

22 August 2017

Mr John Pierce  
Chairman  
Australian Energy Market Commission

Lodged online

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Dear Mr Pierce

**GPR0004: Review into the scope of economic regulation applied to covered pipelines – Issues Paper**

AEMO welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) review into the scope of economic regulation applied to covered pipelines.

**Market Carriage Regulatory Framework (Questions 5 and 6)**

AEMO considers there is merit in reviewing the regulatory framework in Victoria for the Declared Transmission System (DTS) with respect to considering the implementation of a statutory reliability and planning standard.

The need for greater clarity and coordination in the planning and investment process is growing as a consequence of changing demand patterns (that are becoming peakier particularly in distribution networks) and supply dynamics. As there is no statutory reliability or planning standard in Victoria there is a potential for ambiguity with regards to what is an efficient level of investment to maintain a safe and reliable network. The lack of clarity can result from what constitutes necessary new capital expenditure under the *new capital expenditure requirements* (Rule 79) in the NGR. Rule 79(2) states that investment can be justified as necessary:

- (i) to maintain and improve the safety of services; or
- (ii) to maintain the integrity of services; or
- (iii) to comply with a regulatory obligation or requirement; or
- (iv) to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred (as distinct from projected demand that is dependent on an expansion of pipeline capacity)

However, without a reliability and planning standard there may be different views on whether an investment needs to be proposed to maintain a safe and secure system in accordance with Rule 79(2). Greater clarity on the investment rules is particularly important in Victoria given the different institutional roles for the market carriage pipelines in Victoria where AEMO is the system operator, responsible for system security, and is separate from DTS service provider (the asset owner). In addition, if an investment is proposed under the current framework, it may also be challenging to justify new capital expenditure under rule 79 when there is no common basis for what is a reliable and secure network.

A reliability and planning standard would provide a common objective framework for what constitutes a reliable and secure system and this would guide whether the criteria under rule 79 are satisfied. An additional benefit of the planning and reliability standard would be to aid in coordinating investment between the transmission system and distribution networks by defining a minimum level of acceptable reliability for both transmission and distribution customers. Such standards are commonplace in European gas networks and there is a reliability standard in the National Electricity Market. The standard would be set and

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administered by an organisation that is tasked with assessing relevant trade-offs after undertaking public consultation.

A reliability and planning standard should provide incentives for an efficient level of network investment required to maintain a safe and reliable network. Under the framework, the DTS service provider would be obligated and incentivised to meet the DTS reliability and planning standard. Consistent with the current incentive-based regulatory framework, the DTS service provider would choose the technical solution(s) required to meet the standard and ultimately whether to invest in the network at all. If the DTS Service Provider failed to meet the reliability standard during an access period (for example due to choosing not to invest in the system) there would be financial penalties.

### **Reference Services (Question 11)**

AEMO considers that the efficient provision and allocation of pipeline services has become increasingly important to well-functioning wholesale markets. Through our operation of wholesale gas markets, we have observed that the access to and pricing of some pipeline services is important to market participation and that this will ultimately flow through to market liquidity. This is particularly the case where these services are used to transfer title between buyers and sellers to reflect trades undertaken in the wholesale market or are required to transport gas to/away from a market's trading location. These services can typically only be provided by the pipeline operator on that specific pipeline and so they are generally not contestable.

We have observed that the definition of reference services on covered pipelines is often narrow and does not include many of the services that are required to participate effectively in wholesale and retail markets. The current definition of a reference service, which only refers to demand for the service (a service that is likely to be sought by a significant part of the market), and does not consider contestability, may not be adequate to cover an appropriate suite of services<sup>1</sup>. In particular, it may be challenging for the AER to define what "sought by a significant part of the market" means in practical terms. We consider that the criteria for what constitutes a reference service would benefit from greater clarity in the NGR in order to aid the AER in its determinations. In addition, we acknowledge that the timeframes and process associated with the current access arrangement approach may be inhibiting the ability for additional services to be defined as reference services. As such, we would support further consideration of the adoption of the "framework and approach process" for access arrangements.

If the framework and approach process is adopted, reference services would be defined upfront. We would consider it important that this process examine the services that are required to effectively participate in the wholesale market and assess whether these services are contestable.

If you would like to discuss the contents of this submission further, please do not hesitate to contact Violette Mouchaileh, Group Manager Market Enhancement, on 03 9609 8504.

Yours sincerely,



Peter Geers

**Executive General Manager, Markets**

<sup>1</sup> Rule 101 of the NGR