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

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

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Via online submission

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

Dear Ms Papas

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

Jemena Gas Networks (NSW) Ltd (**JGN**) welcomes the opportunity to respond to a number of the issues that were raised in GDF Suez's 30 January 2015 submission to the Australian Energy Market Commission (**AEMC**) on the matched allocation process rule change request.

We thought it worth clarifying a few observations made by GDF Suez on the matched allocation process, and how unaccounted for gas (**UAG**) is dealt with in the market and under JGN's Access Arrangement. These observations include:

- that the matched allocation process "relieves JGN of the need to manage its gas usage" and diminishes its incentive to minimise the volume of UAG;[1]
- the way in which UAG is defined in the NSW/ACT retail market;[2] and
- making the matched allocation process a permanent rule will "act as a barrier to harmonising the treatment of UAG" across markets.[3]

We have also decided to address potential misconceptions and address one of the more fundamental matters in the GDF Suez submission, which is that the AEMC should adopt a "principled approach" when assessing the rule change and require:

> "…all participants impacting on STTM hub transfers and deviations be exposed to the price signals and efficiency incentives".[4]

1 GDF Suez, Submission to the AEMC, 30 January 2015, pp.2 and 4.

2 ibid, p.2.

3 ibid, p.3.

4 ibid, pp. 2-3.

Impact of the matched allocation process on JGN's incentives to minimise UAG

On pages 2 and 4 of its submission, GDF Suez states that the matched allocation process "relieves JGN of the need to manage its gas usage" and diminishes the incentive JGN has to minimise the volume of UAG to "ensure that there are not excessive gas leaks, operating usage or meter errors causing unnecessary amounts of UAG". [5]

Contrary to GDF Suez's claim, the matched allocation process does not have any bearing on the incentives that JGN has to minimise the volume of UAG, nor does the matched allocation process relieve JGN of the need to manage physical system losses or ensure that meter errors do not cause unnecessary amounts of UAG. It is, as explained in JGN's original rule change proposal, just a mechanism that enables JGN to procure operational gas prior to the entry point of the STTM.

The incentive JGN has to minimise the volume of UAG and to ensure meter errors do not cause unnecessary volumes of UAG, can be found in the following instruments:

- section 3.5(D) of the current Access Arrangement, which contains a UAG incentive mechanism. Under this mechanism, JGN is provided an allowance for a quantity of UAG based on a target percentage rate of total network receipts (currently 2.34%).[6] If the actual UAG rate is above (below) the target rate, JGN will under (over) recover the costs of procuring operational gas. In effect, this mechanism provides JGN with a strong incentive to minimise the volume of UAG.
- schedule 1 of the Gas Supply (Consumer Safety) Regulation 2012, which imposes an obligation on JGN to test gas meters[7] and sets out the level of accuracy that gas meters must comply with.[8] This regulation also sets out the penalty that JGN will be subject to if it knowingly allows a gas meter to be inaccurate.[9]

Importantly, neither of these instruments is affected by the operation of the matched allocation process.

Definition of UAG in the NSW/ACT retail market

On page 2 of its submission, GDF Suez has raised some concerns about the way in which UAG is defined in the NSW/ACT retail market and noted the potential for this to result in other gas participants being left to make up the difference between the nominated quantity of UAG and the actual volume of gas used by JGN for operational purposes in a non-transparent manner.

In NSW, UAG is defined as the physical system losses (i.e. the difference between metered receipts and deliveries to/from the network).[10] For the purpose of the daily

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5 ibid,pp.2 and 4.

6 Under the proposed Access Arrangement for the 2015-20 regulatory period, JGN has proposed an overall UAG rate of 2.24%.

7 Gas Supply (Consumer Safety) Regulation 2012, Schedule, 1, Part 3, Division 2 and 3.

8 ibid, cl. 1(2)(b).

9 ibid, cl. 11(3)(a).

10 Note that not all meters are read daily so an actual measure of daily physical losses does not exist. It is only when longer periods are considered that UAG can be measured.

retail market, a reasonable estimate is required to account for the daily UAG allocation. In the NSW distribution network, this estimate is provided by JGN and is typically derived having regard to physical losses that are expected to occur over the year and the seasonal profile for UAG.

Whether or not this is the right way for the NSW/ACT retail market to define and account for UAG is outside the scope of the matched allocation process and this rule change process.[11] It is worth noting though that, if UAG was redefined to represent all daily market uncertainties (rather than represented physical system losses) and daily UAG was calculated by allocating all of the daily market's settlement uncertainty to UAG, this would **not** provide an accurate measure of physical losses from the system. Such a change in definition would also warrant a review of the obligation to supply UAG to ensure that the cost of providing additional gas to account for daily market calculation and settlement uncertainties are not attributed to the network operator.[12]

Effect of the proposed rule change on harmonisation of UAG arrangements

On page 3 of its submission, GDF Suez has contended that:

- differences in trading arrangements in the facilitated markets are giving rise to:

  > "...a level of complexity on gas trading in Australia which increases operational costs and acts as a barrier to entry".

- making the matched allocation process a permanent rule would act as a barrier to the harmonisation of UAG arrangements.

The observations that JGN would make about these contentions are as follows. First, while JGN agrees that differences in some aspects of the design of the STTM and DWGM may affect parties operating in multiple markets, the matched allocation process is not one of those aspects, because:

- the only parties that are affected by this process are JGN, the MAA shipper, the MAA facility operator and AEMO; and
- the process of excluding the matched allocation quantities from the STTM occurs outside the market.

In other words, the matched allocation process has no bearing on the trading activities of STTM participants. JGN disagrees, therefore, with the inference that the matched allocation process adds to the complexity of trading in the Sydney STTM, increasing operating costs and/or acting as a barrier to entry to potential participants in the Sydney STTM.

Second, we note that the proposed rule does not act as a barrier to the UAG arrangements being harmonised. GDF Suez's submission simply contends that this will be the case. As outlined in JGN's 29 January 2015 submission, there are no provisions in the proposed rule that would prevent harmonisation from occurring if AEMO and the market, more generally, considered it appropriate.[13] JGN is,

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11 This is instead a matter that must be considered by AEMO under the retail market procedures.

12 JGN has no control over the calculation processes or design algorithms used by the market and so cannot be incentivised to manage such variations. There would be extremely inefficient outcomes if the additional 'market errors' were to be allocated to JGN (a non-market participant) rather than market participants as they currently are.

13 JGN, Letter to Ms Electra Papas, 29 January 2015, p. 8.

therefore, of the view that no weight can be placed on GDF Suez's contention that the proposed rule will impede harmonisation.

Third, in expressing its preference for a transitional rather than a permanent rule, GDF Suez's submission does not appear to discuss the additional costs that JGN, the AEMC and other stakeholders will incur if, at the end of a five year extension, harmonisation has not occurred and JGN has to seek another rule change. As AGL pointed out in its submission, there is a real risk that harmonisation will not occur in the proposed extension period because it is perceived to be a lesser-order issue for gas market reform.[14] It is important, therefore, that due regard is had to the costs that would be incurred if another rule change has to be sought in five years' time when considering whether or not a permanent rule or a five-year extension is more consistent with the NGO.

"Principled approach" to assessing the rule change

On page 3 of its submission, GDF Suez has proposed that the AEMC take a more "principled approach" to assessing the rule change and require all participants "impacting on STTM hub transfers and deviations be exposed to the price signals and efficiency incentives". At the same time, GDF Suez has acknowledged that the efficiency gains from requiring JGN to procure UAG through the STTM "would not be large" but has contended that this is the case with many elements of market reform. The concerns JGN has with this 'principled approach' are that it:

- distracts from the question the AEMC is required to consider when deciding whether or not to make a rule, which is whether the rule is likely to contribute to the achievement of the national gas objective (NGO);
- ignores the fact that JGN is not in a position to respond to the daily price signals provided by the STTM in the same manner as other STTM participants;[15]
- does not have any regard to the costs and risks that JGN would be exposed to if it were required to procure UAG through the STTM, the effects of which will ultimately be borne by STTM users and other end-users in the Sydney hub;[16] and
- overlooks the longer-term implications that the higher costs and risks associated with the STTM procurement option will have for both:[17]
  - the efficient utilisation of the network and natural gas services; and
  - the long-term interests of consumers.

We feel that the 'principled approach' proposed by GDF Suez is inconsistent with the rule-making framework and should, in JGN's view, be accorded no weight in the AEMC's consideration.

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[14] AGL, Submission: National Gas Amendment (Matched allocation process in the STTM) Rule 2014, p.2.

[15] The reasons for this are explained in some detail on pages 11-12 of JGN's original rule change request and are also acknowledged on page 1 of AGL's 19 January 2015 submission.

[16] A description of the costs and risks that JGN would be exposed to if it had to procure UAG through the STTM can be found in section 3.1 of JGN's original rule change request. In their respective submissions to the consultation paper, AGL and Lumo have both agreed that the STTM procurement option will result in higher procurement costs. See AGL, Submission: National Gas Amendment (Matched allocation process in the STTM) Rule 2014, 19 January 2015, p.1 and Lumo, Submission: GRC0030 Matched allocation process in the STTM, 29 January 2015,p.2 .

[17] See page 18 of JGN's original rule change request for further detail.

Concluding remarks

Thank you once again for providing us with an opportunity to address some of the issues raised in the GDF Suez submission. If you wish to discuss any aspect of this submission, please contact Alex McPherson on (02) 9455 1504 or at alex.mcpherson@jemena.com.au.

Yours sincerely

Robert McMillan
General Manager Regulation
Jemena Limited