



Australian Energy Market Commission

## **RULE DETERMINATION**

**National Gas Amendment (Removal of Force Majeure Provisions in the DWGM) Rule 2014**

**Rule Proponent**

Australian Energy Market Operator

11 December 2014

**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 (Commission or AEMC) has made a rule to remove force majeure provisions from the National Gas Rules as they pertain to the Victorian declared wholesale gas market (DWGM). As a result, the National Gas Rules will be more closely aligned with the market design, reflecting both physical and operational changes in the market that have rendered the force majeure provisions obsolete and ineffective.

The rule will also define the cumulative price threshold in the National Gas Rules. This change highlights and clarifies the role of the cumulative price threshold as the main trigger of an administered price cap applying to the Victorian DWGM.

A requirement on the Australian Energy Market Operator (AEMO) has also been introduced to specify in the administered pricing procedures the process by which AEMO will consult with market participants on the approach to determining the administered price cap and the cumulative price threshold.

Finally, the rule removes redundant provisions relating to the obligations on AEMO and market participants with respect to scheduling instructions, which should improve clarity.

The rule is made in the form provided in AEMO's rule change request.

### *Reasons for the Commission's decision*

The Commission considers that the rule will or is likely to contribute to the national gas objective by providing market participants with greater clarity on how the market can manage unexpected events and market stress. This will allow for more timely and efficient decision making, and may lead to prices more accurately reflecting market conditions.

The rule aligns the National Gas Rules with the causer pays principle, which seeks to make market participants financially responsible for the consequences of actual injections or withdrawals differing from those scheduled. The rule will remove the ability of market participants to declare participant force majeure and thereby require AEMO to make a decision regarding the declaration of system force majeure, which may alter the financial outcomes in the market. Therefore, the rule will incentivise appropriate risk management practices.

By removing system force majeure, the subjectivity and discretion involved in the decision on whether to declare system force majeure is removed. This will allow market participants to better understand the parameters of the market.

The Commission also considers that making minor amendments to add clarity will improve administrative efficiency by allowing the rules to more concisely set out their intended functions.

The rule will commence on 4 May 2015. The rule does not commence immediately as AEMO requires some time to change the respective procedures.

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# 1 AEMO's rule change request

## 1.1 The rule change request

On 6 February 2014, the Australian Energy Market Operator (AEMO) made a request to the Australian Energy Market Commission (Commission or AEMC) to make a rule regarding the removal of force majeure provisions in the declared wholesale gas market (DWGM) in Victoria.<sup>1</sup> Under the proposal, both participant force majeure (PFM) and system force majeure (SFM) provisions in Part 19 of the National Gas Rules (NGR) would be removed. The purpose of this is to remove redundant and ineffective rules. As a result the NGR would reflect the current market design and thereby provide clarity for market participants.

Additionally, the request sought to define the cumulative price threshold (CPT) in the NGR to highlight its role in starting and ending an administered pricing period (APP). It has sought to place a requirement on AEMO to specify the process by which it will consult with market participants on the approach to determining the APC and CPT.

The rule change also sought to remove the provisions in the NGR relating to a failure to comply with scheduling instructions, in order to clarify and simplify the NGR.

## 1.2 Rationale for the rule change request

AEMO identified two key reasons why it considers it is beneficial to remove PFM and SFM provisions:<sup>2</sup>

- The existing force majeure provisions have been made redundant or partially redundant by the introduction of an intraday, ex-ante market in February 2007. The new arrangements mean that the market is better able to resolve issues associated with force majeure events without the need for the specific provisions.
- There is no guidance as to the criteria for AEMO making a decision on whether a PFM event should lead to a declaration of SFM. This lack of criteria led to a significant dispute between AEMO and a market participant following a PFM event in 2008. Removal of force majeure provisions would avoid such a dispute in the future.

In addition, AEMO noted that the Gas Wholesale Consultative Forum (GWCF) has considered the issue in an attempt to find the right mechanism to both facilitate market responses to supply disruptions in the DWGM, and to provide protection from high prices when a supply response is not forthcoming from the market.

The rationale for the rule change request is discussed further below.

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<sup>1</sup> AEMO, *Rule Change Request - Removal of Force Majeure Provisions*, February 2014.

<sup>2</sup> *ibid*

### **1.2.1 Participant force majeure is redundant**

In its rule change request, AEMO claimed that the PFM provisions have become redundant due to the introduction of an intraday market.<sup>3</sup> Specifically:

- Market participants are now required to rebid into the DWGM throughout the gas day to reflect their circumstances, allowing AEMO's next schedule to accurately reflect new information, including any constraints from an event;
- Market participants that do not conform to a scheduling instruction now attract 'cost to cause' deviation payments to cover the costs of the deviation; and
- A PFM event is now less likely to materially affect the operation of the market or system security and thus justify a declaration of SFM. This is because the market is now more flexible, with the possibility for rebidding and the existence of multiple schedules within a gas day. As a result, other supply sources may be able to meet demand in a situation where a PFM type event occurs.

### **1.2.2 System force majeure is ineffective and partially redundant**

With respect to SFM, AEMO provided two reasons in its rule change request as to why the SFM provisions are no longer necessary, and may even be counterproductive to the efficient operation of the DWGM.<sup>4</sup>

First, AEMO argued that SFM is ineffective as there is no guidance as to the criteria for it to declare SFM. The decision involves a broad degree of discretion for AEMO. This has resulted in differing views and interpretations of SFM by market participants, and led to a dispute over AEMO's decision not to declare SFM in November 2008. In that instance, TRUenergy sought a review of AEMO's decision at the Dispute Resolution Panel (discussed in section 1.4.5). AEMO noted that such legal proceedings are costly.

Second, AEMO argued that the increased market flexibility renders SFM partially redundant. This is because AEMO has the opportunity to generate a viable schedule that prevents the market operation or system security from being materially affected, even if a supply disruption occurs. Therefore, the link between PFM and SFM has been weakened. If a viable schedule can be generated and prices remain high, the CPT may be exceeded. This would trigger a price cap (the administered price cap, or APC) and provide market participants with financial protection from sustained high prices.

In addition, if a viable schedule cannot be generated, AEMO can use the Threat to System Security or Emergency provisions in the NGR to manage major market disruptions.<sup>5</sup>

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<sup>3</sup> *ibid*, p.4.

<sup>4</sup> *ibid*, pp.4-5.

<sup>5</sup> NGR, Part 19, Division 5.

### 1.3 Solution proposed in the rule change request

To address the matters identified above, AEMO proposed to remove both PFM and SFM provisions from the NGR. This involves removing rules specifically relating to force majeure provisions in rules 216 and 346, and any reference to force majeure provisions in any other rule (for example, rule 239(5)(b)).

AEMO has claimed that removing the force majeure provisions, which it considers are redundant and ineffective, would allow other provisions to play their intended role with less equivocation. Market forces would be relied upon to resolve any supply disruption, and the CPT or other provisions may be used when market forces are ineffective in this role.

Currently, Part 19 of the NGR, which relates to the Victorian DWGM, does not define the CPT or specify its role. AEMO's rule change request therefore also includes a number of other amendments to effect the rule change and improve clarity in the CPT and the way in which it is determined. These amendments are as follows:

- Defining the CPT in the NGR in terms of its role in determining the start and end of an APP (proposed rule 224(1A)(b)).
- Specifying AEMO's role in making procedures that specify the CPT (rule 224(1)(a)).
- Placing a requirement on AEMO to set out the process by which AEMO will consult on the approach to determining the APC and the CPT (rule 224(1)(b)) in its Administered Pricing Procedures. The Commission notes that these procedures are made by AEMO in accordance with rule 135EE of Part 15B of the NGR. Therefore, the new consultation process to be added to the Administered Pricing Procedures would also be included in rule 135EE.

AEMO also seeks to remove redundant rules regarding responsibilities and obligations relating to the failure to comply with scheduling instructions. These are rules 216(9) and (10). Specifically, if a market participant fails to comply with a scheduling instruction and is not excused from complying with that scheduling instruction under rule 216(4), then:

- AEMO must notify the relevant market participant that the gas injection or withdrawal does not conform and request a reason for the failure to comply with a scheduling instruction; and
- if the market participant fails to respond to the above request, or if AEMO is not satisfied that the relevant market participant will respond to any scheduling instruction, AEMO may intervene by issuing directions in accordance with Division 5, Subdivision 5 of Part 19 of the NGR.

Under rule 216(1), until a market participant provides a reason for the failure to comply with a scheduling instruction and AEMO is satisfied that the market

participant will respond to future scheduling instructions, the gas injection or withdrawal will be regarded as non-conforming.

## **1.4 Relevant background**

### **1.4.1 Force majeure**

Force majeure is a common legal provision found in contracts that absolves certain parties from having to meet contractual obligations in certain circumstances. These are generally events beyond the reasonable control of a party that may prevent that party from meeting its obligations. Often these events are defined in a contract. The concept of force majeure in relation to this rule change request relates to provisions in Part 19 of the NGR, which concerns the operation of the Victorian DWGM. The rule change request is not concerned with force majeure provisions in private contracts.

There are two types of force majeure provisions in the DWGM: participant force majeure and system force majeure. These are discussed in turn below.

### **1.4.2 Participant force majeure**

In summary, PFM absolves a market participant of the requirement to meet its scheduling instructions in respect of a bid if it cannot do so due to the occurrence of a 'PFM event' as listed below.

More specifically, PFM can be declared by a market participant when it is unable to comply, in part or in whole, with AEMO's scheduling instructions, due to an event that is beyond the reasonable control of the market participant affected by the event. As contained in rule 216(6)(a) of the NGR, such events are:

- “(i) acts of God, including earthquake, flood, fires, storms, storm warnings, and navigational and maritime perils;
- (ii) labour disputes;
- (iii) acts of public enemies, wars, terrorism, civil disturbances, blockades, insurrections, riots, epidemics;
- (iv) any law, order, rule, regulation, act, restraint, omission or failure to act of any government authority, civil or military (whether or not in fact legally valid);
- (v) failure of the declared transmission system (which may or may not constitute a system force majeure event);
- (vi) accident, premature, partial or entire failure, breakage, freezing, fire, explosion, or other damage or malfunction, resulting in the partial or complete shutdown of any part of a market participant's facilities;

- (vii) any other event, whether similar or dissimilar to those identified herein which meets the requirements of subrule (5).”

Rule 216(5) specifies a PFM event to be the occurrence or effect of any of the events or circumstances set out in rule 216(6) that is beyond the reasonable control of the market participant affected by the event and results in or causes the market participant who is affected by the event to fail to comply with scheduling instructions.

### 1.4.3 System force majeure

SFM triggers an administered pricing period for the market. This is where AEMO applies the APC to the market for a period of time.<sup>6</sup>

SFM is also one of the preconditions under which AEMO can suspend the market. When the market is suspended, AEMO determines prices in accordance with rule 221 to the extent that is possible. To the extent that it is impractical to do so, AEMO must determine prices on any other basis it considers relevant and necessary in the circumstances. AEMO may suspend the market when:<sup>7</sup>

- “(a) a system force majeure event occurs; or
- (b) an emergency occurs; or
- (c) AEMO has been directed by a government authority to suspend the Market or operate all or part of the declared transmission system in a manner contrary to the provisions of this Part [Part 19]; or
- (d) AEMO determines that it is necessary to suspend the Market because it has become impossible to operate the Market in accordance with the provisions of this Part.”

Under rule 346(2), SFM can only be declared by AEMO if:

- a PFM event has occurred; or
- a government authority gives directions to AEMO, or a declared transmission system service provider, in respect of the operation of the declared transmission system.

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<sup>6</sup> An APC attempts to limit any unnecessary losses resulting from exposures to high prices that are redundant in their role of inducing a supply response. A SFM event may be an event where supply is unresponsive, and therefore where an APC may be of use. For example, a natural disaster may inhibit the ability of a supplier to meet its scheduled injections; here, the market price may not induce a supply response. In this case, using the APC will limit the financial impacts on market participants of the natural disaster and keep the market operating to the extent possible. Such events illustrate the usefulness of an APC.

<sup>7</sup> Rule 347(1)

However, in order to declare a SFM event, AEMO must also reasonably consider that:<sup>8</sup>

- “(a) either:
- (i) the event has resulted in a reduction in the normal capacity of part or all of the declared transmission system and/or the volume of gas which would otherwise normally flow in the declared transmission system; or
  - (ii) the event has resulted in a reduction in the normal capacity of part or all of a Producer's or Storage Provider's plant or facility reducing the volume of gas which would otherwise normally flow into the declared transmission system; and
- (b) that reduction is likely to materially affect the operation of the Market or materially threaten system security.”

As indicated above, the decision to declare SFM (and therefore an APC) requires an assessment on the part of AEMO, giving it some discretion. Therefore, there may be some uncertainty for market participants as to the conditions under which it may be declared.

SFM and the APC may affect the distribution of financial impacts of force majeure events. For example, an APC may limit the financial liabilities of a market participant not able to meet its scheduling instruction.

SFM is not required to handle emergencies or threats to system security, nor is it essential to suspend the market, if necessary. Such events can be managed by rules relating to intervention and market suspension in Division 5 of Part 19 of the NGR.

#### **1.4.4 Relevant market changes**

The DWGM commenced in 1999 with a market design that featured a gas day with one schedule, and prices were determined the following day (a daily ex-post market). As a result, there was no flexibility for market participants to update their planned injections or withdrawals to reflect any changes in their circumstances during the day. In this situation, PFM had a specific purpose – it absolved a market participant from the requirement of meeting scheduling instructions following a force majeure event.

In addition, the market did not have many sources of supply in its early stages, being largely reliant on supply from the Longford injection point. Under these conditions, if one market participant experienced a force majeure event, this could result in an SFM event. This would arise if the supply disruption affecting the individual market participant also materially affected system security or market operation. Such an event would allow AEMO to declare SFM, triggering an APP. Therefore, there was a direct link between a market participant's position, and AEMO putting in place an APP.

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<sup>8</sup> Rule 346(1)

In 2007, the Victorian DWGM was redesigned to form an intraday ex-ante market. It now features five schedules in a gas day and rebidding to inform those schedules, with prices determined throughout the day prior to a trading interval. As a result, market participants can more easily respond to any supply disruptions, directed by the price signal. A gas day with multiple schedules means that market participants have the ability to respond to changes in the market and their own circumstances. These changes coincided with the entry of more supply sources that diversified the market as it matured. Given these developments, the link between PFM and SFM had been diminished.

Another change in the market was the introduction of the CPT on 1 June 2008. The intention was for the CPT to be set at a level that allowed high prices to induce a supply response, or in the absence of such a response, for it to trigger an APP to provide financial protection to the market from persistent high prices. The price signal is also a signal for long-run investment decisions.

The CPT provides market participants with an observable, ex-ante-determined market parameter. Its effectiveness lies in its ability to trigger an APC when a market response is not available and sustained high prices have occurred. Finding this balance is the product of a decision made in advance. The CPT was reviewed in 2013 to assess whether its level was appropriate. The review concluded that the CPT should be reduced from \$3,700 to \$1,800.<sup>9</sup> The administered pricing procedures have been updated to incorporate this recommendation.

#### **1.4.5 Participant force majeure event of 2008**

In its rule change request, AEMO noted that the force majeure provisions led to a dispute under the Victorian Gas Industry Market and Systems Operation Rules (MSOR) between itself and TRUenergy in 2009 following a PFM event on 22 November 2008. On this day, TRUenergy's Iona gas storage facility was due to restart after a period of maintenance. TRUenergy made injection bids into the DWGM in anticipation of the resumption of its supply. However, the Iona gas storage facility was unable to recommence production until 23 November, the day following its planned resumption.

TRUenergy had made bids to inject supply in the 6pm and 10pm schedules of 22 November, but was subsequently unable to meet the scheduling instructions provided to it by the Victorian Energy Networks Corporation (VENCorp). As the 22 November gas day featured more withdrawals than injections, a shortage of linepack emerged and the market price went to VoLL (Value of Lost Load) in the 10pm schedule.

TRUenergy declared a PFM event at 7:25pm on 22 November, and requested that VENCorp consider the imposition of an APC from the 10pm schedule until the PFM event ceased. VENCorp did not declare the SFM event requested by TRUenergy as it did not consider it appropriate given the circumstances.

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<sup>9</sup> AEMO, *DWGM CPT Review 2013* Final Report, 16 September 2013.

TRUenergy contested this decision. The issue was heard by the Dispute Resolution Panel, which was established in accordance with Chapter 7 of the Victorian MSOR.<sup>10</sup> The panel found in favour of VENCorp, noting that the operation of the market was not materially affected by TRUenergy not being able to meet its scheduling instructions. TRUenergy applied for judicial review of the Dispute Resolution Panel's decision in the Victorian Supreme Court. The Court found no error in law in the Dispute Resolution Panel's decision and dismissed TRUenergy's application.<sup>11</sup>

#### 1.4.6 The Gas Wholesale Consultative Forum

The Gas Wholesale Consultative Forum (GWCF) is a forum that facilitates consultation on the operation and development of the DWGM and Short Term Trading Market. It is attended by market participants, AEMO, and any other interested stakeholders.

The GWCF held a force majeure workshop in June 2012 for participants to discuss the PFM event of November 2008 and the legal proceedings that followed.<sup>12</sup> The GWCF concluded that force majeure provisions in the NGR were redundant and ineffective and should be removed. Noting the problem of subjectivity involved in the declaration of SFM by AEMO, the GWCF investigated an objective, quantifiable trigger for an APP that may apply, including the CPT.<sup>13</sup> However, the forum concluded that the CPT was an adequate trigger, and should be the only quantifiable trigger.<sup>14</sup> A potential alternative trigger based on a supply shortfall was not favoured because it would be a pre-emptive market intervention that would prevent market participants from resolving the supply-demand imbalance through the market.

In concluding that the force majeure provisions should be removed, the GWCF acknowledged that the existing triggers for an APC might have been increasingly relied upon. This prompted AEMO to review the CPT to examine whether it was fit for purpose.<sup>15</sup> The review was undertaken concurrently with the development of this rule change request. The recommended change to the CPT has been implemented and is not contingent on this rule change request.

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<sup>10</sup> Many aspects of the MSOR subsequently formed Part 19 of the NGR.

<sup>11</sup> Supreme Court of Victoria, *TRUenergy Pty Ltd v Dispute Resolution Panel & Ors* [2009] VSC 581 (10 December 2009).

<sup>12</sup> AEMO, *Force Majeure Provisions Workshop*, 19 June 2012.

<sup>13</sup> AEMO produced a paper for the GWCF for the purpose of consulting with the forum on the appropriate APP trigger to apply in the DWGM in the event of a major upstream supply failure resulting in a significant increase in market prices. Accessed at: [www.aemo.com.au/About-the-Industry/Working-Groups/Gas-Wholesale-Consultative-Forum/GWCF-Meeting-Archive/GWCF-Meeting-174\\_18-September-2012](http://www.aemo.com.au/About-the-Industry/Working-Groups/Gas-Wholesale-Consultative-Forum/GWCF-Meeting-Archive/GWCF-Meeting-174_18-September-2012).

<sup>14</sup> AEMO, *Rule change request - Removal of force majeure provisions*, pp6-7. See also September 2012 Minutes for GWCF [www.aemo.com.au/About-the-Industry/Working-Groups/Gas-Wholesale-Consultative-Forum/GWCF-Meeting-Archive/GWCF-Meeting-174\\_18-September-2012](http://www.aemo.com.au/About-the-Industry/Working-Groups/Gas-Wholesale-Consultative-Forum/GWCF-Meeting-Archive/GWCF-Meeting-174_18-September-2012).

<sup>15</sup> AEMO, *DWGM CPT Review 2013 Final Report*, 16 September 2013.

#### **1.4.7 Administered pricing procedures**

The power to define the process for managing high price events is placed with AEMO, under rule 135EA(2)(e) of Part 15B of the NGR. AEMO must make administered pricing procedures (the procedures) that specify an APC and define the process that AEMO must apply to declare and end APPs (pursuant to rule 224(1)). The role of the CPT in the commencement and ending of an APP is outlined in the Administered Pricing procedures. Part 15B of the NGR specifies the process for making procedures (including the Administered Pricing Procedures).

#### **1.5 The rule change process**

On 10 July 2014, the AEMC published AEMO's rule change request and a consultation paper identifying specific issues and questions for consultation. Stakeholders were invited to provide feedback on the consultation paper, with submissions due by 8 August 2014. The AEMC received three submissions, which are available on the AEMC website.<sup>16</sup>

On 2 October 2014, the Commission published a draft rule determination and draft rule in relation to the rule change request. Submissions on the draft rule determination closed on 13 November 2014. Three submissions were received, and are available on the AEMC website.

In reaching its conclusion on the rule change request, the Commission assessed the perspectives contained in the stakeholders' submissions in relation to the rule change request. A summary of the issues raised in both rounds of submissions, and the Commission's responses, are included in Chapter 3.

#### **1.6 Commencement of final rule**

The final rule will commence on 4 May 2015. This will allow AEMO sufficient time to update its procedures in light of the change to the rules.

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<sup>16</sup> [www.aemc.gov.au](http://www.aemc.gov.au)

## 2 Final rule determination

### 2.1 Rule making test

Under s. 291(1) of the National Gas Law (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 national gas objective (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.”

For this rule change request, the relevant aspects of the NGO are:

- efficient use of and investment in natural gas services with respect to price; and
- efficient use of and investment in natural gas services with respect to reliability of supply.

### 2.2 Assessment criteria

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

- *Market efficiency*: Rules that encourage market participants to make bids that reflect their circumstances should facilitate efficient price signalling and informed decision making.
- *Efficient management of uncertainty*: To the extent possible, rules should help market participants to plan for and manage risks and contingencies as far as possible using market mechanisms. In the event of a contingency, rules that facilitate a market response are preferred. When market participants are unable to respond, other provisions should be in place. The provisions that provide the clearest architecture for this process should be favoured.
- *Administrative efficiency*: Improving clarity and minimising ambiguity in the application of rules helps to facilitate accurate and timely decision making by market participants, thereby reducing unnecessary administrative costs.

In assessing the rule change request against the NGO, the Commission has considered the likely long term costs and benefits of the proposed rule compared to the counterfactual of not making the proposed changes to the NGR. In doing so, the Commission has considered whether the proposed rule is likely to lead to more efficient use of, and investment in, natural gas services, which is in the long term interests of consumers.

## 2.3 Commission's final rule determination

The Commission's final rule determination is to make the rule proposed by AEMO. Specifically, the rule:

- removes participant force majeure and system force majeure provisions from the NGR, and any references to these provisions;
- defines the CPT in the NGR with respect to its role in starting and ending an APP;
- includes a requirement on AEMO to set out the process for consulting with market participants on the approach to determining the APC and CPT; and
- removes unnecessary rules relating to the obligations on AEMO and market participants with respect to scheduling instructions.

The Commission is satisfied that the rule will, or is likely to, contribute to the NGO. The rule will help to promote the efficient operation of the DWGM by providing clarity to market participants on the arrangements and protections available in times of market stress. This is expected to facilitate efficient decision making and may lead to prices more accurately reflecting market conditions. In turn, this may promote efficiency of the market process.

The rule will remove incentives that are incompatible with the market design. It aligns the NGR with the causer pays principle, which seeks to make market participants financially responsible for the consequences of actual injections or withdrawals differing from scheduled injections or withdrawals. By aligning the rules with this principle, the rule will improve the incentives around decision making at times of market stress, which should encourage risk management practices. This should help improve the efficiency of the process for managing uncertainty.

Further, by removing SFM, the subjectivity of the discretionary decision involved in declaring SFM will be removed. Removing SFM and allowing the CPT (which is observable and set on an ex-ante basis) to act as the main trigger for an APP should allow market participants to better understand the parameters of the market.

To improve clarity of the rules and to effect the key rule changes, the Commission has made a number of minor amendments to the NGR, allowing the rules to more concisely set out their intended functions. The presence of deviation payments incentivises market participants to conform with scheduling instructions, allowing the removal of rules relating to complying with scheduling instructions.

The Commission's reasons for making this rule determination are set out in detail in Chapter 3. A final rule is attached to, and published with, this final rule determination.

## **2.4 Strategic priority**

This final rule determination relates to the second of the AEMC's current strategic priorities: promoting the development of efficient gas markets (the gas priority).

## **3 Commission's assessment**

This chapter sets out the Commission's assessment of the rule change request, and the perspectives of stakeholders, in reaching its conclusion that the rule be made, in the form proposed by AEMO. The chapter examines each issue by providing the perspectives of AEMO and stakeholders, followed by the Commission's assessment of each issue.

### **3.1 Participant force majeure**

#### **3.1.1 AEMO's perspective**

AEMO considers that PFM is redundant and should be removed. AEMO provides three reasons for PFM's redundancy:

- In the daily ex-post market prior to February 2007 – which did not feature rebidding or ex-ante prices – PFM allowed a market participant to advise AEMO of any problems so it could take appropriate action to maintain system security. This was necessary as there was a single daily schedule, meaning the market was unable to adjust to market conditions. However, with the introduction of an intraday ex-ante market, rebidding allowed market participants to update bids to reflect their conditions. The next schedule was able to reflect any constraints resulting from an event. AEMO has stated that rebidding renders PFM redundant in its role of providing information to AEMO to manage a PFM event.
- In the daily ex-post market prior to February 2007, market participants affected by a PFM event were provided protection from action under conduct provisions associated with the obligation to comply with scheduling instructions. AEMO has noted that with the introduction of the intraday ex-ante market, deviation payments apply to market participants not conforming with scheduling instructions. Market participants are still relieved of obligations to comply with scheduling instructions in certain circumstances if PFM is removed.
- A declaration of PFM may invoke a declaration of SFM, which triggers the APC. AEMO stated that this mechanism is inconsistent with the current market design and is no longer required, given market developments. The specific arguments relating to this point will be examined in section 3.2 below.

#### **3.1.2 Stakeholder perspectives**

AGL's submission in response to the consultation paper provided broad support for the rule change request. In terms of the specific issue of the redundancy of PFM, AGL noted that PFM provisions do not provide the protection that they seemingly

conferred, and would provide protection from a regulatory breach only.<sup>17</sup> AGL repeated this point in its submission in response to the draft rule determination. AGL also noted in that submission that the market, having evolved from an ex-post to an ex-ante market with rebidding, now allows market participants to revise their positions in response to changed circumstances. This diminished the use of PFM as a risk management tool.<sup>18</sup>

Similarly, EnergyAustralia provided a submission in response to the draft rule determination in which it stated its support for the draft rule. It noted that PFM is redundant given that multiple schedules through the gas day allow the market to respond to major shortfalls.<sup>19</sup>

GDF Suez provided a submission in response to the consultation paper in which it considered that the rule change request represented the efficient application of the causer pays principle. In general, it supported the rule change request.<sup>20</sup>

Lumo Energy's submission in response to the consultation paper did not focus on the specific redundancies of PFM as identified by AEMO. It did not support the rule change request and provided two alternate proposals.<sup>21</sup> This was repeated in its submission on the draft rule determination. Lumo Energy's second submissions focused on the need to review the market parameters.<sup>22</sup> These issues will be examined closely in section 3.2 below, in the context of SFM.

### **3.1.3 Commission's assessment**

Having regard to the views of AEMO in its rule change request, and stakeholders in their submissions to the rule change process, the Commission considers that the PFM provisions are redundant in the specific roles outlined in section 3.1.

Rules 216(2)(a) and (b) require a market participant to notify AEMO that it cannot comply with all material aspects with a scheduling instruction, and provide reasons for the non-compliance.

In addition, rules 333(2)(a) and (b) require market participants to notify AEMO of any event or situation that may be considered an emergency, and the steps taken to respond to the event.

If market participants cannot comply with scheduling instructions they are able to rebid into the market. Rebidding allows AEMO to determine a new schedule to incorporate any changes to the material conditions of the market. Together with the

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<sup>17</sup> AGL, Consultation Paper submission.

<sup>18</sup> AGL, Draft Rule Determination submission.

<sup>19</sup> EnergyAustralia, Draft Rule Determination submission.

<sup>20</sup> GDF Suez, Consultation Paper submission.

<sup>21</sup> Lumo Energy, Consultation Paper submission.

<sup>22</sup> Lumo Energy, Draft Rule Determination submission.

rules above, AEMO will have the information needed to either operate the market or take other actions as required.

Therefore, the existing NGR provisions would allow AEMO and market participants to attain sufficient information to operate efficiently and for AEMO to maintain system security in the absence of PFM.

With respect to the protection from conduct provisions and the need to comply with a scheduling instruction, rules 216(2)(a) and (b), and 216(4)(b) and (c), in effect, perform these respective functions. In addition to the notification role of rules 216(2)(a) and (b) perform, rules 216 (4)(b) and (c) absolve a market participant from the need to comply with a scheduling instruction if gas is unable to be delivered and reasonable endeavours have been made to deliver that gas.

Deviation payments provide for financial transfers between market participants to account for the cost of deviating from scheduling instructions. A deviation payment is made to a market participant if that participant injects more than its scheduled injection. A deviation payment is made from a market participant if that participant injects less than its scheduled injection. These transfers diminish the need for protection from conduct provisions related to compliance with scheduling instructions if a PFM type event occurs.

## **3.2 System force majeure**

### **3.2.1 AEMO's perspective**

AEMO has proposed that SFM be removed from the NGR. AEMO's rule change request provides two reasons for SFM's removal:

- AEMO considers that there are inadequate criteria for declaring SFM, which requires AEMO to determine whether a PFM event has materially affected the operation of the market or system security under rule 346(1). AEMO's decision under this rule in 2008 resulted in a dispute with TRUenergy. The dispute arose from the differing views - between AEMO and TRUenergy - on the decision on whether to declare SFM based on the criteria provided in rule 346(1). AEMO noted that legal proceedings followed, and that such proceedings are costly. Removing the force majeure provisions would remove the discretionary and subjective SFM rule and therefore reduce the scope for potentially costly legal disputes.
- The introduction of the intraday market - which features rebidding - provides AEMO with the ability to determine a viable schedule that reflects circumstances of the day. AEMO considers it would therefore be unlikely to determine that an event would materially impact the market or system security. This is because, where a viable schedule is generated and prices are high, it is likely that the CPT would be exceeded in the short term, triggering an APP. Further, in the event AEMO was unable to generate a viable schedule, there are other provisions that

allow it to manage the market in light of an event (specifically Threat to System Security or Emergency provisions).

In summary, AEMO argues that market forces should be relied upon to resolve issues in times of market stress, and that there are other adequate provisions in place to manage instances when this is not possible.<sup>23</sup>

### 3.2.2 Stakeholders' perspective

In response to the consultation paper, AGL noted the support of the GWCF in relation to removal of the SFM provisions from the rules. It considered that reliance should be placed on the CPT as a trigger for an APC, in preference to SFM provisions. AGL also recognised the objective nature of the CPT and the absence of a subjective decision needing to be made on the part of AEMO. It also referenced the recent DWGM CPT review, which assessed the level of the CPT in the DWGM relative to the level of the CPT in the Short Term Trading Market (STTM) and the National Electricity Market (NEM). The CPT in the DWGM was subsequently reduced from \$3,500 to \$1,800.<sup>24</sup> AGL's second submission was consistent with its first on this issue.<sup>25</sup>

GDF Suez's submission in response to the consultation paper expressed support for this aspect of the rule change request. It emphasised the importance of the 'causer pays' principle, stating that the proposed rule was consistent with this principle. GDF Suez argued that force majeure provisions are inconsistent with this principle, as the 2008 PFM event illustrated. In this event, a market participant contributed to a higher price and then sought to mitigate its financial exposure by declaring PFM. Had SFM then been declared by AEMO, GDF Suez claimed, all other market participants would have faced a cost, which is in conflict with the causer pays principle.<sup>26</sup>

GDF Suez also noted that the risk exposure to participants from the CPT is aligned with that of other markets, as a consequence of the 2013 DWGM CPT review. Further, it noted that market suspension provisions better address risks in the DWGM, and that SFM should be removed.

EnergyAustralia's submission in response to the draft rule determination noted that the 'discretionary nature' of SFM does not provide certainty to market participants on the operation of the market in extreme events. In its view, the CPT is consistent with the 'causer pays' principle and limits exposure to market participants.

Lumo Energy did not support this aspect of the rule change request in its submission to the consultation paper. It offered two alternatives:

1. retain the force majeure provisions and develop a guideline that would help AEMO apply them more effectively; or

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<sup>23</sup> AEMO, *Rule Change Request - Removal of Force Majeure Provisions*, 6 February 2014.

<sup>24</sup> AGL, Consultation Paper submission.

<sup>25</sup> AGL, Draft Rule Determination submission.

<sup>26</sup> GDF Suez, Consultation Paper submission.

2. if the Commission decided to implement the proposed rule and remove the force majeure provisions, that a full investigation of the market settings be undertaken beforehand to ensure that the settings are at appropriate levels. This would ensure the adequate protections were in place before force majeure provisions were removed.

A more detailed presentation of Lumo Energy's alternative proposals is provided below.

*Retain and improve force majeure provisions*

Lumo Energy argued that force majeure provisions are necessary and should be retained. In the DWGM, they "have the clear purpose of preventing market participants from being exposed to legitimate FM [force majeure] events which could potentially have a serious financial impact on a market participant".<sup>27</sup> Lumo Energy argued that the "substitution of FM provisions with the CPT results in a serious market design flaw that creates additional risk for market participants".<sup>28</sup> In its view, the CPT would usually be effective in offering protection to market participants from force majeure events, but there are circumstances where this would not be the case.

Lumo Energy outlined a scenario – which it also submitted to AEMO's 2013 DWGM CPT review – where it claimed that the CPT may be inadequate for those relying on it. The scenario involves assumptions around the pattern of prices in a force majeure event, and the subsequent financial impacts on a market participant. AEMO claimed that the scenario was unrealistic.<sup>29</sup>

Lumo Energy argued that the removal of force majeure provisions could lead to the "removal of a market participant reducing the level of competition in the DWGM".<sup>30</sup> It noted that the DWGM was not originally designed to operate without force majeure provisions, and so improving them would be the better solution.

*Review market parameters before removing force majeure provisions*

If the Commission decided to remove force majeure provisions, Lumo Energy suggested that it would be preferable to undertake a market parameter review beforehand to ensure the parameters were appropriate. It referred to suggestions that reviewing market parameters individually could distort the results of such a review with unacceptable outcomes for the market. Lumo Energy also referred to the practice of the NEM's Reliability Panel, which reviews the reliability standard and reliability settings for the NEM every four years.

*Lumo Energy's submission to the draft rule determination*

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<sup>27</sup> Lumo Energy, Consultation Paper submission, p2.

<sup>28</sup> Lumo Energy, Consultation Paper submission, p2.

<sup>29</sup> AEMO, *DWGM CPT Review 2013 Final Report*, 16 September 2013.

<sup>30</sup> Lumo Energy, Consultation Paper submission.

Lumo Energy's submission to the draft rule determination was consistent with its first submission. It emphasised the need for the market parameter settings to be set "at the right level", and that a review to examine all the market parameters together in the same process is required.

### **3.2.3 Commission's assessment**

SFM is redundant and may be counterproductive to the management of market stress events in the DWGM. Removing force majeure provisions is consistent with the design of the market and also clarifies the rules. In drawing this conclusion, the Commission has taken into account the issues raised regarding SFM, and the relationship between PFM and SFM as outlined above.

In regard to AEMO's argument on the inadequacy of the criteria for declaring SFM, the Commission notes that SFM is a mechanism that is inherently difficult to define and even more difficult to apply. It may be counterproductive because it is a subjective decision, the criteria for which are not, nor are likely to be, observable. The subjectivity involved is inherently tied to the uncertainty of the future, which renders it problematic for handling market stress events.

On the other hand, the CPT provides an observable trigger for an APP, creating confidence in the manner in which uncertainty will be managed. The CPT clearly defines the relevant market parameter and facilitates informed decision making, allowing market participants to make more accurate and timely decisions. In times of market stress, the price may more accurately reflect market conditions, providing an accurate signal to market participants to inform decision making. Therefore, in this instance, clear rules are preferred over discretion, leading to administrative and market efficiency.

The Commission recognises that the SFM provisions do not sit comfortably with the current design of the market and, as such, may be counterproductive. SFM was designed to trigger an APP because the market was less able to resolve a supply disruption. In contrast, the CPT is designed to facilitate a market response by allowing high prices. It reflects both the physical and operational aspects of the market - both the diversity of the sources of supply, and the design of the market to induce supply responses from these sources. This is a more efficient design.

In addition, force majeure provisions provide a link between a market participant who may have contributed to a high price event, and the decision on whether to declare SFM. Given the preference for a market solution to a supply disruption, force majeure provisions may, in some circumstances, inhibit a market response, and provide uncertainty as to the market parameters and the management of a force majeure event. This is unlikely to promote the efficient operation of the market. The misalignment of force majeure provisions with the current market design was noted by GDF Suez in its submission.

SFM is no longer an effective, or appropriate, mechanism for triggering an APP. Given the current market design, SFM is unlikely to provide protection for the market from

market stress events. This was noted by AGL in both its submissions, and highlighted in the PFM event of 2008 and the subsequent legal proceedings.

The current market design is more flexible and responsive than it was at the time the force majeure provisions were introduced. The market is now much more likely to be able to resolve issues related to supply disruptions through the actions of market participants alone. In the event that this is not possible, the CPT and APC arrangements are in place to provide financial protection from periods of sustained high prices.

Additionally, any benefit that force majeure provisions may have must be weighed against the cost of their continued presence in the NGR. The Commission considers that the provisions' misalignment with the market design and the resulting confusion that may arise may result in a cost to market participants in some instances. Such costs are unlikely to be outweighed by any benefit as the provisions are largely redundant. It is not appropriate to retain flawed and redundant provisions in the NGR to attempt to compensate for, or alleviate, perceived shortcomings in the market parameters.

The issues raised by Lumo Energy in relation to the design of the market and the level of the market parameters are outside the scope of this rule change. If force majeure provisions were providing legitimate protection to market participants, and their removal may expose market participants to substantial potential financial losses, then this may be of concern in this rule change. However, the removal of force majeure provisions is unlikely to materially increase the financial risk faced by market participants.

Further, the Commission understands that, unlike for the STTM and NEM, there is no formal requirement on AEMO to review the market parameters for the DWGM. AEMO is able to review the parameters at any time. In the draft rule determination, the Commission suggested that market participants who considered that a market parameter review was required should raise this issue with AEMO. The Commission understands that this has occurred within the GWCF.

The 2013 Gas Market Scoping Study noted that there may be a need to consider the level of consistency in the setting of the market parameters in the NEM, the STTM and the DWGM.<sup>31</sup> The Commission notes that AEMO may conduct a high-level review of the DWGM price cap early in 2015 to determine whether a full review is required, and is considering conducting an STTM market parameter review.<sup>32</sup>

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<sup>31</sup> K Lowe Consulting, *Gas Market Scoping Study: A report for the AEMC* K Lowe Consulting, July 2013.

<sup>32</sup> AEMO, "STTM Parameter Review - Update and next steps," Agenda item 3.4, Gas Wholesale Consultative Forum, 11 November 2014.

### **3.3 Other changes**

#### **3.3.1 AEMO's perspective**

In its suggested rule, AEMO defines the CPT in the rules in relation to its role in starting and ending an APP. AEMO highlights its role in determining the CPT in the Administered Pricing Procedures. It also seeks to place a requirement on AEMO to specify in the Administered Pricing Procedures the process for consulting on the approach to determining of the APC and CPT.

AEMO also sought to remove redundant rules relating to the obligations of market participants with respect to scheduling instructions. It considered that rules 216(9) and (10) do not have a material purpose and that rules 216(1) and (2) provide the functions contained in rules 216(9) and (10).

#### **3.3.2 Stakeholders' perspective**

No stakeholder raised any issues with regard to these changes in submissions to the consultation paper or the draft rule determination.

#### **3.3.3 Commission's assessment**

The Commission has determined to define the CPT in the rules in the form suggested by AEMO. The CPT plays a prominent role in the Administered Pricing Procedures, and by placing it in the rules, it is more clearly signalled to all market participants. While placing it in the rules renders the Commission the ultimate decision maker as to whether it should continue to remain the key trigger of an APC, the Commission is comfortable with this role. Further, there is currently no indication that the CPT is not the right mechanism to perform its role. The Commission notes that other potential triggers were examined by the GWCF. The proposal to place the CPT in the rules signals that there is broad agreement for its role in administered pricing.

The Commission has determined to add to the rules the specific process for making procedures with respect to administered pricing. This may draw attention to the process and facilitate feedback, which is important in achieving an outcome where the market parameters are set at appropriate levels.

The process for making and amending the Administered Pricing Procedures is set out in rule 135EE of the NGR. Therefore, the new process for consultation on the approach to determining the APC and CPT may be consistent with the process set out in rule 135EE of Part 15B of the NGR. Nevertheless, this will be a matter for AEMO and market participants to determine through the procedure change process.

The Commission has also determined to remove redundant rules relating to the obligations on AEMO and market participants with respect to scheduling instructions. The Commission considers that their removal will not prevent AEMO from performing

its functions and that these particular rules do not serve any purpose not already provided for in other rules.

## Abbreviations

|            |                                      |
|------------|--------------------------------------|
| AEMC       | Australian Energy Market Commission  |
| AEMO       | Australian Energy Market Operator    |
| APC        | Administered Price Cap               |
| APP        | Administered Pricing Period          |
| Commission | See AEMC                             |
| CPT        | Cumulative Price Threshold           |
| DWGM       | Declared Wholesale Gas Market        |
| GWCF       | Gas Wholesale Consultative Forum     |
| NGL        | National Gas Law                     |
| NGO        | National Gas Objective               |
| NGR        | National Gas Rules                   |
| PFM        | Participant force majeure            |
| SFM        | System force majeure                 |
| VENCorp    | Victoria Energy Networks Corporation |
| VoLL       | Value of Lost Load                   |

## **A Legal requirements under the NGL**

This appendix sets out the relevant legal requirements under the National Gas Law for the AEMC in making this final rule determination.

### **A.1 Final rule determination**

In accordance with s. 311 of the NGL, the Commission has made this final rule determination in relation to the rule proposed by AEMO.

### **A.2 Commission's power to make the rule**

The Commission is satisfied under s. 291(1) of the NGL that the final rule will, or is likely to, contribute to the achievement of the NGO as set out in s. 23 of the NGL. It is also satisfied that the final rule falls within the subject matter about which the Commission may make rules, as set out in s. 74 of the NGL.

Specifically, the final rule relates to AEMO's declared system functions and the operation of a declared wholesale gas market (s. 74(1)(a)(v)), and the activities of Registered participants, users, end users and other persons in a regulated gas market (s. 74(1)(a)(vi)).

Further, the rule falls within the matters set out in Schedule 1 to the NGL as it relates to item 55B because it relates to the operation and administration of a regulated gas market.

### **A.3 Commission's considerations**

In assessing the rule change request, the Commission has considered:

- its powers under the NGL to make the rule;
- the rule change request;
- stakeholder submissions received during the rule change process;
- the fact that there is no relevant Ministerial Council on Energy (MCE) statement of policy principles;<sup>33</sup>
- the Commission's analysis as to the ways in which the draft rule will, or is likely to, contribute to the NGO.

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<sup>33</sup> Under s. 73 of the NGL, the AEMC must have regard to any relevant MCE statement of policy principles in making a rule.

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## **A.4 Conduct provisions**

The Commission's rule amends rule 216(2) of the NGR and deletes rule 216(7) of the NGR. These rules are currently classified as conduct provisions under Schedule 4 of the National Gas (Victoria) (Declared System Provision) Regulations.

Conduct provisions are rules or provisions of the NGL for which any person (including the Australian Energy Regulator (AER)) may institute civil proceedings in respect of a breach. A person (other than the AER) who suffers loss or damage by conduct of another person in breach of a conduct provision may recover their loss or damage by action against the other person in a court.

The Commission will be recommending that rule 216(2) of the NGR be retained as a conduct provision, and that rule 216(7) of the NGR be deleted as a conduct provision, and will notify the Victorian Minister of the policy rationale for taking this course of action. The Commission considers that rule 216(2) of the NGR should continue to be classified as a conduct provision because compliance is promoted by allowing a party to seek redress from a party that breaches that conduct provision. The Commission considers that because rule 216(7) is being deleted as part of the rule, it should also be deleted as a conduct provision under the Regulations.

## **A.5 Other**

### **A.5.1 Compatibility with AEMO's declared system function**

Under s. 295(4) of the NGL, the Commission may only make a rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed rule is compatible with the proper performance of AEMO's declared system functions.<sup>34</sup>

The draft rule will impact on AEMO's declared system functions of operating and administering the DWGM. The Commission considers that the draft rule is compatible with the proper performance of AEMO's declared system functions because AEMO would, following changes to its systems to incorporate the amended rules, continue to be able to operate and administer the DWGM.

### **A.5.2 AEMO's allocated powers, functions and duties**

Under s. 295(5) of the NGL, the Commission may only make a rule that affects the allocation of powers, functions and duties between AEMO and a service provider for a declared transmission system if AEMO consents to the making of a rule or the rule is requested by the Minister of the relevant adoptable jurisdiction.<sup>35</sup>

In relation to this rule change request, there is no requirement under s. 295(5) of the NGL for AEMO to consent to the AEMC making this rule. This is because the rule does

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<sup>34</sup> AEMO's declared system functions are specified in section 91BA of the NGL.

<sup>35</sup> The declared transmission system is the transmission pipeline for the DWGM.

not affect the allocation of powers, functions and duties between AEMO and a service provider for a declared transmission system.

### **A.5.3 Participating jurisdictions**

The final rule determination amends Part 19 of the NGR, which currently only relates to the operation of the declared wholesale gas market, transmission system and distribution systems in Victoria, as declared under the *National Gas (Victoria) Act 2008*.<sup>36</sup>

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<sup>36</sup> Under s. 21 of the NGL, the participating jurisdictions are the States, Commonwealth, the Australian Capital Territory and the Northern Territory. The draft rule does 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.

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