Service (MOS) gas. This information is used to set the ex post imbalance price, which is determined and published by AEMO after the relevant gas day for each hub.

The difference between trading participants' scheduled quantities, as adjusted by any MSVs, and their allocations is called a deviation. Participants' deviations are balanced with MOS gas on any gas day, such that the net total of MOS on a day will be equal and opposite to the net quantity of deviations on a day. Increase MOS typically supplies overall short deviations, while decrease MOS typically supplies overall long deviations.

Over a billing period, the STTM will accrue either a surplus or a shortfall of funds. This settlement surplus or shortfall is the difference between market income and market outgoings. This is primarily caused by differences in the way long and short deviations are priced and how MOS is priced, as there is not a single clearing price for balancing gas (the difference between scheduled and actual flows) after the gas day.

2.2 Counteracting MOS

MOS is a pipeline balancing service, not a hub balancing service. As such there are circumstances where the balancing requirement on two pipelines supplying a hub require MOS in opposing directions, in excess of the hub's balancing requirements. This has been referred to as 'counteracting MOS' in discussions with the STTM Consultative Forum (STTM-CF). Investigations into counteracting MOS at the Sydney and Adelaide hubs have identified multiple causes, most of which appear to relate to the physical characteristics of the hubs, rather than to particular actions taken by trading participants.

In these circumstances there can be more MOS to be paid for than there are deviations in the market, and the market will accrue a shortfall. 'Counteracting MOS' is viewed as being due to factors outside of the control of trading participants and its costs should therefore be viewed as a social cost.

2.3 Review of the STTM and resultant recommendations

AEMO undertook a review of the operation of the STTM, concluding in March 2012. The review recommended changes to the deviation pricing design and, by association, the settlement surplus and shortfall mechanism. AEMO subsequently submitted a rule change to enable implementation of these recommended changes.

2.3.1 Review of the STTM

In accordance with Part 20, Division 11, rule 489 of the NGR, AEMO reviewed:

- whether the graduated deviation parameters, the graduated variation parameters and the MOS cost cap are set at appropriate levels;
- whether Division 6 (Market Operator Service) is operating effectively and efficiently;
- options for the allocation of settlement surpluses and shortfalls on a daily basis; and
- potential improvements in the operation of the STTM and the time period for implementation of those identified improvements.

AEMO's key recommendations from the review relating to the allocation of settlement surpluses and shortfalls, and the deviation parameters were:

- AEMO does not recommend allocating surpluses and shortfalls on a daily basis, but rather strengthening the cost to cause principles for funding MOS in the STTM. AEMO recommends introducing the average cost of MOS into the existing deviation pricing mechanism to better assign MOS costs to the parties contributing to MOS on a gas day.
- Under the cost to cause model proposed above, AEMO recommends removing the deviation parameters to ensure that the deviation pricing mechanism better assigns MOS costs to the parties contributing to MOS on a gas day, rather than attempting to achieve this outcome through the adjustment of these parameters.

During the review, AEMO conducted a number of workshops to discuss options for the market design that would meet these objectives. Discussions on the settlement surplus and shortfall initially suggested that both surpluses and shortfalls should be allocated to parties on the basis of withdrawals. With further consideration, however, general consensus emerged that surpluses should be returned to parties on the basis of their deviations.

AEMO's final report on the STTM review recommended that settlement shortfalls should be socialised as they would be dominated by costs without identifiable causers. The report, however, did not prescribe the detailed methodology for the treatment of surpluses and shortfalls on the basis that this would be developed as part of the procedure change process, as this element of the design had previously been contained only in the STTM Procedures.

2.3.2 STTM Deviations Rule

AEMO submitted a rule change proposal to the AEMC in 2012[1] seeking to modify Part 20 of the National Gas Rules to facilitate changes to the deviation pricing mechanism in the STTM. The policy intent of these changes was to better allocate deviation costs to the causers of those costs, where possible. This rule change and associated market design changes, whilst being focussed on deviation pricing, also required supporting changes to the settlement of surpluses and shortfalls in the market, as they would be heavily impacted by changes to deviation pricing.

Under the proposed design changes, the treatment of settlement surpluses and shortfalls would move from a de-facto method to recover MOS costs solely on the basis of deviations, to a mechanism that allowed for recovery or distribution of MOS costs that could not be directly attributed to the actions of any trading participants. In making its rule change proposal, AEMO intended that, on the basis of these principles, the detailed methodology for the recovery or distribution of settlement shortfalls or surpluses would be finalised as part of a consultation on changes to the STTM Procedures, following the final rule determination.

However, implementation of this proposed change introduced a principle guiding the allocation of settlement surpluses and shortfalls, in rule 464(2A) that is inconsistent with the intended design outcomes, as it is likely to prevent the equitable distribution of settlement shortfall charges where they are not attributable to identified causers.

2.4 Causes of settlement surpluses and shortfalls

The STTM can accrue either a surplus or a shortfall of trading funds over each monthly billing period, due to misalignment between market income and market outgoings. This misalignment is caused by differences in the way Market Operator Service (MOS), deviations and contingency gas are priced and balanced.

The STTM was originally designed so that monthly distribution of any surplus or shortfall reflected a compromise position between maintaining deviation incentives and managing risk associated with deviation incentives, whilst applying some degree of cost to cause.

Shortfall charges were designed to be prorated on a participant's share of all deviations over the month, on the basis that a shortfall would indicate that deviation prices over the billing period were insufficient to cover the cost of MOS. All deviations (whether causing MOS or reducing the

[1] STTM deviations and the settlement surplus and shortfall rule change, http://www.aemc.gov.au/gas/rule-changes/completed/sttm-deviations-and-the-settlement-surplus-and-shortfall.html

requirement for it), incur shortfall charges equally. Assigning shortfall charges on a deviation basis ensured that MOS costs are funded by the participants that potentially used MOS (by deviating) over a month. This was seen as a longer term proxy for assigning the cost of MOS to causers (deviators).

The intended changes to the deviation pricing mechanism, enabled by the National Gas Amendment (STTM Deviation and the Settlement Surplus and Shortfall) Rule 2013 No. 4 (the DSSS Rule), will change the nature of the settlement surplus and shortfall.

Settlement surpluses will be generated where deviation quantities are greater than the MOS allocated for balancing the pipelines supplying a hub, or where deviations on a contingency gas day are higher than the amount of contingency gas scheduled[2]. Surpluses may also be generated by the misalignment between when MOS is allocated and MOS service payments made (on gas day D), and when commodity payments and charges for that MOS are made (D+2). This can lead to MOS costs for a day falling into different billing periods, while the recovery of those costs from deviating parties will be on the day the MOS is incurred[3]. This can equally cause a shortfall.

Settlement shortfalls will primarily be generated when MOS quantities are higher than deviation quantities (counteracting MOS). There is also the potential to generate a shortfall when contingency gas scheduled volumes are greater than the contingency gas required on a day (as evident in deviation volumes) and during an administered price cap state, where deviation prices will be constrained by the administered price cap, but MOS costs may not be. MOS costs may not be constrained firstly, because MOS service payments are separate to commodity pricing and have their own MOS costs cap, and secondly, because MOS commodity payments are based upon the ex ante price of the gas day that is two days later. This ex ante price may not be subject to the administered price cap, depending upon the circumstances under which the state is triggered. In this situation, capped deviation payments and charges could be well short of the cost of MOS, and a shortfall will be generated.

3. Statement of Issues

3.1 Current NGR (as amended by the DSSS Rule)

Rule 464(2A) of the National Gas Rules introduced the requirement that the STTM Procedures specify the basis and method for allocating the settlement shortfall charge or settlement surplus payment in accordance with the principle that any settlement shortfall or settlement surplus be allocated to trading participants on the basis of their total deviation quantity at that hub for that billing period. Rule 464(2A) will be effective on 1 May 2014.

3.2 Issue with current NGR

Rule 464(2A) will have the consequence of allocating all MOS costs to parties based on their deviations, including those costs not required for balancing the hub (e.g. counteracting MOS), or

[2] so long as system security is able to be maintained in this circumstance, and curtailment is not required.

[3] MOS service payments for 30 September are included in September settlement surplus / shortfall and MOS commodity charges settled on 2 October are included in October settlement of surplus / shortfall.

contingency gas that is scheduled but not required. This allocation would produce an inequitable outcome as the costs in these instances are not attributable to deviations, and may be due to factors outside the control of trading participants who have deviated.

Parties who have deviated over a month will have already paid the market cost of their deviations due to changes in the deviation pricing arrangements. Allocating shortfalls on the basis of deviations unnecessarily targets those parties. Historically, smaller participants are more likely to have a higher proportion of deviations compared to total market deviations than their proportion of withdrawals compared to total withdrawals, as shown in table 1 below. This means they will be allocated an inequitably higher proportion of any shortfall.

Table 1 – Percentage of all Trading Participants whose deviations are proportionally higher than withdrawals vs market share

Relative trading participant size based on withdrawals [market share]	% of parties where deviations are proportionally higher than withdrawals[4]
0% – 5%	80%
5% – 20%	67%
> 20%	0%

Analysis of the Adelaide hub for the first 6 months of 2013, where there has been frequent counteracting MOS, showed that there would have been up to $200,000 wealth transfer in a single month, with an average of $50,000 a month, primarily from smaller participants to larger participants. These figures compared allocating shortfalls on the basis of deviations to allocating on the basis of market share.

This places undue risk on smaller trading participants. To adequately hedge this risk where shortfalls are caused by counteracting MOS (most common cause), parties would need to obtain MOS contracts on both pipelines. This can have both cost and availability issues for new entrants and small trading particiants. Allocating shortfalls on the basis of deviations increases the amount of hedging required for these parties, increasing barriers to entry.

It is, therefore, considered by AEMO to be more equitable to allocate recovery of shortfalls using withdrawals or a combination of deviations and withdrawals. The requirements to be introduced with rule 464(2A) will impose a restrictive principle that impedes AEMO's ability to make STTM procedures for the recovery of settlement shortfalls in a way that is equitable under all circumstances

[4] Analysis based upon 2012 – 2013 deviation and withdrawal data for all hubs. Market share based upon market share of relevant hub.

4. Proposed Solution and Rule

4.1 Description of the Proposed Rule

AEMO proposes that rule 464(2A) be further amended to provide a principle for allocating settlement surpluses and shortfalls in an efficient manner where practicable, which will allow for the equitable distribution of costs not attributable to specific trading participants' deviations.

AEMO also proposes that a transitional rule be added to effectively delay the commencement of the amendments made in the DSSS Rule, and this rule, if made, until 1 November 2014[5]. AEMO and trading participants require this time to finalise the detailed design of settlement surpluses and shortfalls, and to test the outcomes before implementing the required system changes. This rule will allow the associated deviation pricing changes to be delayed until the appropriate settlement surplus and shortfall design can be implemented alongside them, in order to avoid the adverse market impacts set out in 3.2 above. Effectively this will mean that from 1 May 2014 until 1 November 2014, AEMO and trading participants will continue to comply with the rules as in effect prior to the commencement of the DSSS Rule, and from 1 November 2014 they will comply with the rules as amended by both the DSSS Rule and this proposed rule.

AEMO's proposed change is provided at Appendix I.

4.2 How the Proposed Rule addresses the identified issues

AEMO considers that the amendment to rule 464(2A) in the proposed rule addresses the identified issues in section 3 by allowing costs caused by counteracting MOS, or over-scheduling of contingency gas, which are accrued to the settlement shortfall, to be distributed to trading participants at the relevant hub in an efficient manner. This may not be on the basis of deviations, or not entirely on that basis.

The proposed transitional rule delaying the effect of the DSSS Rule will address the potential issues arising from a mismatch in the timing of implementation of the deviation pricing changes and the settlement surplus and shortfall calculations by providing an additional six months to complete design and testing in consultation with trading participants.

4.3 STTM Procedures

The proposed rule change requires supporting changes to the STTM Procedures to prescribe the method for allocating settlement surpluses and settlement shortfalls. This is already contemplated in the NGR.

[5] As circumstances sometimes change, we may need to request a change to the commencement date of this proposed rule at any time prior to a final decision being made.

Subject to AEMO's own public consultation on these Procedures, AEMO intends to propose that surpluses are returned to parties firstly on a deviation basis, but after a limit, on the basis of withdrawals, and that shortfalls are assigned, most likely, on a withdrawal basis.

The intent of these changes is to return funds generated when the deviation price is set too high to the affected parties, without eroding incentives to follow schedules, but to socialise costs generated by MOS or contingency gas which is not required to balance the market.

4.4 Request for Urgent Rule change

AEMO requests that the AEMC considers this Rule change proposal as an urgent rule under section 304 of the National Gas Law (NGL). Section 304 applies if the AEMC considers that a request for a Rule is a request for an urgent Rule. The NGL defines, at section 290, an urgent Rule to mean:

> "…a Rule relating to any matter or thing that, if not made as a matter of urgency, will result in that matter or thing imminently prejudicing or threatening—
>
> (a) the effective operation or administration of a regulated gas market operated and administered by AEMO; or
>
> (b) the supply of gas.;"

AEMO considers that section 304 applies to this proposal because, as presented in this rule change proposal, the allocation of shortfalls on the basis of deviations can have material impacts on trading participants in the STTM.

If this rule is not amended by the time the DSSS Rule commences on 1 May 2014, the settlement of surpluses and shortfalls will be prejudicial to smaller trading participants. Analysis presented in section 3.2 shows smaller trading participants are likely to attract a higher proportion of any shortfall. This places undue risk on these parties and increases the cost of hedging against this risk. This increases barriers to entry in the market, impeding competition.

The allocation of shortfalls on the basis of deviations potentially creates inefficient wealth transfers and affects trading participants' financial positions, and can potentially even lead to suspension from the market, reducing competition.

If this rule change is not made in time to align with the DSSS Rule, the administration of the market will be prejudiced because AEMO will be required to build systems to comply with the current NGR, and then rebuild those same systems to meet the original intent of surplus and shortfall design changes. This increases costs and reduces the efficiency of the administration of the market.

For the reasons outlined above, AEMO requests that the proposed Rule be considered as an urgent rule because the effective operation and administration of the STTM would be threatened if this proposed rule were not to align with the commencement of the DSSS Rule.

4.5 Request for Transitional Rule

The request for a transitional rule delaying the effect of the DSSS Rule will give AEMO time to confirm Procedures and IT systems associated with this proposed rule change, and will prevent the deviation pricing changes being introduced without an appropriate settlement surplus and shortfall design.

AEMO requires a draft determination before it can confirm IT systems for building. The earliest this rule, if made, could be implemented is in AEMO's September / October 2014 release. However, as discussed in section 4.4, AEMO considers that the commencement of the DSSS Rule, without amendment to rule 464(2A), will increase barriers to entry in the market, cause inefficient wealth transfers and cause inefficiency in the administration of the market due to the requirement to build systems to comply with rule 464(2A) and any amendment to rule 464(2A).

Delaying the commencement of both this rule, if made, and the DSSS Rule, will avoid adverse market outcomes, and will improve the administrative efficiency of the market.

4.6 Stakeholder consultation

AEMO undertook public consultation during the review of the STTM design. This consultation is outlined in Appendix II. Further consultation through the STTM-CF on the settlement surplus and shortfall has since been undertaken, and is ongoing.

During the review of the STTM design, it was recognised that changes to the deviation pricing design would change the magnitude and composition of settlement surpluses and shortfalls. AEMO's draft report recommended modifying the settlement of the market surplus and shortfall so that it is distributed on participants' share of withdrawals over a billing period.

Discussions into the deviation pricing design changes held at a review workshop on 20 February 2012 highlighted that costs due to counteracting MOS would not be recovered from deviations on a day, and would therefore be captured in the settlement shortfall. This would allow it to be socialised across all parties.

Further discussions were held at the STTM-CF meeting on 28 February 2012. TRUenergy raised the suggestion that surpluses and shortfalls should both be allocated on the basis of deviations not withdrawals.

AEMO's final report, released on 30 March 2012, recommended that surpluses could be returned on the basis of deviations, and that analysis based on the current market conditions suggested that this would not remove incentives to follow market schedules. AEMO did not recommend a final design for the shortfall, but rather recommended it be further discussed with stakeholders following the review.

The matter of settlement surpluses and shortfalls was reopened at the STTM-CF meeting in September 2013. AEMO raised the more preferable rule implemented by the AEMC (rule 464(2A)) and noted that it prevented implementation of AEMO's suggested design, being that shortfalls should be allocated on the basis of withdrawals. The STTM-CF agreed that the rule should should set out an overarching principle of efficient cost allocation, and unanimously supported the rule change proposal. The STTM-CF also requested at this stage that the implementation of the system changes required by the DSSS Rule be delayed until 1 November 2014 to allow for certainty of the outcome of the additional rule change and to allow time to finalise the detailed design of settlement surpluses and shortfalls.

The surplus detailed design has been completed (subject to consultation on the procedure change), with agreement to primarily distribute surpluses on the basis of deviations, but allocate some on the basis of withdrawals where incentives to follow schedules would otherwise be eroded.

The design of the shortfall is as yet undecided. There are currently two views held by different trading participants. Some prefer to allocate on the basis of withdrawals, while others would prefer to allocate on the basis of deviations. Discussions on this matter are ongoing.

4.7 Other requirements under the NGL

Compatibility with AEMO's declared system functions under s295(5) of the National Gas Law –

This rule only impacts trading participants in the STTM, where AEMO has no declared system functions under the NGL; therefore this change is not incompatible with the proper performance of AEMO's declared system functions.

5. How the Proposed Rule contributes to the National Gas Objective

Before the AEMC can make a rule change it must apply the rule making test set out in the National Gas Law (NGL), which requires it to assess whether the proposed rule will or is likely to contribute to the National Gas Objective (NGO).

The National Gas Objective 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."

AEMO considers that the proposed rule is likely to contribute to the NGO for the following reasons:

- The proposed rule change supports the original policy objective of causer pays, incorporated in the STTM Deviations rule, but will enable financial risks caused by factors outside the control of trading participants to be allocated appropriately. Distributing settlement shortfalls efficiently means risk can be allocated to parties such that no parties are faced with a disproportionate risk. This may not be on the basis of deviations. This supports the efficient operation of the STTM.
- The proposed rule change reduces barriers to entry as it will reduce the potential for risk being allocated disproportionately to parties who have higher barriers to mitigate that risk.

6. Expected benefits and costs of the Proposed Rule

The parties who are affected by this proposed rule change are existing, and intending, trading participants (STTM shippers and STTM users).

This rule change proposal does not increase or decrease total costs in the market, rather it results in a different, more equitable, method of allocating costs in the market.

Indications are that rule 464(2A) will most often transfer risk (of excessive MOS or overscheduling of contingency gas) from larger trading participants to smaller trading participants, who are less able to manage such risks. The materiality of this issue has been estimated to be up to $200,000 wealth transfer in a single month.

The cost to implement this proposal was already captured in the costs to implement the original deviation pricing proposal.

Appendix I: Draft Rule

This appendix outlines the proposed changes to the NGR covered by the Rule change proposal. Strikethroughs represent proposed deletions and underlined text represents proposed additions. This draft is based on the National Gas Amendment (STTM Deviations and the Settlement Surplus and Shortfall) Rule 2013 No. 4.

Inserts: insert

Deletions: ~~deletion~~

Part 20, Division 6

464 Settlement amounts for billing periods

(2A) The STTM Procedures must specify the basis and method for calculating the settlement shortfall charge or settlement surplus payment under subrule (2)(b)(i) in accordance with the principle that, to the extent practicable, any settlement shortfall or settlement surplus should be allocated efficiently to Trading Participants ~~on the basis of their total deviation quantity~~ at that hub for that billing period.

Schedule 1

Part 7 Transitional Provisions consequent on the National Gas Amendment (STTM Deviations and the Settlement Surplus and Shortfall) Rule 2013 and the National Gas Amendment ([xxx]) Rule 2014

39 Definitions

(1) Terms defined in rule 364 have the same meaning when used in this Part.

(2) In this Part:

commencement date means 1 May 2014.

effective date means 1 November 2014.

new DSSS rules means rules 461(2)(g), 462, 464, and the definitions of 'deviation charge', 'deviation payment', 'deviation price', 'graduated deviation parameters', and 'settlement surplus cap in rule 364, after the commencement date.

old DSSS rules means rules 461(2)(g), 462, 464, and the definitions of 'deviation charge', 'deviation payment', 'graduated deviation parameters', and 'settlement surplus cap in rule 364, as in force immediately before the commencement date.

40 Continuation of old DSSS rules until effective date

From the commencement date to the effective date:

(a) the old DSSS rules continue to apply; and
(b) the new DSSS rules have no effect.

Appendix II - Consultation Undertaken

This Appendix outlines the consultation undertaken by AEMO with respect to the STTM deviation pricing changes and associated surplus and shortfall design changes.

Nature of the consultation

AEMO conducted its review of the operation of the STTM, as prescribed in rule 489, using the extended consultative procedure described in rule 9A of the NGR.

This process began with the release of AEMO's STTM Reviews Phase 1 – Discussion Paper on 16 August 2011. This paper was published on AEMO's website and was open for public consultation for 28 days, with submissions due on 23 September 2011.

As part of its consideration of issues raised by stakeholders, AEMO conducted a public workshop on STTM design and operational issues on 14 November. Notes from this workshop were published on AEMO's website.

Following consideration of the issues raised in both submissions and at the workshop, AEMO released its draft report publically on 19 December 2011. This paper invited comment by 3 February 2012, allowing 29 business days for consultation.

A further public workshop on STTM design and operational issues was held on 20 February 2012 to further discuss details proposed by AEMO in its draft report and provided in submissions to this report.

AEMO released its final report on 30 March 2012, concluding the consultation.

The notes and information for the consultation papers and workshops have been published on AEMO's website on the STTM Reviews page:

http://www.aemo.com.au/Gas/Market-Operations/Short-Term-Trading-Market/Review-of-Short-Term-Trading-Market.

Content of the consultation

AEMO's discussion paper presented analysis showing that whilst the graduated deviation parameters, when viewed on their own, were performing as intended, the deviation prices were insufficient to cover the costs of MOS used to balance those deviations. This resulted in high shortfall charges each month to fund MOS. Whilst much of the consultation focussed on deviation pricing mechanisms views were sought on:

- Should the settlement surplus or shortfall be used to fund the MOS service, or should it only be used to socialise risk not caused by any particular participants?
- Is there a need to change the settlement surplus and shortfall mechanism to a daily mechanism? Why or why not?
- Should "positive" deviators be treated differently to "negative" deviators for the purposes of the settlement surplus/shortfall mechanism?
- If you move to a daily settlement surplus/shortfall mechanism, is the settlement surplus cap (0.14 $/GJ) needed, why or why not?

Submissions to the discussion paper were largely supportive of moving to a more direct cost to cause model for pricing deviations and funding MOS as monthly settlement dulled the incentive to follow schedules and forecast accurately. There were also comments seeking to ensure that any change did not impact incentives to forecast accurately.

AEMO's draft report presented two options for strengthening the cost to cause principles for funding MOS in the STTM. These options were:

- daily settlement of the market surplus or shortfall; and
- linking the deviation price directly to the cost of MOS.

AEMO's draft recommendation was to pursue changes to the pricing and settlement of deviations in the market so that MOS is funded through the deviations that cause it. AEMO also recommended, as part of this change, modifying the settlement of the market surplus and shortfall so that it is distributed on participants' share of withdrawals over a billing period.

Responses to the draft report were again largely supportive of strengthening cost to cause principles, with a preference for linking deviation pricing directly to the cost of MOS. However, concerns were raised around how costs of counteracting or excessive MOS would be assigned, and of the high cost of MOS as a balancing service in general.

AEMO presented more detailed analysis of various options for pricing deviations, at a workshop on 20 February 2012. AEMO also clarified that the costs of counteracting MOS were not intended to be recovered through the deviation pricing mechanism, but rather would be recovered via the settlement shortfall. At this time AEMO proposed retaining the settlement of the surplus and shortfall on a monthly basis, and removing the settlement surplus cap. Further details regarding the design of the settlement surplus and shortfall were deferred to the Procedure change consultation, expected to follow the AEMC's draft determination on any rule change put forward.

AEMO's final report recommended changing the pricing and settlement of deviations in the market so that MOS is funded through the deviations that cause it. AEMO also recommended retaining the distribution of the settlement surplus or shortfall on a monthly basis and removing the surplus cap. The report did not recommend a final design for the distribution of settlement surpluses and shortfalls. The design of these was prescribed in the STTM Procedures, and as such AEMO intended to manage changes through the procedure change consultation process.

Follow up consultation

The matter of settlement surpluses and shortfalls was reopened at the STTM-CF meeting in September 2013. AEMO raised the more preferable rule implemented by the AEMC (rule 464(2A)) and noted that it prevented implementation of AEMO's suggested design, being that shortfalls should be allocated on the basis of withdrawals. The STTM-CF agreed that the rule should should set out an overarching principle of efficient cost allocation, and supported the rule change proposal. The STTM-CF also requested that the implementation of the STTM deviation rule change be delayed from May to September / October 2014 to allow time for there to be both more certainty of the amendment to rule 464(2A) and for the detailed design of the settlement surplus and shortfall to be firmed up.

AEMO noted that Incitec Pivot had raised a concern about whether surpluses should be distributed solely on the basis of deviations and what that did to deviation incentives. Further analysis based on 2013 data showed that returning surpluses on the basis of only deviations did, in fact, reward parties for deviating in some months. AEMO said retaining a cap on the amount distributed to deviating parties, like with the current design, may still be required.

A workshop on the deviation pricing design and the settlement surplus and shortfall design was held in September also. AEMO presented analysis on the surplus distribution based on Brisbane hub operating data for 2013. The STTM-CF agreed that a cap should be retained so as not to erode incentives to follow schedule. Discussions on the shortfall distribution showed there was disagreement about the best method for allocating shortfalls, with two sets of views. Some parties were in favour of allocating on the basis of deviations citing complexity and strengthening of incentives to follow schedule, while others are supportive of allocating based on withdrawals, as it is consistent with other socialisation mechanisms in the STTM and the Declared Wholesale Gas Market (DWGM). Discussions are still ongoing.

Records of the September 2013 STTM-CF can be found at the following location:

http://www.aemo.com.au/Gas/Resources/Working-Groups/~/media/Files/Other/STTM/STTM_Meeting_33_10_Sep_13.ashx

Glossary

Abbreviation	Explanation
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
MOS	Market Operator Service
NGL	National Gas Law
NGO	The National Gas Objective as stated in section 23 of the NGL, being “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”
NGR	National Gas Rules
STTM	Short Term Trading Market
STTM-CF	Short Term Trading Market Consultative Forum