



**Australian Energy Market Commission**

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## **RULE DETERMINATION**

**National Gas Amendment (reference service and rebateable service definitions) Rule 2012**

**Rule Proponent**

The Australian Energy Regulator

1 November 2012

**RULE  
CHANGE**

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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 principal 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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## Summary

The Australian Energy Market Commission (Commission) has amended the definition of reference services in the National Gas Rules (NGR) to provide regulators with greater flexibility in determining the appropriate regulatory treatment of pipeline services.

The amended reference service definition will allow prices for regulated services to be set at levels that are more efficient and cost reflective. As a result, pipeline service providers should receive clearer incentives to efficiently invest in and operate pipeline services. In turn, users of pipeline services, and ultimately gas consumers, should pay only for the services that they use.

The final rule does not amend the rebateable service definition.

This final rule determination has been made in response to the reference service and rebateable service definitions rule change request (rule change request) submitted by the Australian Energy Regulator (AER) on 5 August 2011. The final rule will commence on 2 May 2013.

### *The AER's proposed rule change*

The AER stated that the current definition of a reference service does not provide it with sufficient flexibility for it to determine the most appropriate regulatory treatment of pipeline services such as backhaul and interruptible services. This is because the current definition requires all pipeline services that are likely to be sought by a significant part of the market to be included in an access arrangement. The AER's proposal would have the effect of ensuring that at least one pipeline service that is likely to be sought by a significant part of the market be included in an access arrangement. Without the proposed change to the NGR, the AER considered that the application of the current definition would be likely to result in access arrangement decisions which, in some circumstances, do not provide incentives for the most efficient investment in, and use of, pipeline services.

The AER also proposed that the rebateable service definition be amended. The current definition requires that the market for a rebateable service be substantially different from the market for any reference service. The AER considered that this requirement should be removed as it may prevent revenue from other pipeline services being rebated to users of a reference service, even when it is efficient to do so having regard to the appropriate allocation of costs between users of pipeline services. The proposed rebateable service definition would allow more pipeline services to be classified as rebateable services than is currently possible.

The AER submitted that the proposed rule amending the two definitions would address its specific concern about the revenue earned from authorised maximum daily quantity credit certificates (AMDQ cc) in the Victorian declared transmission system (DTS). It considered that APA GasNet (the service provider of the Victorian DTS) is recovering more than its efficient pipeline costs because of the revenue earned from

AMDQ cc. The AER submitted that the proposed rule would allow AMDQ cc to be treated as a rebateable service. This would have the effect of requiring revenue earned from the sale of AMDQ cc to be rebated against revenue from the reference services on the Victorian DTS, consequently reducing the reference tariff and limiting APA GasNet's over-recovery of revenue.

#### *Commission's decision*

The Commission's final rule amends the current definition of a reference service in the NGR. It provides regulators with some discretion (limited by the revenue and pricing principles) in considering the appropriate regulatory treatment of pipeline services that are likely to be sought by a significant part of the market.

The Commission has decided to make a rule which is a more preferable rule to the AER's proposed rule. The final rule differs from the proposed rule in that it only makes changes to the reference service definition. It requires the AER to take into account the revenue and pricing principles in making a decision about reference services. The final rule also includes a consequential rule change resulting from the changes to the reference service definition. The final rule does not amend the current rebateable service definition.

The final rule applies to all natural gas pipelines that are, or may be, subject to full regulation by the AER or the Economic Regulatory Authority of Western Australia (ERA).

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

The Commission has made a more preferable rule as it considers that it is likely to better contribute to the achievement of the national gas objective than the proposed rule. In particular, the final rule will better promote:

- the efficient use of, and investment in, pipeline services. When significant uncertainty exists about the revenue and demand for a pipeline service, the final rule reduces the likelihood that inefficient tariffs are set for that service; and
- the long term interests of consumers with respect to price and security of gas supply by allowing regulators to decide whether a pipeline service sought by a significant part of the market is a reference service. As a result, regulators would not be required to set a tariff for the relevant service which in certain circumstances may not be reflective of efficient costs.

The final rule will provide regulators with discretion to accommodate the particular circumstances of a pipeline and the services it offers. It will allow regulators to recognise that in some circumstances market mechanisms, rather than setting a reference tariff in accordance with the NGR, may be better at determining the price for, and allocation of, a pipeline service that is likely to be sought by a significant part of the market. As a result, the final rule should not increase investment risk on regulated pipelines. Instead, it may aid investment by providing service providers with relevant and appropriate pricing signals.

The final rule does not amend the rebateable service definition. The Commission has assessed the potential impact of the AER's proposed rebateable service definition on both the Victorian DTS as well as other regulated pipelines. It also carried out additional consultation on whether an alternative amended rebateable service definition should apply.

The consultation carried out throughout this rule change process has brought to the Commission's attention a number of complex issues. These matters include differences in regulating pipeline services on the Victorian DTS compared to regulating pipeline services on other pipelines due to different market designs. Further consideration of the implications in accommodating these different market designs into one economic regulatory framework is beyond the scope of this rule change.

However, the Commission's conclusion is that at present, the case for amending the rebateable service definition in the NGR has not been made for either the Victorian DTS or for other regulated pipelines. The Commission is not satisfied that the potential benefits of making the AER's proposed change to the rebateable service definition outweigh the potential costs. Specifically, any increase in investment risk that may result from a change could result in inefficient investment in pipeline services. This would not be in the long term interest of gas consumers.

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# 1 The AER's rule change request

## 1.1 The rule change request

On 5 August 2011, the Australian Energy Regulator (AER or rule proponent) made a request to the Australian Energy Market Commission (Commission) to make a rule change regarding the definitions of reference service and rebateable service (rule change request).

## 1.2 Rationale for the rule change request

In this rule change request the rule proponent sought to amend the definitions of reference service and rebateable service to provide more flexibility in the regulatory treatment of pipeline services. A number of key points raised in the rule change request are summarised as follows.

In relation to the reference service definition, the AER stated that:

- currently all pipeline services are defined as reference services if they are likely to be sought by a significant part of the market;
- the proposed rule change includes the requirement that at least one pipeline service that is likely to be sought by a significant part of the market be included in an access arrangement. This requirement previously existed under the National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code);
- the current definition does not provide flexibility for the regulatory treatment of pipeline services (such as backhaul and interruptible services) as either reference or rebateable services or neither;
- this flexibility previously existed under the Gas Code and was removed in the transfer to the National Gas Rules (NGR); and
- the application of the current definition is likely to result in access arrangement decisions which, in some circumstances, do not provide incentives for the most efficient investment in, and use of, pipeline services.

In relation to the rebateable service definition, the AER stated that:

- currently, the definition requires that the market for a rebateable service be substantially different from the market for any reference service;
- the current requirement may prevent revenue from other pipeline services being rebated to users, even when it is efficient to do so;
- in circumstances where there is a high level of uncertainty of revenue and demand for a pipeline service or where there is uncertainty due to commercial and technical arrangements, the regulator should have discretion to decide

whether a pipeline service is a rebateable service that is negotiated with users, a reference service, or neither; and

- the use of the current definition is likely to result in access arrangement decisions which are contrary to the long term interests of consumers with respect to price.

The AER raised concerns about regulation of the Victorian declared transmission system (DTS) which are discussed below. It also expressed concerns about its inability to set efficient tariffs for pipeline services such as backhaul and interruptible, which may be offered on other regulated pipelines.

### 1.2.1 Specific issue the rule change was seeking to address

The AER submitted that the proposed rule change would address a specific issue that it anticipated would arise in its review of the APA GasNet access arrangement. The service provider, APA GasNet Australia (Operations) Pty Limited (APA GasNet), submitted a revised access arrangement proposal on 2 April 2012 for the Victorian DTS for the AER's assessment and approval.<sup>1</sup>

APA GasNet's access arrangement extends for a period of five years and sets out tariffs, terms and conditions and non-tariff policies and elements for pipeline services that have been identified as reference services. Under the current access arrangement, pipeline services that are considered as likely to be sought by a significant part of the market (that is, reference services) are the gas transportation services that are provided to users in agreements made in accordance with the Market System Operating (MSO) rules.<sup>2</sup> The MSO rules are now contained in Part 19 of the NGR – the Declared Wholesale Gas Market (DWGM) rules.

The specific issue about the APA GasNet access arrangement that concerned the AER was whether AMDQ credit certificates (AMDQ cc) should be treated as a reference service or as a rebateable service.<sup>3</sup> AMDQ cc provide preferential rights to holders (shippers or pipeline users) for specified amounts of pipeline capacity when the transmission system becomes constrained. AMDQ cc are specific to a certain injection point and are sold to users by APA GasNet through a tender process. The AER's view was that under the current rules AMDQ cc should be regarded as a reference service as they are likely to be sought by a significant part of the market. This would require a reference tariff to be set. However in its rule change request, the AER stated that setting a reference tariff for the AMDQ cc service would not be appropriate due to technical and/or commercial arrangements associated with the APA GasNet and the Victorian gas arrangements. Consequently, it would prefer to have the AMDQ cc service classified as a rebateable service in the next access arrangement period (2013–2017).

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1 The AER released its draft decision in relation to APA GasNet's access arrangement proposal on 11 September 2012. The AER's final decision is to be released in March 2013.

2 APA Group, *GasNet Australia access arrangement*, approved 25 June 2008, commencement date 1 January 2008, pp3 and 17.

3 AMDQ cc only exist in the Victorian DTS. A description of AMDQ cc is provided at Appendix A.

The AER submitted that APA GasNet has already contracted AMDQ cc with a significant part of the market for the 2013–2017 access arrangement period. Under these circumstances if AMDQ cc are not treated as a rebateable service, then according to the AER, APA GasNet may over-recover its efficient pipeline costs by selling unused contracted capacity which would not be taken into account in the setting of reference service. Also, the AER was concerned that APA GasNet would retain all additional revenue resulting from the sale of AMDQ cc at a price that is above the relevant reference tariff. According to the AER, the combined impact of these effects would result in APA GasNet recovering and retaining higher revenue than that set as the target regulated revenue under the access arrangement.<sup>4</sup>

### 1.3 Solution proposed in the rule change request

The AER proposed to resolve the issue discussed above by making a rule that amends both the reference service and rebateable service definitions in the NGR. The proposed rule sought to:

- amend the definition of a reference service in rule 101 of the NGR by:
  - removing the requirement that a full access arrangement must specify all reference services (being pipeline services sought by a significant part of the market);
  - including the requirement that a full access arrangement must specify as a reference service at least one pipeline service likely to be sought by a significant part of the market; and
  - allowing the relevant regulator discretion in determining what other pipeline services that are likely to be sought by a significant part of the market should be included as a reference service.
- amend the definition of a rebateable service in rule 93(4) of the NGR by:
  - removing the requirement that the market for such a service be substantially different to the market for any reference service; and
  - providing that a service that is not a reference service may be a rebateable service if either substantial uncertainty exists concerning the extent of demand for the service, or the revenue to be generated or it is not commercially and technically reasonable to set a reference tariff for such a service.

The proponent's rule change request included a proposed draft rule.

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<sup>4</sup> While reference tariffs are required to be approved by the AER, the level of the target revenue established under its access arrangement is important for APA GasNet. This is because the revenue approach it uses is an average revenue yield. APA Group, *GasNet access arrangement submission*, 14 May 2007, pp104-107.

The effect of the proposed rule change would be to allow the AER to determine which pipeline services can be classified as reference services, rebateable services, or neither. In the AER's opinion, this discretion would better ensure that tariffs for regulated services are efficient and cost reflective.

The proposed rule change would apply to all covered pipelines that are, or may be, fully regulated by either the AER or the Economic Regulation Authority (ERA) of Western Australia.

#### **1.4 Commencement of rule making process**

On 6 October 2011, the Commission published a notice under s. 303 of the National Gas Law (NGL) advising of its intention to commence the rule making process and the first round of consultation in respect of the rule change request. A consultation paper prepared by AEMC staff identifying specific issues and questions for consultation was published with the rule change request. Submissions closed on 3 November 2011.

Eight submissions on the rule change request were received as part of the first round of consultation. They are available on the AEMC website.<sup>5</sup> The submission from DBNGP (WA) Transmission Pty Ltd (DBP) has had confidential information omitted as a result of the Commission accepting a claim of confidentiality by the stakeholder. A summary of the issues raised in all submissions, and the Commission's response to each issue, are contained in Appendix B.

On 22 December 2011, the Commission decided under s. 317 of the NGL to extend the period of time for the making of the draft rule determination to 15 March 2012. The reason for this decision was to allow time for it to consider a number of complex and difficult issues that were raised in submissions.

#### **1.5 Publication of draft rule determination and draft rule**

On 15 March 2012, the Commission published a notice under s. 308 of the NGL and a draft rule determination in relation to the rule change request (draft rule determination). The draft rule determination included a draft rule.

Submissions on the draft rule determination closed on 26 April 2012. The Commission received ten submissions including a number of late and supplementary submissions. The submission from DBP received on 26 April 2012 has had confidential information omitted as a result of the Commission accepting a claim of confidentiality by the stakeholder. A summary of the issues raised in submissions on the draft rule determination, and the Commission's response to each issue, is included in Appendix B.

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5 [www.aemc.gov.au](http://www.aemc.gov.au)

## **1.6 Extensions of time**

Under s. 317 of the NGL, the Commission has twice extended the period of time for the making of the final rule determination. On 7 June 2012, the Commission published a notice to extend the period of time to 26 July 2012. Then on 26 July 2012 it published a notice to extend the period of time to 1 November 2012. The reason why the Commission decided to extend the period of time on both occasions was to allow time for it to consider a number of complex issues that were raised in submissions made in response to the draft rule determination.

## **1.7 Additional consultation**

On 13 September 2012, the Commission published a consultation paper on a proposed variation to the draft rule. In the consultation paper, the Commission proposed an amendment to the rebateable service definition that would only apply to pipeline services provided by means of the Victorian DTS. Submissions on the consultation paper closed on 5 October 2012. The Commission received six submissions. These are also available on the AEMC website. A summary of the issues raised in submissions on the consultation paper, and the Commission's response to each issue, is also included in Appendix B.

## 2 Final rule determination

### 2.1 Commission's determination

The Commission has determined to make a more preferable rule in accordance with ss. 296 and 313 of the NGR.<sup>6</sup> The more preferable rule:

- incorporates changes to the reference service definition in terms similar to that proposed in the AER's rule change request; and
- includes changes to rule 59(2) that are consequential to the changes to the reference service definition.

The more preferable rule does not make changes to the rebateable service definition.

The Commission's reasons for making this final rule determination are set out in section 3.1.

The *National Gas Amendment (Reference service and rebateable service definitions) Rule 2012 No 2* (rule as made) is published with this final rule determination. The rule as made commences on 2 May 2013. The Commission has decided to delay the commencement date of the rule as made to be clear that the rule as made cannot be applied to regulatory processes that are currently underway. This is discussed further in Chapter 8.

The rule as made is a more preferable rule. Its key features are described in section 3.2.

### 2.2 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NGL to make the rule;
- the rule change request;
- submissions received during the first, second and third round of consultation;
- other information relevant to the rule change request; and
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the achievement of the national gas objective (NGO).

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<sup>6</sup> Under s. 296 of the NGL, the AEMC may make a rule that is different (including materially different) from a market initiated proposed rule (a more preferable rule) if it is satisfied that having regard to the issue or issues that were raised by the market initiated proposed rule (to which the more preferable rule relates), the more preferable rule will or is likely to, better contribute to the achievement of the national gas objective.

There is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles relating to this rule change request.<sup>7</sup>

## **2.3 Commission's power to make the rule**

The Commission is satisfied that the rule as made falls within the subject matter about which the Commission may make rules. It falls within s. 74 of the NGL as it relates to regulating access to and the provision of pipeline services. Further, the rule as made falls within the matters set out in schedule 1 to the NGL, including:

- item 17, because it relates to the regulation of access to pipeline services provided by means of a scheme pipeline;
- item 28(a), because it relates to pipeline services including reference services that are provided or may be provided by means of a scheme pipeline which are described in an applicable access arrangement; and
- item 69, because it relates to the specification of pipeline services as reference services.

## **2.4 Rule making test**

Under s. 291(1) of the NGL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NGO. This is the decision making framework that the Commission must apply.

The NGO is set out in 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.”

Under s. 291(2) of the NGL, for the purposes of s. 291(1) of the NGL the AEMC may give such weight to any aspect of the NGO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.

For this rule change request, the relevant aspect of the NGO is the efficient investment in and use of natural gas services for the long term interests of consumers of natural gas with respect to price and security of supply.

The Commission is satisfied that the rule as made will, or is likely to, contribute to the achievement of the NGO because it will promote:

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<sup>7</sup> Under s. 73 of the NGL, the AEMC must have regard to any relevant MCE statement of policy principles in making a rule.

- the efficient use of and investment in pipeline services. When significant uncertainty exists as to the revenue and demand for a pipeline service, the rule as made reduces the likelihood that inefficient tariffs are set for that service; and
- the long term interests of consumers with respect to price and security of gas supply. This can be achieved by allowing the AER to decide whether a pipeline service sought by a significant part of the market, is a reference service. As a result, the AER will not be required to set a tariff for the relevant service which in certain circumstances may not be reflective of efficient costs.

The Commission considers that the rule as made will not increase investment risk on regulated pipelines. It will allow regulators to accommodate circumstances where it is problematic to set a reference tariff due to the uncertainty of demand and/or revenue; or where it is inappropriate to set a reference tariff due to technical and/or commercial arrangements. In these cases, the regulator may find that market mechanisms, rather than a reference tariff, may be better at determining the price for, and allocation of, a pipeline service.

## **2.5 More preferable rule**

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

The Commission has considered the issues raised by the rule proponent in the rule change request as well as the issues raised by stakeholders in submissions. It has concluded that the rule as made (a more preferable rule) will, or is likely to, better contribute to the NGO because it will better promote efficient use of and investment in pipeline services which will promote the long term interests of consumers with respect to price and security of gas supply.

## **2.6 Other requirements under the NGL**

### **2.6.1 Section 292(a) of the NGL**

Under s. 292(a) of the NGL, the Commission must take into account the form of regulation factors<sup>8</sup> when making a rule that:

- specifies a pipeline service as a reference service; or
- confers a function or power on the AER to specify a pipeline service as a reference service when making a full access arrangement decision.

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<sup>8</sup> NGL, s. 16.

The Commission has considered the form of regulation factors in making the rule. In broad terms, the form of regulation factors require an assessment to be made of the potential for market power to be exploited by a service provider in determining how pipeline services provided by means of a full regulation pipeline are to be regulated.

The rule as made provides some discretion to the AER in approving what pipeline services are specified as reference services in an access arrangement. This recognises that although a pipeline service may be sought, or be likely to be sought, by a significant part of the market, it would not always be appropriate to define the service as a reference service (and, as a consequence, have to establish a reference tariff). That is, under the rule as made, the AER would be able to decide that the level of economic regulation applied to a pipeline service should be less than it would otherwise be subject to if it was defined as a reference service. In using this discretion the AER will have regard to the revenue and pricing principles.

### **2.6.2 Section 293 of the NGL**

Under s. 293 of the NGL, the Commission must take into account the revenue and pricing principles when making a rule for or with respect to any matter or thing specified in items 40 to 48 of schedule 1 of the NGL. Items 40 to 48 relate to regulatory economic methodologies.

The Commission considers that because the rule as made is not directly related to items 40 to 48 of schedule 1 of the NGL, it is not required to take into account the revenue and pricing principles when making this rule. However, the Commission considers that the rule as made will enhance the AER's ability to make access arrangement decisions having regard to the revenue and pricing principles.

### **2.6.3 Section 295(4) of the NGL**

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 rule as made is compatible with the proper performance of AEMO's declared system functions.<sup>9</sup>

The Commission considers that the rule as made will not impact on AEMO's declared system functions as it relates to economic regulation of service providers and does not change the operation of the Victorian DTS or DWGM.

## **2.7 Participating jurisdictions**

The rule as made will apply to each participating jurisdiction including Western Australia. Under s. 21 of the NGL, the participating jurisdictions are the States, the Commonwealth, the Australian Capital Territory and the Northern Territory. The rule as made applies in Western Australia as it falls within the subject matters about which

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<sup>9</sup> AEMO's declared system functions are specified in s. 91BA of the NGL.

the Commission may make rules under the *National Gas Access (WA) Act 2009* of Western Australia.

### 3 Commission's reasons

The Commission has analysed the rule change request and assessed the issues arising from it. For the reasons set out below and in the following chapters, the Commission has determined to make a more preferable rule, rather than the proposed rule. This more preferable rule will amend the definition of reference services only. No change will be made to the definition of rebateable services. The Commission's analysis of the proposed rule and the differences between the proposed rule and the rule as made are set out below. Further discussion is included in the subsequent chapters.

#### 3.1 Assessment of issues

In submitting the rule change request, the AER sought to provide more flexibility in the regulatory treatment of pipeline services. In its view, this would be achieved by amending the definitions of reference services and rebateable services to:

- provide the AER discretion in determining what pipeline services sought by a significant part of the market may be classified as reference services; and
- broaden the definition of rebateable services so that services which cannot currently be classified as rebateable services (such as AMDQ cc) may be defined as rebateable services.

The AER presented the amendments to the two definitions as a package to address, in part, its specific concern about the revenue APA GasNet generates from providing AMDQ cc on the Victorian DTS. The AER's concern is that APA GasNet is over-recovering on its efficient pipeline costs because of the revenue earned from AMDQ cc. That is, APA GasNet is recovering more than the target regulated revenue approved by the AER. Without the amended reference and rebateable service definitions, the AER is concerned that this situation will continue into the next access arrangement period of 2013–2017.<sup>10</sup>

The current arrangements relevant to the rule change request and the issues considered in making this final rule determination are set out below.

##### 3.1.1 Current arrangements

###### Reference service definition

Rule 101 of the NGR states that:

- a full access arrangement must specify all reference services;
- a reference service is a pipeline service that is likely to be sought by a significant part of the market.

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<sup>10</sup> AER rule change proposal, 5 August 2011, pp7, 21-22.

## **Rebateable service definition**

Rule 93(4) of the NGR states that:

A pipeline service is a rebateable service if:

- the service is not a reference service; and
- substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; and
- the market for the service is substantially different from the market for any reference service.

### **3.1.2 AER's proposed rule**

#### **Reference service definition**

The AER proposes a change to the definition of a reference service by requiring that a full access arrangement must specify a reference service for:

- at least one pipeline service that is likely to be sought by a significant part of the market;
- each pipeline service that is likely to be sought by a significant part of the market and for which the relevant regulator considers should be included as a reference service.<sup>11</sup>

#### **Rebateable service definition**

The AER proposes a change to the definition of a rebateable service by specifying that a pipeline service is a rebateable service if:

- the service is not a reference service; and
- either:
  - substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; or
  - it is not commercially and technically reasonable to set a reference tariff for the service.<sup>12</sup>

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<sup>11</sup> AER rule change proposal, 5 August 2011, p23.

<sup>12</sup> AER rule change proposal, 5 August 2011, p24.

In proposing this rule change the AER is seeking to remove the requirement that the market for a rebateable service be substantially different from the market for any reference service.

### **3.1.3 Impact and assessment of the proposed rule**

This section summarises the Commission's assessment of the impact of the proposed rule. These matters are discussed in more detail in Chapters 5 to 7.

#### **The problem the proposed rule change sought to address**

The key reason for the AER's submission of the proposed rule change was to address a problem that it considered to exist relating to APA GasNet's access arrangement. In brief, and as noted previously, the AER was concerned that APA GasNet has been (and would continue to) earn revenue from the sale of AMDQ cc in addition to the total revenue approved by the AER. That is, the AER considered that APA GasNet would earn excess revenue outside of its access arrangement.

Consideration of this matter required an understanding and analysis of the AMDQ cc bundled service, the differences in the scope of economic regulation of pipeline services provided by means of the Victorian DTS and other fully regulated pipelines and the rebating back to users of some of the revenue earned from the AMDQ cc service through the updating and operation of APA GasNet's price control model.

In the draft rule determination, the Commission was not satisfied that the key reason for the proposed rule as described by the AER in its rule change request had been clearly demonstrated. That is, that APA GasNet was inappropriately retaining revenue in excess of its target regulated revenue. This was because the Commission had found that in the current access arrangement period APA GasNet was already rebating the majority of this revenue back to users by the annual updating of its price control model. The annual updating of this model was part of the APA GasNet's annual tariff variation process which had been approved by the AER each year as being compliant with the current access arrangement.

The Commission's assessment of the two components of the proposed rule change (that is, the proposed change to the reference service definition and the proposed change to the rebateable service definition) is discussed below.

#### **Reference service definition**

##### **Impact on setting efficient tariffs**

The AER has stated that the proposed definition for reference services is likely to result in price benefits because it will allow the AER discretion not to specify a pipeline service sought by a significant part of the market as a reference service. As a result, the AER will not be required to set a reference tariff for the relevant service. The Commission considers that this discretion could be relevant in circumstances where

setting a reference tariff may result in a tariff that may not be reflective of the efficient costs of providing that service to users. This may occur where there is a high level of uncertainty with respect to revenue and/or demand for the pipeline service, or where there are commercial and/or technical reasons that preclude an efficient tariff being set. The AER has claimed that the provision of AMDQ cc by APA GasNet is one such service where this discretion would be relevant.

### **Impact on the AER's discretion**

The proposed rule would better enable the AER to set reference tariffs that are reflective of efficient costs. This is because the proposed rule would provide increased discretion to the AER to enable it not to specify a pipeline service sought by a significant part of the market as a reference service. As a result, the AER would not be required to set a tariff for the relevant service which in certain circumstances may not be reflective of efficient costs.

However, the Commission considers that this discretion should not be unbounded. For this reason the Commission has amended the proposed rule to require the AER to take into account the revenue and pricing principles<sup>13</sup> when making a decision on classifying a pipeline service as a reference service. This is appropriate because if the AER determines that a pipeline service is a reference service it must set a reference tariff for that service. In accordance with the NGL, the AER would also be required to consider the NGO when making a decision on reference services.

### **Rebateable service definition**

Consideration of the proposed rule change highlighted to the Commission the differences in market structure between market carriage and contract carriage pipelines.<sup>14</sup> These differences may result in differences in the possible impact of the proposed rule change on different pipelines. For this reason, the Commission has carried out separate analysis for the Victorian DTS and for other regulated pipelines.

In its draft determination, the Commission concluded that the case for making the change to the rebateable service definition as proposed by the AER had not been made at that point. The AER's subsequent submissions indicated that it believed, after considering legal advice, that its ability to take into account AMDQ cc revenues in the APA GasNet access arrangement were significantly hampered.

### **Impact on the Victorian DTS**

The Commission carried out additional consultation on the matter of amending the rebateable service definition for pipeline services offered on the Victorian DTS in light of submissions from the AER. Specifically, the Commission sought stakeholder views

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<sup>13</sup> NGL, s. 24.

<sup>14</sup> A description of differences between market carriage and contract carriage is provided at Appendix C.

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<sup>14</sup> Reference service and rebateable service definitions

on the possible introduction of an alternative rebateable service definition to apply to the Victorian DTS. However, stakeholder's responses to the consultation paper indicated that there were still a number of significant issues to be resolved.

Accordingly, the Commission is not convinced that a change to the definition should be made at this time.

### **Impact on the AER's proposed change on other pipelines**

In assessing the AER's proposed rule change and its impact on regulated pipelines other than the Victorian DTS, the Commission has weighed up the potential benefits of making the proposed change against the potential costs. With respect to potential benefits the AER has submitted that the proposed change is required to allow revenue to be rebated (if appropriate) when considering services of significant uncertain demand or uncertain revenue such as backhaul and interruptible services. By way of example, the AER cited specific non-reference services that may be sought on the Roma to Brisbane Pipeline (RBP). In assessing the AER's submission in terms of potential benefits, the Commission:

- considers that the AER has not to date provided clear evidence that pipeline users are requesting that certain pipeline services ought to be classified as rebateable services; and
- notes that non-reference services can be specified as negotiated services and that the revenue from these services must be taken into account when determining the revenue to be allocated to the reference service.

In terms of the potential costs, the Commission considers that the application of the AER's proposed rebateable service definition to regulated pipelines other than the Victorian DTS would generate regulatory uncertainty that could deter investment. Specifically, the Commission is concerned that service providers would be exposed to increased regulatory uncertainty about the treatment of pipeline services each time their access arrangements were reviewed by the regulator. Such uncertainty could also impact on the provision of services that are negotiated with users. This may not be conducive to efficient investment in natural gas services and ultimately would not be in the long term interests of consumers.

In addition, it is likely that there would be an increase in investment risk with respect to fully regulated pipelines other than the Victorian DTS because of the provisions in existing contracts. Under the current rule the requirement that the market for a rebateable service be substantially different to the market for the reference service minimises the risk and impact of triggering the 'most favoured nation' clause in many existing contracts.<sup>15</sup> The removal of this requirement in the proposed rule would increase the likelihood that the 'most favoured nation' clause in these contracts would be triggered. If this were to happen, then the service provider may be exposed to

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<sup>15</sup> A 'most favoured nation' clause provides that if the tariff for the pipeline service on offer to other users is less than that agreed to in the contract, then the lower tariff will also apply to the contract (this is further discussed in section 7.2.1).

increased financial and investment risk as the risk/reward relationship may be altered from that inherent in these contracts.

Particular concern has been raised about the potential impact of the AER's proposed rebateable service definition on the Dampier to Bunbury Natural Gas Pipeline (DBNGP). If the proposed change to the rebateable service definition was implemented it may expose the service provider to the unwinding of regulatory arrangements put in place to preserve pre-existing contractual arrangements. Specifically in the case of DBNGP, it may impact on the fixed principle in the access arrangement.<sup>16</sup> If the proposed rule was made then it may be interpreted as taking precedence over the fixed principle in the current DBNGP access arrangement. As a result, the fixed principle would no longer apply and DBNGP (WA) Transmission Pty Ltd (DBP) may be exposed to greater regulatory uncertainty and greater financial risk. This in turn may impact on the service provider's ability to invest in pipeline expansion which may not be in the long term interests of consumers if future demand is not met.

On balance, the Commission has concluded that to date, the potential benefits of applying the AER's proposed rebateable service definition to all regulated pipelines has not been demonstrated to outweigh the potential costs.

However, the issues raised during the course of this rule change process indicates that there may be some uncertainty about the degree and nature of appropriate regulatory oversight of non-reference services that may be applied under the current provisions of the NGR.

### **3.1.4 Commission's conclusion**

The Commission has decided to consider the two proposed amended definitions separately. The Commission is satisfied that the AER requires greater flexibility in specifying pipeline services as reference services to ensure that it is only required to set a reference tariff where it is practicable and efficient to do so. However, as noted above, the Commission considers that the potential costs of making the proposed change to the rebateable service definition outweighs any potential benefits.

Considering each proposed definition separately:

- the Commission is satisfied that the proposed reference service definition will, or is likely to, contribute to the NGO because it will promote the efficient use and investment in pipeline services and will be in the long term interests of consumers; and
- the Commission is to date, not satisfied that the proposed rebateable service definition will, or is likely to, contribute to the NGO. This is because it may lead to an increase in investment risk which could result in inefficient investment in pipeline services and may not be in the long term interests of consumers.

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<sup>16</sup> A full access arrangement may include a principle declared in the access arrangement to be fixed for a stated period of time extending over two or more access arrangement periods (NGR, rule 99).

The Commission is making a more preferable rule (the rule as made). It is satisfied that the more preferable rule (that is, the change to the reference service definition) will, or is likely to, better contribute to the NGO, as it is likely to promote efficient investment in pipeline services for the long term interests of consumers of natural gas with respect to price and security of gas supply.

### **3.2 The rule as made**

The rule as made is a more preferable rule to the rule proposed by the AER. It is different from the proposed rule in the following respects:

- the rule as made requires the AER to take into account the revenue and pricing principles when making a decision to classify a pipeline service as a reference service;
- the rule as made includes minor drafting changes including the addition of 'and' between the two sub-rules of the reference service definition for the purposes of clarification;
- the rule as made does not include the AER's proposed change to the rebateable service definition; and
- the rule as made includes a consequential amendment (example 2 of rule 59(2) of the NGR) as a result of the change to the reference service definition. The Commission considers that this consequential amendment is required because the existing rule is inconsistent with the rule as made reference service definition.<sup>17</sup>

### **3.3 Civil penalties**

The rule as made does not amend any rules that are currently classified as civil penalty provisions under the National Gas (South Australia) Law or Regulations. The Commission does not propose to recommend to the MCE that any of the amendments in the rule as made be classified as civil penalty provisions.

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<sup>17</sup> Under s. 297 of the NGL, the AEMC may make a rule that is necessary or consequential to the rule that is to be made on request under s. 295(1).

## 4 Commission's assessment approach

In the draft rule determination, the Commission set out its approach to assessing the AER's rule change request.<sup>18</sup> In assessing a rule change request the Commission must consider the relevant NGL requirements. This includes the rule making test: that the Commission must be satisfied that the rule if made will, or is likely to, contribute to the achievement of the NGO.<sup>19</sup>

In assessing the AER's rule change request the Commission considered a number of issues because the definitions of reference service and rebateable service are fundamental to the regulation of covered pipelines under the NGR. The Commission was cognisant that any change to these definitions would have application to all covered pipelines subject to full regulation by the AER and the ERA. The issues that the Commission considered were:<sup>20</sup>

- whether the problem as identified by the AER had been substantiated and justifies a rule change;
- whether the rule change proposal would be likely to address the problem identified by the AER;
- whether the rule change proposal would be likely to contribute to the achievement of the NGO, particularly in respect of promoting efficient investment in, and use of, pipeline services;
- whether there is a more preferable rule that would be likely to better contribute to the achievement of the NGO, particularly in respect of promoting efficient investment in, and use of, pipeline services;
- the likely impact of the rule change proposal on the AER's ability to set efficient tariffs;
- how the rule change proposal may impact on regulated pipelines other than the Victorian DTS;
- other consequences of the rule change (intentional or unintentional) that were not identified by the AER; and
- whether the level of discretion that the rule change proposal provides to the AER would be appropriate.

The focus of the draft rule determination, particularly in regard to the treatment of AMDQ cc in the APA GasNet access arrangement, was the Commission's view that the

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<sup>18</sup> AEMC, *Draft rule determination: National Gas Amendment (Reference service and rebateable service definitions) Rule 2012*, 15 March 2012, p16.

<sup>19</sup> NGL, s. 291(1).

<sup>20</sup> AEMC, *Draft rule determination*, 15 March 2012, pp16-17.

AER had not clearly demonstrated that there was a problem that required an amendment to the NGR. This conclusion largely reflected the evidence that APA GasNet had been rebating users for revenue earned from the AMDQ cc 'volume effect' through the annual updating of its price control model. The Commission had noted that APA GasNet's updating of its price control model was part of its annual tariff variation process which had been approved by the AER as being compliant with the current access arrangement (and by implication, compliant with the NGR).<sup>21</sup>

As the Commission noted in its subsequent consultation paper, it was evident that the AER (having considered legal advice) is clearly of the view that for it to effectively account for AMDQ cc revenue in APA GasNet's access arrangement, a change to the rebateable service definition was also required. Accordingly, the assessment approach in the consultation paper included:

- a focus on the nature and extent of the problem identified by the AER. Specifically, the over-recovery of revenue (both the volume and price effect) from the sale of the AMDQ cc bundled service; and
- the nature of and the differences between, the contract and market carriage capacity management systems for pipelines. In particular, the implications of the differences for the economic regulation of pipelines.

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<sup>21</sup> AEMC, Draft rule determination, 15 March 2012, pp12, 14, 17, 21-22.

## 5 Reference service definition

The Commission's final conclusion regarding the definition of reference services is to amend the definition as set out in the draft determination. It is satisfied that this change is consistent with the NGO. This chapter discusses the issues concerning the AER's proposed change to the reference service definition, stakeholders views in the first round of consultation, the Commission's analysis and conclusion reached in the draft rule determination. It also sets out stakeholders views arising in the second round of consultation and the Commission's final conclusion.

### 5.1 The setting of efficient tariffs

#### 5.1.1 The rule change request

The AER stated that the proposed change to the definition of reference service will allow it to exercise discretion as to whether to set a reference tariff in circumstances where:

- a high level of uncertainty exists with respect to revenue and/or demand for a pipeline service, such that determining an efficient tariff may not be possible; and/or
- commercial and/or technical arrangements preclude an efficient tariff to be set (such as in the case of AMDQ cc).<sup>22</sup>

#### 5.1.2 First round of submissions

AEMO stated that criteria should be developed to guide the AER in making a determination regarding a reference service and making an apportionment to rebateable or negotiated services. In developing this criteria AEMO suggested that consideration be given to the uncertainty in forecasting demand and the difficulty in determining costs for services when determining a reasonable tariff.<sup>23</sup>

Other stakeholders had concerns about the AER's assertion that the current requirement to determine a reference tariff for each reference service gives rise to regulatory risks where the demand or revenues to be derived from services are uncertain (such as, where there are emerging pipeline services). In particular:

- APA submitted that it is unclear how a service for which there is uncertain demand could be considered a reference service;<sup>24</sup> and

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<sup>22</sup> AER rule change proposal, 5 August 2011, p4.

<sup>23</sup> AEMO submission, 3 November 2011, p2.

<sup>24</sup> APA submission, 3 November 2011, p2.

- Australian Pipeline Industry Association (APIA) submitted that the current rules allows for the AER to approve the treatment of emerging or developing pipeline services where demand is uncertain as non-reference services. It also submitted that a service for which there is uncertainty in demand or revenue of itself means that it is a service which is not likely to be sought by a significant part of the market. Therefore, it could not be a reference service.<sup>25</sup>

### 5.1.3 Draft rule determination analysis

The AER has stated that under the current rules it would have no choice but to classify AMDQ cc as a reference service as it is to be likely sought by a significant part of the market (that is, it would otherwise satisfy the definition of a reference service). This outcome would be problematic – by specifying AMDQ cc as a reference service the AER would then be required to approve a reference tariff and non-tariff terms and conditions for the service. Because the incremental costs of providing AMDQ cc is minimal, then any reference tariff set by the AER based on efficient costs would be much lower than the recent contract price for AMDQ cc.

If a reference tariff was set for AMDQ cc that was lower than the AMDQ cc contract price, then it may reduce the incentive for APA GasNet to invest in additional capacity in the pipeline system. Lack of investment would not be in the long term interest of consumers. Alternatively, if a reference tariff for AMDQ cc were higher than the contract price, this could dampen demand for the AMDQ cc service and also affect future investment.

APA and APIA expressed concern about the impact of the proposed rule on emerging pipeline services. In the draft rule determination, the Commission did not agree with these concerns. It considered that the proposed rule maintains the future-looking approach of the current rule by specifying that the AER considers each pipeline service that is likely to be sought by a significant part of the market to be included as a reference service. This means that when making an access arrangement decision, the AER would assess whether an emerging or developing pipeline service is likely to be sought by a significant part of the market over the next access arrangement period.

It may be possible for a pipeline service which is assessed as likely to be sought by a significant part of the market to have uncertain demand and/or revenue. That is, the service would appear to fall within the definition of a reference service. In such a circumstance, the draft rule would enable the AER not to include such a pipeline service in the access arrangement where it is problematic for the AER to set an efficient tariff.

AEMO suggested that criteria be developed to guide the AER in making a reference service decision. The Commission considered that such a guide would be unnecessary and inappropriate as the purpose of the draft rule was to provide the AER flexibility to deal with situations where it is problematic for it to set an efficient tariff, but limits the

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<sup>25</sup> APIA submission, 3 November 2011, p7.

AER's discretion in making a decision about a reference service. This is discussed in section 5.2.

#### **5.1.4 Draft rule determination conclusion**

The Commission considered that the draft rule would give the AER discretion not to specify a pipeline service sought by a significant part of the market as a reference service, and therefore not set a reference tariff. In some cases, this course of action may be desirable if a reference tariff would not be cost reflective. If tariffs are set inefficiently too low or too high, the Commission considered that inefficient use of, and inefficient investment in, pipeline services may occur. This would not be in the long term interests of consumers.

#### **5.1.5 Second round of submissions**

The AER acknowledged that the AEMC's preferred rule provides it with the necessary discretion to achieve a more efficient outcome.<sup>26</sup> It submitted that the change to the definition of a reference service would enable the AER to decide how to deal with services that are likely to be sought by a significant part of the market but for which estimating an efficient tariff would be difficult.<sup>27</sup>

Jemena submitted that there is a case for changing the reference service definition. It noted that there may be circumstances, other than the specific case identified by the AER, where it is not appropriate or practicable to set a reference tariff for a service that is likely to be sought by a significant part of the market.<sup>28</sup>

#### **5.1.6 Commission's final analysis**

The Commission notes stakeholder submissions to the draft rule determination support the need to change the reference service definition in order to achieve efficient tariffs. Taking this into account, the Commission maintains its view that the rule as made will give the AER greater flexibility in specifying pipeline services as reference services to ensure that the AER is only required to set a reference tariff where it is practicable and efficient to do so.

### **5.2 Regulatory discretion**

#### **5.2.1 The rule change request**

The AER stated that the proposed change to the definition of reference service will provide it with flexibility to determine whether more than one pipeline service should

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<sup>26</sup> AER submission, 27 April 2012, p5.

<sup>27</sup> AER submission, 27 April 2012, p4.

<sup>28</sup> Jemena submission, 30 April 2012, p3.

be a reference service.<sup>29</sup> The AER submitted that under the previous regulatory regime (the Gas Code) the regulator had discretion to determine which pipeline services should be reference services and that under the NGR this discretion has been removed. It also submitted that it was unaware of any policy reasons for this change and suggested that it was a drafting outcome rather than a policy intention to mandate all significantly sought services as reference services.<sup>30</sup>

### 5.2.2 First round of submissions

AEMO stated that it supported the proposal to give the AER discretion to determine reference services. It submitted that this would enable the AER to not include augmentation of the pipeline in the calculation of the regulatory asset base that was funded either:

- by a user in return for free rights to capacity; or
- by the sale of all allocation rights by auction at full value.<sup>31</sup>

Other stakeholders had concerns that the proposed change would give too much discretion to the AER and that this discretion would be unbounded. In particular:

- APA submitted that this discretion should not be linked to the AER's stated concern over uncertainty in demand for the service or revenue earned from providing the service;<sup>32</sup>
- Jemena submitted that the increased discretion will expose service providers to significant risk such that the balance and certainty inherent in the service offered by service providers will be altered in a way that is detrimental to the interests of service providers;<sup>33</sup>
- Multinet stated that the AER's discretion should be limited to 'other' pipeline services to those put forward by the service provider under rule 101 of the NGR;<sup>34</sup> and
- Origin was concerned that the discretion will lead to uncertain and unpredictable outcomes. It submitted that if a change were made then it should include limits on the level of discretion to ensure that market participants have certainty and clarity around the AER's decision making criteria.<sup>35</sup>

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29 AER rule change proposal, 5 August 2011, p10.

30 AER rule change proposal, 5 August 2011, p4; AER rule change proposal, cover letter, 5 August 2011, p1.

31 AEMO submission, 3 November 2011, p1.

32 APA submission, 3 November 2011, p2.

33 Jemena submission, 7 November 2011, p6.

34 Multinet submission, 3 November 2011, p2.

35 Origin submission, 3 November 2011, p1.

### **5.2.3 Draft rule determination analysis**

The Commission noted the concerns of stakeholders with regards to the level of the discretion provided to the AER in the proposed rule. While under the proposed rule, the AER would be required to consider the NGO,<sup>36</sup> it may choose to take into account the revenue and pricing principles when making a reference service decision.<sup>37</sup> The Commission considered that in making such a decision, it would be appropriate for the AER have regard to the revenue and pricing principles because of the fundamental link between what is a reference service and establishing a reference tariff. For this reason, the draft rule required the AER to take into account the revenue and pricing principles when making a reference service decision.

This amendment to the proposed rule aims to guide the AER in making decisions on what pipeline services should be classified as reference services. It should also provide service providers and users with context in which to understand how the AER may make, or has made, a decision. The Commission did not consider that any other limits to the AER's discretion were appropriate or necessary.

The Commission also noted that the proposed rule is restoring discretion to the regulator to what it was under the Gas Code.<sup>38</sup> It commented that it was not aware of any concerns with this level of discretion provided to regulators under the Gas Code.

### **5.2.4 Draft rule determination conclusion**

The Commission in the draft rule determination, concluded that the AER's proposed rule does provide an increased level of discretion to the AER, but that this discretion is necessary for the AER to be able to set reference tariffs that are reflective of efficient costs. However, the Commission did consider that the AER's discretion should be limited, and for this reason the draft rule required the AER to take into account the revenue and pricing principles when making a decision about reference services.

### **5.2.5 Second round of submissions**

The AER considered that the inclusion in the draft rule of the requirement that the AER must take into account the revenue and pricing principles when exercising its discretion with respect to reference services, was unnecessary. The AER submitted that this is because it is already required to take into account the revenue and pricing principles in accordance with s. 28(2)(a)(i) of the NGL.<sup>39</sup>

APA submitted that the AEMC's changes to the proposed rule were appropriate – they addressed the AER's concerns while also providing some guidance on the scope of the

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<sup>36</sup> NGL, s. 28(1).

<sup>37</sup> NGL, s. 28(2)(b).

<sup>38</sup> Gas Code, section 3.3.

<sup>39</sup> AER submission, 27 April 2012, p3.

AER's discretion. APA considered that the AEMC's changes addressed concerns it raised that the AER's discretion under the proposed rule would be unbounded.<sup>40</sup>

APIA submitted that the inclusion of the revenue and pricing principles provides appropriate guidance as to the inclusion of a pipeline service as a reference service. It regarded the AEMC's preferred rule as an improvement on the existing rule and the AER's proposed rule. APIA also submitted that there may be merit in including a specific reference to the NGO in the new rule.<sup>41</sup>

DBP also suggested a number of additional amendments to the current version of the NGR if the reference service definition is to be changed as proposed by the AEMC in its draft rule determination. These proposed changes focussed on acknowledgement that an access arrangement may contain only one reference service. The affected rules identified by DBP were 22, 24, 48, 89 and 97 of the NGR.<sup>42</sup>

Jemena stated that it did not support the AEMC's draft rule as it would increase the AER's discretion unnecessarily.<sup>43</sup> Jemena was concerned that, if implemented, the draft rule would change the balance of judgement on what services should be a reference service from the service provider to the AER. It considered that a service provider has detailed knowledge of the gas market and is in the best position to identify what should be a reference service.<sup>44</sup>

According to Jemena, the definition of a reference service should be clear so that the service provider can, with certainty, prepare and submit an access arrangement proposal that includes all reference services.<sup>45</sup> Jemena proposed an alternative to the draft rule 101(2) that it considered would address the problem identified by the AER while avoiding the complications and risks inherent in the AEMC's more preferable rule.<sup>46</sup>

## 5.2.6 Commission's final analysis

The Commission has considered the arguments and evidence put forward in stakeholder submissions to the draft rule determination in relation to the AER's discretion when making a reference service decision. However, the Commission maintains its view as set out in the draft rule determination that this discretion is necessary for the AER to be able to set reference tariffs that are reflective of efficient costs. It also maintains the view that the AER's discretion should be limited, and for this reason the rule as made requires the AER to take into account the revenue and pricing principles when making a decision about reference services.

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<sup>40</sup> APA submission, 26 April 2012, p1.

<sup>41</sup> APIA submission, 26 April 2012, pp1-2.

<sup>42</sup> DBP submission, 26 April 2012, p2.

<sup>43</sup> Jemena submission, 30 April 2012, p1.

<sup>44</sup> Jemena submission, 30 April 2012, p5.

<sup>45</sup> Jemena submission, 30 April 2012, p7.

<sup>46</sup> Jemena submission, 30 April 2012, p1.

In response to the AER's submission, the Commission considers that the inclusion of the reference to the revenue and pricing principles removes any doubt about the limits to the AER's discretion. The explicit requirement to take into account the revenue and pricing principles clarifies to all parties that the AER must have regard to these principles when making a decision about reference services. In considering this matter, the Commission notes that under the rule as made the AER is only required to take into account the revenue and pricing principles in considering whether to specify a pipeline service as a reference service. Also, the Commission notes that s. 28(2)(a)(i) of the NGL refers to a reference tariff rather than a reference service. This relates to the AER being required to take into account the revenue and pricing principles when exercising its discretion in approving or making those parts of an access arrangement relating to a reference tariff.

The Commission considers that it is not necessary to include a specific reference in the rule as made to the NGO as suggested by APIA. This is because it is specified under s. 28(1) of the NGL that the AER must perform or exercise its economic regulatory function or power in a manner that will or is likely to contribute to the achievement of the NGO. The Commission does not consider that a restatement of this requirement is necessary in this context.

In responding to the draft determination, Jemena suggested an alternative reference service definition. The Commission considers that Jemena's proposed definition is less preferable to the rule as made for promoting the NGO with respect to the long term interests of consumers. This is because the rule as made provides the advantage to users that the reference service decision is made by the AER with the requirement that it must take into account the revenue and pricing principles. This is something that Jemena's alternative rule does not provide. Under Jemena's alternative rule, the AER has no ability to add a service that it considers meets the criteria of being a reference service. This is determined by the service provider before it submits its access arrangement proposal.

In considering this matter, the Commission notes Jemena's argument that the service provider with its detailed knowledge of the gas market is in the best position to identify and make a decision about what services should be a reference service. However, this argument could equally be made about any aspect of its access arrangement proposal. It revolves around the asymmetric information problem faced by the regulator. It is for the AER to request the appropriate information and for the service provider to provide that information that will enable the AER to make an informed decision about reference services.

Similarly, the Commission notes that Jemena's argument that under the rule as made, a service provider would face uncertainty when submitting an access arrangement proposal that it is compliant with the NGR, could equally apply to any aspect of its access arrangement proposal. Also, the Commission notes that if a service provider has identified more than one reference service, then under the rule as made there is nothing preventing the service provider including any additional reference service in its access arrangement proposal so long as the service meets the criteria.

With respect to DBP's suggested wording changes to the AEMC's draft rule, the Commission considers that these changes while minor, improve clarity with respect to the reference service definition and ensure consistency with other provisions of the NGR with respect to example 2, rule 59(2) of the NGR. These changes, which the Commission has adopted in the rule as made, are:

- to replace the word 'designated' with 'specified' in the draft rule amendment to example 2, rule 59(2); and
- to replace the word 'considering' with 'deciding' in rule 101(2).

As noted in section 5.2.5 above, DBP also identified a number of other small changes to various rules for consistency with the amended reference service definition. The Commission has reviewed each of these suggestions and has concluded that they are not critical to improve the clarity or consistency across rules that relate to reference services. It is satisfied that in context, the current wording of the various rules does not presume that an access arrangement will always relate to more than one reference service.

### **5.3 Commission's final conclusion**

After considering the submissions made in response to the draft determination, the Commission has concluded that the reference service definition should be amended as set out in the draft rule (with two minor drafting changes).

The limited discretion provided to the AER and ERA by the rule as made will enable these regulators to specify whether a pipeline service should be classified as a reference service and be the subject of a reference tariff. This discretion will mean that a regulator will not be required to determine a reference tariff that is not cost reflective. This approach will be, or is likely to be, consistent with meeting the NGO as the setting of non-cost reflective reference tariffs may encourage inefficient investment in, or use of, gas services. This outcome would not be in the long term interests of consumers as they may find that:

- they could be paying more than is necessary if the reference tariff is in excess of the efficient costs of providing the service; and
- they could lose certainty of supply if the reference tariff does not recover an efficient level of investment for the provision of this pipeline service.

## **6 Rebateable service definition in relation to the Victorian DTS**

The AER's rule change proposal included an amended rebateable service definition that would apply to all fully regulated pipelines. In assessing this proposal the Commission has found that amending the rebateable service definition may have a different impact on a contract carriage pipeline compared to a market carriage pipeline. As a result, the Commission has assessed the AER's proposed rebateable service definition, as well as an alternative definition, separately for contract carriage pipelines and market carriage pipelines.

In the context of market carriage, the Commission has determined that the rebateable service definition for the Victorian DTS will remain unchanged at this time as there are significant issues arising from making a change which mean that the Commission is not satisfied that a change would, or would be likely to, contribute to the achievement of the NGO and be in the long term interest of gas consumers.

This chapter discusses the issues concerning the AER's proposed change to the rebateable service definition in relation to the Victorian DTS. This chapter sets out:

- the AER's rule change request as it relates to the Victorian DTS;
- stakeholders' views in the first round of consultation;
- the Commission's conclusion reached in the draft rule determination;
- stakeholders' views in the second round of consultation;
- the Commission's consideration of issues raised in the second round of submissions as presented in the consultation paper;
- stakeholders' views in the third round of consultation; and
- the Commission's final analysis and conclusion.

Issues related to contract carriage pipelines in the context of the AER's proposed change to the rebateable service definition are discussed in Chapter 7.

### **6.1 The rule change request**

The specific issue in relation to the Victorian DTS that the AER sought to address through its rule change proposal was what it saw as its inability to regulate revenue earned from AMDQ cc, allowing APA GasNet to recover more than its efficient pipeline costs. That is, because some of the revenue earned from AMDQ cc is in addition to the revenue earned from reference tariffs, APA GasNet is recovering more than the total regulated target revenue which is approved by the AER.<sup>47</sup>

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<sup>47</sup> AER rule change proposal, 5 August 2011, pp7, 21-22.

There are two possible types of over-recovery associated with the AMDQ cc bundled service. These are:

- the 'volume effect' which occurs when APA GasNet is able to earn additional revenue for providing reference services on unused AMDQ cc contracted capacity. This is revenue that APA GasNet would otherwise not have earned if the holder of the AMDQ cc had fully used its contracted capacity; and
- the 'price effect' which occurs when the price paid for AMDQ cc is above the reference tariff, and is the difference between these two prices.

In its rule change request, the AER only identified over-recovery due to the 'volume effect'.<sup>48</sup> However, the AER subsequently expressed its concern with regard to the over-recovery of revenue due to the 'price effect' and the increase in this revenue that is forecast for the next access arrangement period.<sup>49</sup>

## 6.2 First round of submissions

APA stated that due to the effect of updating volumes and revenues in its price control model, it is not earning any excess revenues from selling AMDQ cc when AMDQ cc is priced at the reference tariff. Extra revenue is only earned to the extent that AMDQ cc is priced above the reference tariff (that is, the injection tariff for that injection point).<sup>50</sup> In discussions with the AEMC, APA stated that the annual tariff rebalancing is consistent with the ACCC's approved access arrangement and price control model. It also stated that most of the revenue it earns from AMDQ cc is due to the volume effect, which is rebated back to users.<sup>51</sup>

## 6.3 Draft rule determination

In the draft rule determination, the Commission concluded that:<sup>52</sup>

“On the information available to it, the Commission is not satisfied that the problem identified by the AER exists (that is, that APA GasNet is inappropriately retaining revenue that is in excess of the target regulated revenue). This is because APA GasNet is rebating users for the volume effect of AMDQ cc under the current access arrangement and the volume effect represents the majority of the AMDQ cc generated revenue.”

Specifically, the 'volume effect' from AMDQ cc was automatically taken into account when APA GasNet annually updated its price control model by replacing forecast volumes with actual volumes. When actual volumes are above forecast volumes in a

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<sup>48</sup> AER rule change proposal, 5 August 2011, pp6-8, 14-15, 20-22.

<sup>49</sup> AER submission, 27 April 2012, p11 and AER supplementary submission, 15 June 2012, p2.

<sup>50</sup> APA submission, 3 November 2011, p5.

<sup>51</sup> AEMC, Draft rule determination, 15 March 2012, p19.

<sup>52</sup> AEMC, Draft determination, 15 March 2012, p21.

given year, the model update has the effect of reducing reference tariffs for the subsequent year. In this way, users do not pay twice for gas injected at these points in the Victorian DTS. This updating of the price control model has occurred as part of APA GasNet's annual tariff variation process.

The price control model was part of APA GasNet's access arrangement proposal<sup>53</sup> which was approved by the ACCC in 2008.<sup>54</sup> The model applies the approved price control formula to calculate revenues and tariffs for each year of the access arrangement period as described in schedule 4 of the current access arrangement.<sup>55</sup>

In accordance with the access arrangement, APA GasNet has submitted an annual tariff variation proposal to adjust tariffs for the following year to the AER each November for approval. Each year this proposal has included APA GasNet's price control model<sup>56</sup> that has been updated with actual and forecast values to demonstrate compliance with the approved price control formula in the derivation of the proposed adjusted tariffs.<sup>57</sup> The updating of actual and forecast volumes, and hence revenues, have occurred in accordance with clause 4.2 of schedule 4 of the current access arrangement.<sup>58</sup> For example, in approving APA GasNet's annual tariff variation proposal for 2012, the AER stated that the proposal complied with the provisions of the access arrangement and "that the forecasts used by GasNet are acceptable".<sup>59</sup>

As a result of APA GasNet's annual updating of its price control model and the AER's repeated approval of this process, the Commission found that APA GasNet was rebating users for the over-recovery of AMDQ cc revenue due to the 'volume effect'. The Commission considered that this was occurring even though the ACCC had decided not to pursue the classification of AMDQ cc as a rebateable service in its 2008 final decision on the access arrangement.<sup>60</sup> In fact, nominating AMDQ cc as a rebateable service was not required to achieve this outcome – the rebating was occurring through the application of APA GasNet's approved annual tariff variation process and operation of its price control model.<sup>61</sup>

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53 ACCC, *Draft decision, Revised access arrangement by GasNet Australia Ltd for the Principal Transmission System*, 14 November 2007, p213.

54 ACCC, *Final approval, Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 25 June 2008.

55 APA Group, *GasNet Australia access arrangement*, approved 25 June 2008, commencement date 1 January 2008, schedule 4, pp35-38.

56 APA GasNet, *Statement of proposed year 2012 transmission tariffs*, 17 November 2011, p6.

57 APA Group letter to the AER, *APA GasNet transmission system year 2012 tariff reset*, 17 November 2011.

58 APA Group, *GasNet Australia access arrangement*, approved 25 June 2008, commencement date 1 January 2008, schedule 4, p35.

59 AER, *Statement of reasons, GasNet tariff reset for 2012*, 14 December 2011.

60 The ACCC considered that there were uncertainties in satisfying the Gas Code definition of rebateable services which required market separation between the rebateable service and the reference service. ACCC, *Final decision, Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008, pv.

61 AEMC, *Draft rule determination*, 15 March 2012, pp20-21.

The Commission's draft determination also noted that if the AER was concerned with the process of rebating users through the updating and operation of APA GasNet's price control model, then under the NGR the AER could propose an amendment to APA GasNet's proposed reference tariff variation mechanism at the next access arrangement review.<sup>62</sup> However, on this last point, the Commission does acknowledge that the current rebating process through the price control model is not transparent: it is not described in the current access arrangement or access arrangement information.

With respect to revenue earned due to the 'price effect', the Commission's draft rule determination noted that the proportion of total AMDQ cc revenue earned by APA GasNet over the current access arrangement period which was due to the 'price effect' was small.<sup>63</sup>

## **6.4 Second round of submissions**

### **6.4.1 AER's submissions**

In response to the draft rule determination, the AER submitted that:<sup>64</sup>

“unless the AEMC also adopts the AER's proposed change to the rebateable service definition, the AER is not likely to be able to rebate revenue derived from a non-reference service against a reference tariff(s).”

This position was supported by legal advice obtained by the AER.

In addition, the AER stated that if AMDQ cc was a rebateable service, only then could its revenue be rebated against the reference tariff. In its opinion, rebating could not occur in any other circumstances. However, in the AER's opinion AMDQ cc cannot be classified as a rebateable service under the current definition in the NGR due to the requirement that it be in a substantially different market to the reference service.<sup>65</sup> Effectively, this implies that the rebating arrangement that has operated through the price control model in the current access arrangement would not be continued (although it was proposed) into the forthcoming access arrangement period.

The AER also submitted that the additional revenue APA GasNet would be likely to receive from the AMDQ cc service over the next access arrangement period (2013–2017) due to the 'price effect' would be significant. It estimated that the amount could be \$27.5 million over the five year period. This estimate was based on APA GasNet's proposed injection tariff at Port Campbell (\$1.969/GJ) as set out in its

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<sup>62</sup> AEMC, Draft rule determination, 15 March 2012, p21.

<sup>63</sup> AEMC, Draft rule determination, 15 March 2012, p21.

<sup>64</sup> AER submission, 27 April 2012, pp1-2.

<sup>65</sup> AER submission, 27 April 2012, p7.

proposed access arrangement and the AMDQ cc tender price for the sale of 353TJ/day at Port Campbell for 2013–2017.<sup>66</sup>

#### 6.4.2 APA's submissions

In response to the draft rule determination, APA submitted that it agreed with the AEMC's analysis that the AER has not demonstrated that the impact of the alleged 'over-recovery' in relation to AMDQ cc is significant in relation to the risks associated with changing the definition of rebateable services.<sup>67</sup>

It also submitted that the potential additional revenues associated with the 'volume effect' are already returned to customers through the price control model. Additional revenue associated with the allocation of AMDQ cc at a higher price than the reference tariff (that is, due to the 'price effect') is a feature of the Victorian declared wholesale gas market (DWGM) and is critical in providing a form of leading capacity signal under the market carriage model. The removal of this mechanism from the market (by effectively taking away APA GasNet's incentive to allocate AMDQ cc on an efficient basis through the application of rebateable service provisions) has the potential to undermine the efficient operation of the Victorian DWGM.<sup>68</sup> APA did not comment on the AER's calculation that the revenue earned due to the 'price effect' could be \$27.5 million over the 2013–2017 access arrangement period.

However, APA did confirm the AEMC's description of arrangements under the current APA GasNet access arrangement in relation to rebating to users additional revenue associated with the 'volume effect' arising from unused AMDQ cc contract capacity. It noted that this rebate has been applied across all tariffs and is in accordance with the approved price control model under the current access arrangement which the AER reviews and confirms at each annual tariff variation. As a result, APA does not consider that this approach is voluntary as had been suggested by the AER.<sup>69</sup>

APA further submitted that the aspect of the price control model that relates to the rebating of revenue arising from unused AMDQ cc contract capacity has been included in APA GasNet's proposed revised access arrangement for 2013–17 submitted to the AER.<sup>70</sup>

In addition to the above, APA made a supplementary submission specifically responding to the AER's submission of 27 April. In this submission, APA expressed concern about the conclusions made by the AER regarding the operation of the current APA GasNet access arrangement and the AER's powers in approving the revised access arrangement proposal lodged by APA GasNet.<sup>71</sup>

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<sup>66</sup> AER submission, 27 April 2012, p11 and AER supplementary submission, 15 June 2012, p2.

<sup>67</sup> APA submission, 26 April 2012, p2.

<sup>68</sup> APA submission, 26 April 2012, p2.

<sup>69</sup> APA submission, 26 April 2012, p2.

<sup>70</sup> APA submission, 26 April 2012, p2.

<sup>71</sup> APA supplementary submission, 10 May 2012, p1.

APA noted the AER's conclusion that the current access arrangement does not permit or mandate the return to users of revenue associated with the AMDQ cc 'volume effect' and that this revenue could only be rebated if the AMDQ cc service was classified as a rebateable service. In response, APA submitted that the AER's conclusion was reached notwithstanding the fact that over the first four years of the current access arrangement period, the AER has approved demand adjustments that have led to tariff variations returning approximately \$5.2 million to users in relation to the AMDQ cc 'volume effect'.<sup>72</sup>

APA also submitted that the AER's conclusion appears to relate to its focus on its role in determining reference and rebateable services, rather than the tariff variation process. APA does not consider that this focus is appropriate or reflective of the current and expected future arrangements in relation to the APA GasNet access arrangement.<sup>73</sup>

APA further submitted that the AER appears to consider that the price (revenue) control model is not part of the approved access arrangement, and therefore potentially subject to change during an access arrangement period. APA does not consider that this interpretation is consistent with the AER's approval of the tariff variation mechanism in the current access arrangement which specifically references the price (revenue) control model. It considers that the model is part of the access arrangement which was approved by the ACCC in 2008 and therefore cannot be altered outside the access arrangement revision process under the NGR.<sup>74</sup>

With respect to the 2013–2017 access arrangement period, APA noted that it has proposed substantially the same price control formula as in the current access arrangement period. APA submitted that its understanding is that having lodged its proposal, it can only revise the proposal with the AER's consent (rule 58(3) of the NGR). Therefore, APA considered that the AER's concern about the upcoming access arrangement period related to its ability to 'require' the return of these revenues absent a change to the definition of rebateable services under the rules is unfounded.<sup>75</sup>

### **6.4.3 APIA's submission**

APIA submitted that it is apparent that the alleged over-recovery on the Victorian DTS is not occurring. It expressed support for the draft determination conclusion to not change the rebateable service definition.<sup>76</sup>

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<sup>72</sup> APA supplementary submission, 10 May 2012, p1.

<sup>73</sup> APA supplementary submission, 10 May 2012, p1.

<sup>74</sup> APA supplementary submission, 10 May 2012, p2.

<sup>75</sup> APA supplementary submission, 10 May 2012, p2.

<sup>76</sup> APIA submission, 26 April 2012, p2.

#### 6.4.4 Origin's submission

Origin submitted that it encourages the AER to take on board the AEMC's advice to consider the issue of rebating for AMDQ cc through the tariff variation mechanism in its assessment of the APA GasNet 2013–2017 revised access arrangement proposal. It submitted that the differing views of the AER and the AEMC on whether this rebating is occurring voluntarily or not indicates a lack of certainty on this issue. Ensuring that AMDQ cc volumes are included in the annual updates to the price control model would provide clarity which would benefit the AER, APA and market participants alike.<sup>77</sup>

Origin also suggested that in its review of the tariff variation mechanism, the AER should consider the blanket reduction in the reference tariff accessed by all users of the Victorian DTS resulting from any AMDQ cc rebating. Origin's concern was that this occurs irrespective of whether a particular user is a holder of AMDQ cc or not.<sup>78</sup>

Origin further submitted that the AEMC's draft determination did not acknowledge that Origin had raised several issues in its original submission. Origin submitted that acknowledging these issues in the final determination is important to maintain a robust and balanced decision making process. Two of these issues related to AMDQ cc and were:<sup>79</sup>

- ensuring that any change made maintains the commercial value of AMDQ cc; and
- improving the transparency of the AMDQ cc auction process.

#### 6.5 Consultation paper

In light of the AER's submission in response to the draft rule determination the Commission released a consultation paper on 13 September. It further examined the issues surrounding the rebating of revenue earned from the AMDQ cc bundled service. In the consultation paper, the Commission acknowledged that the AER considered that under the current NGR it would not be able to approve the inclusion of the current rebating mechanism in the next revised access arrangement for 2013–2017. It was noted that the AER's opinion is inconsistent with the Commission's draft determination and has created legal uncertainty about whether the AER is able to approve an access arrangement for the Victorian DTS that includes the current AMDQ cc revenue rebating process under the current provisions of the NGR. The Commission considered that this uncertainty is undesirable.<sup>80</sup>

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<sup>77</sup> Origin submission, 26 April 2012, p2.

<sup>78</sup> Origin submission, 26 April 2012, p2.

<sup>79</sup> Origin submission, 26 April 2012, p1.

<sup>80</sup> AEMC, Consultation paper, 13 September 2012, p20.

Also in light of the AER's submissions, the Commission considered the 'price effect' issue further. It noted that the demand for the AMDQ cc service is likely to increase over time as more capacity is added to the Victorian DTS. This means that the share of total revenue (that is, total revenue associated with the operation of the Victorian DTS) from AMDQ cc (which includes revenue from the 'price effect') is likely to increase and become more significant over time. It also noted that the revenue earned from the 'price effect' has not been included in the price control model rebate mechanism – it has been retained by APA GasNet.<sup>81</sup>

The consultation paper also set out a discussion on the apparent inconsistency in outcome between the Victorian DTS and other fully regulated pipelines in applying the NGR to the regulation of pipeline services. It noted that the regulation of most transmission pipelines includes services that represent the 'firm' transportation of gas. However, in the case of the Victorian DTS, regulation to date has not included services that offer some 'firmness' of supply. This outcome reflects differences in the operation of, and market design relevant to, the pipelines.<sup>82</sup>

Having had regard to these matters, the Commission proposed a rebateable service definition that applied only to pipeline services provided by means of the Victorian DTS. If implemented, this proposed rebateable service definition would allow rebateable services to be services in the same market as reference services. The Commission suggested that such a definition would provide a clearer avenue for the AER to take into account the revenues generated from AMDQ cc within the APA GasNet access arrangement framework.<sup>83</sup>

## **6.6 Third round of submissions**

### **6.6.1 AER's submission**

In response to the consultation paper, the AER stated that it maintains its view that the change to the rebateable service definition should be broader than the AEMC's proposal to limit the application of an amended definition to pipeline services provided by the Victorian DTS. That is, it reiterated its view that its proposed rebateable service definition should apply to all regulated pipelines.<sup>84</sup>

In addition, the AER considered that it is important that the AEMC clarifies whether a rule change is to apply to the 2013-2017 access arrangement period for APA GasNet which is currently being assessed by the AER. This was because the AER's rule change proposal was partly premised on how the current definitions of reference service and rebateable service would be applied in the current APA GasNet access arrangement assessment process, in the absence of a rule change that would allow AMDQ cc to be classified as a rebateable service. It is on this basis that the AER proposed that the rule

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<sup>81</sup> AEMC, Consultation paper, 13 September 2012, pp20-21.

<sup>82</sup> AEMC, Consultation paper, 13 September 2012, pp22-25.

<sup>83</sup> AEMC, Consultation paper, 13 September 2012, pp24-26.

<sup>84</sup> AER submission, 28 September 2012, p1.

change include a transitional provision.<sup>85</sup> The AER also noted that the AEMC will need to give careful consideration to the effect of clause 43 of schedule 2 of the NGL in its final rule determination. Clause 43 concerns the effect of repeal, amendment or expiry of a provision of the NGL, National Gas Regulations and the NGR. The AER suggested that clause 1 of schedule 2 of the NGL is of relevance.<sup>86</sup>

The AER submitted that, if the AEMC considers that a rule change should be able to be used in its current assessment of the Victorian access arrangements, a transitional provision should be included to this effect. It submitted that if the rule change could apply to the Victorian assessments and the AEMC intended for service providers to address the rule change in their revised proposals, it may be appropriate, as part of any transitional provisions, to allow additional time for service providers to submit those elements of their proposals that are affected by the rule change. Any extension would need to take into account the time limits that apply to the AER decision making process.<sup>87</sup>

The AER requested that the AEMC's final rule determination indicate when the rule change would be given effect in accordance with s. 314 of the NGL.<sup>88</sup>

## **6.6.2 APA's submission**

In response to the consultation paper, APA concluded that:<sup>89</sup>

- the case for the AEMC's proposed rule change has not been established;
- if the AEMC nonetheless determines to adopt its proposed rule then no transitional provisions should be included in the new rule that would allow it to apply to the 2013–2017 APA GasNet access arrangement period; and
- the process adopted by the AEMC for making of the proposed rule has been deficient and not in accordance with the requirements of the NGL.

These are discussed in detail below.

### **No case for making the proposed rule has been established**

APA identified a number of reasons why, in its opinion, the AEMC had not made a case for implementing its proposed rebatable service definition. In summary, these were:

- the allocation of AMDQ cc is already subject to effective regulation and the treatment of revenues for the APA GasNet 2013–2017 access arrangement period

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<sup>85</sup> AER submission, 28 September 2012, p1.

<sup>86</sup> AER submission, 28 September 2012, p2.

<sup>87</sup> AER submission, 28 September 2012, p2.

<sup>88</sup> AER submission, 28 September 2012, p2.

<sup>89</sup> APA submission, 5 October 2012, p1.

is already subject to appropriate commercial arrangements. In particular, Part 19 of the NGR includes rules on, among other things, the creation, allocation and transfer of AMDQ cc although there are no provisions relating to the pricing of AMDQ cc. Instead, the pricing of AMDQ cc has had regulatory oversight via the AER's review of the AMDQ cc tendering process.<sup>90</sup>

- the AEMC's consultation paper does not recognise that on contract carriage pipelines the majority of firm services are negotiated services and not reference services. That is, the service provider and the shipper have negotiated a set of terms and conditions, including price, that are not the terms and conditions of the reference service. As a result, unregulated revenue is generated and retained by the service provider. APA submitted that this situation is directly comparable to the retention of revenue due to the 'price effect' of AMDQ cc. In its view, the AEMC's conclusion that 'it would be reasonable to expect that the revenue derived from the sale of those rights would also be regulated' is unfounded.<sup>91</sup>
- while APA earns extra revenue from AMDQ cc in the short term from constraints in the pipeline system, in the longer term it has an incentive to make efficient investments in the pipeline system. The need for these investments is signalled by the demand for AMDQ cc (as there is no other signal in the Victorian market carriage system). APA considered that the Victorian DTS specific rebateable service will have a material adverse impact upon its willingness to invest which is not in the long term interests of consumers of gas. It argued that the AEMC should take this into account in assessing a change to the rebateable service definition.<sup>92</sup>
- the rule change to provide the AER the ability to accommodate a 'volume effect' rebate is not required as the 'volume effect' is of little consequence. Specifically, under the contractual arrangements APA GasNet takes payment for AMDQ cc in lieu of payment for flow based reference services (injection charges) up to the quantity purchased for injections at the relevant injection zone. During the 2008-2011 period APA GasNet rebated \$27.6 million consistent with its contractual obligations. This rebating is independent of the access arrangement provisions and the AER: it is based solely on contracts. However, the quantities injected by holders of AMDQ cc that are in excess of the AMDQ cc contract volumes are charged at the injection reference tariff and no rebate is provided for these quantities under contract. It is in relation to these excess quantities (the 'volume effect') that APA GasNet has rebated \$1.037 million over the 2008-2012 period. This is less than 0.25 per cent of the regulated revenue for the same period.<sup>93</sup>
- the tendering process (as well as the auctioning process) for AMDQ cc has been transparent. The ACCC and the AER have been consulted prior to the process

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90 APA submission, 5 October 2012, pp1-2.

91 APA submission, 5 October 2012, p2.

92 APA submission, 5 October 2012, p2.

93 APA submission, 5 October 2012, pp3-4.

and have been provided copies of terms and conditions for review prior to the commencement of the sale process. Each AMDQ cc holder receives invoices that demonstrate the 'offset crediting' (rebate) of the injection tariff.<sup>94</sup>

- the AEMC's consultation paper has misconstrued what the Victorian DTS reference service is and what level of 'firmness' exists in relation to it. In particular, APA stated that under the market carriage model it is the market operator that ensures that there is enough gas to meet demand and thus provides the 'firm' transportation of gas. This is not a right held by individual market participants who only bid for the right to inject gas into the system and not for the volumes of gas to be shipped. Thus, transportation on the Victorian DTS as a whole is 'firm' and there is no concept equivalent to the contract carriage 'non-firm'. In addition, the reference service is not a 'non-firm' service with AMDQ cc providing an increased 'firmness' of transportation. In this context, AMDQ cc are better viewed as providing a hedge for market participants against financial risks associated with exposure to the daily wholesale gas market price and exposure to congestion uplift payments.<sup>95</sup>
- while there is an increase in forecast revenue from the sale of AMDQ cc (that is, due to the 'price effect'), this has occurred due to a shortage of AMDQ cc relative to demand. The shortage of AMDQ cc is a direct result of a decision by the ACCC (the relevant regulator at the time) in 2008 not to approve the forecast expenditure for the Stonehaven compressor for the 2008–2012 access arrangement period. For the future, the AER's draft decision has approved the installation of an additional compressor on the South West Pipeline which will add 50TJ of additional AMDQ cc at the Port Campbell injection zone. This installed capacity will meet market needs (as confirmed by APA's canvassing of the marketplace) over the 2013–2017 access arrangement period.<sup>96</sup>

As the installed capacity will match market needs, the availability of AMDQ cc will meet demand and the price of AMDQ cc will fall (on the basis that the demand for AMDQ cc is about mitigating risk in the event of a system constraint). Therefore, there will not be (as suggested by the AEMC) an increase over the long term in the share of APA GasNet's revenue earned from the AMDQ cc service.<sup>97</sup>

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94 APA submission, 5 October 2012, p4.

95 APA submission, 5 October 2012, pp4-5.

96 APA submission, 5 October 2012, p5.

97 APA submission, 5 October 2012, p6.

## **AEMC is not authorised by law to make rules to apply to the 2013–2017 APA GasNet access arrangement**

APA stated that it is extremely concerned that the AEMC has foreshadowed the making of transitional provisions which would allow the operation and application of the amended rule to:<sup>98</sup>

- access arrangement reviews already in progress; and
- a period in which commercial arrangements have been entered into for AMDQ cc.

APA submitted that the AEMC does not have a legal basis upon which to make a rule that would affect actions that have been taken under the NGR prior to any amendment the AEMC may make in respect to the reference service and rebateable service definitions. The current APA GasNet access arrangement assessment process has not only begun but has passed the draft decision stage. Accordingly, any change in the rules governing the preparation of access arrangement proposals to apply to review processes which have already ‘begun’, would be in clear violation of clause 43(1) of schedule 2 of the NGL.<sup>99</sup>

In addition, APA also submitted that clause 43(1) of schedule 2 of the NGL precludes an amendment to a rule which affects the rights or liabilities accrued under the previous operation of that provision. If the definition of rebateable service under the NGR was to change and AMDQ cc became a rebateable service then APA GasNet could be required to make different rebating arrangements to those currently provided for under existing commercial arrangements. That a rule change could alter the nature of rights and liabilities under existing contractual arrangements represents an unacceptable regulatory risk and would be contrary to the principles set out in clause 43(1) of schedule 2 of the NGL.<sup>100</sup>

APA suggested that if the rebateable service definition were to be amended, this amended definition should not apply until 2018 (after the 2013-2017 period concludes).<sup>101</sup>

### **AEMC’s rule making process**

APA expressed concern that, in its view, the AEMC has not followed the proper procedure in relation to its rule change proposal. It suggested that the AEMC’s consultation paper represents a fundamental reversal of its position regarding the rebateable service definition from the draft determination and that the process adopted by the AEMC in doing so is a flawed, inconsistent and unacceptable practice for rule

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<sup>98</sup> APA submission, 5 October 2012, p6.

<sup>99</sup> APA submission, 5 October 2012, pp6-7.

<sup>100</sup> APA submission, 5 October 2012, pp6-8.

<sup>101</sup> APA submission, 5 October 2012, p8.

development and amendment.<sup>102</sup> APA submitted that it is unclear how the AEMC has reconciled its approach, as presented in the consultation paper, with its earlier view that changing the rebateable service definition would not be in the long term interests of consumers. To the extent that the AEMC proposes to make a more preferable rule of a type not previously foreshadowed, APA suggested that it is incumbent upon the AEMC to clearly set out a draft rule which it intends to make, and provide adequate consultation on this.<sup>103</sup>

APA also submitted that the inclusion of transitional provisions that purport to apply any amended definition of rebateable services to the APA GasNet access arrangement period 2013–2017 could have considerable commercial implications for APA, most importantly due to the potential impact on a number of existing long term contractual arrangements. Under these circumstances, APA considered that it would be inappropriate for the AEMC to proceed to a final rule which includes transitional provisions of the type contemplated in the consultation paper. It submitted that any final rule should only include provisions which have been subject to proper consultation.<sup>104</sup>

In addition, APA commented that it has been unable to definitively identify precisely what impact the proposed change to the rebateable service definition may have on existing contractual arrangements and on the APA GasNet 2013-2017 access arrangement assessment process. It submitted that the prudent course would be to delay the operation of any rule change until at least the next access arrangement period starting in 2018, in order to avoid the potential for retrospective effect.<sup>105</sup>

### **6.6.3 APIA's submission**

APIA expressed concern regarding the AEMC's rule making process, the incompleteness of the proposed rule as canvassed in the consultation paper, and the retrospective effect of the proposed rule if it were implemented.<sup>106</sup> APIA submitted that:

1. The process the AEMC has followed with the proposed rule change is a departure from the normal rule making process – not only does it set a worrying precedent but it may not be the correct process to be followed under the NGL. APIA considered that the AEMC's proposed rebateable service definition amounts to a new proposed rule change. That is, the consultation paper represents a significant variation from the more preferable rule that was set out in the draft determination. If the AEMC were to make an alternative preferable rule in the final determination that is substantially different to the preferred rule

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<sup>102</sup> APA submission, 5 October 2012, p8.

<sup>103</sup> APA submission, 5 October 2012, p9.

<sup>104</sup> APA submission, 5 October 2012, p10.

<sup>105</sup> APA submission, 5 October 2012, p9.

<sup>106</sup> APIA submission, 5 October 2012, pp1-2.

in the draft determination, then this would be inconsistent with good regulatory practice.<sup>107</sup>

2. The AEMC's proposed rule in the consultation paper is incomplete as it does not include the drafting of transitional arrangements that may be required if it is to be applied to the forthcoming revised access arrangements for the Victorian service providers. If the AEMC intends to address new matters in a final rule and the application of the final rule to access arrangement reviews already in progress, then the AEMC is required to publish a draft of the rule which it intends to make for public consultation.<sup>108</sup>
3. If implemented, the AEMC's proposed rebateable service definition would be retrospective in effect. By making transitional provisions so that the final rule could be applied to the APA GasNet access arrangement currently being reviewed would be beyond the power of the AEMC. Such retrospective rule making could undermine investor confidence. Therefore, it would be critical that any changes to the rules should be limited to prospective application and be implemented by following the process envisaged under the NGL.<sup>109</sup>

#### **6.6.4 Australian Power and Gas' submission**

Australian Power and Gas (APG) submitted that while it welcomes the positive step of providing greater flexibility to the AER in the amended definition of rebateable service for the Victorian DTS, it considers that this should also be extended to other pipelines.<sup>110</sup>

APG commented that with respect to the Victorian DTS, to the extent that APA GasNet has rebated additional revenue earned from unused AMDQ cc contract capacity against reference tariffs, it has not been transparent to the market. It considered that AMDQ cc revenues have not been appropriately dealt with to date. There should be greater scope to formally define AMDQ cc rebates in APA GasNet's tariff calculation. APG submitted that it regards the proposed changes to both definitions as a small step to provide greater clarity to defining AMDQ cc.<sup>111</sup>

#### **6.6.5 EnergyAustralia's submission**

EnergyAustralia (EA) (formerly TRUenergy) supported the AEMC's proposed change to the rebateable service definition. EA submitted that the reasons why it supported the AEMC's proposed change were that there is:<sup>112</sup>

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<sup>107</sup> APIA submission, 5 October 2012, pp2-3.

<sup>108</sup> APIA submission, 5 October 2012, p3.

<sup>109</sup> APIA submission, 5 October 2012, p4.

<sup>110</sup> APG submission, 5 October 2012, p1.

<sup>111</sup> APG submission, 5 October 2012, pp1-2.

<sup>112</sup> EA submission, 9 October 2012, pp2-3.

- legal uncertainty over whether the AER can approve an access arrangement that includes the current AMDQ cc revenue rebating mechanism in the price control model;
- likely to be an increase over the long term in the share of APA GasNet's revenue earned from unregulated AMDQ cc;
- forecast to be a significant increase in revenue due to the 'price effect' of AMDQ cc for the next period; and
- an inconsistent outcome between the Victorian DTS and other fully regulated pipelines.

EA suggested a further amendment to the draft rule. It proposed that an amendment be made that would require APA GasNet to deposit all of the revenue that is over-recovered from AMDQ cc in an investment fund. The money in the fund would be used to help pay for transmission augmentation (that is, netted off the capital cost) of the proposed associated infrastructure.<sup>113</sup> Those parties who paid for AMDQ cc would have ownership of the money invested in the fund. Where money from the fund was used to finance new infrastructure, the parties with an ownership in the fund would receive the resulting AMDQ cc's pro rata for financing the infrastructure. EA considered that its idea has merit especially given that the AEMC has argued that demand for the AMDQ cc service is likely to increase over time as more capacity is added to the Victorian DTS.<sup>114</sup> EA submitted that this idea could be developed further through a potential rule change that might be submitted in the future.<sup>115</sup>

#### **6.6.6 The Financial Investor Group's submission**

The Financial Investor Group (FIG) had similar concerns to those expressed by APIA about the AEMC's rule making process, the incompleteness of the proposed rule as canvassed in the consultation paper and the retrospective effect of the proposed rule if it were implemented.<sup>116</sup> These are summarised above in section 6.6.3.

### **6.7 Commission's final analysis**

The Commission has considered the arguments put forward in stakeholder submissions to the draft rule determination and the consultation paper in relation to the impact of the AER's proposed change to the rebateable service definition on the Victorian DTS. The Commission developed the alternative proposal to amend the rebateable service definition (as presented in the consultation paper) that was only applicable to the Victorian DTS as an option for stakeholders to consider. This was in

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<sup>113</sup> That is, the infrastructure that would result in the creation of the additional AMDQ cc as the same type as resulted in the original over-recovery.

<sup>114</sup> EA submission, 9 October 2012, p3.

<sup>115</sup> EA submission, 9 October 2012, p4.

<sup>116</sup> FIG submission, 9 October 2012, pp1-3.

response to particular concerns raised by the AER in the context of its current assessment of the proposed revisions to the APA GasNet access arrangement for the period 2013–2017. It is now clear, as discussed in Chapter 8, that any changes to the rebateable service definition (or for that matter, to the reference service definition) cannot apply to the access arrangements currently under consideration by the AER.

In light of submissions made in response to the consultation paper, the Commission has further considered the arguments for changing the rebateable service definition in relation to the Victorian DTS that have been put to it at this stage. The Commission has decided not to amend the definition having had regard to some of the key arguments made that address the nature of the AMDQ cc service and its effect as an investment signal. In addition, the Commission acknowledges that there are significant differences in the way a market carriage pipeline (such as the Victorian DTS) operates compared to a contract carriage pipeline and that the 'firmness' of gas transportation has a different concept in market carriage compared to contract carriage.

The Commission notes that through the tender process APA GasNet provides users with an opportunity to purchase AMDQ cc contractual rights. APA has compared its retention of AMDQ cc revenue due to 'price effect' with revenue that a service provider may receive from a negotiated service on a contract carriage pipeline. However, users do not appear to have an opportunity to negotiate terms and conditions and prices through the AMDQ cc tender process. Under the AMDQ cc tender process users are provided with the opportunity to nominate volumes that they wish to contract for. In contrast, for negotiated services on a contract carriage pipeline users have the opportunity to negotiate terms and conditions, prices and contract quantities.

APA has stated that it is in favour of reverting to an auction process for the sale of AMDQ cc rights so long as there are no distortions on the supply and availability of AMDQ cc. This, APA submitted, would be consistent with the AER's view that an auction process for the sale of AMDQ cc rights would be efficient and consistent with the NGO and the revenue and pricing principles. Although the application of an auction process to the sale of AMDQ cc may warrant further consideration, it is beyond the scope of this rule change for it to consider such a process in the context of the rebateable service definition.

With respect to the issue of whether or not AMDQ cc provides a signal for investment on the Victorian DTS, the Commission acknowledges that there are differing views on this matter. This may be a reflection on how different parties have perceived AMDQ cc over the years since their inception in the MSO rules in 2000. It is understood that APA use the demand of AMDQ cc as an investment signal. In addition, the AER's recent draft decision comments that the pricing of AMDQ cc through the tender process is efficient and that it provides an investment signal in terms of the cost of network capacity constraints.<sup>117</sup>

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<sup>117</sup> AER, *Draft decision, APA GasNet Australia (Operations) Pty Ltd, access arrangement, 2013–2017*, September 2012, Part 2 attachments, p13.

The Commission considers that based on the sometimes conflicting evidence presented, the link between AMDQ cc and investment is unclear. In this regard, EnergyAustralia's suggestion of establishing an investment fund to be financed directly from revenue that is over-recovered from AMDQ cc is of interest. Such a fund could establish a direct link between revenues earned from AMDQ cc (due to the 'volume effect' and 'price effect') and future investments in the pipeline system aimed at increasing capacity. However, at present, it is beyond the scope of this rule change process to consider establishing such an investment fund in the context of the rebateable service definition.

The Commission notes that APA has not directly responded to the AER's calculation that the revenue earned due to the 'price effect' could total \$27.5 million over the 2013–2017 period. However, APA has stated that the expected increase in revenue from the 'price effect' of AMDQ cc for the 2013–2017 period is a result of the shortage of AMDQ cc and that this shortage is due to the ACCC not approving the forecast capital expenditure to increase the capacity of the South West Pipeline in its 2008 access arrangement decision.

The Commission also notes, that APA considers that the addition of new capacity by the installation of compression on the South West Pipeline will meet expected market demand over the 2013–2017 period, and that this in turn will place downward pressure on AMDQ cc prices in the long term. That is, as APA GasNet expands the pipeline system to meet forecast demand, more capacity is added to the system. This allows APA GasNet to create additional AMDQ cc to be offered by tender. However, as pipeline capacity has been increased there is less likelihood of the system being constrained (at least until all the available capacity has been fully utilised). This means that it is less attractive for users to hold AMDQ cc (as there is less value in holding a hedge against the risk of constraint) resulting in less demand for these certificates. This will feed back to APA GasNet limiting its ability to price AMDQ cc above the reference tariff, thereby reducing the 'price effect'.

Therefore, once new capacity such as the expected expansion of the South West Pipeline is added to the system, the issue of the 'price effect' should become less relevant as the price of AMDQ cc should fall back to a level that is close to the reference tariff. In this way, fluctuation in the 'price effect' functions as an indicator of the level of pipeline constraint and the need for investment.

The Commission also notes APA's submission that it considers the AER's inability to approve a rebate mechanism in the APA GasNet access arrangement that accommodates the revenue earned from the 'volume effect' is of little consequence. This is because APA considers that the revenue earned from the 'volume effect' is insignificant.

With respect to the two issues raised by Origin, the Commission considers that because it is not making the proposed change to the rebateable service definition, then it does not need to consider the impact of such a change on the commercial value of AMDQ cc. Also, as discussed above, the Commission considers that it is beyond the scope of this rule change for it to consider an auction process for the sale of AMDQ cc

in the context of the rebateable service definition. Nevertheless, these matters are not irrelevant to the broader question of how alternative services offered by pipeline service providers relate to the regulatory framework of the NGR.

As to the AER's request that the Commission consider making transitional provisions and stakeholders concerns that to do so could be considered as retrospective rule making, because the Commission has decided to delay the commencement of the rule as made until 2 May 2013 (as discussed in Chapter 8) this issue is no longer of immediate relevance. Similarly, stakeholders' concerns that the AEMC has not followed the correct rule making process by not allowing for consultation on any proposed transitional provisions is no longer of immediate relevance as the Commission has decided not to make transitional provisions in this instance (this is discussed further in Chapter 8).

## **6.8 Commission's final conclusion**

The Commission considers that at this stage a change to the rebateable service definition, as either proposed by the AER or as canvassed in the consultation paper, should not be made in respect of the Victorian DTS.

On balance and after considering the issues raised by APA, the Commission considers that there is not a sufficiently strong enough case for making a change to the rebateable service definition that applies to pipeline services provided by means of the Victorian DTS. In considering a rule change, the Commission must be satisfied that the rule (if made) will, or is likely to, contribute to the achievement of the NGO. In the case of making a change to the rebateable service definition that applies to the Victorian DTS, the Commission is not satisfied that such a change will, or is likely to contribute to the achievement of the NGO.

The Commission considers that any reduction in price that may result from this proposed change would only be marginal and that it may be counter-productive to the long term interests of consumers with respect to security of gas supply if it is the case that the sale of AMDQ cc rights provides an signal for future investment on the Victorian DTS.

Having said this, the Commission recognises that there may be a concern that APA GasNet could retain revenue earned from AMDQ cc that is above its efficient pipeline costs, but not sufficiently invest to expand the capacity of the pipeline system to meet expected market demand. The Commission notes that the link between the provision of the AMDQ cc service and incentives for investment on the Victorian DTS is not clear and that there have been divergent views on this at different times. The inability to come to a consensus on this matter, may reflect differences in regulating pipeline services on the Victorian DTS as a market carriage pipeline compared to regulating pipeline services on a contract carriage pipeline. However, further consideration of the implications in accommodating these two different market designs into the one economic regulatory framework is beyond the scope of this rule change.

## **7 Rebateable service definition in relation to other fully regulated pipelines**

The AER's rule change proposal included an amended rebateable service definition that would apply to all fully regulated pipelines. In assessing this proposal the Commission has found that amending the rebateable service definition may have a different impact on a contract carriage pipeline compared to a market carriage pipeline. As a result, the Commission has assessed the AER's proposed rebateable service definition, as well as an alternative definition, separately for contract carriage pipelines and market carriage pipelines.

In the context of contract carriage pipelines (that is, pipelines other than the Victorian DTS), the Commission retains its approach, expressed in the draft determination, to not amend the rebateable service definition. It is not satisfied that a change would, or would be likely to, contribute to the achievement of the NGO and be in the long term interest of consumers of gas.

This chapter discusses the issues concerning the AER's proposed change to the rebateable service definition in relation to fully regulated contract carriage pipelines. This chapter discusses:

- the AER's rule change request as it relates to other fully regulated pipelines;
- stakeholders' views in the first round of consultation;
- the Commission's conclusion reached in the draft rule determination;
- stakeholders' views in the second round of consultation;
- the Commission's consideration of issues raised in the second round of submissions as presented in the consultation paper;
- stakeholders' views in the third round of consultation; and
- the Commission's final analysis and conclusion.

### **7.1 The rule change request**

In its rule change request, the AER discussed the benefit of its proposed change to the rebateable service definition in relation to pipeline services such as backhaul and interruptible, which may be offered on pipelines other than the Victorian DTS (that is, contract carriage pipelines). The AER submitted that the proposed amendments are required to allow revenue to be rebated (if appropriate) when considering services of significant uncertain demand or uncertain revenue such as backhaul and interruptible services.

By way of example, the AER cited the ACCC's assessment of the reference service in the 2006 draft decision on the RBP access arrangement. The AER argued that if the

ACCC had made its assessment under the current rules, it may not have been able to define services (such as backhaul) as rebateable services if the ACCC had considered that these services were not in a substantially different market to the forward haul reference service.<sup>118</sup>

## 7.2 First round of submissions

In the first round of submissions a number of service providers expressed concern about the impact of the AER's proposed change to the rebateable service definition on pipelines other than the Victorian DTS. These concerns related to:

- the impact on existing contracts; and
- the precedence of the proposed rule over the fixed principle in the Dampier to Bunbury Natural Gas Pipeline (DBNGP) access arrangement.

Stakeholders' views on these two issues are discussed below.

### 7.2.1 The impact on existing contracts

APIA, APA and DBP were concerned that the proposed change to the rebateable service definition could lead to a change in the risk/reward relationship in bilateral contracts between service providers and users in relation to other (that is, not the Victorian DTS) fully regulated pipelines. These concerns related to the possible triggering of the 'most favoured nation' clause in bilateral contracts.<sup>119</sup>

A 'most favoured nation' clause provides that if the tariff for the pipeline service on offer to other users is less than that agreed to in the contract, then the lower tariff will also apply to the contract.<sup>120</sup>

If the requirement in the current rebateable service definition that the market for the rebateable service be substantially different to that of the reference service was removed, then these different services could be in the same market. Service providers have suggested that this would mean that there would be more services that could fall within the definition of a rebateable service. A greater likelihood that a rebateable service will be identified for a pipeline would make it more likely that a rebate resulting in a reduction to the reference tariff would occur. This could trigger the 'most favoured nation' clause in any existing bilateral contracts for the pipeline.<sup>121</sup>

APA submitted that the resulting reduction in revenues could jeopardise the operation of, and investment in, the pipeline and increase risks for a service provider, leading to

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<sup>118</sup> AER rule change proposal, 5 August 2011, pp15-16.

<sup>119</sup> APIA submission, 3 November 2011, p3; APA submission, 3 November 2011, p3; and DBP email, 3 January 2012.

<sup>120</sup> AEMC, Draft rule determination, 15 March 2012, p27.

<sup>121</sup> AEMC, Draft rule determination, 15 March 2012, p27.

a fundamental change in the risk/reward relationship inherent in the contracts between shippers and service providers.<sup>122</sup>

In discussions with the AEMC, APA acknowledged that the 'most favoured nation' clause could be triggered irrespective of whether the rebateable service was in the same market as the reference service or not. However, the requirement in the current rule that these services be in different markets reduces the likelihood of a 'most favoured nation' clause being triggered or, if it is triggered, minimises its impact.<sup>123</sup>

Consequently, there is currently a small risk of a rebate to a reference tariff ultimately impacting on existing contracts. However, this level of risk is able to be managed because:<sup>124</sup>

- as the rebateable service is not a reference service by definition, then it is likely to be a minor service if it is not in the same market as the reference service. This is because the definition of a reference service requires that a reference service is likely to be sought by a significant part of the market; and
- if the rebateable service is a minor service then it is unlikely to generate a material level of revenue. Hence, the rebate to users of the reference service will be small resulting in a minor reduction in the reference tariff and an immaterial impact on the 'most favoured nation' clause (if it is triggered at all).

## **7.2.2 Precedence over the fixed principle in the DBNGP access arrangement**

DBP submitted that if the proposed change to the definition of a rebateable service is made then it will take precedence over the fixed principle<sup>125</sup> in the DBNGP access arrangement. The fixed principle prevents the ERA from 'clawing back' any revenue that DBP might earn from the sale of pipeline services that is in excess of the total revenue set under the access arrangement.<sup>126</sup>

It also submitted that the 'firm' full haul capacity on the DBNGP is fully contracted under contracts and services that are outside the framework of the NGR and NGL. In addition, as the tariffs negotiated under these contracts were fundamental to the purchase of the DBNGP in 2004, then any 'clawing back' of revenues earned under these contracts could have extreme adverse effects on DBNGP investment.<sup>127</sup>

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<sup>122</sup> APA submission, 3 November 2011, p3.

<sup>123</sup> AEMC, Draft rule determination, 15 March 2012, p27.

<sup>124</sup> APA email, 21 December 2011.

<sup>125</sup> A full access arrangement may include a principle declared in the access arrangement to be fixed for a stated period of time extending over two or more access arrangement periods (NGR, rule 99).

<sup>126</sup> DBP submission (public version), 3 November 2011, pp1-2.

<sup>127</sup> DBP submission (public version), 3 November 2011, pp1-2.

### 7.3 Draft rule determination

In the draft rule determination the Commission discussed the two detrimental impacts that were identified by stakeholders about the AER's proposed change to the rebateable service definition on contract carriage pipelines. In assessing both of these impacts the Commission considered that the AER's proposed change may alter the risk/reward relationship between users and the service provider and expose the service provider to greater financial and regulatory uncertainty and risk. The Commission concluded that this may lead to an increase in investment risk which could result in inefficient investment in pipeline services and may not be in the long term interests of consumers.<sup>128</sup>

With respect to the first issue – the triggering the 'most favoured nation' clauses in existing contracts, the Commission concluded that the risk and impact of this occurring under the current rule is minimised by the requirement that the market for a rebateable service be substantially different to the market for the reference service.

The practical impact of removing this requirement (as sought by the AER) would be to potentially expose service providers to increased investment risk by allowing rebateable and reference services to be in the same market. Reductions in the reference tariff due to rebateable services being in the same market, may trigger a 'most favoured nation' clause in existing contracts. If this were to happen, then revenues from existing contract customers may be reduced and service providers may be exposed to greater financial and investment risk. This would be because the risk/reward relationship arising from the AER's proposed rule would be different (riskier) than what is inherent in existing contracts under the current rules. This may impact on the ability or willingness of service providers to make new investments in pipeline infrastructure. If this were to result in less efficient investment than may have otherwise occurred, then it may limit the service provider's ability to meet the demand of consumers.<sup>129</sup>

The second issue concerning stakeholders was the possible impact of the AER's proposed rebateable service definition on the DBNGP. In regard to the DBNGP fixed principle, the Commission concluded that if the proposed rule was made then it may be interpreted as taking precedence over the fixed principle and as a result the fixed principle would no longer apply. If this were the case, DBP may be exposed to greater regulatory uncertainty and greater financial risk than it, its users and financiers have taken into account when establishing their current contracts. This in turn may impact on the service provider's ability or willingness to invest in the currently anticipated pipeline expansions. This is unlikely to be in the long term interests of consumers if future demand is not met.<sup>130</sup>

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128 AEMC, Draft rule determination, 15 March 2012, pp13-14.

129 AEMC, Draft rule determination, 15 March 2012, pp13, 28.

130 AEMC, Draft rule determination, 15 March 2012, pp13-14.

## 7.4 Second round of submissions

### 7.4.1 AER's submissions

In response to the draft rule determination, the AER disagreed with the Commission's conclusion on both issues relating to contract carriage pipelines.<sup>131</sup> The views expressed by the AER were supported by legal advice.

The AER submitted that any increase in risk following the change to the rebateable service definition would be taken into account by the AER in its consideration and it affording appropriate weight to this risk when exercising its discretion taking into account the NGR and the revenue and the revenue and pricing principles.<sup>132</sup> It also submitted that it is obligated to consider such risks in accordance with the NGL, regardless of the definition of rebateable service.<sup>133</sup>

Regarding the DBNGP fixed principle, the AER considered that if the proposed change was made to the rebateable service definition, it would not take precedence over the fixed principle. Rather, rule 99(3) of the NGR would act to protect the fixed principle.<sup>134</sup>

In addition and in broader terms, the AER submitted that its proposed rule change was necessary to address issues relating to emerging pipeline services (such as backhaul and interruptible) on pipelines other than the Victorian DTS which are likely to become more significant.<sup>135</sup> By way of example, the AER referred to three stakeholder submissions to the RBP 2012–2017 access arrangement proposal which identified issues arising from new pipeline services.<sup>136</sup>

In addition, the AER made a supplementary submission responding to DBP's supplementary submission (discussed below). In this submission, the AER disputed DBP's conclusion that there is doubt about the role that the revenue and pricing principles play in the AER's decision making process. It also disputed the suggestion that the AER could exercise its discretion in any decision to determine whether a service was rebateable or not without regard to the revenue and pricing principles.<sup>137</sup>

The AER's supplementary submission also commented on the DBNGP fixed principle. The AER submitted that its legal advice had concluded that the inconsistency referred to in rule 99(4)(b) of the NGR is between 'a rule' and a fixed principle. That is, it is not

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<sup>131</sup> AER submission, 27 April 2012, pp7-11 and AER supplementary submission, 15 June 2012, pp2-5.

<sup>132</sup> AER submission, 27 April 2012, p9.

<sup>133</sup> AER submission, 27 April 2012, p9.

<sup>134</sup> AER submission, 27 April 2012, p11.

<sup>135</sup> AER supplementary submission, 15 June 2012, p1.

<sup>136</sup> AER submission, 27 April 2012, pp4-5.

<sup>137</sup> AER supplementary submission, 15 June 2012, p4.

an inconsistency between a determination made by the regulator in accordance with the NGR and a fixed principle which the AER understood DBP had suggested.<sup>138</sup>

#### **7.4.2 APA's submission**

APA submitted that the AER's rule change proposal had focussed on the unique arrangements in Victoria, and did not address the potentially significant unintended consequences for other pipelines. It considered that retaining the current definition of rebateable services maintains the current risk/reward balance in relation to triggering 'most favoured nation' clauses, which the gas industry has managed through bilaterally negotiated contracts to date.<sup>139</sup>

#### **7.4.3 APIA's submission**

APIA submitted that it strongly supported the draft determination to not to change the definition of a rebateable service. It submitted that it shared the AEMC's concerns that a change to the rebateable services definition risks unintended consequences for service providers on pipelines other than the Victorian DTS.<sup>140</sup>

#### **7.4.4 DBP's submissions**

DBP made one submission in response to the draft rule determination and two supplementary submissions in response to the AER's submissions. In these submissions DBP agreed with the Commission's conclusion on the unintended consequences the AER's proposal may have on investment incentives for other pipelines.<sup>141</sup> The views expressed by DBP were supported by legal advice.

In its supplementary submission in response to the AER submission, DBP made two comments on the 'most favoured nation' issue. These were that:<sup>142</sup>

- there is a subtle but important distinction between the drafting of the Gas Code provisions (section 2.24(b)) and the NGL provisions (ss. 24(6) and 28(2)) that suggests that the NGL provisions could be interpreted to mean that the regulator may not have to give fundamental weight to the principle of the economic costs and risks of the potential for under and over investment and instead, the regulator only has to have regard to the principle; and
- it is not appropriate to establish a regime where it is left to the regulator to exercise its discretion in a way that may trigger 'most favoured nation' clauses in existing contracts.

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138 AER supplementary submission, 15 June 2012, p5.

139 APA submission, 26 April 2012, p2.

140 APIA submission, 26 April 2012, p2.

141 DBP submission, 26 April 2012, p1; DBP supplementary submission, 11 May 2012, p1; DBP supplementary submission, 13 July 2012, p1.

142 DBP supplementary submission, 11 May 2012, p3.

DBP submitted that the bilateral contracts containing 'most favoured nation' clauses were negotiated between the parties on the understanding that the trigger events of those 'most favoured nation' clauses could only result from the actions of the service provider. To allow a third party's actions (in this instance, the regulator) the ability to trigger a 'most favoured nation' clause drastically alters the risk/reward balance in these contracts. Had the parties contemplated that 'most favoured nation' clauses could be triggered by third parties, the risk/reward balance would have been structured differently to account for this different scenario. Without that restructuring, the adoption of the AER's rebateable service definition would most likely to create an adverse impact on investment incentives.<sup>143</sup>

DBP also addressed the AER's views on whether the DBNGP is protected by the NGR. DBP submitted that the AER had taken a narrow view of the operation of rule 99(3) in isolation of how that interpretation may be altered in the context of the remaining provisions of rule 99 of the NGR. DBP concluded that the proposed rule change should be rejected because:<sup>144</sup>

- it would permit the regulator to make a determination that a particular service, which is negotiated outside the regulatory framework and currently subject to the fixed principle and so excluded for the purposes of the NGR, is a rebateable service; and
- there is a relevant inconsistency between the operation of the rule and the fixed principle, at the time that such a regulatory determination is made.

DBP reiterated that if the AER's proposed rebateable service definition was implemented, there is a risk that the operation of the rule would be inconsistent with the fixed principles in the DBNGP access arrangement. Accordingly under rule 99(4)(b) of the NGR, and notwithstanding rule 99(3) of the NGR, the rule would operate to the exclusion of the fixed principle.<sup>145</sup> That is, the rebateable service definition could be applied to the DBP access arrangement and override the existing fixed principle.

#### **7.4.5 Origin's submission**

As previously discussed in section 6.4.4, Origin considered that the AEMC did not acknowledge that it had raised several issues in its original submission. One of these issues was that the AEMC should assess the full range of potential consequences of the proposed change beyond the AER's intended scope to ensure no unintended applications arise. Origin submitted that acknowledging this issue in the final determination is important to maintain a robust and balanced decision making process.<sup>146</sup>

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<sup>143</sup> DBP supplementary submission, 11 May 2012, p3.

<sup>144</sup> DBP supplementary submission, 13 July 2012, p4.

<sup>145</sup> DBP supplementary submission, 13 July 2012, p4.

<sup>146</sup> Origin submission, 26 April 2012, p1.

## 7.5 Consultation paper

In the consultation paper, the Commission concluded that to date, the potential benefits of applying the AER's proposed rebateable service definition to regulated pipelines other than the Victorian DTS had not been demonstrated to outweigh the potential costs. Accordingly, the Commission did not consider that the AER's proposed rebateable service definition should apply to these pipelines.<sup>147</sup>

In reaching this conclusion, the Commission noted that in order to assess whether a proposed rule change is required and satisfies the NGO, it must weigh up the potential benefits of making the proposed change against the potential costs. In relation to regulated contract carriage pipelines, the Commission weighed up the potential benefits of applying the AER's proposed rebateable service definition against the potential costs of doing so. In terms of the potential benefits:<sup>148</sup>

- the Commission had not been provided with any clear evidence that pipeline users are requesting that certain pipeline services ought to be classified as rebateable services; and
- non-reference services can be specified as negotiated services in an access arrangement. The revenue from which must be taken into account when determining the revenue to be allocated to reference services.

In terms of the potential costs, the Commission considered that the application of the AER's proposed rebateable service definition to regulated pipelines other than the Victorian DTS would generate regulatory uncertainty that could deter investment. Specifically, that service providers would be exposed to regulatory uncertainty about the treatment of pipeline services each time their access arrangements were assessed by the regulator. Such uncertainty could also impact on the provision of services that are negotiated with users. This may not be conducive to efficient investment in, or the provision of natural gas services and ultimately would not be in the long term interests of consumers.<sup>149</sup>

The Commission expressed concern in the consultation paper, that there is a significant difference of opinion on the potential impact the AER's proposed rebateable service definition may have on existing contractual arrangements for pipelines other than the Victorian DTS. Despite the differing opinions, there appeared to be no new argument to suggest that the decision to not implement the AER's proposed rebateable service definition (as set out in the draft determination) is not appropriate under the circumstances.<sup>150</sup>

In terms of the potential benefits, the Commission considered that insufficient analysis and evidence to support the AER's view on the need to apply its proposed rebateable

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147 AEMC, Consultation paper, 13 September 2012, p14.

148 AEMC, Consultation paper, 13 September 2012, p14.

149 AEMC, Consultation paper, 13 September 2012, p14.

150 AEMC, Consultation paper, 13 September 2012, p12.

service definition to pipelines other than the Victorian DTS, had been provided to date. The Commission was not satisfied that the arguments made by the AER on the broader need for its proposed amendment to the rebateable service definition were supported by clear and convincing evidence.<sup>151</sup>

In reaching this conclusion the Commission noted that:<sup>152</sup>

- while a number of pipeline services (such as backhaul, interruptible and park and loan services) could be considered as rebateable services, these services may also be offered as negotiated services. Under the RBP access arrangement, negotiated services may be offered where a prospective user's requirements and circumstances vary from the conditions of the reference service. This could include where the prospective user seeks access to capacity other than the existing capacity. In these circumstances, the prospective user may seek to negotiate different terms and conditions (including a tariff), as a negotiated service;<sup>153</sup>
- stakeholder submissions on the proposed RBP access arrangement for 2012–2017 have argued that the AER should consider certain pipeline services (intra-day nominations, as available and backhaul) as reference services. Alternatively, the AER should consider that the revenue from such services be included in the regulated revenue.<sup>154</sup> That is, these stakeholders were not specifically requesting that the services should be rebateable services; and
- the NGR clearly requires total revenue and costs to be allocated between reference services and other services.<sup>155</sup> 'Other services' are not just restricted to rebateable services, but may also include services that are negotiated.

## 7.6 Third round of submissions

### 7.6.1 AER's submission

In response to the consultation paper, the AER submitted that it maintains its view that its change to the rebateable service definition should apply more broadly than the AEMC's proposed restricted application to pipeline services provided by the Victorian DTS.<sup>156</sup>

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<sup>151</sup> AEMC, Consultation paper, 13 September 2012, p13.

<sup>152</sup> AEMC, Consultation paper, 13 September 2012, pp13-14.

<sup>153</sup> APT Petroleum Pipelines Limited, *Access arrangement for Roma Brisbane Pipeline*, effective 1 September 2012 – 30 June 2017, August 2012, p8.

<sup>154</sup> AER submission, 27 April 2012, pp4-5.

<sup>155</sup> NGR, rules 93(1) and 93(2).

<sup>156</sup> AER submission, 28 September 2012, p1.

## 7.6.2 Australian Power and Gas' submission

As previously discussed in section 6.6.4, APG considered that the AEMC's proposed definition of rebateable services as set out in the consultation paper should be extended to pipelines other than the Victorian DTS. It considered that the amended definition should apply to services that are currently ambiguous, or fall outside regulatory treatment when they clearly should not. APG submitted that as it is a shipper on the RBP, it is aware of the challenges of contracting for non-regulated services with a monopoly provider.<sup>157</sup>

APG referred to its submission to the AER's recent consultation on the RBP access arrangement. In that submission it had questioned the extremely high and punitive imbalance/variance charges that were accepted by the AER. APG considered that it is problematic that the intra-day nomination service (which provides flexibility to shippers to effectively manage nominations and avoid excessive variance charges) falls outside the scope of regulatory oversight. In its view, the charge is excessively high and punitive. APG considered that it is penalised either way in managing the risk in a complex, single pipeline environment presented by the STTM in Queensland.<sup>158</sup>

Consequently, APG considered that it is important that the AER is given flexibility to determine whether other services that derive revenue on pipelines (such as those on the RBP) should be classified as reference services or rebated against reference services. This type of regulatory oversight would indicate if the charges are excessive or are cost reflective. Further, APG submitted that this approach would ensure that revenues derived from complimentary or auxiliary services on wholly regulated pipelines are fair and transparent.<sup>159</sup>

## 7.6.3 EnergyAustralia's submission

EnergyAustralia submitted that it agreed with the AEMC that there has not been sufficient evidence to support the argument that the rebateable service definition should be changed for regulated pipelines other than the Victorian DTS.<sup>160</sup>

## 7.7 Commission's final analysis and conclusion

The Commission has considered the various arguments put forward in stakeholder submissions to the draft rule determination and the consultation paper in relation to potential changes to the rebateable service definition for pipelines other than the Victorian DTS. However, the Commission maintains its view that to date, the potential benefits of applying the AER's proposed rebateable service definition to regulated pipelines other than the Victorian DTS have not been demonstrated to outweigh the potential costs. Accordingly, and for the reasons previously discussed, the Commission

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<sup>157</sup> APG submission, 5 October 2012, pp1-2.

<sup>158</sup> APG submission, 5 October 2012, p2.

<sup>159</sup> APG submission, 5 October 2012, p2.

<sup>160</sup> EA submission, 9 October 2012, p3.

does not consider that the AER's proposed rebateable service definition should apply to these pipelines.

In relation to intra-day nominations (or intra-day renominations) on the RBP, the Commission considers that APG has not provided sufficient evidence to support its view that the rebateable service definition should be changed for contract carriage pipelines. In particular, no evidence has been presented as to how the key change in the AER's proposed rebateable service definition (that is, removing the requirement that the market for a rebateable service be substantially different to that of the reference service) could impact on the AER's regulatory treatment of intra-day nominations. The Commission notes the following about intra-day nominations on the RBP:

- intra-day nominations are included in the nominations specified under the transportation agreement where the user requests the service provider to transport gas to the Brisbane hub of the short term trading market under the applicable service;<sup>161</sup>
- the service provider, APT Petroleum Pipelines Pty Limited, is not presently charging users for intra-day renominations and has forecast no revenue from this service over the 2012–2017 access arrangement period. The AER has acknowledged that once the service provider starts charging users for this service, the level of revenue that is expected to be derived will be relatively small;<sup>162</sup> and
- the AER considered that on the basis of the information available to it, it does not appear that intra-day renomination services for the RBP are likely to be sought by a significant part of the market.<sup>163</sup>

As noted above in section 7.4.5, Origin has stated that the Commission should assess the full range of potential consequences of the proposed change beyond the AER's intended scope to ensure no unintended applications arise. The Commission considers that it has given sufficient consideration to the issues raised by stakeholders in assessing the potential impact of the proposed rule change on contract carriage pipelines.

It is acknowledged that the possible implications for service providers and users of contract carriage pipelines in changing the rebateable service definition may be quite different to the possible implications for the Victorian DTS. The Commission's analysis has drawn out a number of complex and related issues. Accordingly, at this stage and on the evidence presented, the Commission is not satisfied that the potential benefits of making the AER's proposed change to the rebateable service definition outweighs the potential costs.

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<sup>161</sup> APT Petroleum Pipelines Pty Limited, *Roma to Brisbane Pipeline access arrangement, effective 1 September 2012–30 June 2017*, August 2012, schedule 2, p10.

<sup>162</sup> AER, *Draft decision, APT Petroleum Pipelines Pty Limited, Roma to Brisbane Pipeline access arrangement, 2012–2013 to 2016–2017*, April 2012, pp84-85.

<sup>163</sup> AER, *Draft decision, APT Petroleum Pipelines Pty Limited, Roma to Brisbane Pipeline access arrangement, 2012–2013 to 2016–2017*, April 2012, p84.

## 8 Commencement of the rule as made

In its consultation paper, the Commission invited stakeholders to comment on the need for, and details, of transitional arrangements if the final rule was to apply to access arrangements that are currently being assessed by the AER.<sup>164</sup> After considering stakeholder views on this matter, the Commission has concluded that the most appropriate course of action in this instance is to specify that the final rule will commence on 2 May 2013. The reasons for this decision, taking into account stakeholders' views are discussed in this chapter.

### 8.1 AER's view

The AER submitted that, if the AEMC considers that a rule change should apply to the forthcoming access arrangement period (that is, 2013–2017) currently under assessment, a transitional provision should be included in the NGR to this effect. It submitted that if the rule change were to apply to the 2013–2017 (Victorian distribution and APA GasNet) access arrangements and the AEMC intended for service providers to address the rule change in their revised proposals, it may be appropriate as part of any transitional provisions to allow additional time for service providers to submit those elements of their proposals that are affected by the rule change. Any extension would need to take into account the time limits that apply to the decision making process.<sup>165</sup>

The AER also submitted that in considering the need for transitional provisions the AEMC would need to carefully consider the effect of clause 43 of schedule 2 of the NGL in its final rule determination.<sup>166</sup>

### 8.2 Other stakeholders' views

In response to the consultation paper, a number of stakeholders expressed concern that the AEMC would include transitional provisions in a final rule that would enable it to be applied to access arrangements that are currently being assessed by the AER. Stakeholders were concerned that:<sup>167</sup>

- transitional provisions that enable the final rule to be applied to access arrangements currently being assessed, could be considered as retrospective rule making;

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<sup>164</sup> AEMC, Consultation paper, 13 September 2012, p26.

<sup>165</sup> AER submission, 27 April 2012, p12 and AER submission, 28 September 2012, p2.

<sup>166</sup> AER submission, 28 September 2012, p2.

<sup>167</sup> APA submission, 5 October 2012, pp1, 6-8; APIA submission, 5 October 2012, pp1-4; and FIG submission, 9 October 2012, pp1-3.

- any change in the rules governing the preparation of access arrangement proposals to apply to review processes which have already ‘begun’, would be in clear violation of clause 43(1) of schedule 2 of the NGL;
- there is unacceptable regulatory risk where a rule change could alter the nature of rights and liabilities under existing contractual arrangements. This would be contrary to the principles set out in clause 43(1) of schedule 2 of the NGL;
- the process that the AEMC has followed for making the rule is deficient and not in accordance with the NGL. If the AEMC considers making transitional provisions, then the proposed rule including transitional provisions should be published in draft form for comment; and
- in effect, the consultation paper has replaced the draft determination given the significant variation of the proposed rule to the more preferable rule that was set out in the draft determination.

### 8.3 Commission's conclusion

#### 8.3.1 Commencement date

The Commission has concluded that it will not make transitional provisions for the rule as made so that the rule could be applied to the APA GasNet and Victorian distribution access arrangements that are currently being assessed by the AER. In reaching this conclusion, the Commission notes that:

- this course of action will address the concerns raised by stakeholders in submissions;
- the revised access arrangements that are currently being assessed by the AER (that is, for the Victorian gas distribution businesses as well as APA GasNet) are well under way, with the AER having already published its draft decisions; and
- the approach taken is consistent with approaches taken by the AEMC in relation to other rule changes.<sup>168</sup> It is also consistent with the AEMC's current consideration of transitional provisions for the economic regulation of network service providers rule change.<sup>169</sup>

In addition, to apply the rule as made to regulatory processes which have already commenced and are well under way would not reflect good regulatory practice and could undermine investor confidence in the regulatory framework. To do so would

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<sup>168</sup> AEMC, *Rule determination, National Electricity Amendment (Cost allocation arrangements for transmission services) Rule 2009*, 29 January 2009, pp53-54; and AEMC, *Final rule determination, National Electricity Amendment (Final rule determination – parameter values, equity beta and gamma) Rule 2008*, 13 November 2008, ppv-vi.

<sup>169</sup> AEMC, *Consultation paper on savings and transitional arrangements, Draft National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012 and Draft National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012*, 14 September 2012.

increase uncertainty and regulatory risk faced by service providers and would not promote efficient investment. In the long term, this would not be in the interest of gas consumers.

For these reasons, the Commission has decided to delay the commencement of the rule as made until after the Victorian access arrangements that are currently being assessed by the AER have been completed. Specifically, the rule as made will commence on 2 May 2012 which corresponds to the first day after the expiry of the absolute time limit for the AER to make a final decision on the APA GasNet 2013–2017 access arrangement proposal in accordance with rule 13 of the NGR. The Commission notes that the expiry of the absolute time limit for the AER's assessment of the Victorian distribution access arrangements is before this date.

### **8.3.2 Process**

The Commission notes that in responding to the consultation paper, a number of stakeholders expressed concern about the process adopted by the AEMC. It is acknowledged that the release of the consultation paper subsequent to the draft determination is not specifically provided for in the rule change process set out in the NGL. Although, s. 312 of the NGL does provide for the making of a further draft rule determination in certain circumstances.

In this instance, however, the time in which to make a further draft rule determination had already expired once the Commission had considered the extensive stakeholder responses to the draft determination. Nevertheless, the Commission considered that it would be good regulatory practice to consult with stakeholders on an alternative rule based solution to the AER's concerns about AMDQ cc and the APA GasNet access arrangement. This has proved to be a valuable consultation phase as stakeholders identified a number of significant issues with the AEMC's rebateable service definition.

In general, however, it should be noted that the construction of the rule change process does not require (nor, in the Commission's view, imply) a final determination to be consistent with a draft determination. In fact, that the draft determination is publically released and open for consultation indicates that stakeholder views on a draft determination are an important input into the final determination. Stakeholder responses will be carefully considered and, where there are found to be persuasive arguments and information to indicate that the draft determination position is unlikely to satisfy the NGO, the Commission may make a final determination that is different to the draft determination. The Commission considers that this is good regulatory practice and is consistent with the NGL.

## Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMDQ	authorised maximum daily quantity
AMDQ cc	authorised maximum daily quantity credit certificates
APA	APA Group
APA GasNet	APA GasNet Australia (Operations) Pty Limited
APG	Australian Power and Gas
APIA	Australian Pipeline Industry Association
Commission	See AEMC
DBP	DBNGP (WA) Transmission Pty Limited
DBNGP	Dampier to Bunbury Natural Gas Pipeline
DTS	declared transmission system
DWGM	declared wholesale gas market
EA	EnergyAustralia (formerly TRUenergy)
ERA	Economic Regulation Authority of Western Australia
FIG	The Financial Investor Group
gas	natural gas
Gas Code	National Third Party Access Code for Natural Gas Pipeline Systems
Jemena	Jemena Limited
LNG	liquefied natural gas

MCE	Ministerial Council on Energy
MSO rules	Market System Operating rules
Multinet	Multinet Gas Distribution Partnership
NGL	National Gas Law
NGO	national gas objective
NGR	National Gas Rules
Origin	Origin Energy
Proponent	See AER
RBP	Roma to Brisbane Pipeline
SWP	South West Pipeline
TJ	terrajoule
VENCorp	Victorian Energy Networks Corporation

## A AMDQ credit certificates

The Victorian DTS generally has sufficient capacity to supply all users' gas needs without suffering congestion on the pipeline on all but a few days of the year.<sup>170</sup>

Authorised maximum daily quantity (AMDQ), and subsequently AMDQ credit certificates (AMDQ cc), were established to prioritise access to the transmission pipeline system at times of congestion and to provide pricing signals to gas users.<sup>171</sup> AMDQ and AMDQ cc provide users with:

- curtailment rights – in the event of transmission constraints, users not holding AMDQ will have their ability to inject gas into the system restrained ahead of users holding AMDQ;
- a hedge against uplift charges – which are incurred in the event of congestion on the transmission system or when demand is significantly different to what was planned; and
- a tie break right when there are competing bids at injection and withdrawal points.

AMDQ were created in 1998 prior to the commencement of the Victorian wholesale market when the primary source of gas supply for the Victorian DTS was from Longford (with the addition of limited peak gas supplied from the Dandenong LNG plant). Total AMDQ was set to equal the peak capacity of the system at that time (that is, 990 TJ/day) and was allocated to existing customers at no charge on the basis of historical usage or pre-existing contractual rights. This was part of the preparations for creating a market carriage based transmission system and wholesale market for gas in Victoria.<sup>172</sup>

AMDQ cc were first introduced in 2002 to provide similar rights (as noted above) to users on new pipeline capacity to those provided by AMDQ on the Longford pipeline. That is, in the event of a constraint, a user holding AMDQ cc will obtain some degree of certainty of supply compared to users who do not hold AMDQ cc. The amount of capacity made available through either investment in new capacity or through pipeline re-configuration is agreed between APA GasNet and AEMO. Once agreement has occurred, new certificates are created and APA GasNet has the right to allocate those certificates to users.<sup>173</sup> AMDQ cc have been issued for new capacity at the Port Campbell and Culcairn injection points.

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<sup>170</sup> The Victorian DTS is a winter peaking system. Congestion is most likely to occur on the coldest winter days.

<sup>171</sup> AEMC, Draft rule determination, 15 March 2012, Appendix A.

<sup>172</sup> AEMC, Draft rule determination, 15 March 2012, Appendix A. Any allocation, re-allocation or transfer of AMDQ is managed by AEMO pursuant to rules 327-332 in the NGR.

<sup>173</sup> NGR, rules 329, 331 and 332 relate to the allocation, re-allocation, transfer and relinquishment of AMDQ cc.

Until 2007 there was no significant demand for AMDQ cc, but since that time demand for AMDQ cc has increased significantly as parts of the pipeline system have been expanded. For the 2013–2017 access arrangement period, there is currently 353 TJ/day contracted under AMDQ cc on the South West Pipeline (SWP) and 50 TJ/day contracted for at Culcairn.

Currently AMDQ cc is sold by a tender process in a bundle with the associated transportation (injection) of gas for that location. APA GasNet sets the price and users bid for quantities of daily capacity made available. Where bids total more than the total of new capacity available, APA GasNet allocates the available capacity on a pro-rata basis based on the capacity tendered for by bidders. The operation of the tender process for AMDQ cc is not specified in the NGR, the current APA GasNet access arrangement, or by AEMO.<sup>174</sup>

The price set by APA GasNet could be equal to or higher than the relevant injection reference tariff. The ability of APA GasNet to charge a price that is higher than the reference tariff is related to the demand for AMDQ cc and users' perception of the benefits afforded to them in holding AMDQ cc. That is, users are prepared to pay a premium when the pipeline system is constrained as a hedge against the risks of curtailment and the payment of uplift charges. This was illustrated in 2008, when APA GasNet (after consultation with the ACCC) decided to sell AMDQ cc by an open auction process. This auction attracted bids that were very high compared to the floor price (which was set at the reference tariff) and all available AMDQ cc was fully allocated. Subsequent to this APA GasNet decided not to continue with the open auction process, as it considered that the high prices were not desirable in the longer term and it was cognisant of the requirement that all shippers should have access to scarce resources. As a result, AMDQ cc bundles have since been offered by a tender process as noted above.<sup>175</sup>

APA GasNet has submitted that the demand for AMDQ cc and hence the revenue it receives from these certificates being priced above the reference tariff is a feature of the Victorian DWGM and is critical in providing a form of leading capacity signal under the market carriage model.<sup>176</sup>

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174 However, AEMO auctions AMDQ according to Part 19 of the NGR.

175 AEMC, Draft determination, 15 March 2012, pp34-35.

176 APA submission, 3 November 2011, p5 and APA submission, 26 April 2012, p2.

## B Summary of issues raised in submissions

### B.1 First round of consultation

Issue	AEMC Response
<b>Reference service definition</b>	
<p><i>Ability of the AER to set efficient tariffs</i></p> <p>AEMO submitted that criteria should be developed to guide the AER in making a determination regarding a reference service and making an apportionment to rebateable or negotiated services. In developing this criteria AEMO suggested that consideration be given to the uncertainty in forecasting demand and the difficulty in determining costs for services. AEMO also raised concerns regarding the allocation of the asset value between reference services and non-reference services.</p> <p>APA was concerned about the AER's assertion that the current requirement to determine a reference tariff for each reference service gives rise to regulatory risks, where the demand or revenues to be derived from services are uncertain. It submitted that it is unclear how a service for which there is uncertain demand could be considered a reference service.</p> <p>APIA submitted that the current rules allows for the AER to approve the treatment of emerging or developing pipeline services where demand is uncertain as non-reference services. It also submitted that a service for which there is uncertainty in demand or revenue means that it is a service which is not likely to be sought by a significant part of the market. Therefore it could not a reference service.</p>	<p><i>Ability of the AER to set efficient tariffs</i></p> <p>The draft rule requires the AER to take into account the revenue and pricing principles when determining a reference service.</p> <p>The allocation of pipeline costs between reference services and non-reference services is beyond the scope of the rule change request.</p> <p>The Commission did not agree with the concerns raised by APA and APIA. The draft rule maintains the future-looking approach of the current rule by specifying that the AER considers each pipeline service that is likely to be sought by a significant part of the market to be included as a reference service.</p>
<i>The AER's discretion</i>	<i>The AER's discretion</i>

Issue	AEMC Response
<p>AEMO supported the proposed rule in respect of it giving the AER discretion to determine reference services.</p> <p>APA submitted that this discretion should not be linked to the AER's stated concern over uncertainty as to the demand for the service or to the revenues earned from providing this service.</p> <p>Jemena submitted that the increased discretion will expose service providers to significant risk such that the balance and certainty inherent in the service offered by the service provider will be altered in a way that is detrimental to the interests of the service provider.</p> <p>Multinet submitted that the AER's discretion should be limited to 'other' pipeline services to those put forward by the service provider under rule 101 of the NGR.</p> <p>Origin was concerned that the discretion will lead to uncertain and unpredictable outcomes. It submitted that if a change were made then it should include limits on the level of discretion to ensure that market participants have certainty and clarity around the AER's decision making criteria.</p>	<p>The draft rule does provide an increased level of discretion to the AER. However, this discretion is necessary for the AER to be able to set reference tariffs that are reflective of efficient costs. The draft rule requires the AER to take into account the revenue and pricing principles when making a decision on classifying a pipeline service as a reference service which leads to the setting of reference tariffs. The AER would also be required to consider the NGO when making a reference service decision.</p> <p>The draft rule restores discretion to the regulator to what it was under the Gas Code. The Commission is not aware of any problems with regards to this discretion under the Gas Code.</p>
<p><i>Policy intent</i></p> <p>APIA disputed the AER's claim that its proposal seeks to address a 'drafting error'. It considered that it was inappropriate for the AER to make assertions as to the policy intention without referencing direct evidence. APIA cited a SCO document which stated that "access arrangements must specify as reference services all services that are likely to be sought by a significant part of the market".</p> <p>Jemena submitted that there is no policy intent for returning to the regulatory framework of the Gas Code. It also submitted that in its view, the presumption must be that what is placed in the current rules is intended to be there.</p>	<p><i>Policy intent</i></p> <p>No explanation of the change from the Gas Code to the NGR with regards to the regulator's discretion to determine reference services has been located. In addition, there is no explanation of the change with respect to the number of reference services that must be included in an access arrangement. Accordingly, it is unclear as to what the policy intent was in changing the reference service definition.</p>

Issue	AEMC Response
<p><i>Alternative rule changes</i></p> <p>Jemena submitted that there are alternatives to the AER's proposed rule which avoids the detrimental effects of the proposed rule change, and better contributes to the achievement of the NGO.</p> <p>For the reference service definition, Jemena proposed adding the provision that a reference service is not a rebateable service. This means that all services which are likely to be sought by a significant part of the market will be reference services unless they are rebateable services.</p> <p>Jemena submitted that the Commission explore the option of a change to the Victorian Wholesale Market Rules as an alternative to the proposed rule change. It also suggested that the AER investigate the possibility that an administrative solution be developed rather than a rule change.</p> <p>Multinet generally supported the proposed rule, however it submitted that the proposed reference service definition be amended by inserting 'and' between the two sub-rules. By doing so, Multinet submitted the proposed rule would align to the Gas Code.</p>	<p><i>Alternative rule changes</i></p> <p>Jemena's alternative reference service definition would not solve the problem of the AER not being able to set efficient tariffs in circumstances where demand and/or revenue are uncertain, or where setting a reference tariff would be inappropriate due to commercial circumstances.</p> <p>Jemena's alternative reference service definition relies on its proposed alternative to the rebateable service definition, which the Commission considered would be likely lead to an increased risk to investment and therefore would not be consistent with the NGO.</p> <p>With regards to Jemena's other suggested alternatives, the reason for making the draft rule is to provide the AER greater discretion in determining reference services. This will allow the AER to avoid situations where it is problematic to set efficient tariffs. This reason for the rule change goes beyond the issue identified by the AER with respect to the Victorian DTS.</p> <p>The Commission adopted Multinet's suggesting drafting change.</p>
<p><i>Supportive of the proposed rule change</i></p> <p>TRUenergy submitted that it was supportive of the proposed rule with respect to the reference service definition as it will result in an outcome that is consistent with the NGO.</p>	<p><i>Supportive of the proposed rule change</i></p> <p>Noted.</p>
<p><b>Rebateable service definition</b></p>	
<p><i>Triggering the most favoured nation clause in existing contracts</i></p>	<p><i>Triggering the most favoured nation clause in existing contracts</i></p>

Issue	AEMC Response
<p>APIA, APA and DBP submitted that they were concerned that the proposed rule could lead to a change in the risk/reward relationship in bilateral contracts between service providers and users in relation to other fully regulated pipelines. These concerns related to the possible triggering of the most favoured nation clause in bilateral contracts.</p>	<p>The proposed rule may expose service providers to increased investment risk by allowing the possibility that rebateable and reference services may be in the same market (see Chapter 7 of the draft determination). This may lead to reductions in the reference tariff being more likely to occur. Significant reductions in the reference tariff may trigger the most favoured nation clause.</p> <p>An increased risk to investment would not be conducive to efficient investment in natural gas services and would not be in the long term interests of consumers.</p>
<p><i>The fixed principle in the DBNGP access arrangement</i></p> <p>DBP submitted that if the proposed rule change is made, then it may take precedence over the fixed principle in the DBNGP access arrangement. The fixed principle prevents the ERA from clawing back any revenue that DBP might earn from the sale of pipeline services that is in excess of the total revenue set under the access arrangement. It also submitted that as the tariffs negotiated under contracts were fundamental to the purchase of the DBNGP in 2004, then any clawing back of revenues earned under these contracts could have extreme adverse effects on DBNGP investment.</p>	<p><i>The fixed principle in the DBNGP access arrangement</i></p> <p>It is possible that transitional rule 6 of the NGR could be interpreted to not apply to the fixed principle described in the current access arrangement (see Chapter 7 of the draft determination).</p> <p>The Commission considered that the proposed rule change may lead to an increased risk to investment which would not be conducive to efficient investment in natural gas services and would not be in the long term interests of consumers.</p>
<p><i>Introduction of cross subsidies</i></p> <p>APA submitted that the proposed rule change has scope to introduce cross subsidies between competitive users served by gas pipelines. It submitted that this will result from the removal of the requirement that the markets for rebateable and reference services be substantially different.</p>	<p><i>Introduction of cross subsidies</i></p> <p>The proposed rule does not introduce cross subsidies. This is because:</p> <ul style="list-style-type: none"> <li>• the rebating of revenue earned from the provision of rebateable services against the reference service is rebalancing a cross subsidy that exists against users of the reference service; and</li> <li>• in any case, the AER has discretion under rule 93(3) of the NGR in determining the appropriate portion of revenue generated from the sale of rebateable services to be rebated to users of reference services.</li> </ul>

Issue	AEMC Response
<p><i>Retrospective regulation</i></p> <p>APA submitted that if the proposed rule was to be accepted then the AER could take the opportunity to take into account revenues already earned under existing AMDQ cc contracts when setting future revenues and tariffs for the Victorian DTS. It also submitted that if the rule were accepted then it should only apply prospectively.</p>	<p><i>Retrospective regulation</i></p> <p>The Commission did not accept that the proposed rule will result in retrospective regulation. This is because:</p> <ul style="list-style-type: none"> <li>• s. 321 of the NGL prohibits an access arrangement from depriving a person of a protected contractual right; and</li> <li>• if the rule was made, it would not be good regulatory practice to apply the rule to revenues generated prior to the commencement of the rule.</li> </ul>
<p><i>Alternative rule changes</i></p> <p>Jemena proposed an alternative to the AER's proposed rule.</p> <p>For the rebateable service definition Jemena proposed adding the provision that a pipeline service may be a rebateable service if the service is likely to be sought by a significant part of the market. This Jemena submitted is consistent with its alternative amendment to the reference service definition.</p> <p>TRUenergy submitted that while it was supportive of the proposed rule, it considered that it should be amended to provide that users who have paid for AMDQ cc are rebated in full where they have effectively paid for transportation pipeline services twice. Also that the return of the rebate should be paid to users on a pro-rata basis.</p>	<p><i>Alternative rule changes</i></p> <p>The Commission did not consider that Jemena's alternative rebateable service definition would better promote the NGO with respect to efficient investment in pipeline services and the long term interests of consumers. It will likely lead to an increased risk to investment, by allowing a rebateable service to be in the same market as the reference service.</p> <p>TRUenergy's proposed amendment to the rule change is specific to the Victorian DTS and should not be included in the rebateable service definition which is relevant to all full regulation pipelines. Also, users who hold AMDQ cc are not effectively paying twice for transportation pipeline services (see Appendix A of the draft determination).</p>

## B.2 Second round of consultation

Issue	AEMC Response
<b>Reference service definition</b>	
<p><i>Ability of the AER to set efficient tariffs</i></p> <p>The AER submitted that the AEMC's preferred rule provides it with the necessary discretion to achieve a more efficient outcome. The definition of a reference service would enable the AER to decide how to deal with services that are likely to be sought by a significant part of the market but for which estimating an efficient tariff would be difficult.</p> <p>Jemena submitted that there is a case for changing the reference service definition. This is to provide for circumstances, other than the specific case identified by the AER, where it is not appropriate or practicable to set a reference tariff for a service that is likely to be sought by a significant part of the market.</p>	<p><i>Ability of the AER to set efficient tariffs</i></p> <p>The rule as made will give the AER greater flexibility in specifying pipeline services as reference services to ensure that the AER sets a reference tariff where it is practicable and efficient to do so. See Chapter 5.</p>
<p><i>The AER's discretion</i></p> <p>The AER considered that the inclusion in the draft rule of the requirement that the AER must take into account the revenue and pricing principles when exercising its discretion with respect to reference services, is unnecessary. This is because it is already required to take into account the revenue and pricing principles in accordance with s. 28(2)(a)(i) of the NGL.</p> <p>APA submitted that the AEMC's changes to the proposed rule are appropriate and address the AER's concerns, while also providing some guidance on the scope of the AER's discretion. The AEMC's changes addressed concerns raised by it that the AER's discretion under the proposed rule would be unbounded.</p>	<p><i>The AER's discretion</i></p> <p>The inclusion of the reference to the revenue and pricing principles removes any doubt about the limits to the AER's discretion. It clarifies that the AER must have regard to these principles when making a decision about reference services.</p> <p>Noted.</p>

Issue	AEMC Response
<p>APIA submitted that the inclusion of the revenue and pricing principles provides appropriate guidance as to the inclusion of a pipeline service as a reference service and that the AEMC's preferred rule is an improvement on the existing rule and the AER's proposed rule. It also submitted that there may be merit in including a specific reference to the NGO in the new rule.</p> <p>DBP submitted that it supported the AEMC's draft rule in relation to the reference service definition. However, DBP made some suggested minor wording changes to the AEMC's draft rule 101(2) and the AEMC's draft rule change to example 2 of rule 59(2) of the NGR. DBP also suggested a number of additional amendments to the current version of the NGR if the reference service definition is to be changed as proposed by the AEMC in its draft rule determination.</p> <p>Jemena submitted that it did not support the AEMC's draft rule as it would increase the AER's discretion unnecessarily. If implemented, the draft rule would change the balance of judgement on what services should be a reference service from the service provider to the AER. It considered that a service provider is in the best position to identify what should be a reference service.</p> <p>Jemena also submitted that the definition of reference service should be clear so that the service provider can, with certainty, prepare and submit an access arrangement proposal that includes all reference services. It proposed an alternative rule to rule 101(2).</p>	<p>The Commission does not consider it necessary to include a specific reference to the NGO in the new rule. This is because the AER is already required under s. 28(1) of the NGL to take into account the NGO in performing or exercising its economic regulatory function or power.</p> <p>The Commission has incorporated DBP's suggested changes to rule 101(2) and example 2 in rule 59(2) in the rule as made.</p> <p>With respect to Jemena's suggested alternative definition, the Commission considers that this is less preferable to the rule as made for promoting the NGO with respect to the long term interests of consumers. This is because the rule as made includes the requirement that the AER must take into account the revenue and pricing principles.</p>
<p><b>Rebateable service definition</b></p>	
<p><i>Rebating of AMDQ cc revenue</i></p> <p>The AER submitted that unless the AEMC adopted its proposed change to the rebateable service definition, then the AER is not likely to be able to rebate revenue derived from the AMDQ cc service against the reference tariff. It</p>	<p><i>Rebating of AMDQ cc revenue</i></p> <p>The Commission notes the AER's concerns.</p>

Issue	AEMC Response
<p>argued that if the AMDQ cc was a rebateable service, only then could its revenue be rebated against the reference tariff. However, in the AER's opinion AMDQ cc cannot be classified as a rebateable service under the current rules.</p> <p>The AER also submitted that it estimated that APA GasNet would earn \$27.5 million in revenue from the AMDQ cc service due to the 'price effect' over the five year period 2013–2017.</p> <p>APA submitted that it considers that the rebating of revenue associated with the 'volume effect' of AMDQ cc through the price control model is not voluntary. This is because the AER each year has reviewed and confirmed that this process is in accordance with the approved price control model under the current access arrangement.</p> <p>APA also submitted that the additional revenue associated with the allocation of AMDQ cc at a higher price than the reference tariff (that is, due to the 'price effect') is a feature of the Victorian DWGM and is critical in providing a form of leading capacity signal. APA submitted that the removal of this mechanism from the market (by effectively taking away APA GasNet's incentive to allocate AMDQ cc on an efficient basis) has the potential to undermine the efficient operation of the Victorian DWGM.</p> <p>APA also submitted that it considers that the price control model is part of the access arrangement and that it cannot be altered outside the access arrangement revision process under the NGR. APA noted that it has proposed substantially the same price control formula as in the current access arrangement for the APA GasNet 2013–2017 access arrangement. It also noted that having lodged its proposal, it can only revise the proposal with the AER's consent. Therefore, APA considered that the AER's concern about its inability to require the return of AMDQ cc revenues absent a change to the rebateable service definition, is unfounded.</p> <p>APIA submitted that it is apparent that the alleged over-recovery on the Victorian DTS is not occurring. It supported the AEMC's draft determination</p>	<p>The Commission notes that there are differing views on whether or not AMDQ cc provides an investment signal on the Victorian DTS. This issue is outside the scope of the current rule change process.</p> <p>Noted.</p> <p>Noted.</p>

Issue	AEMC Response
<p>conclusion to not change the rebateable service definition.</p> <p>Origin submitted that it encourages the AER to take on board the AEMC's advice to consider the issue of rebating for AMDQ cc through the tariff variation mechanism in its review of the APA GasNet 2013–2017 revised access arrangement proposal. It submitted that ensuring that AMDQ cc volumes are included in the annual updates to the price control model would improve clarity which would benefit the AER, APA and market participants alike. Origin expressed concerns about the blanket reduction in the reference tariff resulting from any AMDQ cc rebating. Origin concern was that this benefits all users of the Victorian DTS, irrespective of whether a user is a holder of AMDQ cc or not.</p> <p>Origin further submitted that the AEMC in its draft determination did not acknowledge that Origin had raised several issues in its original submission. Two of these issues related to AMDQ cc and were:</p> <ul style="list-style-type: none"> <li>• ensuring that any change made maintains the commercial value of AMDQ cc; and</li> <li>• improving the transparency of the AMDQ cc auction process.</li> </ul>	<p>Noted.</p> <p>The Commission is not making the proposed change to the rebateable service definition. Accordingly, it does not need to consider the impact of such a change on the commercial value of AMDQ cc. Also, it is beyond the scope of this rule change for it to consider an auction process for the sale of AMDQ cc in the context of the rebateable service definition.</p>
<p><i>Triggering the 'most favoured nation' clause in existing contracts</i></p> <p>The AER disagreed with the AEMC's draft determination with respect to the impact of its proposed change to the rebateable service definition on existing contracts. The AER submitted that any increase in risk following the change to the rebateable service definition will be taken into account by the AER in its consideration of rebateable services. The AER disputed DBP's conclusion that there is doubt as to the role that the revenue and pricing principles play in the AER's decision making process and the suggestion that the AER could exercise its discretion in any decision to determine whether a service was rebateable or not without regard to the revenue and pricing principles.</p> <p>APA and APIA supported the AEMC's draft determination conclusion that a</p>	<p><i>Triggering the most favoured nation clause in existing contracts</i></p> <p>The Commission notes the AER's views.</p>

Issue	AEMC Response
<p>change to the rebateable service definition risks unintended consequences for service providers on pipelines other than the Victorian DTS. APA submitted that retaining the current definition of rebateable services maintains the current risk/reward balance in relation to triggering the 'most favoured nation' clauses.</p> <p>DBP submitted that it agreed with the AEMC's draft determination conclusion. It suggested that the NGR provisions could be interpreted to mean that the regulator may not have to give fundamental weight to the principle of economic costs and risks of the potential for under or over investment, but rather it only has to have regard to the principle. DBP also considered that it is not appropriate to establish a regime whereby it is left to the regulator to exercise its discretion in a way that may trigger 'most favoured nation' clauses in existing contracts.</p> <p>Origin submitted that the AEMC in its draft determination did not acknowledge that Origin had raised in its original submission, the issue that the AEMC should assess the full range of potential consequences of the proposed rule change. Origin submitted that this was to ensure that there be no unintended consequences of the proposed rule change.</p>	<p>The Commission notes the comments from APA and APIA.</p> <p>The Commission notes DBP's views.</p> <p>The Commission considers that it has assessed all of the issues raised by stakeholders which may arise as unintended consequences of the proposed rule change. This includes the issue of triggering the 'most favoured nation' clauses in existing contracts and the issue of the fixed principle in the DBNGP access arrangement.</p>
<p><i>The fixed principle in the DBNGP access arrangement</i></p> <p>The AER disagreed with the AEMC's conclusion in the draft determination with respect to the impact of its proposed change to the rebateable service definition on the fixed principle in the DBNGP access arrangement. The AER considered that if the proposed change was made, then the amended rule would not take precedence over the fixed principle as rule 99(3) of the NGR would act to protect the fixed principle. In response to DBP's submission, the AER submitted that the inconsistency referred to in rule 99(4)(b) of the NGR is between 'a rule' and a fixed principle not between a 'supposed determination' of the AER and a fixed principle as suggested by DBP.</p> <p>DBP submitted that it agreed with the AEMC's draft determination conclusion with regards to the fixed principle in the DBNGP access arrangement. DBP</p>	<p><i>The fixed principle in the DBNGP access arrangement</i></p> <p>The Commission notes the opposing views expressed by AER and DBP. See Chapter 7.</p>

Issue	AEMC Response
<p>submitted that the AER had taken a narrow view in the operation of rule 99(3) of the NGR in isolation of the remaining provisions of rule 99 of the NGR. It concluded that the proposed rule change be rejected because if the proposed rule change was implemented, there is a risk that the operation of the rule will be inconsistent with the fixed principle in the DGNGP access arrangement.</p>	
<p><i>Broader need for the proposed change</i></p> <p>The AER submitted that there was a broader need for its proposed rule change to address issues relating to emerging pipeline services (such as backhaul and interruptible). The AER referred to three stakeholder submissions to the RBP 2012–2017 access arrangement proposal which identified issues arising from new pipeline services.</p>	<p><i>Broader need for the proposed change</i></p> <p>The Commission considers that to date it has not been provided with any clear evidence that pipeline users are requesting that certain pipeline services ought to be classified as rebateable services, and that this requires a change to the rebateable service definition.</p>

### B.3 Third round of consultation

Issue	AEMC Response
<p><b>Rebateable service definition</b></p>	
<p><i>AMDQ cc revenue and the Victorian DTS</i></p> <p>The AER submitted that the AEMC should clarify whether a rule change is to apply to the APA GasNet 2013-2017 access arrangement period. This was because the AER's rule change proposal was partly premised on how the current definitions of reference service and rebateable service would be applied in the current APA GasNet access arrangement assessment process, in the absence of a rule change that would allow AMDQ cc to be classified as a rebateable service.</p> <p>APA submitted that the AEMC in its consultation paper had not made a case for</p>	<p><i>AMDQ cc revenue and the Victorian DTS</i></p> <p>The Commission considers that any changes to the rebateable service definition (or the reference service definition) cannot apply to the access arrangements currently under consideration by the AER. See Chapter 8.</p> <p>The Commission has decided not to amend the rebateable service</p>

Issue	AEMC Response
<p>its proposed amendment to the rebateable service definition that only applies to pipeline services provided by means of the Victorian DTS. APA considered that:</p> <ul style="list-style-type: none"> <li>• the AEMC's conclusion that the revenue derived from the sale of AMDQ cc rights is comparable to revenue derived from reference services on contract carriage pipelines is unfounded;</li> <li>• the AEMC's assessment that AMDQ cc do not provide an investment signal is not correct;</li> <li>• the inability of the AER to include a rebate mechanism in the APA GasNet access arrangement to accommodate the 'volume effect' of AMDQ cc is of little consequence because the revenue earned is insignificant;</li> <li>• the AEMC has misconstrued the Victorian DTS reference service in terms of what level of 'firmness' exists. APA considers that the transportation of gas on Victorian DTS as a whole is 'firm' and that there is no concept equivalent to the contract carriage 'non-firm'. In addition, the AMDQ cc service is not providing an increased 'firmness' of transportation;</li> <li>• the expected increase in revenue from the 'price effect' of AMDQ cc for the 2013–2017 period is a result of the shortage of AMDQ cc. This shortage is due to the ACCC not approving capital expenditure for the Stonehaven compressor in its 2008 decision;</li> <li>• the AEMC's assessment that there is likely to be an increase over the long term in the share of APA GasNet's revenue earned from AMDQ cc is incorrect. Instead, APA argues that there will be downward pressure on AMDQ cc prices over the long term as availability of AMDQ cc will meet demand; and</li> <li>• it is willing to revert to an auction process for the sale of AMDQ cc so long</li> </ul>	<p>definition in light of some of the key arguments made by APA that address the nature of the AMDQ cc service and its effect as an investment signal.</p>

Issue	AEMC Response
<p>as the supply of AMDQ cc is not distorted.</p> <p>Australian Power and Gas (APG) supported the AER's proposed change to the reference service definition and to the rebateable service definition. It submitted that the extent that APA GasNet has rebated AMDQ cc revenue due to the 'volume effect' against reference tariffs has not been transparent. APG considered that AMDQ cc revenues have not been appropriately dealt with to date and that there should be greater scope to formerly define AMDQ cc rebates in APA GasNet's tariff calculation. It considered that the proposed change to both definitions as a small step to provide greater clarity.</p> <p>EnergyAustralia (EA) (formerly TRUenergy) supported the AEMC's proposed change to the rebateable service definition as canvassed in the consultation paper. This was because it considered that there is:</p> <ul style="list-style-type: none"> <li>• legal uncertainty over whether the AER can approve an access arrangement that includes the current AMDQ cc revenue rebating mechanism;</li> <li>• likely to be an increase over the longer term in the share of APA GasNet's revenue earned from unregulated AMDQ cc;</li> <li>• forecast to be a significant increase in revenue due to the 'price effect' of AMDQ cc for the next period; and</li> <li>• an inconsistent outcome between the Victorian DTS and other fully regulated pipelines.</li> </ul> <p>EA suggested a further amendment to the draft rule that would require APA GasNet to deposit all revenue that is over-recovered from AMDQ cc in an investment fund. The money in the fund would be used to help pay for augmentation of the pipeline system (that is, netted off the capital cost). Parties that have paid for AMDQ cc and thereby have contributed to the fund would receive any resulting AMDQ cc from the new pipeline capacity on a pro-rata</p>	<p>APG's comments are noted. See Chapters 6 and 7.</p> <p>EA's comments are noted. See Chapters 6 and 7.</p> <p>The Commission notes EA's suggestion. However, further consideration of an investment fund is beyond the scope of this rule change process.</p>

Issue	AEMC Response
basis.	
<p><i>Broader need for the proposed change</i></p> <p>The AER submitted that it maintains its view that there is a broader need for its proposed change to the rebateable service definition.</p> <p>This view was supported by Australian Power and Gas (APG). APG submitted that an amended definition would enable services that are currently ambiguous, or fall outside regulatory treatment when clearly they should not be, to be considered as rebateable services. APG referred to its submission to the AER's recent review of the Roma to Brisbane access arrangement. APG concern is that intra-day nominations on this pipeline falls outside the scope of regulatory oversight and the associated charges are excessively high and punitive. AGP considered that it is important that the AER is given flexibility to determine whether other services that derive revenue on pipelines such as those on the RBP should be classified as reference services or indeed rebated against reference services.</p>	<p><i>Broader need for the proposed change</i></p> <p>The Commission is not satisfied with the current arguments that a change to the rebateable service definition is needed. See Chapter 7.</p>
<p><i>Transitional provisions</i></p> <p>The AER submitted that the AEMC should include transitional provisions if it considers that a rule change should apply to the 2013-2017 access arrangements that are currently being considered by the AER. If a rule change were to apply to these access arrangements it would be appropriate for the AEMC to include transitional provisions that would allow additional time for service providers to submit those elements of their proposals that are affected by the rule change.</p> <p>Other stakeholders (APA, APIA and the Financial Investor Group) did not support the inclusion of transitional provisions. They expressed concerns that the AEMC would consider that a rule if made would be applied to access arrangements that are currently being assessed by the AER.</p>	<p><i>Transitional provisions</i></p> <p>The Commission has decided that the final rule will not apply to access arrangements that are currently being assessed by the AER. See Chapter 8.</p>

## **C Regulation of pipeline service and differences in market structure**

### **Fundamental principles of economic regulation of gas pipelines**

Economic regulation under the NGL is only applied to covered pipelines which exhibit a level of market power where the benefits of regulation outweigh the costs.<sup>177</sup> This is put into effect by the application of the pipeline coverage criteria (set out in s. 15 of the NGL) by the National Competition Council and the relevant government minister.

There are two types of regulation for covered pipelines, light regulation and full regulation. Full regulation pipelines are required to have full access arrangements which set out reference tariffs, services to be offered and terms and conditions. These access arrangements are to be approved by the AER through an access arrangement approval process. In contrast, light regulation pipelines are not required to have a full access arrangement but may submit a limited access arrangement to the AER for approval. Limited access arrangements do not have reference tariffs. Their intent is to give certainty over terms and conditions applicable to the pipeline services offered.<sup>178</sup>

Central to the regulatory framework is the ability of users and service providers of pipelines to negotiate the terms and conditions (including price) of access. The resulting negotiated terms and conditions of access may differ from the access arrangement relevant to the pipeline.<sup>179</sup> The NGL provides for a dispute resolution process by an arbitrator if a dispute arises between a user or prospective user and a service provider over access to the regulated pipeline service.<sup>180</sup>

Accordingly, in the context of the economic regulation of pipelines under the NGL, reference services and reference tariffs play an important role in providing a point reference for negotiation and dispute resolution. This is because by definition, the reference service is a service that is likely to be sought by a significant part of the market. The policy intent of this definition is clear. That is, to ensure that economic regulation of covered pipelines is effective in promoting the long term interests of consumers, it is necessary that economic regulation applies to services that are sought by a significant part of the market. It should apply to all material pipeline services

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<sup>177</sup> Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), p12.

<sup>178</sup> Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), pp13-17.

<sup>179</sup> Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), p17.

<sup>180</sup> Second Reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P. F. Conlon, Elder - Minister for Transport, Minister for Infrastructure, Minister for Energy), pp18-19.

irrespective of differences in market structure. Differences in the way pipelines operate and their market structures are discussed below.

### **Contract carriage and market carriage pipelines**

The approach used to allocate the capacity of a gas pipeline to users is fundamental to the operation of a transmission pipeline. There are two approaches that may be adopted for the management of capacity on a pipeline. These are:

- the contract carriage approach; or
- the market carriage approach.

Under contract carriage, a service provider manages the pipeline's capacity by entering into bilateral contracts with shippers (users). These contracts are usually made in advance on a long term basis and provide shippers with an exclusive right to an amount of pipeline capacity. However, under the market carriage model an independent system operator manages pipeline capacity through a pool approach. Users of a market carriage pipeline do not reserve capacity on the pipeline.<sup>181</sup>

Contract carriage is used for transmission pipelines in all states and territories except Victoria. The market carriage model is only used for the Victorian DTS where the Australian Energy Market Operator (AEMO) manages the operation of the pipeline which transports gas to distribution networks across the majority of the state. AEMO also operates the Victorian declared wholesale gas market (DWGM) which applies to the Victorian DTS.

The structure of the pipeline system affects which model is more suited to a particular market. Pipelines with a trunkline structure (or point to point) are ideal for the traditional contract carriage capacity management model because network externalities<sup>182</sup> are small and bilateral transactions do not take into account load interdependencies. In contrast, a pipeline system structured as a dense network exhibits network externalities because loads in one line affect loads in another. In this case, the market carriage capacity management model is more appropriate because it allows the pipeline operator to determine the optimal gas flow schedule taking into account the anticipated injection and withdrawals of gas by users.<sup>183</sup>

In establishing the Victorian DWGM, the Victorian Government noted that the Victorian DTS had different characteristics from other transmission pipelines in Australia in that:<sup>184</sup>

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<sup>181</sup> Productivity Commission, *Review of the Gas Access Regime*, 11 June 2004, p315.

<sup>182</sup> Network externalities are defined as the effects on a user of a service of others using the same or comparable service, [http://economics.about.com/cs/economicsglossary/g/network\\_ex.htm](http://economics.about.com/cs/economicsglossary/g/network_ex.htm).

<sup>183</sup> Productivity Commission, *Review of the Gas Access Regime*, 11 June 2004, p315.

<sup>184</sup> Victorian Department of Treasury and Finance, Energy Projects Division, *Victoria's gas industry, implementing a competitive structure*, information paper 3, second edition, April 1998, p67.

- the system was relatively small and had limited storage capacity because of limited physical line pack and a single LNG facility; and
- it was expected that there would be additional sources of gas introduced into the Victorian transmission system.

The Victorian DTS is a network system with gas injected and withdrawn at a number of points. It is a meshed pipeline network more like a large regional distribution system rather than a long distance point to point transmission pipeline. At different points on the network gas flows can be bidirectional depending on supply and demand conditions. There is also potential for gas to either flow into or out of the network at different times or flow by different paths within the network.

Accordingly, these network features of the Victorian DTS meant that it was not feasible to base reference services (and consequently, reference tariffs) on point to point capacity rights. This is because capacity rights cannot be meaningfully defined in a network system which has multiple injection and withdrawal points and with the potential for congestion. Determining the capacity available to meet any one user's requirements depends on the total pattern of user injections and withdrawals, and the ability for the pipeline operator to meet the requirements of any one user is affected by the plans of all users.

For the Victorian DTS, APA GasNet makes the pipeline system available to AEMO under contract (the service envelope agreement).<sup>185</sup> The transportation of gas is provided by the single reference service as included in APA GasNet's access arrangement. It has two key components – injection (gas flows into the Victorian DTS) and withdrawal (gas taken from the Victorian DTS). AEMO provides sufficient gas injections into the Victorian DTS such that all withdrawal demand can be met. Thus the transportation of gas on the Victorian DTS as a whole may be considered as 'firm', however individual users cannot reserve capacity. This is not equivalent to the transportation service provided on a contract carriage pipeline where an individual user's gas is accepted for injection, transportation and delivery at specified points.<sup>186</sup> On a contract carriage pipeline the reference service is typically a single bundled right to inject gas and have it transported and delivered on a 'firm' (that is, reserved) basis.

Unlike the previous regulatory regime, the National Gas Law (NGL) and NGR do not recognise the contract carriage or market carriage models.<sup>187</sup> Nevertheless, the Victorian DTS still operates in a manner consistent with that envisaged by the Victorian Government. For this reason, the rationale and design of the market carriage system in Victoria, and how it differs from contract carriage pipelines, remains relevant today.

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185 NGL, s. 91BE.

186 APA, submission, 5 October 2012, p5.

187 Section 3.7 of the National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code) required an access arrangement to include a statement that the covered pipeline was either a contract carriage pipeline or a market carriage pipeline (these terms were defined in the Gas Code). There is no similar requirement in the NGR or NGL.