AEMC

RULE CHANGE

Australian Energy Market Commission

CONSULTATION PAPER

National Gas Amendment (DWGM-AMDQ Allocation) Rule 2015

Rule Proponent(s)

Australian Energy Market Operator

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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1 Introduction

On 13 November 2013, the Australian Energy Market Operator (AEMO) submitted a Rule change request to the Australian Energy Market Commission (AEMC or Commission) in relation to the creation and allocation of the pipeline capacity instruments authorised maximum daily quantity (authorised MDQ) and authorised maximum daily quantity credit certificates (AMDQcc) in the Victorian Declared Wholesale Gas Market (Victorian DWGM).

Under the proposed rule:

- all extensions and expansions to the Victorian declared transmission system (Victorian DTS) would result in the creation of additional AMDQcc which would be allocated as per the directions of APA Gas Net (APA), the declared transmission service provider (DTS SP);
- authorised MDQ would relate only to the historical capacity on the Longford to Melbourne pipeline at the time the Victorian DWGM commenced and would be auctioned by AEMO;
- both AEMO and APA would provide minimum notice periods prior to an auction or tender for authorised MDQ or AMDQcc, as the case may be; and
- AEMO would be required to offset any proceeds it receives from the auction of authorised MDQ against the operating costs of the Victorian DWGM.

This Consultation Paper has been prepared to facilitate public consultation on the rule change proposal, and to seek stakeholder submissions on the rule change request. This consultation paper should be read in conjunction with AEMO's rule change request, which is available on the AEMC website.

This paper:

- sets out the background to, and a summary of, the rule change request;
- identifies a number of questions and issues to facilitate the consultation on this Rule change request; and
- outlines the process for making submissions.

Submissions on this consultation paper are due by 8 October 2015.

2 Background

This chapter provides background information on the Victorian DWGM, authorised MDQ and AMDQcc, and some context to the rule change request, including the operation of the current rules and the broader context in which this rule change request will be considered.

2.1 Victorian DWGM

The Victorian DWGM operates as a market carriage pipeline system. Under market carriage in the Victorian DWGM, the system operator allocates pipeline capacity through a pool approach where gas is injected and withdrawn at various locations. Market participants who use a market carriage pipeline do not reserve firm capacity on the pipeline. This is in contrast to other transmission pipelines with a trunkline or point to point structure which lends itself to a contract carriage model.[1]

In the Victorian DWGM, APA makes the transmission pipeline system available to AEMO under contract. AEMO manages the receipt, transportation and delivery of gas. The transportation of gas is provided as a reference service[2] pursuant to APA's access arrangement. The transportation of gas in the Victorian DTS is on a 'non-firm' basis in that users cannot reserve capacity.

When the Victorian DWGM was originally established, the Victorian government noted that the Victorian DTS had different characteristics from other transmission pipelines in that:

- the system was relatively small and had limited storage capacity because of limited physical linepack and a single LNG storage facility; and
- it was expected that there would be additional sources of gas introduced into the system.

Authorised MDQ and AMDQcc were established to prioritise access to the DTS at times of congestion and to provide pricing signals to gas users. The Victorian DTS has historically been a winter peaking system where congestion generally only occurs on some of the coldest winter days in a year.

1 Under contract carriage, a service provider manages the pipeline capacity by entering into bilateral contracts with shippers which provide shippers with an exclusive right to an amount of pipeline capacity.

2 Reference service means a pipeline service specified by, or determined or approved by the Australian Energy Regulator (AER) under, the Rules as a reference service. Section 2, National Gas Law (NGL).A reference service is a service that is likely to be sought by a significant part of the market and which the AER considers should be specified as a reference service.

2.2 Authorised MDQ and AMDQcc

In the Victorian DWGM, although users cannot reserve firm capacity on a pipeline in the Victorian DTS, they may hold authorised MDQ or AMDQcc which provides certain market rights and benefits and certain limited physical benefits to holders. Broadly, there are two distinct types of rights created by holding authorised MDQ or AMDQcc:

- **Limited physical access rights**: the rights associated with authorised MDQ and AMDQcc give customers some protection against curtailment in the event of an emergency.[3]
- **Financial rights**: the market benefits associated with authorised MDQ and AMDQcc are held by market participants and include:
  - Priority in scheduled injections (injection tie-breaking rights): when there are equal-priced injection bids, those associated with authorised MDQ or AMDQcc are scheduled first;
  - Reduced uplift payments (uplift hedge protection): market participants can use part or all of their authorised MDQ or AMDQcc to hedge against congestion uplift charges.[4].

There are several ways that market participants can acquire authorised MDQ or AMDQcc:

- they can enter into an agreement with an existing holder of authorised MDQ to transfer an agreed quantity from one site to another or to the reference hub;[5]
- enter into an agreement with an existing holder of AMDQcc to transfer an agreed quantity at the reference hub for a time period no longer than the remaining period of the original AMDQcc;
- participate in the allocation process when new capacity is created on the Victorian DTS;
- fund an expansion of the Victorian DTS;

3 In the event of a transmission constraint, users not holding authorised MDQ or AMDQcc will have their ability to inject gas into the system constrained ahead of users holding authorised MDQ or AMDQcc.

4 Uplift charges are incurred in the event of congestion on the transmission system or when demand is significantly different to what was planned. Holders of authorised MDQ and AMDQcc are permitted to use gas up to a specified amount in a scheduling interval based on their authorised maximum interval quantity which flows from the amount of authorised MDQ or AMDQcc held by the market participant.

5 The reference hub is a notional site within the Victorian DTS established for the purpose of valuing authorised MDQ or AMDQcc. When a market participant does not nominate its entire authorised MDQ to an actual site, it has to nominate its residual authorised MDQ somewhere.

- participate in the allocation process for existing AMDQcc when the current term of AMDQcc expires; or
- participate in the allocation process when spare authorised MDQ becomes available.

2.2.1 Authorised MDQ

The initial allocation of authorised MDQ occurred prior to the commencement of the wholesale market in Victoria and related to the capacity of the Longford pipeline.[6] The total authorised MDQ was set at 990 TJ/day which represented the peak capacity of the pipeline from Longford to Melbourne. The authorised MDQ was allocated at that time to existing and committed new loads as follows:

- for Tariff D[7] large customer sites, typically with demand exceeding 10 TJ per year, authorised MDQ was allocated to each site equal to their existing contract MDQ (maximum daily quantity) with revisions approved by an independent panel;
- for the New South Wales interconnect, Wimmera pipeline, and Murray Valley towns approximately 18 TJ of authorised MDQ was allocated;
- for Tariff V customers the remaining balance of the 990 TJ was allocated as a block - that is, to all residential and small-to-medium sized commercial and industrial customers.

Most large commercial and industrial customers hold authorised MDQ allocated directly to their sites. Authorised MDQ is only valid for the withdrawal of gas made at the delivery point at which it was first allocated. Authorised MDQ is not for a set term.

Authorised MDQ can be transferred in whole or in part to another market participant. This is completed between the two market participants and then AEMO is informed of the transfer. Authorised MDQ is relinquished back to AEMO either if the holder ceases to be a registered participant in the market or if they become disconnected from the Victorian DTS. Once authorised MDQ is relinquished to AEMO, AEMO undertakes its allocation process for the authorised MDQ and the term of the authorised MDQ remains indefinite.

2.2.2 AMDQcc

Since the commencement of the DWGM, the capacity of the Victorian DTS has increased. As new pipeline capacity has become available, AMDQcc has been created to provide similar benefits to those benefits provided to holders of authorised MDQ.

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6 At this time, the Longford to Melbourne pipeline was the only source of gas supply for the Victorian DTS.

7 Tariff D customers are large customers with daily demand meters and are typically large industrial sites.

AMDQcc is not differentiated by final customer (Tariff V or D) and is not allocated directly to customers. Rather, market participants with AMDQcc must advise AEMO whether the allocated AMDQcc are to be nominated to specific sites or the reference hub.[8]

AMDQcc can be transferred between market participants and if the holder ceases to be a registered participant in the market, then the AMDQcc reverts back to APA. AMDQcc are for a set term, which term generally coincides with APA's access arrangement period.

2.2.3 Current requirements

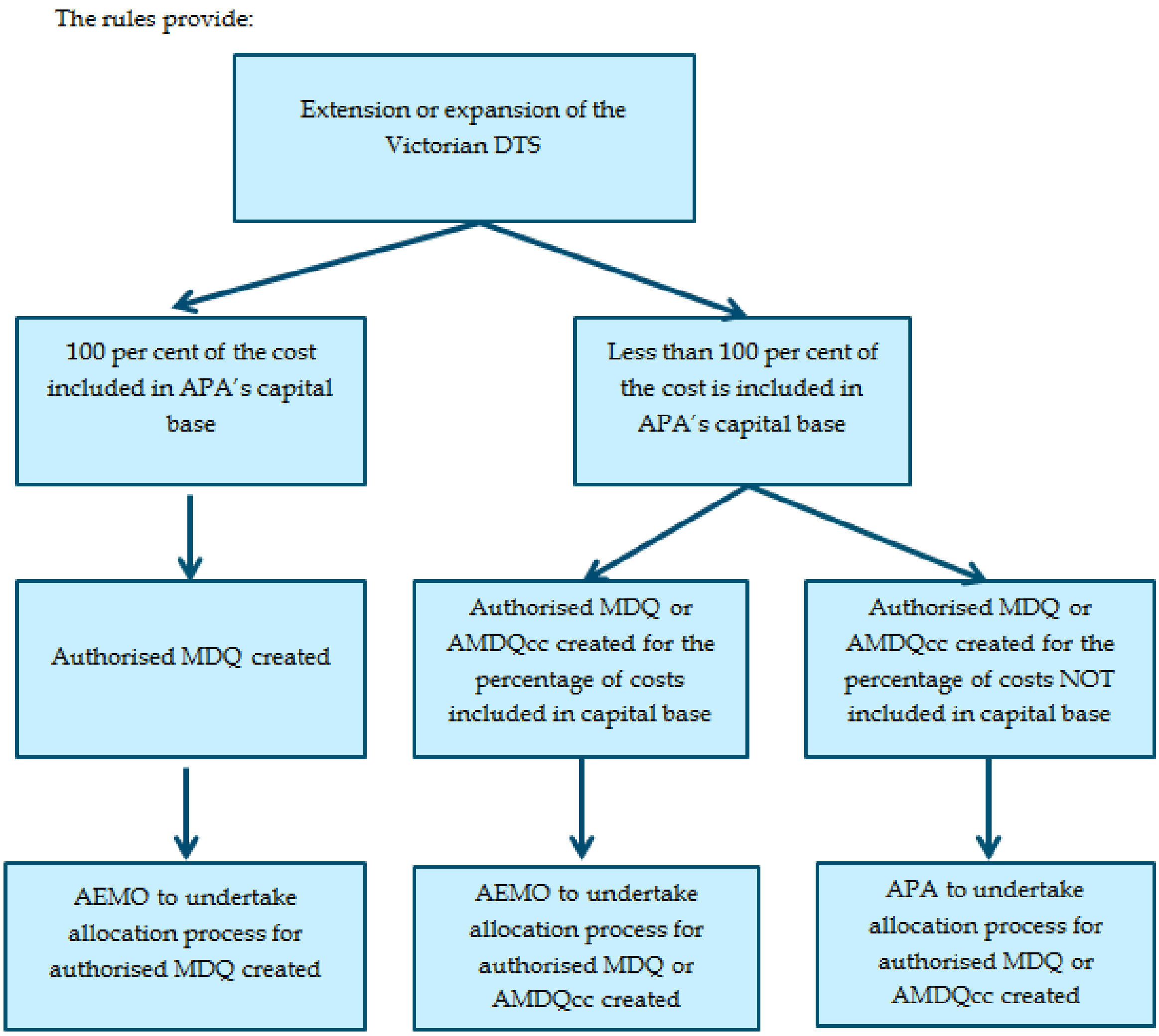
The current requirements as prescribed in Part 19 of the National Gas Rules (NGR) provide that either authorised MDQ or AMDQcc is created when a new expansion or extension is completed and provides that either AEMO or APA is responsible for undertaking the allocation process for those new instruments created.

Under the rules the following applies:

- If the entire cost of the extension or expansion of the Victorian DTS is included in APA's capital base, authorised MDQ is created and is to be allocated in accordance with AEMO's procedures (AMDQ auction procedures);
- If the entire cost of the extension or expansion of the Victorian DTS is not included in the APA's capital base then:
  - either authorised MDQ or AMDQcc is created;
  - for the portion of the extension or expansion that is included in the capital base, the authorised MDQ or AMDQcc that is associated with that portion of included costs is to be auctioned by AEMO;
  - for the portion of the extension or expansion that is not included in the capital case, the authorised MDQ or AMDQcc created that is associated with that portion of the non-included costs, APA is to direct AEMO how to allocate, among market participants the authorised MDQ or AMDQcc.

8 The nominated AMDQcc are called AMDQ credits.

Figure 2.1 Current requirements under the NGR

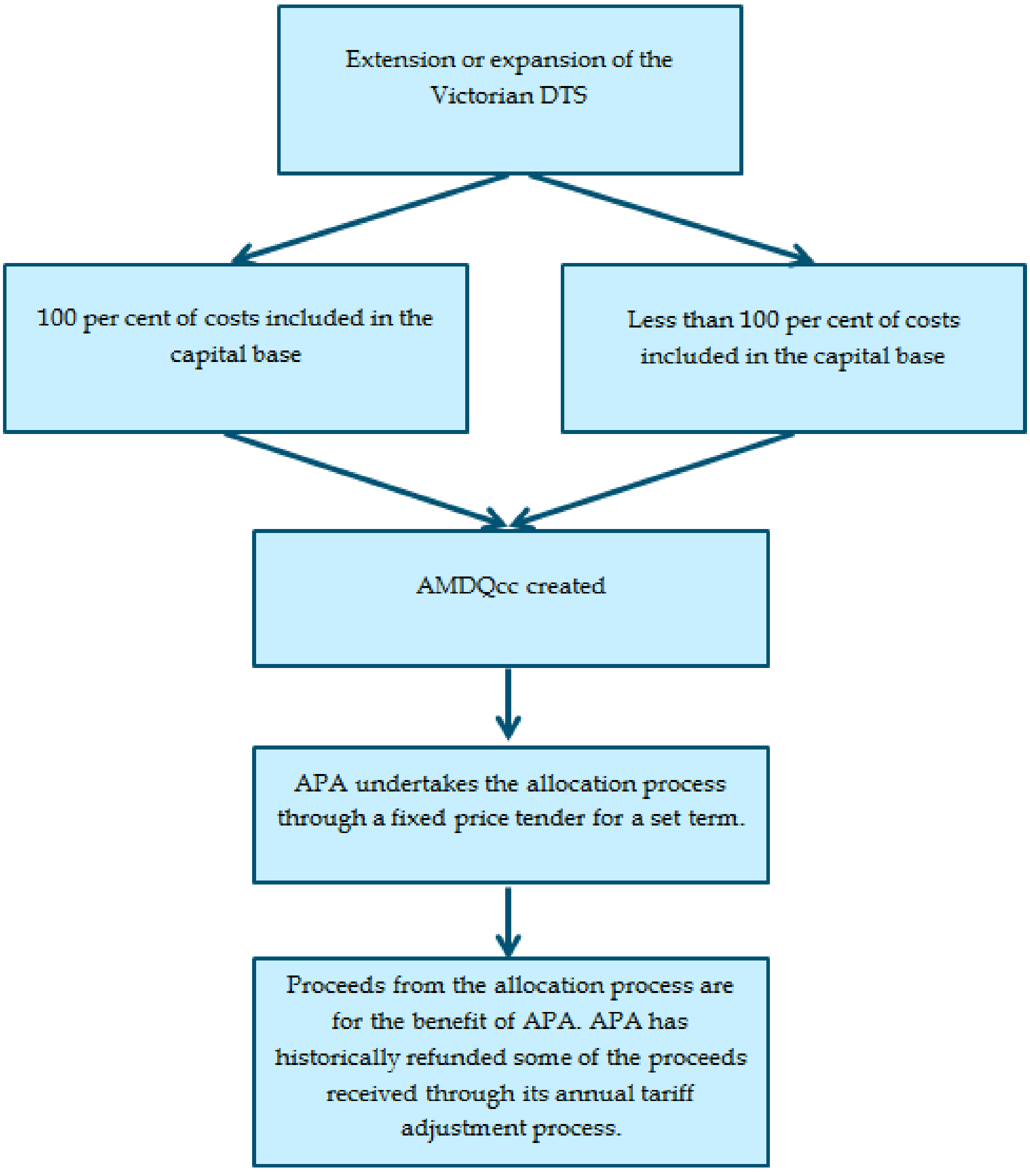


2.2.4 Current practice

Although the rules currently indicate that either authorised MDQ or AMDQcc is created when there is a new extension or expansion, the current practice results in AMDQcc being created in relation to all new extensions or expansions. Further, although the rules prescribe that the inclusion or non-inclusion of costs in the capital base determines the party responsible for undertaking the allocation process (AEMO or APA), all AMDQcc is tendered by APA through its tender process whether or not the costs associated with the extension or expansion are included in the capital base.

Figure 2.2 Current practice

Currently, the practice of APA is as follows:



Under the current practice, authorised MDQ only relates to the historical authorised MDQ which was in existence when the Victorian DWGM was created. To date, no expansion or extension of the Longford pipeline has taken place and no new authorised MDQ has been created. As such, AEMO has so far only been responsible for the re-allocation of existing authorised MDQ that became available.

We understand that the current practice has been followed in relation to all extensions and expansions that have occurred on the Victorian DTS since the inception of AMDQcc.

Question 1 Current practice

(a) Has the current practice relating to the classification of new capacity instruments and the party who undertakes the allocation process been correctly set out above?

(b) If not, please identify any inaccuracies.

2.2.5 Gas Wholesale Consultative Forum

APA proposed the NGR amendments contained within the rule change request in May 2012 at the Gas Wholesale Consultative Forum (GWCF). AEMO, in its rule change request, submitted that the GWCF was generally supportive of the proposed changes but made the following observations:

- stakeholders requested greater clarity around the AMDQcc auction process especially around timing. GWCF agreed that a new clause be inserted requiring AEMO to give twenty business days' notice of an auction of authorised MDQ;
- stakeholders requested a correction of terminology in rule 327 as there is no system access arrangement for the Victorian DTS;
- a stakeholder raised issues with the proposed changes to rule 330. The stakeholder stated that they believe there is a fundamental issue with regard to how additional transmission capacity is treated. If it is treated as authorised MDQ then AEMO will have the role for allocating (auctioning) the additional capacity to market participants and the revenue from the auction will be used to offset AEMO's market fees. If it is treated as AMDQcc then APA will be responsible for the auction process. Potentially this may yield additional revenue to APA in addition to the regulated revenue determined in the access arrangement. AEMO indicated it met with the stakeholder to discuss this issue.[9]

The GWCF signed off the rule change proposal at its June 2013 meeting after AEMO incorporated feedback received from stakeholders through the GWCF process.

Although the main issue in the rule change request was raised by APA, pursuant to section 295(3) of the NGL only AEMO or the Victorian minister may submit a rule change request related to the Victorian DWGM to the AEMC.

2.2.6 Review of the Victorian Declared Wholesale Gas Market

On 4 March 2015, the Victorian government requested the AEMC to initiate a review of the Victorian DWGM. Under the review, the AEMC is to consider:

9 Rule change request, p 7

- **effective risk management in the Victorian DWGM**: the ability of market participants to manage price and volume risk in the Victorian DWGM and options to increase the effectiveness of risk management activities;

- **signals and incentives for efficient investment in and use of pipeline capacity**: whether market signals and incentives are providing for efficient use of, and efficient timely investment in, pipeline capacity on the Victorian DTS;

- **trading between the Victorian DWGM and interconnected pipelines to maximise the efficiency of trade**: whether producers and shippers can operate effectively across the different gas trading hubs on the east coast without incurring substantial transaction costs;

- **promoting competition in upstream and downstream markets**: whether the Victorian DWGM arrangements continue to facilitate market entry and promote competition in upstream and downstream markets and how this could be improved.

The Victorian gas market review is looking at the Victorian gas market at a much broader level than this rule change request. Nonetheless, the classification and allocation of new capacity as authorised MDQ or AMDQcc and who is responsible for undertaking the allocation process for the capacity instruments appears to interact with some of the broad issues being considered as part of the review.

3 Details of the Rule Change Request

AEMO submitted the rule change request to clarify the classification of new capacity created in the Victorian DWGM. Specifically, AEMO proposes that all new capacity created through an extension or expansion of the Victorian DTS create AMDQcc which is to be tendered by APA. The rule change request is available on the AEMC website.[10]

This section sets out:

- the issues the rule change request seeks to address;
- the operation of the proposed rule; and
- the rationale for the proposed rule.

3.1 Issues the rule change request seeks to address

AEMO considers that there are three issues with the current rule that it is seeking to resolve through the rule change request:

- **Structure of the rules**: AEMO indicates that the current rules are difficult to interpret with significant cross-referencing and nesting of clauses and that there are gaps in the rules. AEMO submits that the current difficulties with the rules have arisen, in part, due to the incorporation of the original Victorian Market and System Operation Rules into the NGR. There was little revision between these original rules and the rules as set out in the NGR. AEMO indicates that this process was controlled by the Victorian government with little opportunity for stakeholder input. AEMO indicates that the requirement in the rules to move from rule to rule and rely on non-application of provisions creates an unnecessarily complex rule structure and hinders easy interpretation of the rules.

- **Basis for deciding capacity type**: AEMO provides that the current rules do not provide a basis for determining if an expansion or extension creates authorised MDQ or AMDQcc and as a result, the classification of new capacity is done by agreement between AEMO and APA.

- **Basis for allocation**: AEMO provides that, generally AEMO re-allocates existing authorised MDQ based on its own auction process. However, under the current rules AEMO indicates that there is one exception to this which results in APA directing the allocation of authorised MDQ when the costs of an extension or expansion are not wholly included in APA's capital base.

10 See: http://www.aemc.gov.au/Rule-Changes/DWGM-AMDQ-allocation

Question 2 Issue identification

(a) Has AEMO correctly identified the issues relating to the current provisions of the NGR?

(b) If not, what other issues, if any, do stakeholders see in relation to the NGR provisions as currently drafted?

3.2 Operation of the proposed rule

The rule change request seeks a clarification of the rules which would bring in line the rules with the current practice. AEMO's proposed rule includes three components to address the issues identified by AEMO in its rule change request:

1. confirmation that authorised MDQ only relates to historical capacity by amending the definition of authorised MDQ in rule 200 to include a specific reference to authorised MDQ relating to the capacity of the system injection point at Longford as at 15 March 1999;

2. providing that all new capacity created through an extension or expansion on the system, including an extension or expansion of the Longford pipeline, would create AMDQcc through the inclusion of a specific reference to AMDQcc being created in rule 329(1) and removing the link between the classification of new capacity with the determination of the AER relating to costs being included or disallowed in APA's capital base by removing rule 329(2) and (3) of the rules;

3. providing that APA is the party responsible for undertaking the allocation process of the AMDQcc created and then directing the AEMO to allocate the AMDQcc to market participants pursuant to rule 329(4).

In addition to the proposed amendments which are meant to address the specific issues identified by AEMO, there are two consequential amendments that AEMO has proposed to provide for better operation of the system:

1. Minimum notice periods: AEMO is proposing to include a minimum notice period of twenty business days which must be provided to market participants prior to an AEMO auction for authorised MDQ or an APA tender of AMDQcc, as the case may be, through the inclusion of rules 329(1A) and 330(4)(b);

2. Use of proceeds: AEMO is proposing to include a specific requirement in rule 330(7) that any proceeds AEMO receives from its auction of authorised MDQ is to be used to offset the costs of operating the DWGM.

Question 3 Identified solution

(a) Do you consider the solution identified by AEMO will address all of the issues associated with the classification of new capacity and the party responsible for undertaking the allocation process in the Victorian DWGM?

(b) Why or why not?

3.3 Rationale for proposed rule

3.3.1 National Gas Objective

In its rule change request, AEMO provides the following reasons for why the rule as proposed is likely to contribute to the National Gas Objective (NGO):

- **impact on efficient investment in the Victorian DTS**:

  - AEMO considers that the proposed changes will provide clarity to all parties involved in the Victorian DWGM which may assist in investment decisions in the Victorian DTS;

  - AEMO considers that providing a minimum notice period will allow market participants to make more informed decisions related to participating in the auction or tender process;

- **operational improvement**s:

  - AEMO considers that adding clarity to the rules is likely to contribute to the achievement of the NGO, although the efficiency gains could be minor. The clarification of the allocation of tasks between AEMO and APA is important for all stakeholders as it impacts their commercial transactions.

3.3.2 Expected costs and benefits

AEMO provides a high level cost-benefit assessment in the rule change request. It considers that the proposed rule provides a benefit to all participants by providing clarity rather than an actual financial benefit.

AEMO provides that the rule change request will not impose any direct costs on market participants or have an impact on the cost structures of market participants.

Question 4 Costs and benefits

Do you consider AEMO's analysis of the total market costs and benefits include all potential costs and benefits that may result from the proposed rule? If no, why not?

4 Assessment Framework

The Commission's assessment of this Rule change request must consider whether the proposed Rule promotes the NGO as set out under section 23 of the NGL.

The NGO 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."

The NGO captures three dimensions of efficiency: productive (efficient operation), allocative (efficient use of) and dynamic efficiency (efficient investment).[11]

Based on a preliminary assessment of this rule change request, the most relevant aspects of the NGO, for the purpose of this rule change request, are:

- efficient use of the transmission system by market participants;
- efficient operation of the transmission system with respect to price; and
- efficient investment in the Victorian DWGM.

The rule change request will be examined in light of the NGO which requires rule changes to promote efficiency in the long term interests of consumers. In assessing the rule change request the AEMC will first consider whether there is a problem to be addressed. If the AEMC considers there is a problem, it is proposed that the rule change request be assessed against the following factors to determine whether the rule change would contribute to the achievement of the NGO:

- **Effective capacity allocation process**: The process used to auction or tender authorised MDQ and AMDQcc may impact the decisions made by the AEMO, APA and market participants. The AEMC will investigate whether increased certainty in the process used to auction or tender authorised MDQ or AMDQcc, including the use of the proceeds from the auction or tender process, will promote efficient investment in the system. Further, the AEMC will investigate whether certainty in the process used and in the use of the proceeds from the auction or tender process will promote efficient use of the system by market participants who participate in the auction or tender processes.

11 Productive efficiency means goods and services should be provided at lowest possible cost to consumers; allocative efficiency means that the price of goods and services should reflect the cost of providing them, and that only those products and services that consumers desire should be provided; dynamic efficiency means arrangements should promote investment and innovation in the production of goods and services so that allocative and productive efficiency can be sustained over time, taking into account changes in technologies and the needs and preferences of consumers.

- **Increased information provision**: generally, greater information provision allows all parties to make more informed decisions regarding how they will operate their business and how they will behave in the market. The AEMC will investigate whether the mandatory notice provisions included in the proposed rule will assist market participants in making more informed and efficient decisions.

- **Regulatory certainty**: improved regulatory certainty improves confidence in the operation of the market by market participants, AEMO and APA. The potential for the rule change to reduce inconsistencies in the rules and reduce gaps in the rules will be investigated. The AEMC will examine whether greater certainty in relation to the classification of new capacity created as a result of extensions and expansions as AMDQcc will promote efficient investment in the Victorian market.

5 Issues for Consultation

Issues relevant to this rule change request are outlined below and have been provided for guidance. Based on its initial assessment, the AEMC is of the view that the rule change request does more than clarify the rules but rather would change the current requirements in relation to authorised MDQ and AMDQcc in a way that may have an impact on various parties who participate in the Victorian DWGM. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper, including the proposed assessment framework.

5.1 Effective allocation process

5.1.1 AEMO's allocation process

Currently when authorised MDQ becomes available on the system, AEMO undertakes the allocation process. Rule 330(6) of the NGR provides that AEMO must have procedures related to the allocation process it will use, the AEMO auction procedure.

Under AEMO's process, when authorised MDQ is available, AEMO provides notice via its website[12] regarding the quantity of authorised MDQ available and seeks bids for the quantity available.

Auction process: AEMO uses a 'multi-unit pay-as-bid' (or discriminatory) auction design to allocate available authorised MDQ. Market participants may submit up to five price bids. Each bid contains a quantity of authorised MDQ requested at the specific bid price (price step). Bidders may submit a price of zero. Market participants must also indicate if they are willing to accept a partial allocation of authorised MDQ as part of their bid.

Winner and price determination: Upon receipt of the bids, if the quantity of bids received is less than the quantity of authorised MDQ available, then all those parties who submitted a bid receive their requested quantity of authorised MDQ for zero dollars.

If on the other hand, the quantity of bids received is greater than the quantity available, authorised MDQ is allocated in order of the highest to the lowest bid price until the authorised MDQ is fully allocated. Successful bidders pay their own bid price for each of the successful bids.

Revenue: We understand that, historically, AEMO has used the auction proceeds to offset the cost of operating the Victorian DWGM. As part of the proposed rule, AEMO has included a provision requiring this practice to continue.

12 http://aemo.com.au/Gas/Metering-and-Settlements/Victorian-Declared-Wholesale-Gas-Market/Authorised-Maximum-Daily-Quantity-AMDQ

5.1.2 APA's allocation process

Currently, the NGR does not stipulate any requirements regarding the allocation process to be used for allocating AMDQcc. Historically, APA has sold AMDQcc through a tender process together with the transportation or injection of gas for a specific location.

Auction Process: APA uses a fixed price tender to allocate AMDQcc. APA sets a price and requests bids from market participants for the quantities of AMDQcc they require at the specific price set by APA.

Winner and price determination: If APA receives bids for less than the quantity available, it allocates the quantity requested to all those market participants who submitted bids. Where the quantity of bids submitted exceeds the quantity available, APA allocates the available capacity on a pro-rata basis based on the capacity requested in each bid.

The price is not set by market participants but rather by APA. Market participants only nominate the quantity of AMDQcc that they are seeking. The price set by APA is generally equal to or greater than the injection reference tariff for that location set by the AER. The ability of APA to set a price that is greater than the reference tariff is a result of several factors, including supply conditions (additional AMDQcc can only be obtained from APA) and demand conditions (market participants' perception of the benefits they will receive from holding AMDQcc).

We understand that market participants are more willing to pay a premium for AMDQcc over the relevant reference tariff when the DTS is constrained. This is due to AMDQcc providing a hedge against the risk of curtailment and the payment of uplift charges.

Revenue: When APA tenders AMDQcc, the revenue it receives can be broken down into two components:

- the 'volume effect': which arises as a result of:
  - APA collecting the AMDQcc price on the full capacity amount whether or not the holders uses their full capacity entitlement; and
  - APA collecting the reference tariff from other market participants who don't hold AMDQcc on the spare capacity not being used by AMDQcc holders but for which AMDQcc holders have already paid.
- the 'price effect: which arises as a result of the difference in price between the reference tariff and the tender price for the AMDQcc.

Currently, APA retains any additional revenue obtained as a result of the 'price effect' but refunds the 'volume effect' back through its annual tariff adjustment mechanism. The annual tariff adjustment mechanism results in a reduction of the reference tariff associated with a particular location for the following year.

5.1.3 Auction design

Auction design and auction rules have a potential influence on market outcomes. For example, the opportunity for a bidder to nominate or influence the price or to revise their bids allowing them to outbid other market participants are important considerations in auction design. 'Tie-breaking' and 'rationing' rules also can have significant influence on the strategic incentives of bidders to formulate their bids and to over-or-understate their required quantities or the prices they are willing to pay for these. As a consequence, the allocation mechanism can influence the efficiency of the price signal that a specific market design creates.

In the context of allocating capacity instruments in the Victorian DWGM, the bids relate to values held privately by market participants about their experiences and expectations relating to increased uplift charges and curtailment. These private values can be translated into bids through the allocation process implemented by AEMO or APA. However, due to the difference in auction design used by AEMO and APA it may be the case the same capacity instrument allocated through the different mechanisms may result in different market outcomes. This implies that it is the allocation process used and not necessarily the organisation that conducts the auction that is important in creating the right price signal.

Question 5 Allocation process

(a) Is the process and design of the allocation mechanism used by AEMO to allocate authorised MDQ efficient? If not, what improvements are necessary?

(b) Is the process and design of the allocation mechanism used by APA to allocate AMDQcc efficient? If not, what improvements are necessary?

5.2 Regulated revenue amount

Economic regulation under the NGL is applied to covered pipelines. There are two types of regulation for covered pipelines: full regulation and light regulation.

Under full regulation, the pipeline owner is required to have a full access arrangement which sets outs the reference tariffs, services to be offered and terms and conditions applicable to the services provided. These access arrangements are approved by the AER, typically on a five-year cycle.

Under light regulation, the pipelines are not required to have a full access arrangement but rather may submit a limited access arrangement to the AER for approval. These limited access arrangements do not set out reference tariffs but rather set out the non-price terms and conditions applicable to the pipeline services offered.

The Victorian DTS pipeline is under full regulation and APA is required to submit a full access arrangement, including the applicable reference tariffs to the AER for approval. The AER sets "tariffs for reference services ...at a level that allows a service provider the opportunity to earn sufficient revenue to cover the efficient cost of providing these services".[13]

The AER uses the building block approach to determine the efficient level of costs to provide the services and the amount of revenue that is required. The revenue requirement is based, in part, on APA's capital base, its capital expenditures projected during the access arrangement period (which would include expenditures for extensions or expansions of the system), forecast operating expenditures and a rate of return. The estimated usage of the pipeline services are then used to determine the appropriate tariffs so that the tariffs provide the pipeline owner will the opportunity to collect the total revenue requirement.

The NGR as currently drafted provides that APA does not receive any revenue from the allocation of authorised MDQ or AMDQcc when the costs of the extension or expansion are included in its capital base. This results from AEMO being the party responsible for undertaking the allocation process for the capacity instruments created.

APA will receive revenue in addition to its regulated revenue amount when either the AER has made a determination that all or part of the cost of the extension or expansion should not be included in the capital base (for that portion of costs not included in the capital base) or if the extension or expansion is privately funded. In this case, APA would be responsible for the allocation process and the price it collects from this process would be for its benefit.

In contrast, AEMO's proposed rule and the current practice would allow APA to earn the regulated revenue amount and other revenue outside the regulated revenue amount as a result of the sale of AMDQcc even when the costs are included in APA's capital base. This gives rise to the possibility of an over-collection problem; namely, the over-collection of revenue by APA resulting from the 'price effect' and 'volume effect' (outlined above). Therefore, it would appear that under the current practice and the proposed rule, the possibility exists for APA to collect an amount over its regulated revenue amount in relation to extensions or expansions that have been included in its capital base.

Question 6 Regulated revenue

(a) Is the AEMC's understanding of the linkage between the inclusion of costs into the capital base and the opportunity to earn only the regulated revenue amount correct? If not, why not?

(b) Is the inclusion of the costs associated with an extension or expansion in the capital base an appropriate factor to determine who undertakes the allocation process? Why or why not?

13 AER, Access arrangement final decision APA GasNet Australia (Operations) Pty Ltd 2013-17, Part 1, p.8

(c) Is the regulated revenue amount received by APA pursuant to its access arrangement a sufficient investment incentive to ensure efficient investment in the DTS? Why or why not?

(d) Do stakeholders have a view on the materiality of the issue related to the 'volume effect' and 'price effect' going forward? What is this view based on?

(e) If stakeholders are of the view that neither the 'volume effect' or 'price effect' are material at this time, are there specific market developments that may impact the market resulting in the 'volume effect' or 'price effect' becoming material?

(f) If so, what are these market developments?

(g) If the party who undertakes the allocation process was determined based on the inclusion or exclusion of costs in the capital base in comparison to the current practice of AEMO undertaking the allocation process for authorised MDQ and APA undertaking the allocation process for AMDQcc:

- **what, if any, impact would this have on parties participation in the market?**
- **what parties are likely to be affected either positively or negatively?**
- **how would these parties be affected?**
- **will market participants' behaviour be affected? If so, how?**
- **if so, what are the consequences or outcomes of these behavioural changes on efficiency in the market and/or the long-term interests of consumers?**

5.3 Investment signals

Appropriate and efficient investment signals are an important part of the Victorian DWGM to ensure that investments are made when and to the extent needed for the long term benefits of consumers. Typically, in contract carriage markets the investment signals are provided by market participants seeking long term contracts for the use of pipeline capacity. Pipeline capacity rights also represent exclusive rights for a share of the pipeline capacity. In the Victorian DWGM, which is a market carriage system, capacity instruments do not relate to an exclusive right to use a share of the capacity. Market participants are not obliged to hold capacity instruments in order to ship gas. In this market, investment signals and incentives are derived from other market mechanisms.

The capacity instruments in the Victorian DTS differ in terms of their location and time period. Authorised MDQ relates to the Longford to Melbourne pipeline only, but for an indefinite time period. AMDQcc on the other hand relates to the rest of the

Victorian DTS but for a set term. Therefore, the price market participants are willing to pay for these instruments may be different.

Generally, the price of authorised MDQ or AMDQcc reflects the benefits provided (or cost avoided) by holding the instrument. In the case of authorised MDQ and AMDQcc this may include, for example, the value of the avoided uplift charges and curtailments as a result of holding these instruments.

When the price of authorised MDQ is above zero dollars or when the price of AMDQcc is above the reference tariff, this may reflect that market participants perceive that uplift charges or curtailment will increase in the future. The price paid for authorised MDQ or AMDQcc reflects the participant's willingness to pay to avoid these increased costs and may be perceived as the investment signal to APA that an extension or expansion of the Victorian DTS may be warranted.

Alternatively, it may be thought that the actual increase in uplift charges and curtailment activity is the investment signal to APA that an extension or expansion of the Victorian DTS may be warranted.

If the actual increase in uplift charges and curtailment is the investment signal in the Victorian DTS, rather than the price paid for authorised MDQ or AMDQcc to avoid this increase, then this signal is not dependent on the allocation process or the responsible party who undertakes the process. The investment signal, which is the total amount of uplift charges paid and the occurrence of curtailment on the system, will occur regardless of the price paid for the authorised MDQ or AMDQcc.

That is not to say that the price paid for authorised MDQ and AMDQcc does not provide insight into the market and the behaviour of market participants, including that of APA. The price paid for authorised MDQ and AMDQcc may provide an indication of the level of the perceived risk of increased uplift charges and curtailment whereby a higher price would indicate a higher perceived risk.

Question 7 Investment signals

(a) Are the allocation processes currently used in the Victorian DWGM efficient mechanisms to provide investment signals in the market? If no, why not?

(b) Does AEMO's auction process for authorised MDQ provide any investment signals to the market? If no, why not? If yes, how?

(c) Does APA's tender process for AMDQcc provide investment signals to the market? If no, why not? If yes, how?

(d) Are there other mechanisms, under the current market design, that provide investment signals in the Victorian DWGM? What are these other mechanisms?

(e) If there are other market mechanisms, how do they interact with the price determination and allocation processes currently used by AEMO or APA?

(f) Would the same investment signals exist if AEMO undertook the allocation process for AMDQcc? If no, why not?

5.4 Information provision

Generally, the more information available in the market, the more informed and efficient the outcome of the decision making process. However, a balance is usually required relative to the amount and type of information that must be provided. This balancing will take into account the time and expense involved in providing the required information, the value of providing the information to the market and commercial sensitivities associated with the content of the information.

Currently, the NGR does not require either AEMO or APA to provide a minimum notice period to market participants prior to undertaking their allocation process. This results in AEMO and APA determining the amount of notice that will be provided, which notice may vary over time.

That said, in order to ensure that the authorised MDQ or AMDQcc is fully allocated, it would appear that both AEMO and APA would want to ensure that market participants have adequate notice to participant in the allocation process. There is no evidence currently before the AEMC that the notice historically provided by AEMO or APA has been inadequate. However, given that the minimum notice provisions were included in the rule change request as a result of the issue being raised by stakeholders at the GWCF, there would be some indication that stakeholders are of the opinion that notice periods could be improved.

Although notice has been provided to market participants in the past, notice in and of itself does not necessarily equate to adequate notice for a market participant to fully analyse its current position, its future prospects and make an informed decision relative to its participation in the allocation process. Adequate notice allows participants in the allocation process sufficient time to consider the bid price, quantity or both, depending on the process, and the potential benefits and consequences of the allocation process outcome on both the financial and operational aspects of their business.

Therefore, the setting of a minimum mandatory notice provision may provide greater certainty to all participants regarding the time they will have to undertake the required assessment to determine their level of participation in the allocation process. The improved decision as a result of the mandated minimum notice period may lead to better signals to the market. This may lead to greater efficiency relative to how market participants use the system and efficient investment in the system by APA.[14]

14 The investment signal is created, in part, as a product of the market or auction design used for allocation and the strategic incentives that the auction design provide for market participants to

Question 8 Information provision

(a) Has the current practice of allowing AEMO or APA to determine the notice period associated with their respective allocation process impacted market participants' ability to fully participate in the allocation process? If so, how?

(b) Would the inclusion of a mandatory minimum notice period prior to the allocation process occurring allow parties to make more informed decisions?

(c) What may be the benefits for the market of market participants making more informed decisions in relation to the allocation process?

(d) Would inclusion of a mandatory minimum notice provision alter the way parties participate in the market? If so, how?

(e) Is twenty business days' notice the appropriate minimum notice period? If not, what is and why?

(f) Is there a need for a maximum notice period? If so, what should it be?

5.5 Regulatory certainty

Generally, a rule needs to balance flexibility to adjust to practical and operational requirements in the market with certainty relating to parties rights and obligations in the market. When provisions are unclear, uncertain or ambiguous it can lead to increased risk or a perceived increased risk for market participants.

Unclear, uncertain or ambiguous provisions may result in behavioural changes from market participants and inefficient outcomes relating to the decisions made by those market participants. The inefficient outcomes may relate to investment or lack of investment in the market or market participants making inefficient decisions about entering, leaving or participating in the market.

AEMO notes that the NGR as currently drafted contains inconsistencies and gaps resulting in regulatory uncertainty for all parties involved in the Victorian DWGM. This is due in part, submits AEMO, from the fact that the NGR provisions provide no basis for determining if new capacity results in the creation of authorised MDQ or AMDQcc.

The AEMC sees two distinct issues raised by AEMO that relate to regulatory certainty or uncertainty that may arise in relation to the current provisions of the NGR. The first relates to which type of instrument (authorised MDQ or AMDQcc) is created as a result of an extension or expansion. The second relates to who undertakes the allocation process when new authorised MDQ or AMDQcc becomes available. The proposed rule appears to address both of these issues by providing that all new

submit bids. Whereas the rule change request aims to address the latter, it does not address any of the problems that there may be related to the market or auction design that is used to allocate authorised MDQ or AMDQcc.

instruments resulting from an extension or expansion are AMDQcc. The rule also attempts to clarify that all AMDQcc will be allocated through APA's, rather AEMO's, allocation process. That said, AEMO's proposed rule is only one option for addressing any perceived regulatory uncertainty. There may be other appropriate options which address the regulatory uncertainty issues which results in a more efficient outcome.

Question 9 Regulatory certainty

(a) Do the provisions of the NGR at issue in this rule change request result in a perception of regulatory uncertainty in the market? Why or why not?

(b) Does the proposed rule address any regulatory uncertainty in the current provisions? If no, why not?

(c) Are there other appropriate ways to address any regulatory uncertainty present in the market as a result of the operation of the NGR provisions? If so, what are they?

(d) In your view, is your alternate approach more appropriate then (a) the current provisions as set out in the NGR; and (b) AEMO's proposed rule? Why?

(e) If the current provisions are considered to result in regulatory uncertainty:

- **what, if any, impacts does this have on efficient investment in the Victorian DTS and by whom?**
- **what, if any, impacts does it have on market participants in relation to their participation in the market?**

Although this rule change request is examining the issues related to the creation and allocation of authorised MDQ and AMDQcc broadly, the rule change request will be assessed in the framework of the current market design of the Victorian DWGM. Broader issues related to the market design of the Victorian DWGM are being examined in the review of the Victorian gas market.

6 Lodging a Submission

The Commission invites written submission on this rule change proposal[15]. Submissions are to be lodged online or by mail by 8 October 2015 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change proposals.[16] The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Shari Boyd on (02) 8296 7869.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code GRC0029. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail or fax

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

The envelope must be clearly marked with the project reference code GRC0029.

Alternatively, the submission may be sent by fax to (02) 8296 7899.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

15 The Commission published a notice under section 303 of the NGL to commence and assess this rule change request.

16 This guideline is available on the Commission's website.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMDQcc	authorised daily quantity credit certificates
APA	APA Gas Net
authorised MDQ	authorised maximum daily quantity
Commission	See AEMC
DTS SP	declared transmission service provider
GWCF	Gas Wholesale Consultative Forum
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Victorian DTS	Victorian declared transmission system
Victorian DWGM	Victorian Declared Wholesale Gas Market