AEMO
AUSTRALIAN ENERGY MARKET OPERATOR

10 August 2012

FROM THE OFFICE OF THE
CHIEF EXECUTIVE OFFICER

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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear ~~Mr Pierce~~ John,

Rule Change Request – Increase in Brisbane STTM Participant Compensation Fund

We request the Australian Energy Market Commission (AEMC) make an amendment to the National Gas Rules (NGR) with regard to the Participant Compensation Fund (PCF) amount for the Brisbane Short Term Trading Market (STTM) hub.

The PCF is a 'ring-fenced' fund collected and managed by AEMO to provide compensation to trading participants if AEMO makes a scheduling error under defined circumstances. It is, in effect, a co-insurance scheme. PCF contributions are collected based on a fee per GJ for gas withdrawals from each hub.

The PCF value in the NGR was determined for the Brisbane hub on the basis of the retail load for the two distribution areas in Brisbane. However the Brisbane hub includes transmission connected STTM Users whose withdrawals make up approximately four-fifths of the withdrawals in the hub. Therefore the PCF for the Brisbane hub was calculated on a forecast approximately a fifth of the size of actual gas withdrawals. This has resulted in a disproportionally small PCF for the Brisbane hub compared with the PCF for the Adelaide and Sydney hubs.

AEMO requests that the AEMC consider this rule change request as non-controversial under section 304 of the National Gas Law. This request is made on the basis that the Brisbane PCF is currently too small, and the increased PCF was supported by participants during AEMO's consultation on this change. Additionally, the amendment will not result in a material changes to costs, will apply equally to all trading participants making withdrawals, and will increase the level of risk mitigation available to trading participants for scheduling errors in Brisbane.

A description and drafting of the proposed Rule, a statement of the issues concerning the existing NGR, and how the proposed Rule contributes to the achievement of the National Gas Objective is provided at Attachment A.

To allow the amended PCF fee to be collected for the 2013-14 financial year, this rule change, if made, will need to be finalised by March 2013. This will allow AEMO to publish the amended funding requirement and contribution rate for the PCF prior to the start of that financial year as required by the NGR.

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AEMO would be pleased if you could have these matters considered by the AEMC. For further details, please do not hesitate to contact Terry Grimwade, Group Manager—Market Development, on (03) 9609 8520.

Yours sincerely

Matt Zema
Managing Director and Chief Executive Officer

Attachment A: Rule Change Proposal

Attachment A: Rule Change Proposal

This Rule Change Proposal is structured as follows:

1. Summary

AEMO is proposing a non-controversial rule change to Rule 452(3) of the National Gas Rules (NGR) to increase the Brisbane Participant Compensation Fund (PCF) for the Brisbane hub of the Short Term Trading Market (STTM) from $100,000 to $450,000. This rule change is required to align the PCF to an amount commensurate to the size of the Brisbane hub.

The value of the PCF for the Brisbane hub was set on the basis of the retail load on the two Brisbane distribution networks and excluded the transmission connected STTM Users. The total gas withdrawals for all STTM Users are almost five times higher than the original forecast PCF in the NGR. This means that potential scheduling error costs are likely to be greater than the amount covered by the PCF.

AEMO proposes that the PCF amount be increased for the Brisbane hub on a proportional basis to the Sydney hub. This increase will provide consistency across the STTM hubs so that reasonable participant costs associated with any scheduling error that may occur are more likely to be covered by the PCF.

This rule change, if made, will need to be finalised by March 2013 to allow the amended PCF fee to be collected for the 2013-14 financial year. This will allow AEMO to publish the amended funding requirement and contribution rate for the PCF prior to the start of that financial year as required by the NGR.

2. Background

The STTM is an market which sets an ex ante price and schedule ahead of the relevant gas day using supply offers and demand bids submitted by trading participants.

If there is a scheduling error in the STTM there may be circumstances, as defined in Rule 455, where compensation may be awarded to relevant shippers and/or users. Any compensation payment is made by drawing funds from the PCF.

The PCF is a co-insurance scheme for trading participants. The fund is paid for by trading participants as a fee per gigajoule for gas withdrawn from the hub.

The initial funds established for the STTM was based on a split of $1 million divided pro-rata between Adelaide and Sydney. This led to a fund of $330,000 and $670,000 being established for the Adelaide and Sydney hubs respectively.

The initial PCF for the Brisbane hub was based on the Brisbane retail market load and therefore set at $100,000. The Brisbane demand is actually much larger than was originally forecast when the PCF value was finalised in the NGR as it also includes transmission connected STTM Users. The transmission connected STTM Users make up roughly four-fifths of the withdrawals at the Brisbane hub. Therefore the current PCF funding level is approximately only a fifth of the appropriate size based on total withdrawals.

AEMO reviewed the PCF funding level following market trials in the Brisbane hub. AEMO raised the issue of whether the PCF funding level was appropriate with the STTM Consultative Forum (STTM CF)[1]. A summary of the stakeholder consultation can be found in Appendix II while

[1] The STTM CF is a public consultative forum, facilitated by AEMO, which meets monthly with industry participants including the AER, Pipeline Operators, STTM Shippers, STTM Users, consumer representative groups and industry groups. Other stakeholders may register their interest with AEMO and attend the next STTM CF. STTM CF documents (including detailed meetings minutes and discussion papers) are publically available on AEMO's website and are emailed to the registered STTM CF attendees prior to each meeting.

discussion papers and minutes for these meetings can be found on AEMO's website. AEMO has consulted on this issue with industry and interested parties through the STTM CF:

- AEMO raised the PCF funding requirement through the STTM CF at both the January and February 2012 Meetings. The paper recommended an increase in the Brisbane PCF amount be increased from $100,000 to $450,000.
- Following the February meeting the paper was circulated to the STTM CF seeking written feedback by 13 March 2012, in particular any objections to the proposal to increase the PCF funding for Brisbane. No objections were received from the STTM CF.
- At the 27 March 2012 STTM CF, the matter was again discussed and AEMO proposed that the Brisbane PCF amount be increased. Meeting attendees did not object to increasing the PCF fund for the Brisbane hub and proposed that the $450,000 funding limit be used. AEMO agreed to start preparing a rule change to increase the Brisbane PCF funding.

On the basis of this consultation AEMO considers that trading participants have no objection to this proposed rule change to better align the Brisbane hub PCF amount with the Sydney and Adelaide hubs.

2.1 Request for Non-controversial Rule change

AEMO requests that the AEMC reviews this Rule change proposal under section 304 of the NGL. Section 304 applies if the AEMC considers that a request for a Rule is a request for a non-controversial Rule. The National Gas Law (NGL) defines, at section 290, a non-controversial Rule to mean:

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

AEMO has considered the requirements of 'significant effect on a market for gas or the regulation of pipelines services' to mean:

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

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

1.1 Does the rule change cause a significant distortion to the gas market?

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 this change in the PCF is very unlikely to alter the market incentives and the behaviour of participants. AEMO therefore concludes the increase in the PCF fee will not distort the activities of any particular segment of the market.

The rule change is not designed to alter market incentives or market behaviour. The rule change is designed to increase the PCF funding level to an appropriate level to allow the compensation of trading participants for a scheduling error at the Brisbane hub. This rule amendment will ensure that trading participants have the same level of scheduling error risk mitigation in the Brisbane hub as they do in the Sydney and Adelaide hubs. This will ensure the markets in each hub operate efficiently and without distortions.

1.2 Does the rule change have a significant financial impact on the gas market?

The PCF fee will not have a significant financial impact on the trading participants to whom it will be applied. Please note the proposed rule change alters the quantum of the PCF for the Brisbane hub but not the application of the PCF which is consistent with the Sydney and Adelaide hubs.

- By the time of the proposed rule change, assuming no scheduling errors occur, the PCF will be fully funded to meet the current rule requirement of $100,000. Therefore in the financial year following the proposed rule change the PCF will increase by $350,000 to a total PCF for Brisbane of $450,000. AEMO will collect $225,000 from participants in the Brisbane hub in the first financial year. In the following financial year AEMO will collect the remaining $125,000 to ensure the PCF is fully funded (to the proposed $450,000). Based on current demand forecasts, the expected cost impact in these years will be:
    - in the first financial year following the rule change the PCF fee will be $0.0039 GJ.
    - in the second financial year following the rule change the PCF will be $0.0022 GJ.
        - The rolling average price for gas has steadily been increasing since March 2012 to a current peak of $4.37 GJ which aligns with a price increase in the Adelaide and Sydney hubs. The cost of PCF represents 0.09 per cent in the first financial year and 0.05 per cent in the second financial year following the implementation of the proposed rule change.
        - The rolling average price for gas reached a low in March 2012 of $3.04 GJ in the Brisbane hub. The cost of PCF represents 0.13 per cent in the first financial year and 0.07 per cent in the second financial year following the implementation of the proposed rule change.

In the event of a scheduling error in the Brisbane hub, trading participants will have a far greater likelihood of receiving an appropriate level of compensation under the amended PCF funding level of $450,000 than under the $100,000 PCF funding level. AEMO considers that a co-insurance scheme, like the PCF, tries to balance risk mitigation against the cost of insurance. Therefore AEMO acknowledges the cost of the PCF is incurred as an operator expense of the business but does not consider the cost on a GJ basis to be material or significant.

1.3 Does the rule change have a significant regulatory burden on the gas market?

The rule change does not alter the current regulatory burden on the gas market or participants but as noted above will change the quantum of the PCF and therefore the amount recovered from participants until the funding level is reached.

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

AEMO considers this rule change will have no effect on the regulation of pipeline services as the regulatory framework is not being altered, only the quantum of the PCF. In addition the PCF fee is paid by trading participants and not by the pipeline operators. Therefore AEMO concludes there will be no significant effect on the regulation of pipeline services.

While not a requirement of the NGR, AEMO also notes that stakeholders have been consulted through the STTM CF on this proposed rule change and have raised no objections.

3. Statement of Issues

The risk mitigation provided by the PCF which is a co-insurance scheme to cover Trading Participants against a scheduling error is comparatively small in Brisbane compared to the other STTM hubs in Adelaide and Brisbane.

Rule 452(3) of the NGR currently sets the PCF amount for the Brisbane hub at $100,000 total, with a maximum of $50,000 to be collected each year. For comparison the NGR currently sets the PCF amount under rule 452(1) and 452(2) for the Sydney and Adelaide hubs are $670,000 and $330,000 respectively, with a maximum of $335,000 and $165,000 respectively to be collected each year.

When comparing the current 2012-13 forecast gas demand for the Brisbane (58,092 TJ) and Sydney (85,716 TJ) hubs it becomes apparent that the Brisbane hub's forecast demand is two thirds the size of the Sydney hub's forecast demand. In turn this suggests the Brisbane hub's PCF amount should be about two thirds of the Sydney hub's PCF amount, rather than the one sixth it is currently.

The Brisbane STTM hub comprises two distribution areas and three transmission connected loads. The transmission connected demand is made up of three large industrial companies (Stanwell power station, Incitec Pivot and the Caltex refinery). The current PCF funding level (total $100,000) was determined based on the distribution areas retail load forecast and was not adjusted to account for the transmission connected STTM Users when the Rules were made. The transmission connected STTM Users make up approximately four fifths of the withdrawals in the Brisbane hub and therefore the PCF is only about a fifth of the size considered appropriate for the Brisbane hub.

As the transmission connected STTM Users withdrawals were not included in forecast of PCF for the Brisbane hub, it is likely that the PCF will be insufficient to cover the costs of a scheduling error. Therefore the PCF will be unable to meet its objective of providing co-insurance to trading participants at the Brisbane hub.

This suggests that the PCF amount in rule 452(3) needs to be adjusted to reflect the actual size of the Brisbane hub.

4. Proposed Solution

AEMO is proposing to increase the PCF amount in Rule 452(3) to reflect the actual size of the Brisbane hub. The Sydney hub is the most directly comparable STTM hub to Brisbane in terms of gas demand. In addition the Sydney hub's PCF fund is considered to be of an appropriate size by trading participants. Therefore AEMO has based its calculation of the Brisbane hub's appropriate PCF amount on the Sydney hub's PCF.

The current forecast gas demand for 2012-13 for Brisbane is about 68 per cent of Sydney's gas demand. The PCF in Sydney is $670,000 as stated in Rule 452(1). Adjusting for the size of gas demand this suggests the Brisbane hub's PCF should be $454,075. AEMO has rounded this value and proposes that the Brisbane hub's PCF be $450,000.

Rule 452(2) also states the maximum amount of the PCF fund that can be recovered from trading participants. This amount for all hubs under rule 452 is half the maximum size of the PCF. AEMO therefore proposes that this amount should be $225,000 for the Brisbane hub.

5. Proposed Rule

5.1 Proposed Rule Change

AEMO is proposing an amendment to the NGR (Rule 452) which would increase the Brisbane PCF amounts to $450,000 with a maximum fee collection rate of $225,000 per annum. This increased amount is proportional to the PCF that was set for Sydney.

AEMO's proposed change to rule 452 is provided at Appendix I.

5.2 Transitional requirement of rule change

The PCF fee is applied by AEMO on a financial year basis and as such it is appropriate for the rule change to be applied from 1 July of a financial year. AEMO is required to collect a set minimum amount of either half the PCF in each financial year or the PCF amount minus the value of total PCF fees collected to date. If, for example, the PCF was adjusted and applied from half way through a financial year AEMO would be required to collect a fee that was double the annual PCF fee that would have been applied at the start of the financial year.

AEMO proposes this PCF rule change be applied from 1 July 2013.

5.3 Timing of rule change decision

In order to release its fees to market and inform trading participants' prices and strategies AEMO requires its fees to be finalised in March. To ensure the PCF fee can be implemented in a transparent manner, AEMO will require the final decision on the rule change to be made by March of the year with the rule change applied from the following date of 1 July.

AEMO has proposed this rule change be finalised by March 2013.

5.4 Other requirements

Compatibility with AEMO's declared system functions under s295(5) of the National Gas Law –

This proposed rule only impacts market participants in the Short Term Trading Market, where AEMO has no declared system functions in gas; therefore this change is not incompatible with the proper performance of AEMO's declared system functions.

6. How the Proposed Rule contributes to the National Gas Objective

Before the AEMC can make the a Rule change it must apply the rule making test set out in the NGL, which requires it to assess whether the proposed Rule will or is likely to contribute to the NGO. Section 23 of the NGL states the national gas objective (NGO) is:

> *… to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

An inadequate PCF will increase the risk of a trading participant not being appropriately compensated should there be a scheduling error. Therefore, by increasing the PCF at Brisbane, the proposed rule change is designed to increase the Brisbane hub's PCF funding to an appropriate level to compensate trading participants for a scheduling error.

This rule change will contribute to the 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. This will ensure that each STTM hub operates efficiently and without distortion.

7. Expected benefits and costs of the Proposed Rule

The parties who are affected by this proposed rule change are existing and intending STTM shippers and STTM users. AEMO considers that the proposed rule change:

- 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;
- ensures consistency in the level of risk reduction for the Brisbane, Sydney and Adelaide hubs in regards to a scheduling error through the PCF.
- trading participants in the Brisbane hub would receive an additional charge until the new PCF is fully funded. This represents a trade-off for trading participants between the shared cost of co-insurance and the benefit of risk reduction.

Appendix I: Draft Rule

This appendix outlines the proposed changes to the NGR covered by the Rule change proposal. Strikethroughs in red font represent proposed deletions and underlined text in blue font represents proposed additions.
This draft is based on version 12 of the NGR.

National Gas Rules – Part 20

452 Funding the participant compensation fund

(1) The funding requirement for the participant compensation fund for the Sydney hub each financial year is the lesser of:

(a) $335,000; and

(b) $670,000 minus the amount that AEMO reasonably considers will be the balance of the participant compensation fund at the end of that financial year.

(2) The funding requirement for the participant compensation fund for the Adelaide hub each financial year is the lesser of:

(a) $115,000; and

(b) $330,000 minus the amount that AEMO reasonably considers will be the balance of the participant compensation fund at the end of that financial year.

(3) The funding requirement for the participant compensation fund for the Brisbane hub each financial year is the lesser of:

(a) ~~$50,000~~ $225,000; and

(b) ~~$100,000~~ $450,000 minus the amount that AEMO reasonably considers will be the balance of the participant compensation fund at the end of that financial year.

(4) No later than the commencement of each financial year, AEMO must publish the funding requirement and the contribution rate for each participant compensation fund for that financial year.

Proposed Transitional Rule

The amendment to rule 452(3) will become effective 1 July 2013.

Appendix II – Consultation Documents

STTM Consultative Forum

All STTM-CF papers and minutes published on the AEMO Website –

STTM / Short Term Trading Market / STTM Consultative Forum / Records of STTM Consultative Forum Meetings

http://www.aemo.com.au/en/Gas/Wholesale-Gas-Markets/Short-Term-Trading-Market/STTM-Consultative-Forum

The papers relevant to this issue are summarised below.

31 January 2012 STTM Consultative Forum Meeting

Papers STTM 12-15-01 CG scheduling errors and the PCF

Minutes of Meeting 21 – 31 January 2012

Summary

During the Queensland STTM Market Trial's a contingency gas scheduling error occurred. Two Contingency Gas (CG) scenarios were held as part of the Queensland STTM Market Trial. During the second CG scenario (11 October 2011) AEMO did not correctly tie-break between offers on the tied $400 marginal price step[2]. As a result one participant's $400/GJ CG offer step was partially cleared, while the other two participants' $400/GJ CG offer steps were fully cleared. Under the correct tie-breaking solution all three participants' $400/GJ offer steps would have been partially cleared in proportion to their offer step quantity. Participants subsequently questioned the availability of compensation in this situation.

Compensation for scheduling errors is funded by the PCF and as such payments to Trading Participants can be no greater than the size of the PCF. In accordance with rule 452, the PCF funding requirement for the Brisbane hub is capped at $100,000. The funding requirement as a proportion of annual withdrawals is lower than that of the Sydney and Adelaide hubs.

AEMO recommended developing a rule change to the NGR to increase the funding requirement for the participant compensation fund at the Brisbane hub. The Consultative Forum discussions were limited and held over for the February meeting.

28 February 2012 STTM Consultative Forum Meeting

Papers STTM 12-15-02 CG scheduling errors and the PCF

Minutes of Meeting 22 – 28 February 2012

Summary

AEMO provided an overview of the operation of the PCF in compensating for a scheduling error in its discussion paper to the STTM Consultative Forum. AEMO recommended that no change be made to the PCF rule framework but rather that the value of the PCF for the Brisbane hub should be increased from $100,000 to $450,000. AEMO requested feedback on the proposed rule change. No feedback was received from stakeholders.

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[2] For more information about the outcomes of the QLD STTM Market Trial refer to paper STTM 11-70-06.

27 March 2012 STTM Consultative Forum Meeting

Papers STTM 12-15-02 CG scheduling errors and the PCF

Minutes of Meeting 23 – 27 March 2012

Summary

At the 27 March 2012 STTM Consultative Forum, the matter was again discussed and AEMO proposed that the Brisbane PCF amount be increased.

AGL spoke in support of the increased funding and proposed using the limit of $450,000. No participants objected to the increase in funding. AEMO agreed to start preparing a rule change to increase the Brisbane PCF funding.

Gas Market Leaders Group

Available on the Department of Resources Energy and Tourism at www.ret.gov.au

Paper Gas Market Leaders Group – 21st Meeting 30 June 2009

Summary

Members agreed to the establishment of two Participant Compensation Fund (PCF) accounts (one at each gas hub – Sydney and Adelaide) and a PCF balance of $1 million, to be allocated proportionately between the two hubs. The PCF will operate as a co-insurance scheme for trading participants disadvantaged by an AEMO scheduling error.

Glossary

Abbreviation	Explanation
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
GJ	gigajoule
NGL	National Gas Law
NGO	The National Gas Objective as stated in section 23 of the NGL, being “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”
NGR	National Gas Rules
PCF	Participant Compensation Fund
STTM	Short Term Trading Market
STTM-CF	Short Term Trading Market Consultative Forum
TJ	Terajoule