RULE CHANGE

Australian Energy Market Commission

CONSULTATION PAPER

National Gas Amendment (STTM Brisbane participant compensation fund) Rule 2013

Rule Proponent

Australian Energy Market Operator

17 January 2013

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

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1 Introduction

On 10 August 2012, the Australian Energy Market Operator (AEMO or the proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission). The rule change request proposes to amend a provision in the National Gas Rules (NGR) relating to an operational aspect of the short term trading market (STTM). Specifically, the request relates to the dollar amount specified for the Brisbane hub participant compensation fund (PCF).

This consultation paper has been prepared by the staff of the AEMC to facilitate public consultation on the rule change request and does not necessarily represent the views of the AEMC or any individual Commissioner of the AEMC.

This paper:

- sets out a summary of, and a background to, the STTM Brisbane participant compensation fund rule change request proposed by the proponent;
- identifies a number of questions and issues to facilitate the consultation on this rule change request; and
- outlines the process for making submissions.

1.1 Request for expedited process

The proponent requests that the rule change request be assessed under the expedited process as set out in s. 304 of the National Gas Law (NGL), as it is perceived to be non-controversial. The NGL defines a non-controversial rule as:[1]

> "... a Rule that is unlikely to have a significant effect on a market for gas or the regulation of pipeline services."

The proponent considers that the rule change request will not have a significant effect on the market for gas and will have no effect on the regulation of pipeline services. Specifically, the rule change will not cause a significant distortion to the gas market, will not have a significant financial impact on trading participants and will not alter the current regulatory burden on the gas market.[2]

AEMO notes that stakeholders have been consulted through the STTM Consultative Forum on the proposed rule change and that no objections were raised to the proposed rule.[3]

The Commission proposes to expedite the rule change request (subject to written requests from stakeholders not to do so) under s. 304 of the NGL. Under an expedited

1 s. 290 of the NGL.

2 AEMO, rule change request, 10 August 2012, pp3-4.

3 AEMO, rule change request, 10 August 2012, p4.

process, no draft rule determination is published and the Commission has six weeks from the publication of the notice under s. 303 of the NGL to publish a final rule determination. The final rule determination is to be released on 28 February 2013.

Stakeholders have:

- until 31 January 2013 to lodge written requests not to make a rule under the expedited process in s. 304 of the NGL; and
- until 14 February 2013 to lodge written submissions on the rule change request.

More information on the expedited process and on lodging a submission is contained in Chapter 6 of this consultation paper.

2 Background

This chapter describes the relevant STTM operations that are affected by this rule change request and the role of the PCF.[4]

2.1 Overview of the STTM

The STTM is a market for the trading of natural gas at the wholesale level, operating at defined hubs in Adelaide, Brisbane and Sydney. It provides participants with the opportunity to buy and sell gas in the open market, as an alternative for or in addition to existing long-term industry contracts. As a trading market, the STTM does not deal with the actual physical flow of gas. It only deals with financial transactions. The STTM is operated and administered by AEMO.

Essentially, gas is traded a day before it is scheduled to be flowed along the pipeline to be distributed to users (that is, it is a 'day ahead' market). The day before the gas is scheduled to flow (that is, the gas day) pipeline operators submit pipeline capacity information to AEMO, who publishes this data. STTM trading participants[5] can then place bids to buy quantities of gas at the hub and STTM shippers can place offers to sell quantities of gas to the hub.

On the basis of this information, via an automated process, AEMO then matches offers and bids, determines the (ex-ante) market price and draws up the market schedules for the flow of gas to and from the hub for the gas day. The ex-ante market price is the price that is applied to all gas that is allocated through the hub on the gas day.

The market schedule is published by AEMO ahead of the gas day so that shippers can use this information to nominate the quantity of gas they require from each pipeline operator (a process which occurs outside of the STTM). Pipeline operators then prepare pipeline schedules, which detail the quantities of gas that are scheduled to be flowed from each STTM facility.[6]

On the gas day, pipeline operators deliver gas to the hub and users withdraw gas at the hub. However, the quantities delivered to or withdrawn from the hub generally will not match the ex-ante market schedule. The differences between quantities of gas allocated to shippers and users and the market schedule (known as deviations) are physically balanced by pipeline operators maintaining pressures at the distribution gates within agreed operating ranges. The STTM settles this balancing of gas under AEMO's market operator service (MOS) arrangements.

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4 Information in this chapter was generally derived from AEMO, *Industry Guide to the STTM*, December 2011, *Overview of the Short Term Trading Market (STTM)*, 2012 and rule change request, 10 August 2012.

5 This term refers to either STTM shippers or STTM users (rule 364 of the NGR).

6 A STTM term for a transmission pipeline, hub-connected storage facility or hub-connected production facility (rule 364 of the NGR).

If normal STTM mechanisms are unlikely to achieve this balance, AEMO can call on contingency gas to safeguard the continuity of supply. Contingency gas arrangements may involve increasing supply and reducing demand in an under-supply situation, or reducing supply and increasing demand in an over-supply situation. In such circumstances, AEMO schedules gas from trading participants who have submitted bids and offers for contingency gas on that gas day by merit order (in the order of increasing price for offers in an under-supply situation and of decreasing price for bids in an over-supply situation).

2.2 PCF

If AEMO makes an error in scheduling (either in the ex-ante market or for contingency gas) which results in a trading participant being scheduled out of merit order, then the trading participant is entitled to be compensated for losses incurred. The participant is only entitled to compensation for direct losses and not for opportunity costs. Compensation is paid out by AEMO from the PCF applicable to that hub and the total amount payable is capped by the balance of the PCF.

AEMO describes the PCF as a co-insurance scheme for trading participants. There are separate PCFs for each hub which are managed by AEMO. Trading participants fund the PCFs based on a fee per gigajoule (GJ) for gas withdrawn at each hub.[7]

In 2009 prior to the commencement of the STTM, the Gas Market Leaders Group agreed to the establishment of two PCF accounts (one for the Sydney hub and the other for the Adelaide hub) with a total balance of $1 million. This was allocated between the two hubs ($670,000 for the Sydney hub and $330,000 for the Adelaide hub).[8] In 2010 prior to the establishment of the STTM at Brisbane, the PCF for the Brisbane hub was set at $100,000 which was based on forecast withdrawals of the distribution network connected users (that is, the Brisbane retail load).[9]

The STTM Brisbane hub was initially designed to only include distribution network connected users. However in 2011, AEMO reviewed the application of the STTM to Brisbane prior to its commencement and identified the need to include transmission connected users for the provision of contingency gas. This, among other proposed rule changes related to the STTM Brisbane hub was the subject of a rule change request by AEMO to the AEMC.[10] The AEMC decided to make these proposed rule changes in September 2011.[11] The STTM Brisbane hub commenced operating in December 2011.

7 AEMO, rule change request, 10 August 2012, p2.

8 AEMO, rule change request, 10 August 2012, p10.

9 AEMO, rule change request, 10 August 2012, p2.

10 AEMO, rule change proposal – STTM: Brisbane hub, cover letter, 1 April 2011, p1.

11 AEMC, *Final determination, National Gas Amendment (STTM Brisbane Hub) Rule 2011*, 15 September 2011.

3 Details of the rule change request

The rule change request proposes to:

- increase the maximum PCF amount for the Brisbane hub, from $100,000 to $450,000; and
- increase the maximum PCF amount for the Brisbane hub that can be recovered from participants in one year, from $50,000 to $225,000.

These proposed changes relate to rule 452(3)(b) and (a) of the NGR respectively.

The proponent has also requested that the AEMC assesses its rule change request on an expedited basis.

The proponent's rule change request includes a proposed rule, which is published on the AEMC's website.[12]

3.1 Rationale for the rule change request

In its rule change request, the proponent provides its rationale for the rule change. The key points raised in the request are summarised below:[13]

- The current PCF for the Brisbane hub was based on the Brisbane retail market load. Demand at the Brisbane hub is much larger than was originally forecast when the PCF value was finalised in the NGR. This is because of the inclusion of transmission connected STTM users (that is, the large industrial users) in the hub. The transmission connected STTM users makeup roughly eighty per cent of the withdrawals at the Brisbane hub. AEMO argue that the current PCF funding level is approximately only twenty per cent of the appropriate size, based on total withdrawals.
- As the total gas withdrawals for all STTM users (that is, distribution connected and transmission connected users) are almost five times higher than originally forecast, then there is the potential for scheduling error costs to be greater than the amount covered by the PCF.
- The proposed increase in the maximum PCF amount for the Brisbane hub is based on a calculated proportion of the maximum PCF amount for the Sydney hub. Based on current forecast gas demand for 2012–2013 AEMO has estimated that the Brisbane STTM is approximately 68 per cent the size of the Sydney STTM. Given that the Sydney PCF is $670,000 and adjusting for the size of gas demand, AEMO suggested that the Brisbane PCF should be $454,075. AEMO has rounded this value to $450,000.

12 See www.aemc.gov.au

13 AEMO, rule change request, 10 August 2012, pp1-6.

- The proposed increase in the maximum amount that can be recovered from participants in one year is based on the requirement under rule 452 of the NGR that it be half the maximum size of the PCF. This means that by increasing the Brisbane PCF amount to $450,000 requires that the maximum amount that can be recovered in one year be increased to $225,000 as proposed.

- As the PCF fee is applied by AEMO on a financial year basis, it is appropriate for the rule change to be applied from 1 July of a financial year. AEMO has proposed that the PCF rule change be applied from 1 July 2013. AEMO has requested that the rule change be finalised by March 2013 in order that it has sufficient time to finalise the PCF fee and inform trading participants before it is applied.

The proponent considers that the proposed rule change will contribute to the national gas objective (NGO) as it ensures trading participants have at least the same level of scheduling error risk mitigation in the Brisbane hub as they do in the Sydney and Adelaide hubs. AEMO argue this will ensure that each STTM hub operates efficiently and without distortion.[14]

Also, the proponent considers that the proposed rule change will only affect existing and intending STTM shippers and users in Brisbane and that it will provide the following benefits:[15]

- it provides a reduction in the risk of scheduling error losses for trading participants as the PCF is sufficiently funded for the reasonable costs of a scheduling error at the Brisbane hub; and

- it ensures consistency in the level of risk reduction for the Brisbane, Sydney and Adelaide hubs in regards to a scheduling error through the PCF.

The only cost that the proponent has identified with its proposed rule change is that trading participants in the Brisbane hub would receive an additional charge until the new PCF is fully funded. This it considers is a trade-off for trading participants between the shared cost of co-insurance and the benefit of risk reduction.[16] It is expected that the PCF will be fully funded after the initial two years of top up payments.

3.2 Consideration as a non-controversial rule change

The proponent has requested that this rule change request be considered a non-controversial rule under s. 304 of the NGL. A non-controversial rule is defined in s. 290 of the NGL as:

> "...a Rule that is unlikely to have a significant effect on a market for gas or the regulation of pipeline services."

14 AEMO, rule change request, 10 August 2012, p6.

15 AEMO, rule change request, 10 August 2012, p7.

16 AEMO, rule change request, 10 August 2012, p7.

The proponent has considered the requirements of 'significant effect on a market for gas or the regulation of pipeline services' to mean:[17]

1. *Does the rule change have an effect on the market for gas?*

   AEMO considers that the proposed rule change will have an effect on the market for gas. Therefore, it has to demonstrate whether this effect is significant. To do this, AEMO considered the following questions:

   (a) *Does the rule change cause a significant distortion to the gas market?*

   AEMO considers that an increase in the PCF is not expected to have a significant effect on the Brisbane STTM market for gas as it impacts all trading participants in proportion to their withdrawals through the PCF fee. Therefore, the change in the PCF is unlikely to alter the market incentives and the behaviour of participants. AEMO concludes that the proposed rule change which results in an increase in the PCF fee will not distort the activities of any particular segment of the market as all participants are treated equally.

   (b) *Does the rule change have a significant financial impact on the gas market?*

   AEMO considers that the PCF fee will not have a significant financial impact on the trading participants to whom it will be applied. AEMO estimates that based on current demand forecasts, the PCF fee in the first financial year following the rule change will be $0.0039 GJ and for the second financial year $0.0022 GJ. This represents 0.09 per cent of the current rolling average peak gas price ($4.37 GJ) for the first financial year and 0.05 per cent in the second financial year.

   AEMO acknowledges the cost of the PCF is incurred as an operator expense of the trading participant, but does not consider that this cost on a GJ basis is material or significant.

   (c) *Does the rule change have a significant regulatory burden on the gas market?*

   AEMO considers that the proposed rule change does not alter the current regulatory burden on the gas market or participants. However, AEMO does acknowledge that the proposed rule change will alter the quantum of the PCF and the amount recovered from participants until the funding level is reached.

2. *Does the rule change effect the regulation of pipeline services?*

   AEMO considers that the proposed rule change will have no effect on the regulation of pipeline services as the regulatory framework is not being altered. In addition, AEMO notes that the PCF fee is paid by trading participants and not

17 AEMO, rule change request, 10 August 2012, pp3-4.

by the pipeline operators. Therefore, AEMO concludes that there will be no significant effect on the regulation of pipeline services.

The Commission considers that the proponent's request is reasonable and it is therefore prepared to commence the process on an expedited basis in accordance with s. 304 of the NGL. The expedited process will be subject to objections received.

4 Assessment framework

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

> "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."

In assessing the rule change request against the NGO, the Commission will consider:

- the effect of the rule change request on efficiency in the operation and use of gas services in the STTM Brisbane hub;
- the effect of the rule change request on efficiency in administering the STTM Brisbane hub; and
- the effect of the rule change request on market outcomes and on the substantive rights, obligations or duties of participants in the STTM Brisbane hub.

The proposed rule will be assessed against the relevant counterfactual arrangements, which in this case are the existing provisions in the NGR.

5 Issues for consultation

Taking into consideration the assessment framework and potential requirements to implement the proposed rule, we have identified a number of issues for consultation that appear to be relevant to this rule change request.

These issues outlined below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper including the proposed framework as set out in Chapter 4 above.

5.1 Trade-off between minimising risk and the cost of insurance

According to the proponent, the PCF was established to provide trading participants in the STTM compensation for losses incurred resulting from scheduling errors. That is, to minimise the risk of incurring uncertain costs in the event of AEMO making a scheduling error, trading participants spread this risk among themselves by paying an insurance premium (the PCF fee) to a pooled fund (the PCF).[18] It is from the PCF that funds are made available to compensate individual trading participants that have incurred direct losses resulting from a scheduling error event.

Therefore, trading participants face a trade-off between minimising the risk of incurring losses in the event of a scheduling error and the costs of insurance (that is, the appropriate amount of premium to be paid). An efficient outcome would be where all costs are revealed and there is an appropriate balance between the perceived size of risk and costs shared by all participants.

In its rule change request, AEMO has suggested that the size of the risk for trading participants incurring losses due to a scheduling error is greater than what the market expects and does not reflect an efficient outcome. This is because AEMO considers that the PCF amount is too small to cover this risk as it does not reflect the size of the Brisbane market.

Stakeholders may therefore wish to reflect on the trade-off between reducing the risk of scheduling error losses by being compensated from the PCF and the cost of insurance (that is, the appropriate level paid to fund the PCF).

Question 1 Appropriateness of the proposed PCF amount

(a) Is the PCF amount that is proposed for the Brisbane hub (that is, $450,000) appropriate?

(b) Does it reflect the desired trade-off between the size of the risk associated with scheduling error losses and the cost of insurance?

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18 This is described as co-insurance where the risk is split or spread among multiple parties.

5.2 Other issues

The proponent has identified several benefits to STTM shippers and users with regards to its proposed rule change. These are that it:

- will reduce the risk of scheduling error losses; and
- will ensure consistency in the level of risk between all STTM hubs with regards to scheduling error through the PCF.

The only cost identified by the proponent was that trading participants would receive an additional charge until the new PCF is fully funded.

Question 2 Benefits and costs

Are there other benefits and costs associated with increasing the PCF amount which have not been identified by the proponent?

The proponent has calculated its proposed Brisbane PCF amount by comparing the forecast demand for the Brisbane hub with that for the Sydney hub. It has used this as a basis to proportion the PCF amount from that which is allocated to the Sydney hub.

Question 3 Calculating the PCF amount

Are there other methods for calculating the Brisbane PCF amount?

6 Commencement of the rule change process and lodging a submission

The Commission has published a notice under ss. 303 and 304 of the NGL to assess this rule change request under an expedited rule making process.

The Commission is now accepting written requests not to make a rule under the expedited process, and inviting written submissions on this rule change request.

Written requests not to make a rule under the expedited process in s. 304 of the NGL must include reasons for the request, and must be lodged with the Commission by 31 January 2013, either online or by mail, in accordance with the requirements specified below.

Written submissions on the rule change request must be lodged with the Commission by 14 February 2013, either online or by mail, in accordance with the requirements specified below. Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on rule change proposals.[19] The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Trevor Johnston on (02) 8296 7800.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code "GRC0018". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

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

6.2 Lodging a submission by mail

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

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: GRC0018.

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

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

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

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
Commission	See AEMC
GJ	gigajoule
MOS	market operator service
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
PCF	participant compensation fund
Proponent	See AEMO
Rule	See NGR
STTM	short term trading market