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Dear John

Re: AEMC Draft Determination (Prioritisation of Tied Controllable Withdrawal bids)

AEMO welcomes the opportunity to provide a submission in response to the AEMC's Draft Determination, made on 25 February 2010, on our proposed amendment to the National Gas Rules to introduce improved tie-breaking provisions for equally beneficial withdrawal bids in the Victorian Declared Wholesale Gas Market.

In its Draft Determination, the AEMC decided not to make the proposed Rule because it was not satisfied, on the basis of information provided to it at that time, that the proposed Rule will or is likely to contribute to the achievement of the National Gas Objective (NGO).

We remain of the view that the proposed Rule will contribute to achievement of the NGO, and the attached submission presents further information, together with commentary on issues raised in the Draft Determination, which we believe will assist the AEMC in its further review of this matter.

In the Draft Determination the AEMC states that, in their view, the proposed Rule would provide "*greater benefits in terms of increased regulatory certainty on the allocation of gas in tie-breaking scenarios*" and that "*greater certainty of the allocation of gas could promote improved risk management from market participants which could bring price and reliability benefits to customers, promoting more efficient operation and use of natural gas services*".

The Draft Determination goes on to say, however, that "*the Commission's preliminary consideration is that the materiality of these potential effects is unclear.*" We are unclear on the nature of the materiality test that the AEMC is seeking to apply in this regard. We accept that the benefits from the proposed Rule are likely to be incremental. However, the costs of implementation are also incremental, such that there is a high likelihood of positive net benefits.

The AEMC's Draft Determination also places significant weight on a hypothetical scenario under which a holder of AMDQ/AMDQ Credits at Culcairn could exert market power in retail markets in NSW by using such AMDQ to frustrate the entry and/or prevent other competitors from supplying customers in NSW. We consider that this scenario cannot occur in practice, and have provided additional detail on the interaction of the Victorian and NSW gas markets in this submission.

Our attached submission expands on each of the matters discussed above, and provides further explanation and illustration of the issues with the current tie breaking rules for controllable withdrawals, the mechanism by which the proposed Rule would address these

issues and facilitate an improved and more efficient allocation of natural gas, better facilitate pipeline investment and, hence, contribute to the achievement of the NGO.

I would be pleased to discuss any aspect of this submission at your convenience, please do not hesitate to contact me on 03 9648 8520.

Yours sincerely



Terry Grimwade
Executive General Manager, Market Development

Attachments A: Submission on AEMC Draft Determination

ATTACHMENT A

AEMO Submission in response to AEMC Draft Determination (25 February 2010) – National Gas Amendment (Prioritisation of Tied Controllable Withdrawal bids) Rule

1. Overview

On 25 February 2010, the AEMC issued a Draft Determination on a proposal by AEMO for an amendment to the National Gas Rules to introduce improved tie-breaking provisions for equally beneficial withdrawal bids in the Victorian Declared Wholesale Gas Market (DWGM).

In its Draft Determination, the AEMC decided not to make the proposed Rule because it was *“not satisfied, on the basis of the information it has considered to date, that the proposed Rule will or is likely to contribute to the achievement of the National Gas Objective (NGO)¹.”*

Nevertheless, the AEMC noted, in section 7.3.1 of the Draft Determination, that the proposed scheduling of tied controllable withdrawal bids would be preferable to, and provide greater certainty for shippers, than the pro-rating methodology under the existing rules. Further, section 7.4 of the Draft Determination states that *“the Commission considers that the proposed Rule, if made, would have the potential to promote more efficient operation and use of natural gas services by promoting reliability and lower prices at times of market stress through allowing parties to more effectively and efficiently manage their risks”*. The Draft Determination therefore appears to have recognised some benefits of the proposed Rule in the context of the NGO, but indicates that the AEMC is unclear on the materiality of these effects.

A substantial part of the Draft Determination was devoted to discussion of a hypothetical scenario whereby a holder of AMDQ or AMDQ credits at Culcairn may refuse to trade such AMDQ/AMDQ credits and, hence, frustrate the entry and/or prevent other competitors from supplying customers in NSW. AEMO has addressed this issue in section 2.2 of this submission, explaining our view that this scenario could not occur under the proposed market arrangements.

In the following sections of this submission, AEMO provides additional information to further clarify the potential benefits of the proposed Rule and to assist the AEMC in its consideration of the extent to which it will, or is likely to, contribute to the achievement of the NGO.

¹ Draft Determination page i

2. Issues Addressed by and Benefits of the Proposed Rule

2.1. Consistency of Treatment

Currently, there is no explicit tie-break procedure for “equally beneficial²” withdrawal bids, and such bids are simply scheduled on a pro-rata basis, based on the quantities included in the tied price bids.

The Draft Determination acknowledged that this results in inconsistent treatment of tied injection and tied withdrawal bids, in that the existing rules provide for priority scheduling of equally beneficial injection bids for holders of AMDQ or AMDQ Credits, but do not do the same for equally beneficial withdrawal bids.

However, the Draft Determination did not address the related issue of inconsistent treatment of withdrawal bids in the event of transmission pipeline constraints. In the event of pipeline constraints that give rise to the need for curtailment of gas withdrawals then, where practical, those withdrawals that are not covered by AMDQ/AMDQ Credits are to be curtailed first. This is a fundamental underlying principle of the Victorian market carriage arrangements. It could be argued that this situation arises when two or more parties submit equally beneficial withdrawal bids at the same withdrawal point, with a total withdrawal quantity in excess of the physical withdrawal capacity at that point. Strictly speaking, the withdrawal bids need to be “curtailed” to match the physical withdrawal capacity. However, under the current rules such tied bids would be pro-rated based on the quantities in each tied bid, regardless of AMDQ/AMDQ credits.

It should be noted that prior to the commencement of the Victorian DWGM in March 1999, the 17TJ of available AMDQ at Culcairn was allocated to APA GasNet. Market Participants currently holding AMDQ or AMDQ Credits at Culcairn have purchased or otherwise procured those rights from APA GasNet since market commencement, yet under the current Rules they receive little or no real benefit from those rights in terms of physical certainty in gas delivery.

The scheduling and pricing arrangements for the DWGM were revised significantly in 2007, introducing ex-ante pricing and within-day rebidding and rescheduling. At this time, tie-breaking priority for tied injection bids was given to AMDQ/AMDQ credit holders. The same rights were not implemented to tied withdrawal bids at that time due to an issue of “injection dependence” of AMDQ that had not been resolved (explained simply, “injection dependence” refers to the concept that in order to activate AMDQ or AMDQ Credits as a form of withdrawal right, a party must also inject a commensurate quantity of gas).

² Contrary to what is stated in section 1.2 of the Draft Determination, “equally beneficial” bids are not simply bids with equal prices. A more accurate description is contained in footnote 2, page 2 of AEMO’s Rule Change Request, namely “equally beneficial bids means bids that, in the absence of a tie-break procedure, and taking account of bid price, location, accredited constraints, system capacity and the temporal and physical distribution of system demand over the gas day, would be scheduled with equal priority on a pro-rated basis by the scheduling systems and processes.”

After further discussions with interested parties through the Gas Market Consultative Committee (GMCC) and the Gas Wholesale Consultative Forum (GWCF)³, the injection dependence issue was resolved with a decision taken that injection dependence should not apply to AMDQ used for tie-breaking at withdrawal points. This decision was reached on the basis that it was recognised as unworkable from a market clearing and market process perspective, and recognising the precedent under the Victorian legislation that AMDQ provides withdrawal rights at times of load curtailment due to constraints (regardless of injections). This question of injection dependency was the main issue where there were any significant differences of opinion debated during consultation on the proposed Rule through the GMCC and GWCF processes. As such, the issue was flagged in Appendix 2 of AEMO's Rule Change Request dated 16 November 2009, along with a summary of the concerns raised and how they were responded to in finalising the proposed Rule.

The proposal to prioritise tied withdrawal bids on this basis is, hence, an incremental but logical extension in the use of the AMDQ withdrawal rights provided at the start of the market 11 years ago and is consistent with the tie-breaking rights extended to injection bids.

2.2. Efficient Use of Natural Gas Services

The AEMC's Draft Determination states, in section 6.3.1, that "*an inefficient allocation of gas would occur in circumstances where a rule is in place which prevents gas being allocated to parties who value it the most*".

AEMO agrees with this sentiment and considers that one of the benefits of the proposed Rule is that it is more likely than the existing rule to ensure that gas is allocated to those who value it most. If two parties submit equally priced withdrawal bids and only one holds AMDQ, AEMO considers that the holder of the AMDQ values the gas more highly as they are willing to pay both the price of the gas and the additional cost of procuring the AMDQ.

The Draft Determination states that "*the proposed Rule creates a risk that a party that values the gas more highly relative to the holder of AMDQ/AMDQ rights is prevented from accessing the gas at Culcairn*⁴". However, in the Victorian DWGM, gas injections and withdrawals are scheduled on the basis of spot market bids, irrespective of AMDQ or AMDQ Credits. A holder of AMDQ or AMDQ credits cannot prevent any other party from accessing pipeline capacity for injections or withdrawals unless it is prepared to at least match the other party's bid price. The proposed Rule only applies in the event of the need to break tied, or equal, bids. By definition, on the basis that the bids are equal, neither party has indicated through its bid alone that it values the gas more than the other. However, the proposed Rule would reflect that, in the event of equal bids, those parties who have gone the extra step of procuring AMDQ or AMDQ credits in advance to support their bids have placed greater value on the gas. Hence, we do not believe that the potential risk identified in the Draft Determination can occur.

³ The roles of the GMCC and GWCF were explained in AEMO's Rule Change Request

⁴ Section 6.3.1, page 24 of Draft Determination

The Draft Determination also expressed a related concern that *“the party that holds the AMDQ/AMDQ Credits might refuse to trade its AMDQ/AMDQ Credits to potential competitors in order to frustrate entry into NSW or another relevant market.”*⁵ As explained above, this concern is unfounded and would not be a viable strategy to exert market power. Simply holding and refusing to trade AMDQ at a withdrawal point would not prevent a competitor from flowing gas at that point. The holder of the AMDQ would still need to match other parties’ market bids in order to get their gas scheduled and, regardless of whose gas is scheduled, all gas withdrawal bids would be met and gas would flow to meet customer requirements up to the physical capacity of the pipeline. Under the Victorian DWGM arrangements, provided there is spare physical capacity on the pipeline, parties who do not hold AMDQ rights are able to flow gas through the pipeline at no additional cost. Under the proposed Rule, the only time that holders of AMDQ rights would get priority treatment over parties without AMDQ would be in the event of tied bids with aggregate bid quantities exceeding the pipeline capacity.

2.3 Impacts on Network Investment

AEMO’s Rule change proposal argued that the proposed Rule *“may contribute to signalling investment in the DTS in situations of system constraints because it incrementally increases the utility of AMDQ and AMDQ Credits”*⁶.

In section 5.3 of its Draft Determination, the AEMC noted that this view was shared by APA GasNet, Origin and Visy Paper, with APA GasNet quoted as having claimed that “investment in additional capacity was being hampered by the inability to offer certainty in withdrawals rights”, and both Origin and Visy Paper stating that “the main benefit of prioritising tied controllable withdrawal bids would be increased signals for investment in the network”.

In its Draft Determination, the AEMC accepted that the proposed Rule would incrementally increase the benefits of holding AMDQ or AMDQ Credits, but remained unconvinced that this would have “a material impact on informing more efficient network investment decisions”.

AEMO accepts that its Rule change proposal did not spell out the primary mechanism by which the proposed Rule would enhance the utility of AMDQ or AMDQ Credits in facilitating investment and this mechanism was not considered or discussed in the Draft Determination.

The increased utility of AMDQ and AMDQ Credits afforded by the proposed Rule, is that it would provide scheduling priority to holders of these rights in the event of tied bids. On face value this would appear to be an incremental benefit. However, AEMO has been informed and lobbied by various users or potential users of the Culcairn interconnection, in particular, that this is an important deficiency in the current market arrangements in terms of risk management and in facilitating investment to expand the interconnection.

⁵ Page 25 of Draft Determination

⁶ Section 3 of AEMO Rule Change Request (16 November 2009)

This can be illustrated by two examples.

Example 1: a shipper has access to gas under contract from a Victorian producer and wants to use that gas to supply a gas fired power station or paper plant in southern NSW, north of Culcairn. That shipper, who must also have contracted firm capacity on the EAPL (NSW) system north of Culcairn, wants certainty that it can withdraw the gas at Culcairn having arranged for the gas to be injected by its producer in Victoria—irrespective of spot price in Victoria or at the Sydney Hub in the STTM. Under the current arrangements it does not have this certainty, even if it holds AMDQ as a withdrawal right at Culcairn. If it bids the maximum price of \$800/GJ for the controllable withdrawal, another party who does not hold AMDQ may do the same and, if the aggregate of withdrawal quantities exceeds the physically deliverable capacity on the day, the quantities will be pro-rated between them – with the party who bid that price for the highest quantity being allocated the greater share and no account being taken of any AMDQ held. Under this scenario, the market price would not necessarily be \$800/GJ, indeed this would be highly unlikely. The price would likely be set by the marginally priced scheduled injection offer, with the inability to deliver all withdrawals at Culcairn most likely due to a transmission constraint, rather than a supply constraint.

It could be argued that if the Victorian DTS spot price rises above the STTM price at the Sydney Hub, then shippers may be willing to forego exports at Culcairn to access potentially lower priced gas backhauled from the Sydney Hub. However, some shippers may not be interested in managing their supply arrangements and price risks in this way, preferring instead to achieve certainty of their own physical supply through supply and pipeline contracts. The proposed Rule would be an incremental but seemingly important improvement in the utility of the AMDQ rights to enable them to achieve this. Under the contract carriage arrangements that apply on transmission pipelines in Australia other than the DTS, this is equivalent to firm capacity taking priority over ‘as available’ or ‘non-firm’ capacity when there is a capacity constraint.

Example 2: a shipper with a potential new large load, such as a gas fired power station, that it wishes to supply with gas from Victoria, may be willing to fund the cost of expanding the capacity of an interconnection, for example by meeting the costs of additional compression (AEMO has received enquiries in this regard for the interconnection at Culcairn, but in theory it could apply elsewhere on the DTS). This is not the type of investment for which APA GasNet could seek regulatory approval for cost recovery through its general tariff structure, since it would only have one identified beneficiary. However, for the shipper concerned to fund the investment itself, it would in return expect some form of rights to the additional capacity that would result. It would be possible for the shipper to arrange an AMDQ transfer to Culcairn equal to the additional capacity at the interconnect, but under the current rules (as illustrated in Example 1), this would not provide certainty that the shipper’s gas would be delivered, regardless of what price it bid for withdrawals at the interconnection. Even if it were physically possible to deliver gas to the interconnect equal to its physical capacity for export, and even

if the shipper bid the maximum allowable \$800/GJ for its withdrawals, it would not be guaranteed to be allocated the full quantity of gas in its bid.

In its Draft Determination, the AEMC states that APA GasNet, Origin and Visy Paper appear to be the only stakeholder views expressed on these issues during the VENCORP/AEMO consultation recorded in the GMCC/GWCF documentation. AEMO can assure the AEMC that there was much wider participation than just these three parties in the GMCC/GWCF consideration of this proposed rule change and all of the associated issues raised in this submission (as indicated by the minuted attendance lists of the six GMCC/GWCF meetings and the half-day workshop at which these matters were discussed⁷). Furthermore, other parties have individually and privately taken up these issues with AEMO and APA GasNet at various times over the life of the Victorian gas market. It is equally important to note that there have been no strong dissenting views expressed against the proposed Rule, either through the GMCC/GWCF consultative processes, or in response to the AEMC's Information Paper released on 23 December 2009.

In summary, AEMO believes that the additional information contained in sections 2.1, 2.2 and 2.3 above, further reinforces the conclusions reached by the AEMC itself in the Draft determination that *"the proposed Rule, if made, would have the potential to promote more efficient operation and use of natural gas services by promoting reliability and lower prices at times of market stress through allowing parties to more effectively and efficiently manage their risks"*. AEMO also believes that the additional information provided in section 2.3 further illustrates the potential benefits of the proposed Rule in providing improved signals for investment, through improved capacity (AMDQ) rights for investors in pipeline capacity at discrete parts of the DTS network.

Consequently AEMO believes that the proposed Rule satisfies the "Rule making test" in that it will, or is likely to, contribute to the achievement of the NGO through the promotion of *"efficient operation and use of natural gas services for the long term interests of consumers of natural gas with respect to price, reliability and security of supply of natural gas"*.

⁷ Details of these GMCC/GWCF meetings and the half-day workshop were provided in AEMO's Rule Change Request, 16 November 2009.

3. Materiality Test

AEMO notes that while the Draft Determination appears to accept that the proposed Rule has a number of potential benefits consistent with the NGO, the materiality of these benefits remained unclear to the AEMC.

AEMO hopes that the additional information provided in this submission will assist the AEMC in this regard. Nevertheless, AEMO remains concerned by comments in the draft determination that anticipated benefits were not considered to be material.

This is of concern to AEMO as many changes to the Rules only provide incremental improvements in the achievement of the NGO. The estimated cost of implementing the proposed Rule was quoted in AEMO's original submission to the AEMC at \$40,000. In its Draft Determination, the AEMC considered scenarios where tie-breaking may be required either at \$400/GJ or \$800/GJ. At these prices the cost of implementing the proposed Rule would equate to the value of 0.1TJ or 0.05TJ, respectively. Hence, even if a tie-breaking event is considered to be an unlikely event, and even if it occurred at lower prices than these, the likelihood of the proposed Rule having a positive net benefit would have to be considered as very high.

AEMO remains willing to provide further assistance to the AEMC in its consideration of this submission and/or matters raised in any other submissions it receives in response to the Draft Determination. Please do not hesitate to contact Terry Grimwade on (03) 9648 8520.