HSBC Building
Level 19
580 George Street
Sydney NSW 2000
PO Box R41
Royal Exchange NSW 1225

Telephone 61 2 9693 0000
Fax 61 2 9693 0093
www.apa.com.au

APA Group

Australian Pipeline Ltd
ACN 091 344 704

Australian Pipeline Trust
ARSN 091 678 778

APT Investment Trust
ARSN 115 585 441

5 October 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
Lodged Electronically: www.aemc.gov.au
Matter GRC0012

Dear Mr Pierce

APA Group is pleased to take the opportunity to respond to the AEMC's Consultation Paper, National Gas Amendment (Reference service and rebateable service definitions) Rule 2012 dated 13 September 2012.

This submission considers the propositions advanced and the processes utilised by the AEMC as embodied in the Consultation Paper and reaches the following three material conclusions:

1. That the case for the proposed Rule Change has not been established.
2. That if the AEMC nonetheless determines to adopt its proposed rule then no transitional provisions should be included in the new rule that would purport to apply the amended rule to APA GasNet during the 2013-17 Access Arrangement period.
3. That the process adopted by the AEMC for the making of the proposed rule has been deficient and not in accordance with the requirements in the National Gas Law (NGL).

In the following submission APA Group details the assessment and arguments that lead to the above conclusions.

1. No case for making the proposed rule has been established

In this section of the submission APA Group addresses the construct of the AEMC's (and for that matter the AER's) rationale for the proposed rule change.

Allocation of AMDQ Credit Certificates already subject to effective regulation and the treatment of revenues are subject to appropriate commercial arrangements

APA Group submits that the allocation of AMDQ Credit Certificates is already subject to effective regulation and the treatment of revenues in respect of the 2013-17 access arrangement period is already subject to appropriate commercial arrangements. Therefore there is no basis upon which the AEMC can be satisfied that the making of the Rule will or is likely to contribute to the achievement of the national gas objective.

Further, and specifically in light of the commercial arrangements in place in respect of the AMDQ Credit Certificates covering the period 2013-17, there is no basis upon which the AEMC could be satisfied that any Rule that purported to provide the opportunity for AMDQ Credit Certificates to be classified as a rebateable service for the purposes of the Access Arrangement period 2013-17 will or is likely to contribute to the achievement of the national gas objective.

APA Group submits that AMDQ Credit Certificates are already subject to extensive regulatory oversight. The National Gas Rules (NGR) numbers 327 to 333 contain extensive provisions dealing with the creation, allocation, transfer and relinquishment of AMDQ Credit Certificates. NGR Part 19 Division 2 provides extensive detail as to when, how and to what effect AMDQ CC may be utilised.

APA Group notes that AMDQ Credit Certificates are not directly regulated as to price. However the regulator has been actively involved in overseeing the auction and tender processes undertaken by APA Group. Further APA Group notes that the AER's preferred pricing mechanism for AMDQ Credit Certificates is an auction.

With respect to the commercial arrangements in place in respect of the AMDQ Credit Certificates covering the period 2013-17, APA Group re-tendered the majority of its AMDQ Credit Certificates in 2011 for this period. APA Group consulted with the AER ahead of the tender process being conducted.

The AEMC in paragraph 4.3.2 of the 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 Reference Service. As a result unregulated revenue is generated and retained by the Service Provider. APA Group submits that this situation is directly comparable to retention of the "price effect" of AMDQ Credit Certificates and so the conclusion by the AEMC that "it would be reasonable to expect that the revenue derived from the sale of those rights would also be regulated" is unfounded.

Further APA Group submits that AMDQ Credit Certificates have similar characteristics to a negotiated service on a contract carriage pipeline as the terms and conditions have been agreed by the service provider and the Market Participant.

While APA Group earns extra revenue through AMDQ Credit Certificates in the short term from constraints in the pipeline system, in the longer term APA Group is incentivised to make efficient investments in the pipeline system. The need for these investments is signalled by the demand for AMDQ Credit Certificates, as they are not otherwise signalled in the Victorian market carriage system.[1] APA Group submits that the AEMC should include in its assessment advice that the Declared Transmission System (DTS) specific rebateable service will have a material adverse impact upon APA Group's willingness to invest which is not in the long term interest of consumers of gas.

[1] APA Group notes that at page 9 of AEMC 13 September Consultation Paper that the AEMC references that AMDQ Credit Certificate were not originally intended to create signals for investment, the reality is that APA Group has and does utilize AMDQ Credit Certificate as an investment signal.

Rebating of AMDQ Credit Certificates

The AEMC at paragraph 4.1.3 appears to accept the AER's opinion that under the current NGR and access arrangement it would not be able to approve the inclusion of the current rebating mechanism in the next revised access arrangement for 2013-2017. The AEMC identifies uncertainty as to whether the current AMDQ Credit Certificate revenue rebating process under the current NGR is acceptable, including because such uncertainty may be undesirable.

APA Group submits that there are two elements of the rebating (or what is more accurately offset crediting) of AMDQ Credit Certificates that APA Group undertakes. Under existing contractual arrangements between APA Group and AMDQ Credit Certificate holders, APA Group takes payment for the AMDQ Credit Certificates in lieu of payment for flow based injection charges up to the quantity of the certificates purchased for injections at the relevant Injection Zone. This treatment effectively rebates quantities up to the level of AMDQ Credit Certificates held[2]. During the period 2008 to 2011 APA Group rebated $27.6 million under the prevailing contractual obligations. This rebating is independent of the access arrangement provisions and the AER. It is based solely on the commercial arrangements between APA Group and the AMDQ Credit Certificate holders.

APA Group submits that the commercial arrangements between APA Group and holders of AMDQ Credit Certificates is an example of what the AEMC correctly identified as "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".[3]

Quantities injected by Market Participants in excess of the AMDQ Credit Certificates held are charged the injection tariff and under the contract no rebate is provided. It is in relation to these excess quantities (the so called "volume effect") that historically APA Group has rebated through the 2008-12 Access Arrangement and the applicable price control model. The AER has stated it will not or is not able to approve the rebate of the volume effect going forward. As APA Group stated in its April Access Arrangement submission, APA Group is willing to continue with this form of rebate of the volume effect. Nonetheless the AER has stated it is not able to proceed on this basis.

As a result the volume effect will not be rebated. Whilst this is not APA Group's preferred outcome, APA Group submits that once the scale of this matter is put into perspective it is clearly demonstrable that it is inconsequential. In the period 2008 to 2011 the annual value of volume effect has ranged between $0 and $510,000. The total dollar value of the volume effect for the period 2008 to 2011 was $1.037m. APA Group's total regulated DTS revenue for the same period is in excess of $450m - that is the volume effect is equivalent to less than 0.25% of the regulated revenue. To express it in another measure to further illustrate

[2] This rebate treatment has applied under AMDQ Credit Certificate agreements that operated during the 2008-12 Access Arrangement and is operative for AMDQ Credit Certificate agreements entered into for the 2013-17 Access Arrangement.

[3] Page 21 AEMC Consultation Paper National Gas Amendment (Reference service and rebateable service definitions) Rule 2012.

its insignificance, it is equivalent to $0.0011 per gigajoule of gas transported through the DTS in that period.

Further APA Group submits that pursuant to the prevailing AMDQ Credit Certificate contractual arrangements, 97% of the revenue rebate occurs irrespective of the regulator's involvement. Therefore the ability or inability of the AER to include a rebate mechanism in the access arrangement with respect to the AMDQ Credit Certificates is of little consequence. Hence a rule change to provide AER with ability to accommodate a volume effect rebate is not required.

In light of the inconsequential nature of the volume effect not being rebated, APA Group submits that the AEMC cannot be satisfied that the proposed Rule will or is likely to contribute to the achievement of the national gas objective.

The market is informed

APA Group submits that the processes APA Group has conducted for auctioning or tendering AMDQ Credit Certificates have been transparent. The ACCC and AER have been consulted prior to the processes and provided copies of terms and condition for review prior to the commencement of the sale processes.

Each holder of AMDQ Credit Certificates receives invoicing that demonstrates the offset crediting (rebate) of the injection tariff. APA Group of course does not disclose to AMDQ Credit Certificate holders the detail of commercial arrangements with other AMDQ Credit Certificate holders as this may lead to wholesale market distortions. Certain Market Participants may use lack of disclosure of the list of AMDQ Credit Certificate holders and prices paid as a basis for a self-serving claim of a lack of transparency.

Market design

In section 4.3.2 of the Consultation Paper the AEMC enters into an assessment of the impact of market design upon pipeline services.

There is a key fundamental aspect that the AEMC has misconstrued. Namely in relation to the DTS, what the reference service is and what level of firmness exists in relation to it.

It does not work to treat DTS as if it were a contract carriage system and try to shoehorn the aspects of market carriage into that structure. If we look at market carriage by itself we see that the concepts of 'firm' and 'non-firm' are completely different than in contract carriage. In market carriage Market Participants do not nominate volumes of gas to be shipped, they bid for the right to inject gas into the market. The market operator then notifies which Market Participants are successful and they then ensure that the gas is injected. The actual transportation of the gas is assured because the market operator always schedules enough gas to meet demand. Thus there is firm transportation of gas to meet all demand but it is not held as an individual Market Participant right. The service provided by AEMO as the market and system operator, using the system provided under the APA GasNet AA and in accordance with the SEA, is the provision of sufficient gas into the VTS to enable delivery of gas at the withdrawal points. Note that this is a system wide service not a service to individual users.

The physical topology of the VTS, being more like a large scale distribution system than a point to point pipeline, means that a firm transportation right between a specific injection point and one or more specific withdrawal points for an individual user is not meaningful. It is, in fact, a specific design feature of the market carriage system that users do not have to specify transportation paths and can provide and withdraw gas at any points. Moreover, users do not actually control the withdrawals which are merely estimated. Rather, AEMO provides sufficient gas injections into the VTS such that all withdrawal demand can be met. This is not the service provided on a contract carriage pipeline where an individual Shipper's gas is accepted for injection, transportation and delivery at specified points. Thus transportation on the VTS as a whole is 'firm' and there is no concept equivalent to the contract carriage 'non-firm'. Therefore APA Group submits that the conclusion that the AEMC draws at the bottom of page ii of the Consultation Paper that there is an inconsistency is ill founded.

It is also not correct for the AEMC to characterise the reference service as a 'non-firm' service, and to characterise AMDQ Credit Certificates as increasing the 'firmness' of transportation. As noted above, actual transportation of the gas is assured and therefore there is firm transportation of gas to meet all demand. In this context, AMDQ Credit Certificates 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.

AMDQ Credit Certificate revenue forecasts

On the basis of commercial arrangements entered into by APA Group with AMDQ Credit Certificates holders there will be an increase revenue derived from the sale of AMDQ Credit Certificates in the period 2013-17. APA GasNet submits that this has occurred due to a shortage of AMDQ Credit Certificates relative to the demand. This shortage of AMDQ Credit Certificate is a direct result of the decision by the ACCC (the relevant regulator at the time) in 2008 not to approve the Stonehaven compressor in the 2008 to 2012 Access Arrangement.

In 2011, APA Group recognising that there was potential for the market to pay higher than desirable prices for AMDQ Credit Certificates, changed the AMDQ Credit Certificate allocation process from using the regulators preferred auction process to a pro-rated tender process at a fixed price (the fixed price set at a material level below the result of an earlier auction process. Whilst APA Group earns extra revenue in the short term from constraints in the pipeline system through AMDQ Credit Certificates, in the longer term APA Group is incentivised to make efficient investments in the pipeline system. The need for these investments are signalled by the demand for AMDQ Credit Certificate, as the need are not otherwise signalled in the Victorian market carriage system.

The AER in its draft decision has now approved additional compression on the South West Pipeline that will add 50TJ of additional AMDQ Credit Certificates at the Port Campbell Injection Zone. The capacity installed will meet market needs (as confirmed by APA Group's active canvassing of the marketplace) over the forthcoming access arrangement period. As the installed capacity will match market needs then the availability of AMDQ Credit Certificates will meet demand and on the basis that AMDQ Credit Certificates are about mitigating risk the price of these AMDQ Credit Certificates will fall. Therefore APA Group does not agree with the AEMC's assessment that there is likely to be an increase over the long term in the share of APA Group's revenue earned from the AMDQ Credit Certificate service.

In the circumstance where supply of AMDQ Credit Certificates has not been distorted APA Group would be comfortable reverting to an auction process which would be consistent with AER's view that "issuing AMDQ Credit Certificates through an auction is efficient and consistent with the NGO and RPP of promoting efficient investment in pipeline services by providing an investment signal in terms of the cost of network capacity constraints".[5]

2. AEMC is not authorised by the law to make rules purporting to apply any amended rule to the declared transmission system for the purposes of the 2013-17 access arrangement period

APA Group is extremely concerned by the AEMC's foreshadowing of the making of transitional provisions which would purport to provide for the operation and application of the final Rule determination to:

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

In addition to questions of fairness, APA Group submits 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 of reference service and rebateable service definitions.

APA Groupt submits that clause 43(1) of Schedule 2 of the NGL precludes the application of an amended definition of rebateable service to an access arrangement review which in the case of the DTS has not only "begun", but in the case of the DTS has passed the draft decision stage. APA Group also submits that clause 43(1) of Schedule 2 of the NGL likewise precludes an amendment to a rule which affects the rights or liabilities accrued under the previous operation of that provision.

Application to a review process that has already begun

As the AEMC is aware, APA Group is in the middle of an access arrangement review process for the DTS for the period of 1 January 2013 – 31 December 2017. In April 2012, APA Group submitted proposed revisions to its access arrangement for the DTS to the AER for review. On 11 September 2012, the AER released its draft decision not to approve APA

[5] Page 8 AER "Request for making of a rule relating to rebateable service and reference service definitions & Criteria"

Group's proposal, and as part of this draft decision, set out alternative revisions to the access arrangement that would be acceptable to the AER. The draft decision requires APA Group to submit a revised access arrangement proposal to the AER by 9 November 2012.

APA Group's proposal for its VTS access arrangement was premised on the current National Gas Rules (NGR) definitions for reference services and rebateable services. In particular, APA GasNet's service definitions, revenue modelling and proposed tariffs are all based on the current NGR definitions of reference services and rebateable services and reflect current APA GasNet practice in respect of services which do not meet these definitions. The AER's draft decision on the proposed VTS access arrangement is also based on the current NGR definitions. In response, APA GasNet is currently preparing to submit a revised access arrangement proposal in response to the AER's draft decision, and is doing so on the basis of the current provisions in the NGR, as it must do.

The service provider's original proposal and the AER's draft decision are key steps in the access arrangement review process. The documents establish the scope for further amendments by either the service provider or the AER (if it refuses to approve the service provider's proposal). In accordance with the NGR, the amendments which may be made by the service provider after the draft decision stage are limited to those necessary to address matters raised in the draft decision (unless the AER approves further amendments). Similarly, any amendments which may be made by the AER if it refuses to approve a revised access arrangement proposal are to be formulated with regard to the service provider's proposal and the AER's reasons for refusing to approve that proposal. It is clear from the structure of the NGR that the access arrangement review is intended to be an iterative process which commences with, and is clearly framed by, the service provider's original proposal.

APA Group submits it is implicit in the NGR that a consistent set of rules are to apply throughout the access arrangement review process. If not, amendments to an access arrangement proposal could not be limited in the way it is envisaged and the process would be flawed creating an unacceptable regulatory risk of uncertainty. It is subsequently exceedingly inappropriate for any change in the rules governing the preparation of access arrangement proposals to apply to review process which have already "begun". APA Group submits such a change would be in clear violation of clause 43(1) of Schedule 2 of the NGL.

Potential impact on APA GasNet's existing commercial arrangements

As discussed above APA Group has existing contractual arrangements relating to services which may be affected by the proposed changes to the definition of "rebateable services".

APA Group's existing commercial arrangements with shippers provide for a form of rebate to shippers that take the Tariffed Transmission Service for transmission in respect of which they hold an AMDQ Credit Certificate entitlement. The rebate is based on the volume they take at the reference tariff and the extent to which the shipper has an existing AMDQ Credit Certificate entitlement for all or part of that volume. This means that where the price of AMDQ Credit Certificates reflects the reference tariff, there is no revenue impact on APA Group associated with issue of AMDQ Credit Certificates. It is only where shippers pay a price above the reference tariff for AMDQ Credit Certificate capacity that APA Group sees a positive revenue impact associated with its issue of AMDQ Credit Certificate (and receives a market signal to increase capacity of the pipeline).

APA Group has recently issued AMDQ Credit Certificates for 353,000 GJs of daily capacity on the South West Pipeline from the Port Campbell Injection Zone. The AMDQ Credit Certificates were issued for a five year period from 1 January 2013 to 31 December 2017. While the contracts themselves do not contain any express provision in relation to rebates for volume acquired under the reference tariff, this is stated as a principle underpinning the tender process.

If the definition of "rebateable service" under the NGR was to change such that AMDQ Credit Certificates became a rebateable service, it could potentially require different rebating arrangements to those currently provided for under existing commercial arrangements and affect the risk/reward relationship under the existing commercial relationships.

APA Group submits that it is an unacceptable regulatory risk for a rule change to alter the nature of rights and liabilities under existing contractual arrangements and is contrary to the principles set out in clause 43(1) of Schedule 2 of the NGL. As APA Group has already contracted with shippers for AMDQ Credit Certificates for the forthcoming access arrangement period, it would be wrong for any rule change to be applied in a way that affects rights and liabilities accrued under these arrangements. As a result, APA Group submits that if the rule change is enacted, the definition of rebateable services should not apply until the access arrangement for 2018 onwards.

3. AEMC's Rule making Process

Process for making the proposed Rule

APA Group is concerned the AEMC has not followed the proper procedure in relation to its Rule change proposal. By way of its Consultation Paper dated 13 September 2012, the AEMC announced a fundamental reversal of its position regarding the rule change for rebateable services as stated in its Draft Rule Determination. APA Group considers that the process adopted by the AEMC in respect of this Rule change is flawed and represents an inconsistent and unacceptable practice for rule development and amendment

In the Draft Rule Determination, the AEMC considered that a change to the rebateable service definition as proposed by the AER would not be in the long term interests of consumers, noting in particular the increased risk to new investment. The AEMC concluded:

> *The Commission considers that the proposed rule 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. This is because there is potential to change the risk/reward relationship in existing bilateral contracts if the proposed change to the rebateable service definition is accepted.*

By way of its Consultation Paper, the AEMC is now proposing a significant change to the rebateable service definition that applies only to pipeline services provided by means of the DTS. This new definition is sought to remove the existing limitation on rebateable services that the market for the service is substantially different from the market for any reference service. It is not clear to APA GasNet how the AEMC has reconciled this new approach with its earlier view that changing the rebateable service definition would not be in the long term interests of consumers.

APA Group's view is that as there is such a significant variation to the more preferable rule contained in the Draft Rule Determination, the Consultation Paper effectively replaces the Draft Rule Determination. Therefore to the extent that the AEMC proposes to make a more preferable rule of a type not previously foreshadowed, it is incumbent upon the AEMC to clearly set out a draft of the rule which it now intends to make, and provide for adequate consultation on this.

Given the potentially significant implications of any Rule change affecting the definition of rebateable services, it is critical that the AEMC clearly articulate what Rule it intends to make (including transitional provisions) and provide for adequate consultation. This is particularly important in circumstances where the Rule may purport to affect accrued rights and liabilities and / or affect an access arrangement review process which is already well progressed.

In the absence of a draft of the Rule which the AEMC intends to make and given the very short period provided for consultation on the AEMC's proposal, APA Group 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 access arrangement review process. However to the extent there are such impacts, we note that this may mean that any final rule is in conflict with clause 43(1) of Schedule 2 to the National Gas Law.

Given the very limited opportunities provided for consultation on the AEMC's substantially revised proposal, APA Group considers that a high degree of caution should be exercised in proceeding to any final rule. In particular, the AEMC should be careful to ensure that any final rule does not adversely affect any accrued rights or liabilities or unduly prejudice stakeholders in respect of processes which have already begun. APA Group submits that in these circumstances, the prudent course would be to delay the operation of any rule change until at least the next access arrangement review, in order to avoid the potential for retrospective effect.

Incomplete proposed rule

APA Group notes the AEMC has sought submissions on possible transitional provisions that would deal with the operation and application of the final rule to access arrangement reviews already in progress. It has done this at the AER's request. APA Group further notes that transitional arrangements were not identified in the draft Rule Determination and that neither the AER nor the AEMC have provided any proposed drafting for the transitional provisions in the Consultation Paper. Consequently, in APA Group's view, the Consultation Paper does not contain a complete proposed rule change as required by section 308 of the NGL.

To satisfy the requirements of section 308, APA Group considers the AEMC is legally required to publish a complete draft of the rule that it proposes to make, including any transitional provisions. A rule dealing with transitional issues is of the same character and importance as any other rule the AEMC is entitled to make. Transitional provisions have substantive operation and it is erroneous to regard them as ancillary or of inferior importance to the making of any other rule.

If transitional provisions that purport to apply any amended definition of rebateable services to APA Group in the access arrangement period 2013-17 were to be included in a final Rule determination, such inclusion could have considerable commercial implications for APA Group for many reasons, but most importantly due to the potential impact it could have on a number of existing long term contractual arrangements. Particularly in these circumstances it is unsatisfactory for the AEMC to simply publish a Consultation Paper identifying matters which it may seek to address in a final rule determination which could have such significant implications for stakeholders.

In these circumstances, APA Group considers 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. Any final rule should only include provisions which have been subject to proper consultation.

APA Group would be pleased to discuss matters addressed in this submission if the Commission should so desire. Please contact Peter Bolding on 02 96930053 or peter.bolding@apa.com.au should you have any queries.

Yours faithfully

Ross Gersbach
Chief Executive Strategy and Development