

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (DWGM-AMDQ Allocation) Rule 2015

Rule Proponent(s)

Australian Energy Market Operator

10 December 2015

RULE
CHANGE

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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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Summary

The Australian Energy Market Commission (AEMC or Commission) has made this draft rule determination which sets out a framework for determining the type of market benefit instruments (authorised MDQ and AMDQ credit certificates¹) created as a result of an extension or expansion of the Victorian declared transmission system and the party responsible for undertaking the allocation process for those instruments.

The Commission's more preferable draft rule addresses issues raised by the Australian Energy Market Operator in its rule change request² and would:

- clarify the type of market benefit instrument created in respect of extensions or expansions of the Victorian declared transmission system by providing that:
 - authorised MDQ would relate only to historic capacity on the Longford to Melbourne pipeline at the time of commencement of the Victorian Declared Wholesale Gas Market;
 - AMDQ credit certificates would be created in relation to all extensions or expansions where new market benefit instruments are created.
- provide that the Australian Energy Market Operator would be required to use the proceeds from its allocation process to offset the operating costs of the Victorian Declared Wholesale Gas Market; and
- provide that the Australian Energy Market Operator would provide twenty business days' notice prior to undertaking the allocation process of either authorised MDQ or AMDQ credit certificates.

These three aspects of the more preferable draft rule are collectively referred to as the "non-controversial aspects" of the more preferable draft rule.

The more preferable draft rule also addresses the "controversial aspect" of the more preferable draft rule relating to the party responsible for undertaking the allocation process for market benefit instruments. On this aspect of the more preferable draft rule stakeholders may hold varying views. Also the costs and benefits of this aspect of the more preferable draft rule needs to be considered in light of the Review of the

¹ Authorised MDQ and AMDQ credit certificates are instruments held by market participants in the Victorian Declared Wholesale Gas Market. These instruments differ in respect of their location and time validity but are similar in terms of the rights they represent which includes: (1) limited physical access rights which provide some protection against curtailment; and (2) some market rights which provide priority in scheduling and reduced uplift payments - for further discussion on the rights associated with market benefit instruments see section 1.1.1.

² On 13 November 2013, the Australian Energy Market Operator submitted the DWGM-AMDQ Allocation rule change request

Victorian Declared Wholesale Gas Market³ currently being undertaken by the Commission.

The more preferable draft rule in relation to the controversial aspect would:

- clarify the party responsible for undertaking the allocation process by providing that:
 - the Australian Energy Market Operator would be responsible for undertaking the allocation process for all authorised MDQ;
 - the Australian Energy Market Operator would be the party responsible for undertaking the allocation process for AMDQ credit certificates where the costs of the extension or expansion that created or creates the AMDQ credit certificates are included in the declared transmission system service provider's opening capital base for an access arrangement period or is included in its approved capital expenditures for an access arrangement period;
 - the declared transmission system service provider would be the party responsible for undertaking the allocation process for AMDQ credit certificates where the costs of the extension or expansion that created or creates AMDQ credit certificates are not included in its opening capital base for an access arrangement period or in its approved capital expenditure for an access arrangement period.

Details of the rule change request

The Australian Energy Market Operator has identified a number of issues with the current provisions dealing with authorised MDQ and AMDQ credit certificates as a result of uncertainty and lack of clarity in the rules. To address this problem, the rule change request proposed a number of amendments to Part 19 of the National Gas Rules to provide clarity in relation to the type of market benefit instrument (authorised MDQ or AMDQ credit certificates) created as a result of an extension or expansion of the Victorian declared transmission system and the party who undertakes the allocation process for the market benefit instruments.

In particular, the Australian Energy Market Operator's proposed rule would provide that all new market benefit instruments created from an extension or expansion create AMDQ credit certificates. Further, the proposed rule would provide that the declared transmission system service provider is responsible for undertaking the allocation process for all AMDQ credit certificates and the Australian Energy Market Operator is responsible for undertaking the allocation process for all authorised MDQ.

In addition, amendments were proposed requiring the Australian Energy Market Operator to offset the costs of operating the Victorian Declared Wholesale Gas Market

³ See the AEMC website: www.aemc.gov.au, Review of the Victorian Declared Wholesale Gas market

with any proceeds it receives from undertaking the allocation process and requiring twenty business days' notice to be provided prior to undertaking an allocation process for market benefit instruments.

Appendix C of this draft determination provides a table outlining the differences between the current rule requirements, the current practice undertaken in the Victorian Declared Wholesale Gas Market, the Australian Energy Market Operator's proposed rule and the Commission's more preferable draft rule.

Commission's decision

The Commission considers that the current provisions relating to the creation and allocation of authorised MDQ and AMDQ credit certificates are unclear and create regulatory uncertainty. The Commission has determined a more preferable draft rule will, or is likely to, contribute to the achievement of the National Gas Objective, by promoting more efficient use of, and possibly investment in, natural gas pipelines in the long term interests of consumers.

The Commission's assessment of this rule change request is based on the current design and operation of the Victorian Declared Wholesale Gas Market. However, the Commission is currently undertaking a review of the Victorian Declared Wholesale Gas Market which may result in subsequent changes to the design and operation of the market. Depending on the outcome of the review, the mechanisms, incentives and signals in the market may be altered. Therefore, the Commission's assessment of this rule change request is confined to the specific conditions in the Victorian Declared Wholesale Gas Market at this time.

Non-controversial aspects of the more preferable draft rule

The Commission is satisfied that the non-controversial aspects of the more preferable draft rule will, or are likely to contribute to the achievement of the National Gas Objective as follows:

- the more preferable draft rule would provide regulatory certainty to market participants with respect to the type of market benefit instruments created from an extension or expansion of the Victorian declared transmission system. This should improve confidence in the operation of the market as the interpretation and functioning of the rule will be clearer;
- the more preferable draft rule would provide increased information provision to market participants by requiring the Australian Energy Market Operator to provide twenty business days' notice to market participants prior to undertaking an allocation process. This would provide market participants an opportunity to make informed decisions about their participation in the allocation process. More informed decisions may lead to a more efficient use of the system by market participants and more efficient investment in the Victorian declared transmission system.

Controversial aspect of the more preferable draft rule

The effect of the Commission's more preferable draft rule in relation to the controversial aspect would be that the declared transmission system service provider would have diminished opportunity to over-recover in relation to AMDQ credit certificates. Further, the Commission's more preferable draft rule would result in the unbundling of AMDQ credit certificates from the pre-payment of the reference tariff for transportation services when the AMDQ credit certificates are allocated by the Australian Energy Market Operator.⁴

The Commission is satisfied that the controversial aspects of the more preferable draft rule will, or is likely to contribute to the achievement of the National Gas Objective as follows:

- the more preferable draft rule, similar to the non-controversial aspects of the more preferable draft rule, will provide regulatory certainty to market participants. In this case, the more preferable draft rule provides clarity in respect of the party who is responsible for undertaking the allocation process for market benefit instruments;
- in addition, the more preferable draft rule, would provide a more efficient allocation process by:
 - providing for the alignment of the term of AMDQ credit certificates with the term of the declared transmission system service provider's access arrangement period;⁵
 - unbundling AMDQ credit certificates from the pre-payment of the reference tariff on transportation services, which would help to ensure that market participants (and, as a result consumers) pay for those transportation services actually used. In addition, the price paid for authorised MDQ and AMDQ credit certificates as a result of the unbundling would more clearly reflect the value that market participants assign to the rights associated with holding the market benefit instruments, thereby providing better signals to the declared transmission system service provider and market participants.

Regulatory certainty and a more efficient allocation process for AMDQ credit certificates may lead to more efficient use of and investment in the Victorian declared transmission system. This is a result of market participants' demand for and the price

⁴ APA GasNet's submission to the Commission's consultation paper provided that AMDQ credit certificates allow APA GasNet to accurately forecast the demand for the expansion and gain certainty over the tariffing arrangements for the extension or expansion as AMDQ credit certificates create a take or pay arrangement for the service agreed to between the declared transmission system service provider and the market participant. See APA GasNet submission to AEMC consultation paper, p.7.

⁵ AMDQ credit certificates have historically been issued for a set term which coincides with the access arrangement period; however, the rules currently only indicate that AMDQ credit certificates are for a set term and does not address the length of the term.

paid for AMDQ credit certificates more clearly reflecting market participants' assessment of the benefits associated with holding the market benefit instruments and ensuring appropriate investment signals in the system.

The Commission notes that the unbundling of AMDQ credit certificates from the pre-payment of the reference tariff for transportation services would not necessarily mean that market participants would no longer be able to pre-pay for transportation services. Further, it is acknowledged that the economic regulatory regime under the National Gas Rules does not preclude the declared transmission system service provider from earning revenue in addition to its regulated revenue amount.

However, the Commission is of the view that the market benefits provided by AMDQ credit certificates which are used by market participants and managed by the market operator are different to other services which are provided by the declared transmission system service provider and, where possible, the potential for over-recovery of revenue related to these instruments should be minimised.

Although the Commission considers the more preferable draft rule, in relation to the allocation process is in the long term interests of consumers, the Commission has made a number of recommendations in the draft report⁶ in the Review of the Victorian Declared Wholesale Gas Market that, if implemented, would make the Commission's more preferable draft rule redundant. Therefore, the implementation and administration costs associated with this aspect of the more preferable draft rule may outweigh the short-term benefits, if the Commission's recommendations in the review are adopted.

Invitation for submissions

The Commission invites public submissions on this draft rule determination, including the more preferable draft rule, by 28 January 2016.

⁶ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

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1 AEMO's rule change request

On 13 November 2013, the Australian Energy Market Operator (AEMO) submitted a rule change request to the AEMC in relation to the creation of, and the allocation process for, the market benefit instruments authorised maximum daily quantity (authorised MDQ) and authorised maximum daily quantity credit certificates (AMDQcc) in the Victorian Declared Wholesale Gas Market (Victorian DWGM). Although the main issue in the rule change request was raised to AEMO by APA Gas Net (APA), pursuant to section 295(3) of the National Gas Law (NGL), only AEMO or the Victorian minister can submit a rule change request related to the Victorian DWGM.⁷

1.1 Relevant background

The Victorian DWGM operates as a market carriage pipeline system.⁸ Under market carriage in the Victorian DWGM, the system operator (AEMO) allocates pipeline capacity through a pool approach where gas is injected and withdrawn at various locations.

In the Victorian DWGM, APA, as the declared transmission system service provider (DTS SP)⁹ makes the transmission pipeline available to AEMO under contract. AEMO manages the receipt, transportation and delivery of gas. The transportation of gas is provided as a reference service pursuant to APA's access arrangement. The transportation of gas in the Victorian declared transmission system (Victorian DTS) is on a 'non-firm' basis whereby market participants cannot reserve capacity. This is in contrast to a contract carriage model where firm capacity can be reserved.

1.1.1 Market benefit instruments

In the Victorian DWGM, although users cannot reserve firm capacity on a pipeline, they may hold market benefit instruments which provide some limited physical benefits and some market rights and benefits for holders. There are two types of market benefit instruments, authorised MDQ and AMDQcc. These instruments differ in respect of their location and term but are similar in terms of the rights they represent. Broadly, there are two distinct types of rights created through authorised MDQ and AMDQcc:

⁷ In the Commission's Stage 1 Final Report on the East Coast Wholesale Gas Market and Pipeline Frameworks review the Commission recommended that this restriction be removed to allow any party to propose a change to the rules dealing with the Victorian DWGM, Stage 1 Final Report, East Coast Wholesale Gas Market and Pipeline Frameworks Review, 23 July 2015, p. 42

⁸ The types of transportation contracts and services available to a user will depend on whether the pipeline operates under a contract carriage model or a market carriage model.

⁹ In this draft rule determination, where there is a reference to APA it is made in the context of APA acting in its capacity as the declared transmission system service provider.

- **Limited physical access rights:** the rights associated with authorised MDQ and AMDQcc give customers some protection against curtailment in the event of an emergency. In the event of a transmission constraint in the Victorian DTS, users holding authorised MDQ or AMDQcc will have the ability to inject gas into the system ahead of users not holding authorised MDQ or AMDQcc;
- **Market 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. 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 or 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.

1.1.2 Authorised MDQ

The initial allocation of authorised MDQ occurred at the commencement of the Victorian DWGM and related to the capacity of the Longford to Melbourne pipeline. The total authorised MDQ was set at 990 TJ/day which represented the peak capacity of the Longford to Melbourne pipeline. The authorised MDQ was allocated in perpetuity at the time to existing and committed new loads as follows:

- for Tariff D¹⁰ 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; and
- 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 valid in

¹⁰ Tariff D customers are large customers with daily demand meters and are typically large industrial sites

perpetuity. The right may be relinquished, in which case AEMO may re-allocate the instruments.

1.1.3 AMDQcc

APA (the owner of the Victorian DTS) and AEMO (the operator of the Victorian DWGM) may agree to extend or expand the Victorian DTS. An extension or expansion may result in additional market benefit instruments being created. Since the commencement of the Victorian DWGM, additional market benefit instruments created as a result of extensions or expansions have been AMDQcc rather than authorised MDQ.¹¹ AMDQcc have been created to provide similar benefits in terms of the limited physical access rights and market rights to those arising from authorised MDQ but differ in respect of time validity. While AMDQcc provides rights for a set term (usually for the period of an access arrangement) authorised MDQ is for an indefinite term. AMDQcc is also not allocated directly to a customer or a customer site but to a market participant. The increase in pipeline capacity resulting from an extension or expansion project is agreed as between APA and AEMO (the operator of the Victorian DTS and Victorian DWGM). Once agreement is reached and the new capacity becomes operational, new AMDQcc are created.

1.1.4 Comparison of authorised MDQ and AMDQcc

The following table summarises the key differences between the two types of market benefit instruments:

¹¹ Since the commencement of the Victorian DWGM, the capacity of the Victorian DTS has increased as a result of numerous augmentations, including the Interconnect, the South-West Pipeline, the connection of the former Western Transmission System, the Brooklyn Lara Loop and the BassGas project.

Table 1.1 Comparison of authorised MDQ and AMDQcc

Authorised MDQ	AMDQcc
Right recognised under the NGR	Rights associated with AMDQcc are defined in the NGR but are granted to a market participant under contract
Usually held by customer or a retailer (as part of a block) for an indefinite term	Usually held by a market participant for a set term
Allocated when the market commenced in 1998 to existing and committed new loads	Allocated when new AMDQcc is created through an extension or expansion. AMDQcc is for a set term and historically has been reallocated upon the expiry of a set term
Allocation was and remains commensurate with the capacity at the Longford to Melbourne pipeline	To date, all new capacity which results from an extension or expansion has been classified as AMDQcc by agreement between AEMO and APA
Rights are in relation to withdrawal points	Rights are in relation to 'close proximity points'
Does not expire but can be transferred between parties or surrendered back to AEMO	AMDQcc is allocated for a set term and may be transferred between parties prior to the expiry of the set term but remains allocated only for the period of the original term remaining
AEMO undertakes the allocation process for spare authorised MDQ and allocates based on the results of the 'pay-as-you-bid' process	Directions from APA to AEMO on the allocation of AMDQcc where historically this is reflective of the outcome of a competitive tender process where APA tenders the available AMDQcc at a pre-determined fixed price
AEMO offsets the proceeds from the auction against the operating costs of the Victorian DWGM	APA has historically offset a portion of the proceeds from AMDQcc through its annual tariff variation adjustment

1.2 Economic regulation of gas pipelines

Economic regulation of gas pipelines under the National Gas Law (NGL) is only applied to covered pipelines which exhibit a level of market power where the benefits of regulation outweigh the costs.¹²

There are two types of regulation for covered pipelines, light regulation and full regulation. Full regulation pipelines are required to have full access arrangements

¹² Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P.F. Conlon, Elder - Minister of Transport, Minister of Infrastructure, Minister of Energy), p.12

which set out reference tariffs, services to be offered and terms and conditions. These access arrangements are to be approved by the AER through an access arrangement approval process.

In the context of economic regulation of pipelines, reference services and reference tariffs play an important role in providing a point of reference for negotiation and dispute resolution. Users and the service provider of the pipeline then have an ability to negotiate terms and conditions (including price) of access which may differ from the access arrangement terms.

The Victorian DTS is a fully regulated pipeline system. Users of the Victorian DTS then would pay to APA either the reference tariff amount or the negotiated amount for the services they use, including the transportation of gas from one point to another on the Victorian DTS.

1.3 Current rule requirements

The current rule requirements in relation to the creation and allocation of market benefit instruments are in Part 19 of the National Gas Rules (NGR).¹³ The rules provide that when an extension or expansion results in additional market benefit instruments, either authorised MDQ or AMDQcc is created and provides that either AEMO or APA is responsible for undertaking the allocation process. Currently, the allocation process used by AEMO is a 'pay-as-you' bid process¹⁴ and a competitive tender process is used by APA.

Under the current rules, the following applies:

- if the total cost of the extension or expansion that results in additional market benefit instruments is entirely added to APA's capital base, authorised MDQ is created and AEMO is responsible for undertaking the allocation process;
- if only part of the cost of the extension or expansion that creates additional market benefit instruments is added to APA's capital base then:
 - either authorised MDQ or AMDQcc is created;¹⁵
 - for the portion of the extension or expansion that is included in the capital base, then the market benefit instruments created are subject to AEMO's allocation process;
 - for the portion of the extension or expansion that is not included in the capital base, then APA undertakes the allocation process and directs

¹³ Subdivision 3 of Division 4 of Part 19 of the NGR.

¹⁴ The allocation process used by AEMO for authorised MDQ is prescribed in the AMDQ auction procedures made by AEMO.

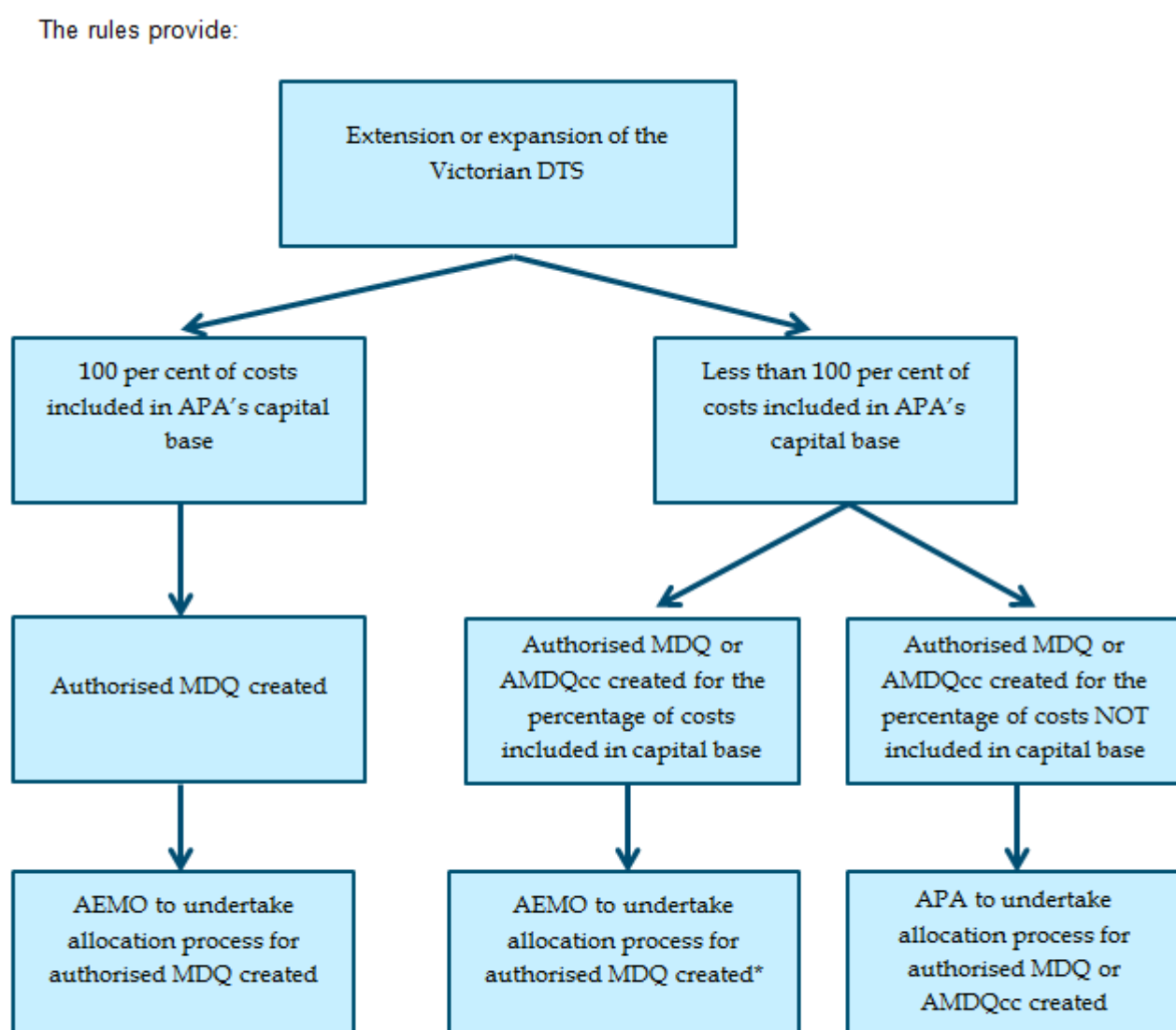
¹⁵ The rule change request identified that the lack of direction in respect of whether authorised MDQ or AMDQcc is created under the current rules is an issue and creates uncertainty.

AEMO how to allocate, among market participants, the market benefit instruments created.

- if AEMO undertakes the allocation process it must do so in accordance with rule 330 which sets out the procedure for subsequent allocations and re-allocations of authorised MDQ; and
- where AEMO is not the party responsible for the allocation process, then in accordance with current rule 329(5), the authorised MDQ or AMDQcc are to be allocated by AEMO to market participants for a set term for use within specific withdrawal zones or for use at system injection points, as directed by APA.

The current rules are further demonstrated in the following flow chart:

Figure 1.1 Current rule requirements



* Although the rules provide that either authorised MDQ or AMDQcc may be created where the costs of the extension or expansion are included in APA's capital base, the rules also only provide an allocation process to be followed by AEMO in relation to authorised MDQ.

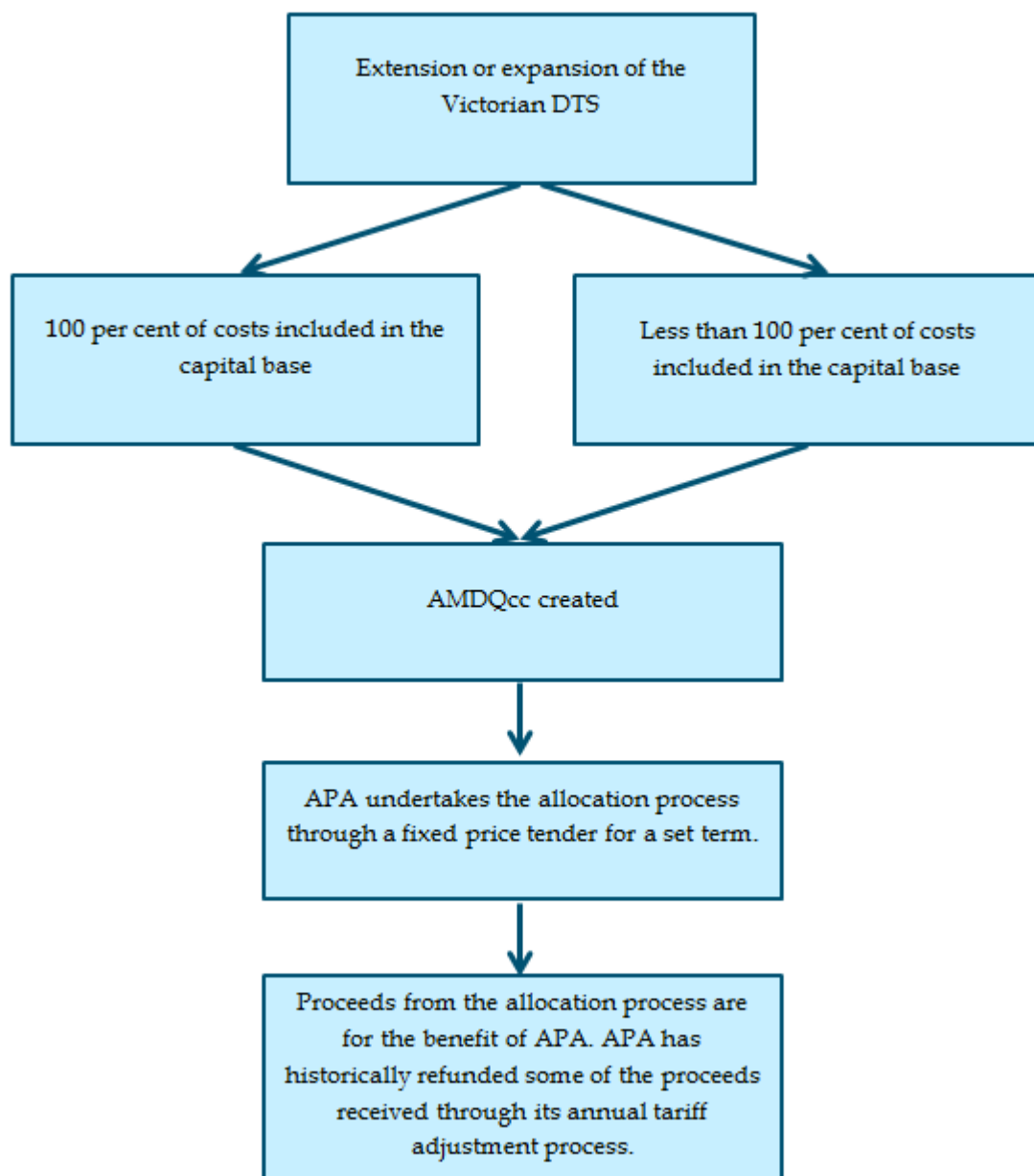
1.4 Current practice

Although the rules currently indicate that when an extension or expansion results in new market benefit instruments, either authorised MDQ or AMDQcc is created, the current practice results in AMDQcc being created in relation to all such extensions or expansions. Further, all AMDQcc is currently subject to APA's allocation process, namely a competitive tender process, whether or not the costs associated with the extension or expansion are included in APA's capital base.

The current practice is further demonstrated in the following flow chart:

Figure 1.2 Current practice

Currently, the practice of APA is as follows:



Under the current practice, authorised MDQ only relates to the historic authorised MDQ that was in existence when the Victorian DWGM commenced operation. To date, no expansion or extension of the Longford to Melbourne pipeline has taken place and no new authorised MDQ has been created. As such, AEMO has only been responsible for undertaking the allocation process for existing authorised MDQ when it becomes available.

The current practice has been followed in relation to all extensions or expansions that have created new market benefit instruments on the Victorian DTS.

Under the current practice, there has been some concern that APA is able to collect more than its regulated revenue amount, as a result of the:

- **Price effect:** which arises as a result of the difference in the price between the reference tariff and the tender price for AMDQcc (AMDQcc is sold by APA in a "bundle" which includes the market benefits associated with AMDQcc and the pre-payment of the reference tariff on transportation services¹⁶); and
- **Volume effect:** which arises as a result of:
 - APA collecting the AMDQcc price (which includes the pre-payment of the reference tariff for transportation services) on the full capacity amount associated with AMDQcc whether or not the AMDQcc holders use the full amount of the volume of transportation services which they pre-paid; and
 - APA collecting the reference tariff for transportation services from other market participants who don't hold AMDQcc when AMDQcc holders do not use the full volume of transportation services for which they have pre-paid.

Under APA's current access arrangement for the period 2013 to 2017, the AER determined that AMDQcc is a pipeline service¹⁷ and set a reference tariff for AMDQcc. The reference tariff for AMDQcc was based on the costs of issuance of AMDQcc¹⁸ and was set at \$0.0125 per GJ.¹⁹ A reference tariff had not previously been set for AMDQcc. At the time of the access determination for the 2013-2017 access arrangement period, all AMDQcc for the period 2013-2017 had been allocated through APA's tender process prior to the AER determining that AMDQcc was a reference service. However, any AMDQcc that becomes available during the current access arrangement period would be subject to the reference tariff set for AMDQcc.

In addition to the setting of the reference tariff by the AER in APA's the last access arrangement, the current practice may also be altered as a result of the Commission's decision on the reference service and rebateable service definitions rule change

¹⁶ See APA GasNet's submission to the AEMC consultation paper, p. 7

¹⁷ AER final decision, APA Gas Net, part 2, p.22

¹⁸ AER final decision, APA Gas Net, part 2, p.22

¹⁹ AER final decision, APA Gas Net , part 2, p. 262

request.²⁰ The National Gas Amendment (Reference service and rebateable service definitions) Rule 2012 No. 2 provides some discretion to the AER in deciding which pipeline services that are sought by a significant part of the market should be classified as a reference service and, therefore, a reference tariff set. As a result, in the future the AER has discretion in determining if a reference tariff will be set for AMDQcc.

1.5 The rule change request

AEMO's rule change request indicates that there are at least three issues with the current rules:

- the structure of the rules hinders easy interpretation;
- there is no basis for deciding the type of market benefit instrument created as a result of an extension or expansion; and
- there is uncertainty in relation to the party responsible for undertaking the allocation process for authorised MDQ.

These issues are further described in Chapter 3 of this draft rule determination.

To address the matters identified above, AEMO has proposed a number of amendments to Part 19 of the NGR. The rule change request includes a proposed rule.

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

- authorised MDQ relates only to the historic capacity of the Longford to Melbourne pipeline at the time of commencement of the Victorian DWGM;
- any market benefit instruments created as a result of an extension or expansion of the Victorian DTS will be AMDQcc;
- AEMO is responsible for undertaking the allocation process for authorised MDQ; and
- APA is responsible for undertaking the allocation process for AMDQcc.

²⁰ AEMC 2012, Reference service and rebateable service definitions, Rule Determination, 1 November 2012, Sydney

In addition to the amendments proposed to address the issues identified by AEMO in its rule change request, two other amendments are proposed by AEMO to improve the operation of the Victorian DWGM:

- a mandatory notice requirement of twenty business days prior to AEMO or APA, as the case may be, undertaking its allocation process for market benefit instruments; and
- a requirement for AEMO to offset any proceeds received from its allocation process against the operating costs of the Victorian DWGM.

AEMO considers that clarification of the rules is necessary in regards to the type of market benefit instrument created and the party responsible for undertaking the allocation process for the market benefit instruments. AEMO provides that its proposed changes would have an impact on efficient investment in the Victorian DTS and result in operational improvements.

A table comparing the current rule requirements, the current practice, the proposed rule requirements and the Commission's more preferable draft rule related to the type of market benefit instrument created and who undertakes the allocation process, is included in Appendix C.

1.6 The rule making process to date

On 10 September 2015, the Commission published a notice advising of its commencement of the rule making process and the first round of consultation in respect of the rule change request.²¹ A consultation paper identifying specific issues and questions for consultation was also published with the notice. Submissions closed on the consultation paper on 8 October 2015.

The Commission received three submissions as part of the first round of consultation. They are available on the AEMC website.²² Issues raised in submissions and the Commission's responses are generally set out in the following chapters. Some other issues raised in submissions and the Commission's responses to these are set out in Appendix A.

1.7 Review of the Victorian Declared Wholesale Gas Market

On 4 March 2015, the Victorian government and the Council of Australian Governments' (COAG) Energy Council requested the AEMC to initiate a review of the Victorian DWGM. Under the review, the AEMC is to consider:

²¹ The notice was published under section 301 of the NGL.

²² <http://www.aemc.gov.au/Rule-Changes/DWGM-AMDQ-allocation>

- **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, an 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 Commission published its draft report in relation to its Review of the Victorian DWGM on 4 December 2015.²³

1.8 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination including the draft rule, by 28 January 2016.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 17 December, 2015.²⁴

Submissions and requests for a hearing should quote project number "GRC0029" and may be lodged online at www.aemc.gov.au or by mail at:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

²³ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

²⁴ In accordance with section 310(2) of the NGL, a public hearing is a formal requirement for the Commission to appear before the applicant to enable the applicant to make a presentation to the Commission.

2 Draft rule determination

The Commission's draft rule determination is to make a more preferable draft rule (draft rule). The Commission considers there are two aspects of its draft rule.

The first aspect has been referred to as the "non-controversial aspect" as no stakeholder expressed concern with these aspects of the rule change, they are in line with the current practice in the Victorian DWGM and are generally in line with the rule proposed by AEMO.

The second aspect of the draft rule has been referred to as the "controversial aspect" as stakeholders have varying views, it is a departure from current practice and AEMO's proposed rule and is inter-related to the Review of the Victorian DWGM currently being undertaken by the Commission.

- **Non-controversial aspects of the draft rule:** the draft rule provides that:
 - authorised MDQ relates only to the historic capacity of the Longford to Melbourne pipeline at the time of commencement of the Victorian DWGM;
 - all new market benefit instruments created as a result of an extension or expansion of the Victorian DTS are AMDQcc;
 - AEMO must offset the costs of operating the Victorian DWGM with any proceeds from its allocation process; and
 - twenty business days' notice must be provided to market participants prior to AEMO undertaking its allocation process.
- **Controversial aspect of the draft rule:** the draft rule links the inclusion of costs of an extension or expansion of the Victorian DTS that creates new market benefit instruments in APA's capital base (either as part of its approved capital expenditures during an access arrangement period or its opening capital base for an access arrangement period), with the party (AEMO or APA) who undertakes the allocation process for those instruments.;

The draft rule would clarify what type of market benefit instrument is created as a result of an extension or expansion and the party responsible for undertaking the allocation process of the market benefit instruments. The draft rule made by the Commission is attached to and published with this draft rule determination.

This chapter outlines:

- the Commission's rule making test for changes to the NGR;
- the Commission's assessment framework for considering the rule change request; and

- the Commission's consideration of the more preferable draft rule against the National Gas Objective (NGO).

Further information on the legal requirements for making this draft rule is set out in Appendix B.

2.1 Rule making test

Under s.291(1) of the NGL, the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NGO. The NGO is set out under s.23 of the NGL, as follows:

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

The Commission can make a rule that is different (including materially different) from a proposed rule if it is satisfied that, having regard to the issues raised in the rule change request, the more preferable rule will, or is likely to, better contribute to the NGO.²⁵

2.2 Assessment framework

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 investment in the Victorian DTS.

To give effect to the NGO, the Commission has considered the following principles in assessing the rule change request:

- **Regulatory certainty:** improved regulatory certainty improves confidence in the operation of the market by AEMO, APA and other market participants. Greater certainty in relation to the classification of new market benefit instruments created as a result of an extension or expansion and the party responsible for undertaking the allocation process may provide market participants with increased confidence in the market.
- **Increased information provision:** generally, greater information provision allows all parties to make more informed decisions regarding how they will operate their businesses and how they will behave in the market. A mandatory notice provision which requires AEMO to provide a minimum notice period prior to the allocation process for authorised MDQ or AMDQcc occurring may

²⁵ See section 296 of the NGL.

assist market participants in making more informed and efficient decisions in relation to their participation in the allocation process and the market;

- **efficient allocation process:** The allocation process employed in respect of authorised MDQ or AMDQcc may impact on decisions made by AEMO, APA and other market participants. There are two main aspects related to the allocation process considered as part of the assessment of this rule change request. The first relates to impacts that the choice of allocation process may have on possible investment signals and/or incentives in the Victorian DWGM. The second relates to how the allocation process may impact price certainty and ensure that users only pay for services for which they use given that the Victorian DWGM operates as a market carriage pipeline, thereby promoting efficient use of the system by users.

In assessing the proposed rule against the NGO, the Commission has also considered the likely long term costs and benefits of the draft rule compared to the counterfactual of not making the proposed changes to the NGR. In particular, the recommendations made by the Commission in its draft report on its Review of the Victorian DWGM have been incorporated into this consideration. In doing so, the Commission has considered whether the draft rule is likely to lead to more efficient use of, and investment in, the Victorian DWGM, which is in the long-term interests of consumers.

2.3 The Commission's draft rule

The Commission's draft rule addresses the issues raised by AEMO in its rule change request and would:

- clarify the type of market benefit instrument created in respect of extensions or expansions of the Victorian DTS by providing that:
 - authorised MDQ would relate only to historic capacity on the Longford to Melbourne pipeline at the time of commencement of the Victorian DWGM;
 - AMDQcc would be created in relation to all extensions or expansions where new market benefit instruments are created.
- provide that AEMO would be required to use the proceeds from its allocation process to offset the operating costs of the Victorian DWGM; and
- provide that AEMO would provide twenty business days' notice prior to undertaking the allocation process of either authorised MDQ or AMDQcc.

The above three issues addressed by the draft rule are collectively referred to as the "non-controversial aspects" of the draft rule.

The draft rule also addresses the issue raised by the rule change request in relation to the party responsible for undertaking the allocation process and would:

- clarify the party responsible for undertaking the allocation process by providing that:
 - AEMO would be the party responsible for undertaking the allocation process for all authorised MDQ;
 - AEMO would be the party responsible for undertaking the allocation process for AMDQcc where the costs of the extension or expansion that created or creates the AMDQcc are included in APA's opening capital base for an access arrangement period or is included in its approved capital expenditures for an access arrangement period;
 - APA would be the party responsible for undertaking the allocation process for AMDQcc where the costs of the extension or expansion that created or creates AMDQcc are not included in APA's opening capital base for an access arrangement period or in its approved capital expenditure for an access arrangement period.

This part of the draft rule is referred to as the "controversial aspect" of the rule change request and draft rule. On this aspect of the draft rule stakeholders may hold varying views. Also the costs and benefits of this aspect of the draft rule needs to be considered in light of the Review of the Victorian DWGM as more expressly discussed in section 5.6.

Appendix C of this draft determination provides a table outlining the differences between the current rule requirements, the current practice undertaken in the Victorian DWGM, AEMO's proposed rule and the Commission's draft rule.

2.4 Summary of reasons

The Commission considers that the current provisions in Part 19 of the NGR relating to the creation and allocation of authorised MDQ and AMDQcc are unclear and create regulatory uncertainty. This is in line with AEMO's assessment of the current provisions in its rule change request. The Commission considers that its draft rule will or is likely to, better contribute to the achievement of the NGO than AEMO's proposed rule.

Non-controversial aspects of the draft rule

Having regard to the non-controversial aspects raised in the rule change request, the Commission is satisfied that the draft rule will, or is likely to, contribute to the achievement of the NGO for the following reasons:

- the draft rule would provide regulatory certainty to AEMO, APA and market participants in respect of:
 - the type of market benefit instruments created from an extension or expansion of the Victorian DTS;
 - the party responsible for undertaking the allocation process for authorised MDQ and AMDQcc.

Compared with the current market arrangements, this should improve confidence in the market by AEMO, APA and market participants as the interpretation and functioning of the rule will be clearer. Greater certainty in the regulatory arrangements will allow the relevant parties to make better informed decisions in relation to the use of, and investment in, the Victorian DTS - providing for more efficient outcomes, with resulting benefits flowing through to consumers in respect to the prices paid for natural gas.

- the draft rule would provide increased information provision to market participants. The requirement for AEMO to provide twenty business days' notice prior to undertaking the allocation process would provide market participants an opportunity to make informed decisions about their participation in the allocation process. This may lead to a more efficient use of the system by market participants and more efficient investment in the Victorian DTS by APA, resulting in long term benefits to consumers.

Given that under the draft rule, APA will only undertake an allocation process related to extensions or expansions of the Victorian DTS that are not included in its capital base (either as approved capital expenditures during an access arrangement period or as part of its opening capital base for an access arrangement period), mandating a minimum notice period for its allocation of AMDQcc is not considered appropriate. This is because, subject to the terms of its access arrangement, the Commission considers APA should have discretion to determine the process by which it undertakes the allocation process for AMDQcc in these circumstances (e.g. it may choose to allocate AMDQcc to a market participant as part of an agreement by a market participant to fund the relevant extension or expansion).

Further details of the Commission's reasoning related to the non-controversial aspects of the draft rule are set out in Chapter 4.

Controversial aspect of the draft rule

Having regard to the controversial aspect raised in the rule change request, the Commission is satisfied that the draft rule will, or is likely to, contribute to the achievement of the NGO for the following reasons:

- the draft rule may provide a more efficient allocation process by:
 - clarifying the type of market benefit instruments created, including providing for the alignment of the term of AMDQcc with the term of APA's access arrangement;
 - clarifying who undertakes the allocation process for market benefit instruments thereby improving regulatory certainty; and
 - unbundling AMDQcc from the pre-payment of the reference tariff on transportation services, which may help to ensure that:
 - market participants (and, as a result consumers) only pay for those transportation services they actually use; and
 - the price paid for authorised MDQ and AMDQcc more clearly reflects the value that market participants assign to the rights associated with holding the market benefit instruments, thereby providing better signals to APA and market participants.

A more efficient allocation process for AMDQcc may lead to more efficient use of and investment in the Victorian DTS by ensuring that a market participants demand for and the price paid for AMDQcc reflects market participants assessment of the benefits associated with holding the market benefit instruments and ensuring appropriate investment in the system - providing for more efficient outcomes, with the resulting benefits flowing through to customers via the prices paid for natural gas and use of system charges.

The Commission is also satisfied that the draft rule will, or is likely to, better contribute to the NGO, compared to the proposed rule submitted by AEMO, as a result of:

- AEMO undertaking the allocation process for AMDQcc would remove the opportunity for APA to over-recover on its regulated assets through either the 'price effect' or 'volume effect' (these are discussed in section 1.3) related to AMDQcc which the Commission is of the view is not an appropriate instrument to provide the opportunity for over-recovery when APA is earning the regulated revenue amount on the extension or expansion which creates the AMDQcc;
- The unbundling of AMDQcc from the pre-payment of the reference tariff for transportation services would allow market participants to make decisions to participate in the AMDQcc allocation process based on their demand for the benefits provided by AMDQcc alone. This may provide investment signals regarding what system augmentations may be warranted. As a result of the

unbundling this signal may be reflected through the demand and price for AMDQcc. This demand and price would be determined without market participants having to take into account the amount they are prepared to pre-pay for transportation services;

- The unbundling of AMDQcc from the pre-payment of the reference tariff for transportation services would mean that market participants only pay for the transportation services they actually use. This is in contrast to the current practice, and the potential under AEMO's proposed rule, whereby market participants pay for a quantity associated with their AMDQcc which is not refunded back directly to them if not used. Rather, the over-collection may be refunded back to all market participants who use the pipeline through APA's annual tariff variation mechanism.

The Commission considers the draft rule, in relation to the allocation process is in the long term interests of consumers and contributes to the achievement of the NGO. It would, in the Commission's view, promote a more efficient allocation process for AMDQcc and provide regulatory certainty to market participants regarding the party responsible for undertaking the allocation process.

However, the Commission has made recommendations in its draft report²⁶ in the Review of the Victorian DWGM that would, if implemented, result in authorised MDQ and AMDQcc being replaced by an entry-exit system. Therefore, the benefits of implementing this aspect of the draft rule, given its possible short-term operation, may be outweighed by the implementation and administrative costs associated with the draft rule. At this time, the Commission has not found this to be the case, but it is cognisant of the possibility and welcomes stakeholder submissions on this issue.

The Commission's detailed reasoning related to the controversial aspect of the draft rule is set out in Chapter 5.

2.5 Strategic priority

This draft rule determination relates to the second of the AEMC's strategic priorities: promoting the development of efficient gas markets (the gas priority). This rule change would provide certainty to market participants in relation to the type of market benefit instruments created as a result of an extension or expansion and the party responsible for undertaking the allocation process. This is likely to promote efficient development and use of the gas market by allowing market participants to make more informed decisions regarding their participation in the market, providing price certainty and ensuring users pay only for the services they use. Ultimately, this would be in the long terms interests of consumers as it may ensure efficient investment in the system and avoid increased overall costs to consumers, all else being equal, by ensuring they pay only for the services used.

²⁶ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, draft report, 4 December 2015, Sydney

3 AEMO's rule change request

3.1 Problem identified by AEMO

AEMO considers that there are at least three issues with the current provisions in the NGR, which 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, as well as 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. AEMO indicates that the requirement in the rules to move from rule to rule and rely on the non-application of provisions creates an unnecessarily complex rule structure and hinders easy interpretation of the rules.²⁷
- **Basis for deciding market benefit instrument type:** AEMO provides that the current provisions of the NGR do not provide a basis for determining if an extension or expansion creates authorised MDQ or AMDQcc. As a result, the classification of new market benefit instruments is done by way of an agreement between APA and AEMO.²⁸
- **Party responsible for undertaking the allocation process for authorised MDQ:** AEMO indicates that APA always undertakes the allocation process for AMDQcc and that AEMO always undertakes the allocation process for authorised MDQ. However, there is one exception to this under the current provisions that provides that if authorised MDQ is created and the costs of the extension or expansion are not included in APA's capital base, then APA would undertake the allocation process for the authorised MDQ created.²⁹

3.2 Solution proposed by AEMO

AEMO proposed to address the issues it has identified in its rule change request through amendments to Part 19 of the NGR. AEMO's proposed rule would bring the rules in line with the current practice. AEMO's proposed rule includes the following components:

1. **Clarifying the type of pipeline market benefit instrument created when there is an extension or expansion of existing pipeline capacity:**
 - confirmation that authorised MDQ relates only to historic capacity by amending the definition of authorised MDQ in clause 200 to include

²⁷ AEMO rule change request, p.4

²⁸ AEMO rule change request, p.5

²⁹ AEMO rule change request, p.5

specific reference to authorised MDQ relating to the capacity of the system injection point at Longford as at 15 March 1999;³⁰

- providing that all new capacity created through an extension or expansion on the Victorian DTS, including an extension or expansion of the Longford to Melbourne pipeline, would create AMDQcc. This will be achieved through the inclusion of a specific reference to AMDQcc in clauses 329(1) and 329(7);³¹

2. Clarifying the party responsible for undertaking the allocation process when an extension or expansion creates new market benefit instruments:

- removing the link between the classification of new market benefit instruments with the determination of the AER relating to costs of the extension or expansion being allowed or disallowed into APA's capital base. This is accomplished by removing clauses 329(2) and 329(3);³²
- providing that APA is the party responsible for undertaking the allocation process for all AMDQcc and then directing AEMO to allocate the AMDQcc to market participants. This is achieved through an amendment to clause 329(4);³³

3. Clarifying the use of the allocation process proceeds received by AEMO:

- including a specific requirement, as clause 330(7), that any proceeds AEMO receives as a result of its allocation process must be used to offset the operating costs of the Victorian DWGM;³⁴

4. Requiring minimum notice periods prior to the allocation process being undertaken:

- including a requirement that twenty business days' notice be provided by AEMO or APA, as the case may be, to market participants prior to the allocation process for authorised MDQ or AMDQcc, being undertaken. This is accomplished through the inclusion of two new clauses in the rules, 329(1) in relation to AEMO and 330(4) (b) in relation to APA.³⁵

³⁰ AEMO rule change request, p.9

³¹ AEMO rule change request, p.8

³² AEMO rule change request, p.8

³³ AEMO rule change request, p.8

³⁴ AEMO rule change request, p.9

³⁵ AEMO rule change request, p.9

AEMO indicates that the proposed rule will address the issues it has identified as follows:

- the amendments will result in rules that are easier to understand by:
 - removing all references to the status of full or part inclusion in APA's capital base and AER determination of part capacities;
 - simplifying cross-referencing between the various clauses of the rules; and
 - removing redundant clauses.³⁶
- the proposed rule will clarify the basis for deciding instrument type, as follows:
 - although authorised MDQ and AMDQcc fulfil identical roles in the market, the authorised MDQ will be restricted to the original tranche created at the commencement of the Victorian DWGM;
 - any future capacity resulting from system augmentations will create AMDQcc and undergo the allocation process of APA; and
 - specifically provide that any future market benefit instruments made available in respect of pipeline extensions or expansions will be in the form of AMDQcc.³⁷

3.3 Stakeholder views

The Commission received three submissions from stakeholders on the rule change request.³⁸ A more detailed summary of the key issues raised by stakeholders in their submissions to the consultation paper, and the Commission's response, is set out in Appendix B.

Broadly, all three stakeholders who made submissions on the AEMC consultation paper indicated that the current provisions relating to the creation and allocation process for market benefit instruments are unclear and subject to various interpretations.

APA and GDF Suez both expressed support for AEMO's proposed rule, albeit for different reasons. In particular, GDF Suez indicated that the proposed rule would provide a practical solution and is in line with current practice. However, GDF Suez indicated that its support should not be interpreted as endorsement of the current practice as it has a number of concerns regarding that practice, whether risks are appropriately allocated under the current practice, and the investment signals and cost recovery arrangements in the market. GDF Suez indicated that it expects these

³⁶ AEMO rule change request, p.5

³⁷ AEMO rule change request, pp. 5-6

³⁸ EnergyAustralia, APA and GDF Suez.

concerns will be addressed as part of the Victorian Declared Wholesale Gas Market Review which is currently being undertaken.³⁹

EnergyAustralia does not support AEMO's proposed rule but rather is of the view that a more preferable rule is warranted. The more preferable rule should provide that AEMO would undertake the allocation process for authorised MDQ and AMDQcc when the costs associated with the extension or expansion are included in APA's capital base. This would reduce, in EnergyAustralia's view, the opportunity for APA to over-recover on its regulated assets.⁴⁰

APA indicated that based on its last access arrangement whereby the AER set a reference tariff for AMDQcc at the administrative cost of the AMDQcc, the opportunity to collect additional revenue has already been reduced. Further, as APA has historically refunded back the 'volume effect' (as discussed above in section 1.3) through its annual tariff adjustment mechanism, the potential for over-recovery has already been minimised, if not removed.⁴¹

EnergyAustralia is of the view that AEMO undertaking the allocation process for AMDQcc included in APA's capital base will not affect investment⁴². APA on the other hand, is of the view that the current practice provides the market with investment signals by allowing market participants to directly invest in an extension or expansion, and secure new AMDQcc prior to the investment proceeding. This provides certainty to APA that its forecast of demand, which it uses to justify the investment, actually occurs.⁴³

³⁹ GDF Suez submission to AEMC consultation paper, p. 2

⁴⁰ EnergyAustralia submission to AEMC consultation paper, p.1

⁴¹ APA submission to AEMC consultation paper, pp.6 - 7

⁴² EnergyAustralia submission to AEMC consultation paper, p.1

⁴³ APA submission to AEMC consultation paper, pp.6-8

4 Commission's assessment of non-controversial aspects of draft rule

4.1 Problem identified by AEMO

The Commission is of the view that there is a problem with the existing provisions in the NGR as they are not clear and create uncertainty for AEMO, APA and other market participants. The Commission considers that there are issues with the current provisions in the NGR in as identified by AEMO in relation to the non-controversial aspects of the draft rule.

The issues identified by the Commission and which are being addressed as non-controversial aspects of the rule change request are:

1. Clarifying the type of market benefit instrument to be created when there is an extension or expansion of the Victorian DTS;
2. Clarifying the use of allocation process proceeds by AEMO; and
3. Requiring minimum notice periods prior to AEMO undertaking its allocation process.

4.2 Type of market benefit instrument created

The provisions as currently drafted provide that when the costs of the extension or expansion are not wholly included in APA's capital base, either authorised MDQ or AMDQcc is created. However, there is no guidance in how AEMO and APA are to determine which of the two types of market benefit instruments are created. The draft rule clearly provides that authorised MDQ would only relate to the historic capacity of the Longford to Melbourne pipeline and that all extensions and expansions that create market benefit instruments would result in the creation of new AMDQcc.

This is in line with AEMO's proposed rule and the historic practice that has occurred since AMDQcc was introduced. The AEMC has determined this aspect of AEMO's proposed rule contributes to the achievement of the NGO and is included in the draft rule as it provides clarity to market participants and allows timely assessment of the current perceived value of the market benefits associated with AMDQcc.

By clearly articulating that all new market benefit instruments are AMDQcc, certainty is provided to the market that is not present in the current provisions of the NGR. This certainty may provide greater confidence to AEMO, APA and market participants in relation to expectations when new market benefit instruments are created in the future.

Further, given the nature of authorised MDQ and AMDQcc, the Commission sees benefit in new extensions or expansions resulting in AMDQcc which operate for a set term. The specific term of AMDQcc provides market participants an opportunity to participate in the allocation process either when new AMDQcc becomes available or

when the previous term of AMDQcc draws to a close. This process allows for market participants to examine the circumstances of their operation at the time of the allocation process, including:

- examining past congestion on the system;
- projections for ongoing or increased congestion during the term of the AMDQcc; and
- any planned extensions or expansions;

to determine their participation in the allocation process. This would involve a determination of the quantity of AMDQcc that they would seek, as well as the price they would be willing to pay for it.

This process would provide some ongoing signals to AEMO and APA in relation to market participants' assessment of the benefits from holding AMDQcc for the next term. This ability to reassess the need to hold market benefit instruments is not readily available with authorised MDQ as a result of authorised MDQ's indefinite term.

4.3 Notice periods

The current provisions of the NGR are silent on the notice that must be provided to market participants prior to an allocation process occurring. Stakeholders indicated that they were not aware of any past issues that arose under the current practice in respect of notice, but were not opposed to or in APA's case supportive, of the requirement to include a minimum notice period.

The draft rule provides that AEMO would provide twenty business days' notice prior to undertaking the allocation process.

Given that APA would only undertake the allocation process relating to AMDQcc for which the costs of the extension or expansion are not included in its capital base (either as approved capital expenditure during the access arrangement period or in its opening capital base) the Commission has determined that a minimum notice period would not be required. This determination is based on the arrangement between APA and the market participants being a private relationship for which the parties should be able to negotiate the necessary terms and conditions.

Although the current provisions of the NGR are silent in regards to notice, it is the Commission's understanding that notice has historically been provided to market participants prior to AEMO or APA undertaking an allocation process. The draft rule prescribes a mandatory notice period for AEMO when it undertakes the allocation process to provide greater certainty to market participants over the practice that would be followed each time the allocation process occurs.

The inclusion of a mandatory notice period would ensure participants have a reasonable period of time to make informed decisions regarding their participation in the allocation process. This may lead to a more efficient use of the system by market

participants. In turn, this may lead to benefits in the long term interests of consumers, in terms of prices and investment in the system.

Further, more informed decisions by market participants regarding their participation in the allocation process may lead to better signals to AEMO and APA regarding the demand for AMDQcc. This may assist in determining whether there is any basis for further investment in the system. An appropriate level of investment in the system is in the long term interests of consumers, not only in terms of ensuring that consumers do not pay for over-investment in the system but also ensuring that under-investment does not result in increased uplift charges and system congestion.

4.4 Use of allocation process proceeds by AEMO

The current provisions of the NGR are silent in relation to the use of the proceeds AEMO receives from undertaking the allocation process for market benefit instruments. Historically, AEMO has offset the proceeds from the costs of operating the Victorian DWGM.

AEMO in its proposed rule, and in the Commission's draft rule, this historic practice would be implemented as a requirement. Through this requirement there would be certainty that the proceeds from the allocation process go to the benefit of those market participants who participate in the Victorian DWGM rather than for the benefit of the broader markets for which AEMO has a rule and incurs costs.

4.5 Conclusion

The Commission considers that the non-controversial aspects of the draft rule clearly contribute to the NGO. In this regard, the draft rule provides regulatory certainty to AEMO, APA and market participants in relation to the types of market benefit instruments created from an extension or expansion.

Further, it provides regulatory certainty in relation to the use of proceeds from the AEMO allocation process which will have an impact on market participants' overall costs payable to AEMO in relation to the operation of the Victorian DWGM. In addition, these aspects of the draft rule improve timely provision of information regarding when an allocation process will occur. This provides the opportunity for market participants to make informed decisions regarding how they will participate in the allocation process of AEMO.

The benefits of regulatory certainty and timely provision of information leads to long term benefits for consumers in terms of the prices consumers pay for gas. This results from market participants having more confidence in the operation of the market, which may lead to less risk being priced into consumer contracts. In addition, ensuring market participants have sufficient time to make efficient decisions regarding participation in the market may result in lower costs or fewer price increases, all else being equal for consumers.

The Commission is aware that recommendations in the Review of the Victorian DWGM may result in authorised MDQ and AMDQcc being replaced and the draft rule becoming redundant. However, given that there are expected to be minimal implementation and administrative costs associated with the non-controversial aspects of the draft rule, the Commission is of the view that even in the short-term the benefits of these aspects of the draft rule outweigh any possible costs and contribute to the achievement of the NGO.

5 Commission's assessment of controversial aspects of draft rule

5.1 Problem identified by AEMO

The Commission is of the view that unlike the issue as identified by AEMO, the controversial aspect of the draft rule is not who should be the party responsible for undertaking the allocation process for authorised MDQ but rather who should be the party responsible for undertaking the allocation process for all market benefit instruments.

The rule change request submitted by AEMO is not only a clarification of the rule. Rather, AEMO's proposal diverges from the current provisions of the NGR where there is a link between the costs being included in APA's capital base with the party responsible for undertaking the allocation process.

Specifically, the Commission is of the view that the provisions in the NGR attempt to ensure that APA is not able to over-recover on regulated assets through the sale of AMDQcc given that AMDQcc relates to market benefits and not to specific services provided by APA. The party responsible for undertaking the allocation process, whether authorised MDQ or AMDQcc, goes directly to the possibility of over-recovery.

This is not to say, however, that APA does not have the ability to over-recover on services for which it provides, whether included in its regulated asset base or not, but rather that in respect of AMDQcc and the specific market benefits provided, over-recovery, where possible, should be limited.

5.2 Party responsible for undertaking the allocation process

As indicated earlier, some stakeholders have varying views on whether there should be a link between whether the costs of an extension or expansion that creates new market benefit instruments are included in APA's capital base with the party responsible for undertaking the allocation process. The Commission is of the view that this link should be maintained whereby AEMO undertakes the allocation process where costs are included in APA's capital base and APA undertakes the allocation process where the costs are not included in its capital base.

The determination of whether this link is appropriate requires a balancing between the possible impacts on APA's incentives and investment signals, price certainty and paying only for the services one receives.

5.2.1 Demand forecast risk

APA has indicated that its ability to undertake the allocation process for AMDQcc, which it bundles with the pre-payment of the reference tariff on transportation

services, is necessary for it to know that the demand it has forecasted supporting the need for the extension or expansion, will actually occur.⁴⁴

APA is bundling the market benefits associated with AMDQcc with the pre-payment of the reference tariff for transportation services. When AMDQcc is bundled in this fashion, a purchaser of AMDQcc will pay the price for AMDQcc plus the reference tariff for transportation services on the full capacity amount associated with the AMDQcc purchased. For example, if 100 TJ of AMDQcc is purchased, the market participant would also pre-pay the applicable reference tariff for transportation services on 100 TJ, whether they actually ship 100 TJ or a lesser amount.

If the market participant does not ship the full quantity associated with their AMDQcc and this spare capacity is used by another market participant, that market participant pays the reference tariff for transportation services. This results in a double collection of the reference tariff on the transportation services associated with that capacity. APA has historically refunded the double collection of the reference tariff on the transportation services back to all market participants that use that pipeline through its annual tariff adjustment mechanism (this over-collection is what has been referenced to as the 'volume effect'⁴⁵).

The AMDQcc holder is not directly refunded the full amount of their over-payment but rather a proportion is refunded back through the annual tariff adjustment mechanism. However, the over-payment is also refunded to those market participants who do not hold AMDQcc and have not paid the cost associated with purchasing AMDQcc. Further, if another market participant does not use the spare capacity paid for but not used by the AMDQcc holder, APA ensures that it has collected the reference tariff for the transportation services on the full forecasted amount even if actual demand is less.

Through the bundling of the AMDQcc with the pre-payment of the reference tariff for transportation services, APA appears able to limit its demand forecast risk. If APA has overestimated demand for transportation services on the pipeline, as a result of the bundling of AMDQcc with the pre-payment of transportation services, it ensures that it receives an amount equal to at least the reference tariff on capacity of AMDQcc held for that pipeline.

There may be some necessity for this risk to be minimised to ensure efficient levels of investment can proceed in the Victorian DTS. The draft rule, in the Commission's view would have no impact on private investment in the Victorian DTS but may have implications on investment related to regulated assets. However, the Commission has

⁴⁴ APA submission to AEMC Consultation paper, pp. 6 - 9

⁴⁵ The volume effect arises as a result of: (1) APA collecting the AMDQcc price (which includes the pre-payment of the reference tariff for transportation services) on the full capacity amount associated with AMDQcc whether or not the AMDQcc holders use the full amount of the volume of transportation services which they pre-paid; and (2) APA collecting the reference tariff for transportation services from other market participants who don't hold AMDQcc when AMDQcc holders do not use the full volume of transportation services for which they have pre-paid.

not determined the materiality of the possible impact of the draft rule on APA's demand forecast risk.

The bundling of AMDQcc with the pre-payment of the reference tariff for transportation services is not the only possible mechanism to deal with demand forecast risk nor, in the Commission's view, the most efficient mechanism to address this risk. There may be other mechanisms that can be used or designed by APA that may be able to be incorporated into its access arrangement application to allow APA to manage this risk. These other possible mechanisms would be examined by the AER and may be approved as part of its access arrangement determination.

5.2.2 Funding of investment in the Victorian DTS

The minimisation of demand risk and the pre-payment of the reference tariff on transportation services to ensure that forecasted demand eventuates, may be one factor considered by parties when assessing whether funding may be provided for a particular investment. No stakeholders specifically indicated that the bundling of AMDQcc with the pre-payment for transportation services is necessary to ensure that investment funding can be obtained for extensions or expansions, however, the Commission has considered this possibility in assessing the rule change request.

AMDQcc is for a set term, generally in line with APA's access arrangement period. Therefore, APA would have an access arrangement decision from the AER approving the capital expenditures on a forecast basis for the same period as the term of the AMDQcc. This access arrangement decision may provide the same assurances to possible investors or lenders in respect of the return that can be obtained on the investment, in the same or similar way as the bundling of AMDQcc with the pre-payment of the reference tariff on the transportation services.

Given that the Commission is of the view that:

- the signal provided by AMDQcc may be strengthened when not bundled with the pre-payment of the reference tariff for transportation services; and
- another process is in place through the access arrangement decision to provide assurances regarding the revenue to be earned on any investment during the access arrangement period;

the Commission is satisfied that the draft rule better contributes to the achievement of the NGO than the rule proposed by AEMO.

5.2.3 Investment incentives

Under the current practice where APA undertakes the allocation process for AMDQcc, there appears to be mixed investment incentives in the Victorian DTS.

On the one hand, when there is increased congestion or increased risk of congestion, the price for AMDQcc would be expected to increase where its price is based on a

determination of the value of the market benefits provided. As a result, the 'price effect' received by APA from the tender process would be expected to increase.

On the other hand, when extensions or expansions of the Victorian DTS are completed, it would be expected that the price of AMDQcc would decrease as the expected congestion and other benefits of AMDQcc would not be as highly valued by market participants. However, in this case APA would earn its regulated revenue on the new extension or expansion.

The 'price effect' provides an incentive not to build an extension or expansion. The ability to earn the regulated revenue amount on approved capital expenditures or on its capital base provides APA with an incentive to build an extension or expansion. These two incentives appear to provide conflicting incentives to APA. Therefore, the removal of the 'price effect' minimises the conflicting incentives and may result in efficient decisions regarding future investment in the Victorian DTS.

5.2.4 Impacts on investment signals

There may be implications in relation to APA's incentives and demand forecast risk resulting from the draft rule. Although the Commission has not determined the materiality of these possible implications, the Commission has assessed them in making the draft rule and weighed them against the alternative impacts of making AEMO's proposed rule or making no rule.

These alternative impacts include ensuring market participants only pay for the services they use and the signals that may be provided from the allocation process for AMDQcc when it is not bundled with the pre-payment of transportation services.

In circumstances where AEMO undertakes the allocation process for AMDQcc, there would be no requirement to bundle AMDQcc with the pre-payment of the reference tariff for transportation services. A holder of AMDQcc would not be required to pre-pay the reference tariff in order to obtain the market benefits associated with AMDQcc. Therefore, they would only be required to pay the reference tariff on the amount of gas they actually shipped. This provides an opportunity for market participants (and by consequence, consumers) to only pay for the transportation services they actually use rather than the amount associated with the quantity of AMDQcc they hold.

That being said, there is nothing preventing APA and a market participant from negotiating and entering into a contract for the pre-payment of the reference tariff for transportation services. This contract would not, where AEMO is responsible for undertaking the allocation of AMDQcc, also provide the market participant with AMDQcc and its associated market benefits.

In these situations the market participant would be able to make a decision regarding the quantity of AMDQcc they may want to hold separate and apart from the question of the amount of transportation services they may wish to pre-pay for. This ability of a market participant to make a decision regarding these two distinct benefits, in the

Commission's view, contributes to the achievement of the NGO through the efficient use of and investment in the system and more so that AEMO's proposed rule.

Although it has been recognised as part of the Review of the Victorian DWGM that the market may not contain adequate investment signals and that the current basis for determining investment based on demand forecast and regulatory judgment may just as likely result in over-investment as under-investment⁴⁶, where possible any signal that may exist should be designed to provide the best signal possible given the limits of the current market design and operation.

In addition, by unbundling AMDQcc from the pre-payment of the reference tariff on transportation services, AMDQcc would only reflect market rights and market system benefits to holders. As a result, the allocation process and the decisions made by market participants in relation to the allocation process may provide a clearer signal related to the benefits and value of those benefits associated with AMDQcc. These decisions can be made without also having to consider the amount of pre-payment a market participant would be willing to incur. This AMDQcc only signal may provide a better investment signal to the market regarding augmentations that may be needed in the Victorian DTS.

5.2.5 Pre-payment of reference tariff

It should be noted that the unbundling of AMDQcc from the pre-payment of the reference tariff for transportation services would not necessarily mean that market participants would no longer pre-pay for transportation services. There remains the opportunity for market participants and APA to agree to such pre-payment arrangements.

However, it does mean that AMDQcc which is subject to AEMO's allocation process would not include the requirement for the pre-payment of the reference tariff for transportation services. As indicated, this may result in market participants not having to pay for transportation services that they have not used.

5.2.6 Regulated revenue

The economic regulatory regime under the NGR does not prohibit APA from earning an amount in excess of its regulated revenue. However, the Commission is of the view that the unique attributes of authorised MDQ and AMDQcc (ie risk mitigating market benefits) results in an instrument which should not provide a basis for excess recovery, to the extent possible, for APA.

In circumstances where APA is earning regulated revenue on the underlying asset associated with the authorised MDQ or AMDQcc, the Commission considers that the

⁴⁶ See the discussion regarding investment signals and demand forecast in the Victorian DWGM Discussion Paper, AEMC 2015, Review of the Victorian Declared Wholesale Gas Market Discussion Paper, 10 September 2015, Sydney

market operator (AEMO) should be the party responsible for undertaking the allocation process associated with these market benefit instruments.

5.2.7 Timing of extensions or expansions

APA raised an issue in the current rules in respect of timing as a result of the requirement that the costs of an extension or expansion are to be included in APA's capital base. The opening capital base is set at the beginning of an access arrangement period, and as a result, APA argues that this would cause difficulties in relation to when investment occurs so that a decision could be made by the Australian Energy Regulator (AER) in respect of whether the costs are or are not included in APA's capital base.

In response, the draft rule would require AEMO to undertake the allocation process for AMDQcc when the costs of the extension or expansion are included in APA's approved capital expenditures for an access arrangement period or its opening capital base. As a result, if the costs of an extension or expansion are approved by the AER on a forecast basis in APA's access arrangement and it starts to earn regulated revenue on the asset, AEMO would undertake the allocation process.

However, if the costs of an extension or expansion are not included in the approved capital expenditures, for example, as a result of an extension or expansion occurring during the access arrangement period was not forecast, then APA would undertake the allocation process for the AMDQcc. However, if that asset is then included in APA's opening capital base at the start of the next access arrangement period, when the term of the AMDQcc has expired, AEMO would be responsible for undertaking the next allocation process for the AMDQcc associated with the extension or expansion.

The following table shows some examples of the operation of the Commission's draft rule assuming that in 2019, during the 2017-2022 access arrangement period, APA expanded the Victorian DTS. This would result in additional capacity and corresponding new AMDQcc being created. Depending on whether the costs of the extension or expansion were to be included in APA's access arrangement application for 2017-2022, whether it is approved by the AER on a forecast basis or included in the opening capital base for the 2022-2027 period, the following table provides some examples of who may be able to undertake the allocation process for the AMDQcc created:

Table 5.1 Example of draft rule operation

Costs of extension or expansion:		APA able to collect regulated revenue on forecast amount approved by AER	Cost of extension or expansion:	Party responsible for undertaking allocation process
included in access arrangement application for 2017-2022	approved by AER on a forecast basis for 2017-2022 access arrangement period		included in the opening capital base for 2022-2027 period	
Yes	Yes	Yes	Yes	AEMO
Yes	Yes	Yes	No	AEMO undertakes allocation process for AMDQcc with term 2019-2022 APA undertakes allocation process for AMDQcc with term starting 2022 and beyond
Yes	No	No	No	APA
Yes	No	No	Yes	APA undertakes allocation process for AMDQcc with term 2019 -2022 AEMO undertakes allocation process for AMDQcc with term starting 2022 and beyond
No	No	No	No	APA
No	No	No	Yes	APA undertakes allocation process for AMDQcc with term 2019-2022 AEMO undertakes allocation process for AMDQcc with term starting 2022 and beyond

5.3 Review of the Victorian DWGM

In parallel to this rule change request, the Commission is undertaking a Review of the Victorian DWGM at the request of the Victorian government and the COAG Energy Council. The Commission's draft report was published on 4 December 2015.⁴⁷

The Commission's draft recommendation is to replace the existing market carriage arrangements with an entry-exit system for allocating capacity. An entry-exit system would allow network users to book capacity rights independently at each entry and exit point to the system, supporting the development of gas trading liquidity and risk management tools. Moreover, demand for entry and/ or exit capacity would create market-driven signals for investment in the Victorian DTS, where these signals are currently limited.

Under an entry-exit system, revenue earned by APA would be regulated, on a similar basis to today. However, requiring users to purchase capacity at entry and exit points will change the risk allocation of that investment as the user bears at least some of, the costs (and risks) associated with their decisions. Allocating risk in this way creates incentives on users to ensure their decisions on access are well informed and ultimately efficient.

If the Commission's recommendations in the final report reflect those in the draft, and the Victorian government and the COAG Energy Council supports the implementation of an entry-exit system in the Victorian DTS, the current market carriage regime will be replaced, negating the requirement for authorised MDQ and AMDQcc. Depending on when and if this occurs, the implementation costs of the draft rule may outweigh the benefits, particularly if the draft rule is only in effect for a short period of time.

Costs that will likely be incurred in implementing the Commission's draft rule, in relation to the controversial aspect, may include:

- implementation costs: AEMO will have to prepare and consult on an AMDQcc auction procedure. In addition, it may necessary for AEMO to implement or review other processes or procedures which may result in additional implementation costs. Further, APA may incur implementation costs in relation to amending its procedures and processes so they align with the requirements of the draft rule;
- allocation process costs: under the draft rule, the allocation process will be completed by AEMO for a more significant portion of AMDQcc which may result in AEMO incurring additional costs related to undertaking that process. These costs would form part of the costs of operating the Victorian DWGM and would be offset by the proceeds received by AEMO from its allocation process;

⁴⁷ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney.

- administrative costs: AEMO will be required under the draft rule to prepare and maintain a register of authorised MDQ and AMDQcc and as such costs may be incurred to keep this information current and available to market participants. In addition, APA and the AER may incur additional administrative costs associated with the determination process of whether AMDQcc is subject to AEMO's allocation process or APA's allocation process.

There may also be other costs incurred by AEMO, APA or market participants as a result of the Commission's draft rule which have not been outlined above.

The next regulatory period for the Victorian DTS is 1 January 2018 to 31 December 2022. In the draft report for the Review of the DWGM, the Commission outlined an indicative timeframe for implementing an entry-exit system in Victoria by 2020.⁴⁸ This means that, if this more preferable draft rule is made, the new arrangements for allocating authorised MDQ and AMDQcc may only apply for one regulatory period. Further, there is also the potential for a transitional mechanism to be considered if an entry-exit system is implemented during the next regulatory period for the DTS.

Question 1 Impact of the Review of the Victorian DWGM

- (a) Given the draft recommendations set out in the Review of the Victorian DWGM, what is the view of stakeholders in relation to whether the NGO would be best promoted by implementing the aspects of the draft rule that relate to which party should be responsible for allocating AMDQcc?**
- (b) Should the Commission consider an alternative approach?**
- (c) Alternatively, are stakeholders of the view that no rule should be made? If yes, why?**

5.4 AEMO's allocation process

Given that, unlike in the current practice, AMDQcc will be subject to AEMO's allocation process under certain circumstances⁴⁹, it may be appropriate for AEMO to assess its current allocation process to determine if its auction design remains the best mechanism for ensuring efficient signals, as much as these signals may be provided through the allocation process for authorised MDQ or AMDQcc.

In particular, it appears that AEMO's auction design, which currently only deals with the allocation process for authorised MDQ, provides some incentive for market participants to decrease their demand, in an attempt to ensure that the price is set at

⁴⁸ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney, p. 47.

⁴⁹ As indicated previously, under the draft rule, AEMO will be responsible for undertaking the allocation process for AMDQcc when the costs of the extension or expansion that created or creates the AMDQcc is included in APA's capital base or as an approved capital expenditure in APA's access arrangement.

zero dollars. This is a result of the auction design whereby if there is more authorised MDQ available than demand from market participants, all participants receive the authorised MDQ they have requested for zero dollars. Therefore, there may be some incentive for market participants to underbid their demand in order to receive the market benefits of authorised MDQ for zero dollars.

The Commission has not made a determination on the effectiveness of the allocation auction design operated by AEMO. The draft rule will result in AEMO's auction procedure being examined through the rules consultation process and a procedure for an AMDQcc auction being prepared and implemented.

Question 2 AEMO's allocation process

(a) Are stakeholders of the view that it would be beneficial for any final rule to provide a set of guiding principles to be taken into account as part of AEMO's auction design?

(b) Are stakeholders of the view that the same, or a different auction design, as the one used for authorised MDQ should be implemented by AEMO for AMDQcc?

5.5 Conclusion

The Commission has examined the rule change request, the issues identified by AEMO, the solution proposed by AEMO, stakeholder input, the recommendations made in the Draft Report in the Review of the Victorian DWGM and its own assessment and determined that the more preferable draft rule should be implemented.

It is acknowledged by the Commission that the draft rule diverges from current practice and the proposed rule provided by AEMO in its rule change request in respect of the party responsible for undertaking the allocation process for AMDQcc. The Commission is of the view that the potential for over-recovery of revenue from AMDQcc is more effectively addressed by clarifying the requirements in the rule than through APA's historic practice of refunding some of this over-recovery back as part of its annual tariff variation mechanism.

The Commission is of the view that the market benefits associated with AMDQcc and the signals provided to the market from market participants demand for these market benefits should not be tied to the pre-payment of the reference tariff for transportation services.

Further, the Commission is of the view that AMDQcc represents market benefits which should be dealt with by AEMO, as market operator, where APA is earning regulated revenue on the assets which created the AMDQcc. The market benefits provided by authorised MDQ and AMDQcc are unlike other services provided in the Victorian DWGM and this unique nature is what gives rise, in part, to the Commission's decision that these are not instruments for which APA should have the potential to earn additional revenue.

The unbundling of AMDQcc from the requirement that the holder must pre-pay the reference tariff for transportation services may lead to more efficient use of the system by market participants. This is due to the consideration of demand for AMDQcc no longer being tied to a market participant's willingness to pre-pay the reference tariff for transportation services it may not fully utilise. This then allows the market participants to make independent decisions regarding their demand for AMDQcc and whether or not they want to enter into an agreement with APA for the pre-payment of transportation services.

In addition, the draft rule would result in the unbundling of AMDQcc and therefore, market participants (and by consequence, consumers) would only be required to pay the reference tariff for transportation services that they actually use.

Although it was necessary to balance various aspects in determining the outcome of the rule change request, the Commission is of the view that the draft rule in respect of who undertakes the allocation process, will or is likely to better contribute to the achievement of the NGO that the proposed rule in principle. The draft rule has the potential to improve the investment signals provided by AMDQcc, where these investment signals exist, thereby improving efficient investment in the system.

The Commission considers that the draft rule in relation to the controversial aspect is in the long-term interests of consumers. However, given the recommendation in the Review of the Victorian DWGM to implement an entry-exit system which would replace authorised MDQ and AMDQcc, the Commission is cognisant of the possibility that the draft rule may only be in place in the short-term. Although the Commission is of the view that the long-term benefits of the draft rule outweigh the associated implementation and administrative costs, the Commission is prepared to examine this aspect of the draft rule in light of stakeholders' views on whether implementation costs associated with this aspect of the draft rule may outweigh the benefits if the draft rule was only to operate in the short-term.

6 Transitional Arrangements

The Commission is aware that the draft rule is a marked departure from the current practice of AEMO, APA and market participants. As such, the Commission is considering appropriate transitional arrangements to ensure that any policies or procedures that may be required can be developed and operational prior to operation of the rule. As well, the transitional arrangements would provide clarity and certainty to parties regarding responsibilities between the time the final rule is implemented and when it would become operative.

APA's current access arrangement expires 31 December 2017 and any revised access arrangement application must be lodged with the AER by 1 January 2017. Therefore, it is expected that the implementation of any final rule will be able to be taken into account in APA's revised access arrangement application. Stakeholder input is sought on the following transitional arrangements specified in the draft rule (which assume a final rule is made in March 2016):

- APA must not set the term for any AMDQcc for which it undertakes the allocation process for a period longer than its current access arrangement period (31 December 2017). This provision would take effect upon any final rule being made;
- any AMDQcc for which a term has already been set for a period beyond the revision commencement date specified in APA's current access arrangement period, will continue to have effect and upon expiry will be subject to the allocation process as prescribed in the final rule;
- AEMO must prepare and implement the AMDQcc auction procedure by 30 September 2016;
- AEMO must prepare and implement the register of authorised MDQ and AMDQcc by 30 September 2016; and
- the operative provisions of the final rule will commence on 1 October 2016.

It is expected that through the transitional arrangements, that any final rule adopted by the Commission will be in place so that as the current term of the AMDQcc expires, the allocation process prescribed in the final rule will be able to be undertaken with minimal AMDQcc being subject to the current practice. However, it is noted that some AMDQcc may potentially become available for allocation prior to any final rule becoming operative.

Abbreviations

AEMC or Commission	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMDQcc	Authorised Maximum Daily Quantity Credit Certificates
APA	APA Gas Net
authorised MDQ	Authorised Maximum Daily Quantity
COAG Energy Council	Council of Australian Governments' Energy Council
DTS SP	Declared Transmission System Service Provider
MCE	Ministerial Council on Energy
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

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC Response
EnergyAustralia p.1	There should be no distinction between authorised MDQ and AMDQcc.	The distinction between authorised MDQ and AMDQcc is beyond the scope of this rule change and the overall structure and operation of the Victorian Declared Wholesale Gas Market is being considered as part of the review currently being undertaken by the AEMC. More information on the Review of the Victorian DWGM is available on the AEMC website at www.aemc.gov.au
EnergyAustralia p.1	Under the current process and the proposed rule, there is a possibility of over-recovery on regulated assets.	The AEMC is proposing a draft rule which would reduce the possibility of over-recovery by APA on regulated assets by requiring AEMO to auction all authorised MDQ and AMDQcc where they relate to an extension or expansion for which the costs have been included in APA's approved capital expenditures during an access arrangement period or its opening capital base.
EnergyAustralia pp. 1 & 3	AMDQ cannot currently be applied to controlled withdrawals from the South West Pipeline. AMDQcc should be applied to controlled withdrawals and uncontrolled withdrawals.	The AEMC considers that the issue of whether AMDQ can be applied to controlled withdrawals from the South West Pipeline is out of scope of this rule change request. Further, the AEMC Review of the Victorian DWGM will consider opportunities to impact the efficient operation of the market.
EnergyAustralia p.2	AEMO's auction may result in participants paying different amounts for the same product and may result in some users being disadvantaged.	The AEMC is of the view that given the draft rule, that AEMO should assess its current allocation process to determine if it remains appropriate. In addition, the Commission has asked for stakeholder input on whether it is necessary, if AEMO's allocation process should be amended, whether the rules should include principles to guide the development of a new allocation process.
GDF Suez	The current rules are unclear in describing how authorised MDQ and AMDQcc should be	The AEMC is proposing a draft rule which would clarify how authorised MDQ and AMDQcc is established and allocated.

Stakeholder	Issue	AEMC Response
p.1	established and allocated by AEMO and APA.	
APA pp. 1, 2 & 3	The interpretation prescribed by the AEMC in its consultation paper in relation to the current rules is incorrect, the AEMC has not considered the timing elements associated with the current rule and concluded that the rules provide a clearer allocation methodology than is actually the case.	The AEMC is proposing a draft rule which addresses the timing issue raised by APA by providing that AMDQcc is to be allocated pursuant to AEMO's allocation process when the costs of the extension or expansion that create the AMDQcc is included in APA's approved capital expenditures during an access arrangement period or its opening capital base. In addition, the draft rule provides clarity in relation to the type of market benefit instrument created and the party responsible for undertaking the allocation process.
APA pp.5, 8-9	<p>The current practice and AEMO's proposed rule provides clear incentives to invest in new injection pipeline capacity whereby investment is support though contractual commitment to purchase new AMDQcc prior to construction of any expansion.</p> <p>A change in the allocation process may lead to less investment in the Victorian DTS and where investment occurs it may be delayed or be based on conservative estimates of demand (which may lead to it being undersized).</p>	The AEMC is of the view that the Victorian DWGM may not contain adequate investment signals and that the current basis for determining investment which is based on demand forecast and regulatory judgment may just as likely result in over-investment as under-investment, whereby consumers bear this risk. Further, the AEMC is of the view that the unbundling of AMDQcc from the pre-payment of the reference tariff for transportation services may provide a clearer signal regarding what investment may be needed in the Victorian DTS. Further, although the current practice of bundling AMDQcc with the pre-payment of the reference tariff for transportation services provides some demand forecast protection, there are other mechanisms that APA may be able to include as part of its access arrangement to provide it with similar protections.
APA p.5	The efficiency of APA's process used for allocating AMDQcc is outside of the scope of the rule change request.	The AEMC is of the view that it was important to understand the process used by APA to allocate AMDQcc, but agrees that the rules should not include any guidance or direction on the process to be used by APA.
APA pp. 6-7	APA is not able to over-recover on regulated assets under the current practice as a result of a reference tariff being set for the allocation of spare AMDQcc. Further, under a price cap form of	Although APA has indicated that under the current environment there is no over-recovery, the AEMC is of the view that the rules should be drafted to ensure that where APA earns the regulated revenue amount on the extension or expansion, it does not have the potential to also earn

Stakeholder	Issue	AEMC Response
	regulation, regulated service providers can earn more than the regulated revenue decision through outperformance, including through volume and price outperformance.	either the 'price effect' or 'volume effect' from undertaking the allocation process of AMDQcc.
APA p.9	Notice periods for the allocation of AMDQcc have not been a material issue in the past but to the extent it provides market certainty it is supported.	The AEMC draft rule provides a mandatory minimum notice period prior to the allocation process to be undertaken by AEMO. However, given that APA will only undertake the allocation process for AMDQcc not related to regulated assets, the AEMC has determined it is not necessary to include a requirement for APA to provide a minimum notice period.

B Legal requirements under the NGL

This appendix sets out the relevant legal requirements under the NGL for the AEMC to make this draft rule determination.

B.1 Draft rule determination

In accordance with section 308 and 296 of the NGL the Commission has made this draft rule determination, including a more preferable draft rule, in relation to the rule proposed by AEMO.

The Commission's reasons for making this draft rule determination are set out in section 2.3.

A copy of the more preferable draft rule is attached to and published with this draft rule determination. Its key features are described in section 2.3.

B.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within section 74 of the NGL as it relates to regulating the provision of pipeline services, AEMO's declared system functions and operation of a declared wholesale gas market.⁵⁰

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NGL to make the rule;
- the rule change request;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;⁵¹
- submissions received during first round consultation;

⁵⁰ The more preferable draft rule would not apply in Western Australia as it does not fall within the subject matters about which the Commission may make rules under the National Gas Access (WA) Act 2009 of Western Australia.

⁵¹ Under section 225 of the NGL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated Council is now called the COAG Energy Council

- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NGO;
- the Commission's analysis as to the ways in which the draft rule will or is likely to, better contribute to the NGO than the proposed rule; and
- the Commission's analysis in respect of the Victorian Gas Market Review.

B.4 Power to make a more preferable rule

Under section 296 of the NGL, the Commission may make a rule that is different (including materially different) from a market initiated proposed rule if the Commission is satisfied that, having regard to the issue or issues that were raised by the market initiated proposed rule, the more preferable rule will or is likely to better contribute to the achievement of the NGO.

As discussed in Chapter 2, the Commission has determined to make a more preferable draft rule. The reasons for the Commission's decision are set out in section 2.4 and Chapters 4 (non-controversial aspect) and Chapter 5 (controversial aspect).

B.5 Civil penalty and conduct provisions

The Commission's more preferable draft rule does not amend or omit any clauses that are currently classified as civil penalty or conduct provisions under the NGL or National Gas (Victorian) (Declared System Provisions) Regulations. The Commission does not recommend that any provisions of the draft rule be classified as civil penalty or conduct provisions under the NGL or National Gas (Victorian) (Declared System Provisions) Regulations.

B.6 Declared system functions

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of AEMO's declared system functions.⁵² The Commission is satisfied that the draft more preferable rule is compatible with AEMO's declared system functions as the draft rule will clarify the processes for the creation and allocation of market benefit instruments in the Victorian DWGM. In particular, the amendments will clarify when AEMO is the party responsible for undertaking the allocation process for authorised MDQ and AMDQcc and how the proceeds from its allocation process are to be used.

B.7 Allocation of powers, functions and duties

Further, the Commission may only make a rule that affects the allocation of powers, functions and duties between AEMO and the DTS SP provider if AEMO has provided

⁵² See section 295(4) of the NGL.

its consent to the making of the rule.⁵³ Although the draft more preferable rule continues to align the party responsible for undertaking the allocation process with the inclusion or non-inclusion of costs associated with the extension or expansion that created the AMDQcc in APA's capital base, it does represent a departure from the current practice operating in the market and clarifies a number of processes and requirements related to the creation and allocation of market benefit instruments. As such, the AEMC will seek consent from AEMO prior to making of any final rule that affects the allocation of powers, functions and duties as between AEMO and APA.

⁵³ See section 295(5) of the NGL.

C Comparison of current rule requirements, current practice, AEMO's proposed rule and the Commission's more preferable rule

	Current rule requirements	Current practice	AEMO's proposed rule	Commission's more preferable rule
What is the classification of new market benefit instruments created as a result of an extension or expansion	<p>If 100% of costs included in the capital base then authorised MDQ created</p> <p>Less than 100% of costs included in the capital base then either authorised MDQ or AMDQcc created</p>	All new market benefit instruments are AMDQcc	All new market benefit instruments are AMDQcc	All new market benefit instruments are AMDQcc
Who determines classification of new market benefit instruments created as a result of an extension or expansion	Silent when determining if new market benefit instruments should be authorised MDQ or AMDQcc	The classification of new market benefit instruments is determined by agreement between AEMO and APA	The rules prescribe that AMDQcc is created	The rules prescribe that AMDQcc is created
Who undertakes the allocation process for AMDQcc when it is included in the capital base	AEMO; however, the rule only provides an allocation process for AEMO when undertaking the allocation process for authorised MDQ	APA	APA	AEMO
Who undertakes the allocation process for AMDQcc when it is NOT included in the capital base	APA	APA	APA	APA
What happens to the proceeds from the allocation	Silent	APA refunds the volume effect through its annual tariff adjustment	AEMO is required to offset the costs of operating the Victorian	AEMO is required to offset the costs of operating the Victorian

	Current rule requirements	Current practice	AEMO's proposed rule	Commission's more preferable rule
process		mechanism. AEMO offsets the costs of operating the Victorian DWGM with any proceeds received from its allocation process.	DWGM with any proceeds received from its allocation process.	DWGM with any proceeds received from its allocation process.
Who undertakes the allocation process for authorised MDQ	AEMO and APA (in limited circumstances where the costs of the extension or expansion that created authorised MDQ are not included in APA's capital base)	AEMO	AEMO	AEMO
What is the minimum notice period prior to an allocation process taking place	Silent	Unknown	Minimum twenty business days' notice prior to AEMO's or APA's allocation process being undertaken	Minimum twenty business days' notice prior to AEMO's or APA's allocation process being undertaken