

Australian Energy Market Commission

RULE DETERMINATION

National Gas Amendment (DWGM- AMDQ Allocation) Rule 2016

Rule Proponent(s)

Australian Energy Market Operator

24 March 2016

RULE
CHANGE

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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Summary

The Australian Energy Market Commission (AEMC or Commission) has made this final rule determination which sets out a framework for determining the type of market benefit instruments (authorised MDQ or AMDQ credit certificates created¹) as a result of an extension or expansion of the Victorian declared wholesale transmission system and the party responsible for undertaking the allocation process for those instruments.

The Commission's final rule, is a more preferable rule, and:

- clarifies the type of market benefit instruments created in respect of extensions or expansions of the Victorian declared transmission system by providing that:
 - authorised MDQ will relate only to historic capacity on the Longford to Melbourne pipeline at the time of commencement of the Victorian Declared Wholesale Gas Market;
 - AMDQ credit certificates will be created in relation to all extensions or expansions where new market benefit instruments are created.
- provides that the Australian Energy Market Operator (AEMO) will be required to use the proceeds from its allocation process to offset the operating costs of the Victorian Declared Wholesale Gas Market; and
- provides that the AEMO will provide a minimum of twenty business days' notice prior to undertaking the allocation process of either authorised MDQ or AMDQ credit certificates.

These three aspects of the final rule are collectively referred to as the 'non-controversial aspects' of the final rule.

The final rule also addresses the 'controversial aspect' of the rule change request relating to the party responsible for undertaking the allocation process for market benefit instruments. On this aspect of the final rule, stakeholders held differing views and the Commission considered whether the benefits outweigh the costs of implementation and administration given the Review of the Victorian Declared Wholesale Gas Market currently being undertaken by the Commission² and the draft recommendations made by the Commission as part of the review.

¹ Authorised MDQ and AMDQ credit certificates are instruments held by market participants in the Victorian Declared Wholesale Gas Market. These instruments differ in respect of their location and time validity but are similar in terms of the rights they represent. This includes: (1) limited physical access rights which provide some protection against curtailment; and (2) some market rights which provide priority in scheduling and reduced uplift payments. For further discussion on the rights associated with market benefit instruments see section 1.1.1

² See the AEMC website: www.aemc.gov.au, Review of the Victorian Declared Wholesale Gas Market

The final rule in relation to the controversial aspect:

- clarifies the party responsible for undertaking the allocation process by providing that:
 - AEMO is responsible for undertaking the allocation process for all authorised MDQ;
 - AEMO is the party responsible for undertaking the allocation process for AMDQ credit certificates where the costs of the extension or expansion that created or creates AMDQ credit certificates are included in the declared transmission system service provider's opening capital base for an access arrangement period or is included in its approved capital expenditures for an access arrangement period;
 - the declared transmission system service provider is the party responsible for undertaking the allocation process³ for AMDQ credit certificates where the costs of the extension or expansion that created or creates AMDQ credit certificates are not included in its opening capital base for an access arrangement period or in its approved capital expenditure for an access arrangement period.

Details of the rule change request

On 13 November 2013, AEMO submitted the DWGM-AMDQ allocation rule change request in which AEMO identified a number of issues with the current provisions dealing with authorised MDQ and AMDQ credit certificates as a result of uncertainty and lack of clarity in the rules. To address this problem, the rule change request proposed a number of amendments to Part 19 of the National Gas Rules to provide clarity in relation to the type of market benefit instrument created (authorised MDQ or AMDQ credit certificates) as a result of an extension or expansion of the Victorian declared transmission system and the party who undertakes the allocation process for the market benefit instruments.

In particular, the proposed rule provided that:

1. all new market benefit instruments created from an extension or expansion create AMDQ credit certificates; and
2. the declared transmission system service provider is the party responsible for undertaking the allocation process for all AMDQ credit certificates and AEMO is the party responsible for undertaking the allocation process for all authorised MDQ.

In addition, amendments were proposed requiring AEMO to offset the costs of operating the Victorian Declared Wholesale Gas Market with any proceeds it receives

from undertaking the allocation process and requiring twenty business days' notice to be provided prior to a party undertaking an allocation process for market benefit instruments.

Under the current practice, the declared transmission system service provider undertakes the allocation process for all AMDQ credit certificates and bundles the AMDQ credit certificates with a take or pay contract. Under the bundled take or pay contracts, the market participant agrees to pay for the quantity of transportation services associated with its contract, and pursuant to the terms and conditions of the contract including when payment will occur, whether it is used or not.

Commission's decision

The Commission considers that the current provisions relating to the creation and allocation of authorised MDQ and AMDQ credit certificates are unclear and create regulatory uncertainty. Further, the current tender process used by the declared transmission system service provider related to AMDQcc is not clear and transparent. The Commission has determined a more preferable rule will, or is likely to, contribute to the achievement of the National Gas Objective, by promoting more efficient use of, and possibly investment in, natural gas pipelines in the long term interests of consumers.

The Commission's assessment of the rule change request is based on the current design and operation of the Victorian Declared Wholesale Gas Market. However, the Commission is currently undertaking a review of the Victorian Declared Wholesale Gas Market which may result in substantial changes to the design and operation of the market. Depending on the outcome of the review, the mechanisms, incentives and signals in the market may be altered. Therefore, the Commission's assessment of this rule change request is confined to the specific conditions in the Victorian Declared Wholesale Gas Market at this time.

Non-controversial aspects of the final rule

The Commission is satisfied that the non-controversial aspects of the final rule will, or is likely to contribute to the achievement of the National Gas Objective as follows:

- the final rule will provide regulatory certainty to market participants with respect to the type of market benefit instruments created from an extension or expansion of the Victorian declared transmission system. This should improve confidence in the operation of the market as the interpretation and functioning of the rule will be clear;
- the final rule will provide increased information provision to market participants by requiring AEMO to provide twenty business days' notice to market participants prior to undertaking an allocation process. This will provide market

³ The allocation of AMDQcc is always undertaken by AEMO based on either the direction of the declared transmission service providers following its allocation process or based on the results of the allocation process undertaken by AEMO.

participants an opportunity to make informed decisions about their participation in the allocation process. More informed decisions may lead to a more efficient use of the system by market participants and more efficient investment in the Victorian declared transmission system.

Controversial aspect of the final rule

The effect of the Commission's final rule in relation to the controversial aspect will be:

- the unbundling of AMDQ credit certificates from a take or pay contract for transportation services⁴ when AMDQ credit certificates are allocated pursuant to the allocation process of AEMO; and
- the declared transmission system service provider will have diminished opportunity to over-recover revenue in relation to AMDQ credit certificates.

The Commission is satisfied that the controversial aspect of the final rule will, or is likely to contribute to the achievement of the National Gas Objective as follows:

- the final rule, similar to the non-controversial aspects of the final rule, will provide regulatory certainty to market participants. In this case, the final rule provides clarity in respect of the party who is responsible for undertaking the allocation process for market benefit instruments;
- in addition, the final rule, will provide a more transparent and efficient allocation process by:
 - providing for the alignment of the term of AMDQ credit certificates with the term of the declared transmission system service provider's access arrangement period when the AMDQ credit certificates are subject to the allocation process of AEMO;⁵
 - having the effect of unbundling AMDQ credit certificates from a take or pay contract for transportation services⁶, which contracts provide no firm capacity rights, which will help to ensure that market participants (and, as

⁴ In the Commission's draft rule determination, this bundling was referred to as the bundling of AMDQ credit certificates with the pre-payment of the transportation tariff on transportation services. APA indicated that the concept of a pre-payment mischaracterised the bundling as market participants are not required to make any up-front payment. Therefore, the Commission has adopted APA's terminology of bundling of AMDQ credit certificates with a take or pay contract; however, the Commission is of the view that this change in terminology does not impact the underlying concept that AMDQ credit certificates are tied to the payment for transportation services.

⁵ AMDQ credit certificates have historically been issued for a set term which in some cases coincides with the access arrangement periods. However, the rules currently only indicate that AMDQ credit certificates are for a set term but the rules do not address the length of the term.

⁶ Neither the NGR or the final rule prescribe the bundling or unbundling of AMDQ credit certificates. Rather, as a result of AEMO undertaking the allocation process for AMDQ credit certificates, the ability for the declared transmission system service provider to bundle the payment for AMDQ credit certificates with payment for transportation services is removed.

a result consumers) only pay for those transportation services they actually use given the lack of firm capacity rights. In addition, the price paid for authorised MDQ and AMDQ credit certificates from the resulting unbundling will more clearly reflect the value that market participants assign to the rights associated with holding the market benefit instruments, thereby providing better signals to the declared transmission system service provider and market participants.

Regulatory certainty and a more transparent and efficient allocation process for AMDQ credit certificates may lead to more efficient use of and investment in the Victorian declared transmission system. This is a result of market participants' demand for and the price paid for AMDQ credit certificates more clearly reflecting market participants' assessment of the benefits associated with holding the market benefit instruments and ensuring appropriate investment signals in the system.

The Commission notes that although the effect of the final rule is the unbundling of AMDQ credit certificates from the take or pay contract, where AEMO is responsible for undertaking the allocation process for the AMDQ credit certificates, this will not necessarily mean that market participants will no longer be able to enter into a take or pay contract where it is in their commercial interests to do so. It is also acknowledged that the economic regulatory regime under the National Gas Rules does not preclude the declared transmission system service provider from earning revenue in addition to its regulated revenue amount.

However, the Commission is of the view that the market benefits provided by AMDQ credit certificates, which are used by market participants and managed by the market operator, are different to other services which are provided by the declared transmission system service provider and, where possible, the potential for over-recovery of revenue related to these instruments should be minimised.

In parallel to this rule change request, the Commission is undertaking a Review of the Victorian Declared Wholesale Gas Market at the request of the Victorian government and the Council of Australian Governments' Energy Council. The Commission's draft report was published on 4 December 2015.⁷ The Commission's draft recommendation in the review is to replace the existing market carriage arrangements with an entry-exit system for allocating capacity. An entry-exit system would allow network users to book capacity rights independently at each entry and exit point to the system, supporting the development of gas trading liquidity and risk management tools.

If the Commission's recommendations in the final report reflect those in the draft, and the Victorian government and Council of Australian Governments' Energy Council supports the implementation of an entry-exit system in the Victorian declared transmission system, the current market carriage regime will be replaced, and authorised MDQ and AMDQ credit certificates will no longer be relevant instruments in the market. Depending on when and if this occurs, the final rule may operate at a

⁷ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

minimum for the next access arrangement period of the declared transmission system service provider. The Commission acknowledges that there will be costs associated with implementing and administering the final rule, but consider the benefits outweigh these costs and contribute to the achievement of the National Gas Objective.

The Commission recognises that the review of the Victorian Declares Wholesale Gas Market is ongoing and that the Victorian government and the Council of Australian Governments' Energy Council will need to make a determination in respect to adoption and implementation of any final recommendations that may be made. The process related to the review and implementation of any recommendations may have an impact of APA's and market participants' behaviour including decisions related to investment in the Victorian Declared Wholesale Gas Market. In the absence of the possible impact on participant behaviour that may flow from questions on the outcome of the review process (including implementation of any recommendations), the final rule serves to improve investment incentives and/or signals in the Victorian Declared Wholesale Gas Market and contributes to the achievement of the National Gas Objective.

Following is a table that provides a comparison of the current rule requirements, the current practice, the proposed rule, the Commission's draft more preferable rule and the Commission's final rule. The draft more preferable rule and the final rule are the same in respect of intent; however, the final rule contains some amendments to improve the implementation and operation of the rule.

Table 1 Comparison of the rule requirements

	Current rule requirements	Current practice	Proposed rule	Commission's draft more preferable rule	Commission's final rule
What is the classification of new market benefit instruments created as a result of an extension or expansion?	<p>If 100 % of the costs are included in the capital base then authorised MDQ is created.</p> <p>If less than 100 % of costs are included in the capital base either authorised MDQ or AMDQ credit certificates are created.⁸</p>	All new market benefit instruments created through an extension or expansion are AMDQ credit certificates.			
What is the process for determining the classification of new market benefit instruments created as a result of an extension or expansion?	Silent when determining if new market benefit instruments created are authorised MDQ or AMDQ credit certificate.	The classification of new market benefit instruments created is determined by agreement between AEMO and the declared transmission system service provider	The rules prescribe that all new market benefit instruments created are AMDQ credit certificates.		
Who undertakes the allocation process for	AEMO; however, the rules currently only	The declared transmission system service provider	AEMO		

⁸ The rules do not provide direction on the process used to determine if authorised MDQ or AMDQ credit certificates are created in these circumstances.

	Current rule requirements	Current practice	Proposed rule	Commission's draft more preferable rule	Commission's final rule
AMDQ credit certificates when it is included in the declared transmission system service provider's capital base?	provide an allocation process for AEMO when it is undertaking the allocation process for authorised MDQ.				
Who undertakes the allocation process for AMDQ credit certificates when it is not included in the declared transmission system service provider capital base?	The declared transmission system service provider				
What happens to the proceeds from the allocation process?	Silent	<p>The declared transmission system service provider refunds the volume effect through its annual tariff adjustment mechanism.</p> <p>AEMO offsets the costs of operating the Victorian Declared Wholesale Gas Market with any proceeds received from its allocation process.</p>	The rules require AEMO to offset the costs of operating the Victorian Declared Wholesale Gas Market with any proceeds received from its allocation process.		

	Current rule requirements	Current practice	Proposed rule	Commission's draft more preferable rule	Commission's final rule
Who undertakes the allocation process for authorised MDQ?	AEMO and the declared transmission system service provider (in limited circumstances where the costs of the extension or expansion that created the authorised MDQ are not included in the declared transmission system service provider's capital base).	AEMO			
What is the minimum notice period prior to an allocation process taking place?	Silent	Unknown	Minimum twenty business days' notice prior to either AEMO or the declared transmission system service provider undertaking an allocation process	Minimum twenty business days' notice prior to AEMO undertaking an allocation process	
What allocation process is used for relinquished authorised MDQ?	The rules prescribe it is to be done in accordance with the AMDQ auction procedure where there is a two stage process where market participants provide their demand and	AMDQ auction procedure provides where demand is less than supply, authorised MDQ is allocated at zero dollars.	The rules prescribe it is to be done in accordance with the AMDQ auction procedure where there is a two stage process where market participants provide their demand and where demand exceeds supply, the bid price determines the allocation.		

	Current rule requirements	Current practice	Proposed rule	Commission's draft more preferable rule	Commission's final rule
	where demand exceeds supply, the bid price determines the allocation.				
What allocation process is used for AMDQ credit certificates?	Silent	The declared transmission system service provider has historically undertaken a tender process.	Silent	<p>The rules prescribe that when AEMO undertakes the allocation process it is to be done in accordance with the AMDQ credit certificate auction procedure where there is a two stage process where market participants provide their demand and where demand exceeds supply, the price.</p> <p>The rule is silent for the process to be undertaken when AMDQ credit certificates are subject to the allocation process of the declared transmission system service provider.</p>	<p>The rules prescribe that when AEMO undertakes the allocation process it is to be done in accordance with the AMDQ credit certificate auction procedure where there is a single stage process where market participants provide their demand and the price they are willing to pay. The rules specify that the AMDQ credit certificates are required to be allocated to those who offer the highest amount for those AMDQ credit certificates.</p> <p>The rule is silent on the process to be undertaken when AMDQ credit</p>

	Current rule requirements	Current practice	Proposed rule	Commission's draft more preferable rule	Commission's final rule
					certificates are subject to the allocation process of the declared transmission system service provider

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1 Introduction

On 13 November 2013, the Australian Energy Market Operator (AEMO) submitted a rule change request to the AEMC in relation to the creation of, and the allocation process for, the market benefit instruments authorised maximum daily quantity (authorised MDQ) and authorised maximum daily quantity credit certificates (AMDQcc) in the Victorian Declared Wholesale Gas Market (Victorian DWGM).

Although the main issue in the rule change request was raised by APA VTS Australia (Operations) Pty Limited (APA)⁹, pursuant to section 295(3) of the National Gas Law (NGL), only AEMO or the Victorian minister can submit a rule change request related to the Victorian DWGM.¹⁰

1.1 Relevant background

The Victorian DWGM operates as a market carriage pipeline system where pipeline users have no firm capacity rights.¹¹ Under market carriage in the Victorian DWGM, the system operator (AEMO in this case) allocates pipeline capacity through a pooled approach where gas is injected and withdrawn at various locations throughout the network.

In the Victorian DWGM, APA as the declared transmission system service provider (DTS SP)¹² makes the transmission pipeline available to AEMO under contract. AEMO manages the receipt, transportation and delivery of gas.

The transportation of gas through APA's transmission network is provided as a reference service pursuant to APA's access arrangement. The transportation of gas in the Victorian declared transmission system (Victorian DTS) is on a 'non-firm' basis whereby users cannot reserve firm capacity. This is in contrast to the typical contract carriage model where firm capacity can be reserved.

1.1.1 Market benefit instruments

In the Victorian DWGM, although users cannot reserve firm capacity on a pipeline, they may hold market benefit instruments which provide some limited physical benefits and some market rights and benefits to holders. There are two types of market

⁹ Effective 4 December 2015 APA Gas Net Australia (Operations) Pty Limited became APA VTS Australia (Operations) Pty Limited

¹⁰ In the Commission's Stage 1 Final Report on the East Coast Wholesale Gas Market and Pipeline Frameworks review, the Commission recommended that this restriction be removed to allow any party to propose a change to the rules dealing with the Victorian DWGM, Stage 1 Final Report, East Coast Wholesale Gas Market and Pipeline Framework Review, 23 July 2015, p.42

¹¹ The types of transportation contracts and services available to a pipeline user depend on whether the pipeline operates under a contract carriage model or a market carriage model.

¹² In this final determination, where there is a reference to APA it is made in the context of APA acting in its capacity as the declared transmission system service provider.

benefit instruments, authorised MDQ and AMDQcc. These instruments differ in respect of location on the network and time validity but are similar in respect of the rights provided to holders.

Broadly, there are two distinct types of rights associated with authorised MDQ and AMDQcc:

- **Limited physical access rights:** the rights associated with authorised MDQ and AMDQcc provide holders some protection against curtailment in the event of an emergency. In the event of a transmission constraint in the Victorian declared transmission system (DTS), holders of authorised MDQ or AMDQcc have the ability to inject gas into the system ahead of users not holding authorised MDQ or AMDQcc;
- **Market rights:** the market benefits associated with authorised MDQ and AMDQcc include:
 - priority in scheduled injections (injection tie-breaking rights): when there are equal-priced injection bids, those associated with authorised MDQ or AMDQcc are scheduled first;
 - reduced uplift payments (uplift hedge protection): market participants can use part of all of their authorised MDQ or AMDQcc to hedge against congestion uplift charges. Uplift charges are incurred in the event of congestion on the transmission system or when demand is significantly different to what was planned. Holders of authorised MDQ or AMDQcc are permitted to use gas up to a specified amount in a scheduling interval based on their authorised maximum interval quantity which flows from the amount of authorised MDQ or AMDQcc held by the market participant.

1.1.2 Authorised MDQ

The initial allocation of authorised MDQ occurred at the commencement of the Victorian DWGM and related to the capacity of the Longford to Melbourne pipeline. The total authorised MDQ was set at 990 TJ/day which represented the peak capacity of the Longford to Melbourne pipeline. The authorised MDQ was allocated in perpetuity to existing and committed new loads at that time, as follows:

- for Tariff D¹³ large customer sites, typically with demand exceeding 10 TJ per year, authorised MDQ was allocated to each site equal to their existing contract MDQ (maximum daily quantity) with revisions approved by an independent panel;
- for the New South Wales interconnect, Wimmera pipeline and Murray Valley towns approximately 18 TJ of authorised MDQ was allocated; and

¹³ Tariff D customers are large customers with daily demand meters and are typically large industrial sites

- for Tariff V customers, the remaining balance of the 990 TJ was allocated as a block - that is, to all residential and small-to-medium sized commercial and industrial customers.

Most large commercial and industrial customers hold authorised MDQ allocated directly to their sites. Authorised MDQ is only valid for the withdrawal of gas made at the delivery point at which it was first allocated. Authorised MDQ is valid in perpetuity. The right may be relinquished, in which case AEMO may re-allocate the authorised MDQ.

1.1.3 AMDQcc

APA (the owner of the Victorian DTS) and AEMO (the operator of the Victorian DWGM) may agree to extend or expand the Victorian DTS. An extension or expansion may result in additional market benefit instruments being created.

Since the commencement of the Victorian DWGM, additional market benefit instruments created as a result of extensions or expansions have been AMDQcc rather than authorised MDQ.¹⁴

AMDQcc have been created to provide similar benefits in terms of the limited physical access rights and market rights to those arising from authorised MDQ but differ in respect of location and time validity. While AMDQcc provides rights for a set term (usually for the same period as APA's access arrangement period), authorised MDQ is for an indefinite term. AMDQcc is also not allocated directly to a customer or a customer site but to a market participant.

The increase in pipeline capacity resulting from an extension or expansion is agreed to as between APA and AEMO. Once agreement is reached and the new capacity becomes operational, new AMDQcc are created.

1.1.4 Comparison of authorised MDQ and AMDQcc

The following table summarises the key differences between the two types of market benefit instruments:

¹⁴ Since the commencement of the Victorian DWGM, the capacity of the Victorian DTS has increased as a result of numerous augmentations, including the Interconnect, the South-West Pipeline, the connection of the former Western Transmission System, the Brooklyn Lara Loop and the BassGas project.

Table 1.1 Comparison of authorised MDQ and AMDQcc

Authorised MDQ	AMDQcc
Right recognised under the NGR	Rights associated with AMDQcc are defined in the NGR but are granted to market participants under contract
Usually held by a customer or a retailer (as part of a block) for an indefinite term	Usually held by a market participant for a set term
Allocated when the market commenced in 1998 to existing and committed new loads	Allocated when new AMDQcc is created through an extension or expansion. AMDQcc is for a set term and has historically been reallocated upon expiry of the set term
Allocation was and remains commensurate with the capacity at the Longford to Melbourne pipeline	To date, all new capacity which results from an extension or expansion has been classified as AMDQcc by agreement between APA and AEMO
Rights are in relation to withdrawal points	Rights are in relation to 'close proximity points'
Does not expire but can be transferred between parties or surrendered back to AEMO	AMDQcc is allocated for a set term and may be transferred between parties prior to the expiry of the set term but remains allocated only for the period of the original term remaining
AEMO undertakes the allocation process for spare authorised MDQ and allocated based on the results of a 'pay-as-you-go' process	Directions from APA to AEMO on the allocation of AMDQcc where historically this is reflective of the outcome of a competitive tender process where APA tenders the available AMDQcc at a pre-determined fixed price
AEMO offsets the proceeds from the auction against the operating costs of the Victorian DWGM	APA has historically offset a portion of the proceeds from AMDQcc through its annual tariff variation adjustment

1.2 Economic regulation of gas pipelines

Economic regulation of gas pipelines under the NGL is only applicable to covered pipelines which exhibit a level of market power where the benefits of regulation outweigh the costs.¹⁵

There are two types of regulation for covered pipelines, light regulation and full regulation. Under full regulation, pipeline owners are required to have full access arrangements which set out reference tariffs, services to be offered and terms and

¹⁵ Second reading Speech, National Gas (South Australia) Bill 2008, House of Assembly, 9 April 2008 (Hon. P.F. Conlon, Elder - Minister of Transport, Minister of Infrastructure, Minister of Energy), p.12

conditions. These access arrangements are approved by the Australian Energy Regulator (AER) through an access arrangement approval process.

In the context of economic regulation of pipelines, reference services and reference tariffs play an important role in providing a point of reference for negotiation and dispute resolution. Users and service providers of the pipeline then have an ability to negotiate terms and conditions (including price) of access which may differ from the access arrangement terms.

The Victorian DTS is a fully regulated pipeline network. Users of the Victorian DTS pay to APA either the reference tariff amount or the negotiated amount for the services they use. This includes the transportation of gas from one point to another on the Victorian DTS.

In addition to the setting of reference tariffs, extensions or expansions of the Victorian DTS generally result from the AER's review of APA's access arrangement application and subsequent approval or disallowance of investment costs.

APA is not obliged to extend or expand the Victorian DTS to meet increased demand. It has the discretion to determine which extensions or expansions it will include in its access arrangement application. APA may draw on planning information provided by AEMO, and other commercial information or drivers, which is submitted to the AER to help support the case in support of its proposed revenue requirement and tariffs for the upcoming period.

When an extension or expansion is included in APA's access arrangement application, the extension or expansion is included as forecast capital expenditure. The AER will use the specific information regarding the extension or expansion to assess on an ex-ante basis, whether the forecast capital expenditure is 'prudent' and meets the test for conforming capital expenditure.¹⁶

Where the criteria are satisfied and the forecast capital expenditure is approved, APA is able to collect revenues to recover the costs, allowed rate of return and depreciation where the extensions or expansions are expected to be operational in the coming access arrangement period. This recovery is accomplished through the reference tariff set for the reference services associated with the extension or expansion.

At the end of the access arrangement period, APA submits an access arrangement application to the AER for the next access arrangement period. As part of this application, APA will seek to include the actual capital expenditures of the extensions or expansions in its opening capital base for the next period. The AER will assess on an ex-post basis the actual capital expenditures for each project and make a determination on whether it satisfies the approved capital expenditures assessment as prescribed in rule 79 of the NGR. Where the extension or expansion satisfies this test, the new asset will be included in APA's capital base and APA will continue to have an opportunity to earn regulated revenue on the asset.

¹⁶ Rule 79 of the National Gas Rules sets out the matters the AER is to consider when determining whether or not the capital expenditure will be rolled into the capital base.

APA may choose not to proceed with a planned project that has been approved on a forecast basis as part of its access arrangement and may do something else or nothing at all. In addition, APA may choose to proceed with a project not included, on a forecast basis, in their access arrangement for the period the extension or expansion is undertaken and then apply to have it included in its opening capital base for the next access arrangement period, on an actual basis.

1.3 Current rule requirements

The current rule requirements in relation to the creation and allocation of market benefit instruments are in Part 19 of the National Gas Rules (NGR).¹⁷ The rules provide that when an extension or expansion results in additional market benefit instruments, either authorised MDQ or AMDQcc is created and either AEMO or APA is responsible for undertaking the allocation process for the market benefit instruments created. Currently, the allocation process used by AEMO is a 'pay-as-you-bid' process¹⁸ and an alternative (fixed price) tender process is used by APA.

Under the current rules, the following applies:

- if the total cost of the extension or expansion that results in additional market benefit instruments is entirely added to APA's capital base, authorised MDQ is created and AEMO is responsible for undertaking the allocation process;
- if only part of the cost of the extension or expansion that creates additional market benefit instruments is added to APA's capital base then:
 - either authorised MDQ or AMDQcc is created;¹⁹
 - for the portion of the costs of the extension or expansion included in the capital base, the market benefit instruments created are subject to AEMO's allocation process;
 - for the portion of the costs of the extension or expansion that are not included in the capital base, then market benefit instruments created are subject to APA's allocation process and APA directs AEMO how to allocate, among market participants, the market benefit instruments.
- if AEMO undertakes the allocation process it must do so in accordance with rule 330 which sets out the procedure for subsequent allocations and re-allocations of authorised MDQ; and
- where AEMO is not the party responsible for the allocation process, then in accordance with rule 329(5), the authorised MDQ or AMDQcc are to be allocated

¹⁷ Subdivision 3 of Division 4 of Part 19 of the NGR

¹⁸ The allocation process used by AEMO for authorised MDQ is prescribed in the AMDQ auction procedures made by AEMO

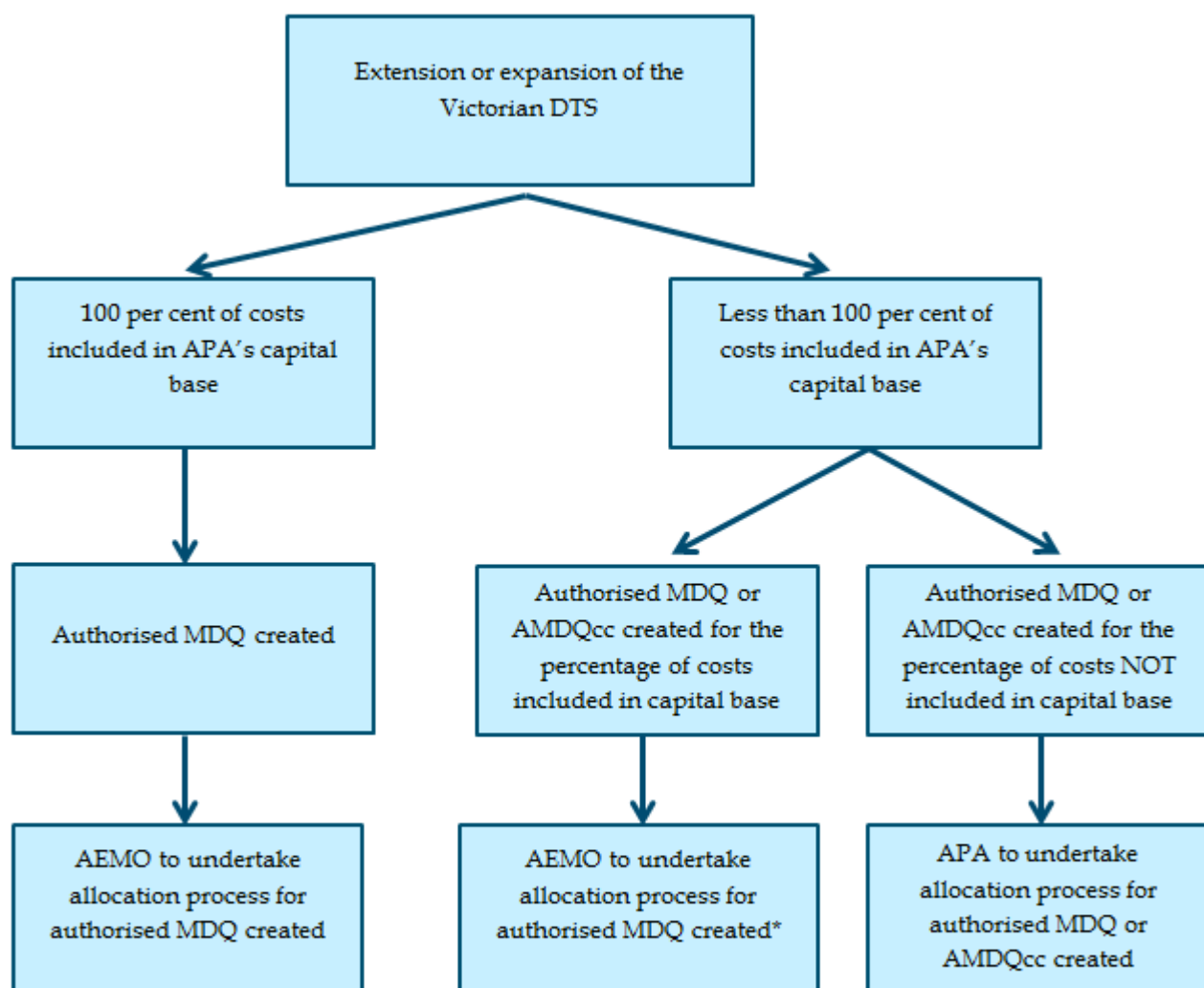
¹⁹ The rule change request identified that the lack of direction in respect of whether authorised MDQ or AMDQcc is created under the current rules as an issue which creates uncertainty.

by AEMO to market participants for a set term for use within specific withdrawal zone or for use at system injection points, as directed by APA.

The allocation process under the current rules is depicted below:

Figure 1.1 Current rule requirements

The rules provide:



* Although the rules provide that either authorised MDQ or AMDQcc may be created where the costs of the extension or expansion are included in APA's capital base, the rules also only provide an allocation process to be followed by AEMO in relation to authorised MDQ.

1.4 Current practice

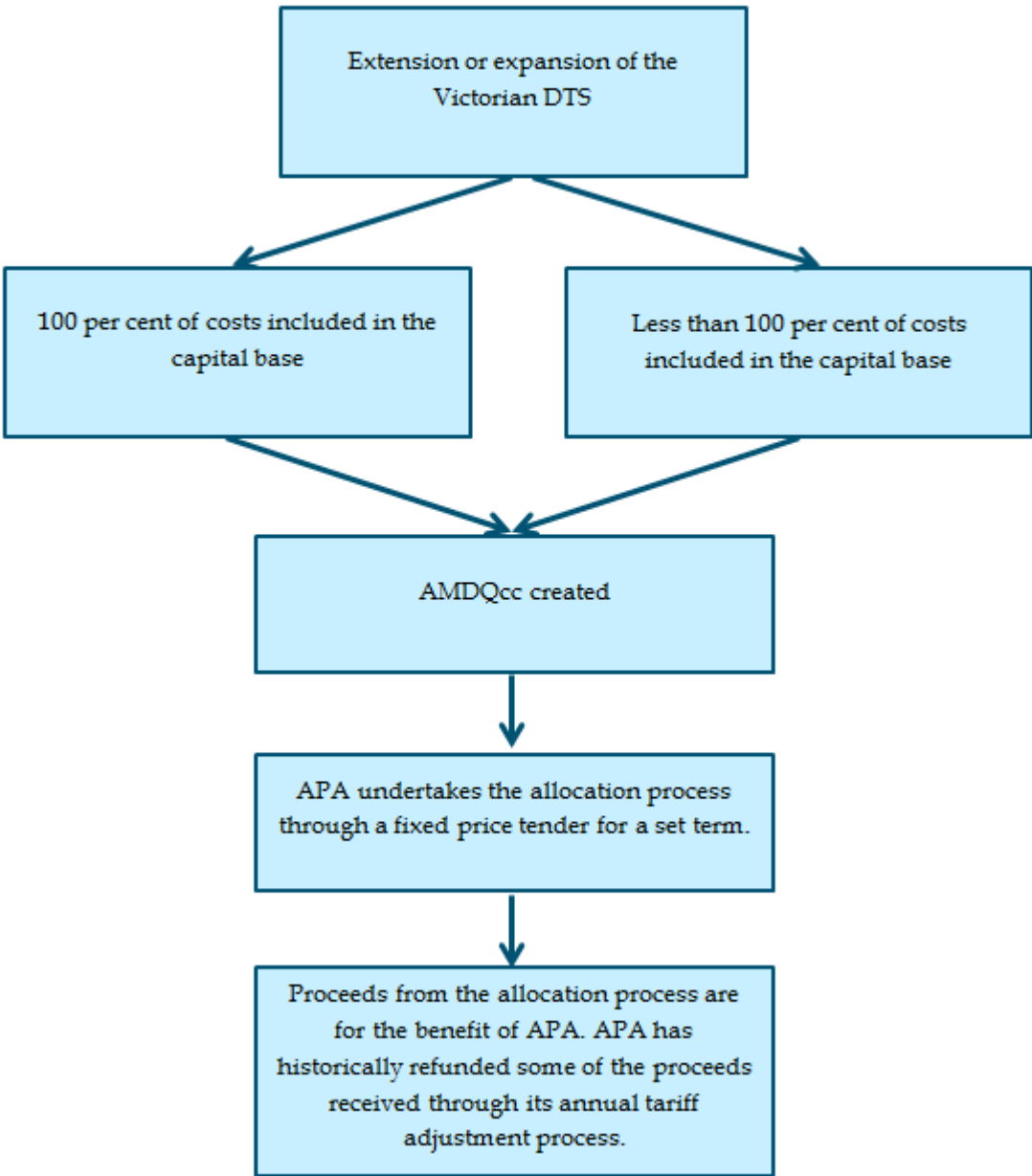
Although the rules indicate that either authorised MDQ or AMDQcc may be created through an extension or expansion of the Victorian DTS, current practice results in AMDQcc being created in relation to all such extensions or expansions. Further, all AMDQcc is currently subject to APA's allocation process, namely a competitive tender

process, whether or not the costs associated with the extension or expansion are included in APA's capital base.

The allocation process under the current practice is depicted below:

Figure 1.2 Current practice

Currently, the practice of APA is as follows:



Under current practice, authorised MDQ only relates to the historic authorised MDQ that was in existence when the Victorian DWGM commenced operation. To date, no extension or expansion of the Longford to Melbourne pipeline has taken place and no new authorised MDQ has been created. As such, AEMO has only been responsible for undertaking the allocation process for existing authorised MDQ when it becomes available.

This practice has been followed in relation to all extensions or expansions that have created new market benefit instruments on the Victorian DTS. APA has historically bundled AMDQcc with a take or pay contract. In its draft determination, the Commission referred to this practice as the bundling of AMDQcc with the pre-payment of the reference tariff for transportation services; however, APA indicated that this reference provided a misconception because it suggests market participants are required to pay an amount up-front equal to the capacity associated with the AMDQcc.

The Commission, in using the phrase 'pre-payment of reference tariff for transportation services' was not commenting on the actual payment structure between APA and market participants, but rather, was simply indicating that AMDQcc was bundled with transportation services. Therefore, to ensure no misconception regarding the payment structure, throughout the rest of this determination, the Commission will refer to the bundling of AMDQcc with a take or pay contract. In the Commission's view, this represents a change in terminology between the draft determination and the final determination but does not represent a shift in the underlying concept of AMDQcc being bundled with transportation services.

Under current practice, there is the potential for APA to collect more than its regulated revenue amount, as a result of:

- **Price effect:** which arises as a result of the difference in the price between the reference tariff and the tender price for AMDQcc (AMDQcc is sold by APA in a "bundle" which includes the market benefits associated with AMDQcc and a take or pay contract); and
- **Volume effect:** which arises as a result of:
 - APA collecting the AMDQcc price (which is the take or pay contractual price for transportation services and AMDQcc) on the full capacity amount associated with the AMDQcc, whether or not the AMDQcc holders use the full amount of the volume of transportation services associated with their take or pay contract; and
 - APA collecting the reference tariff for transportation services from other market participants who don't hold AMDQcc when AMDQcc holders do not use the full volume of transportation services associated with their take or pay contract.

Under APA's current access arrangement for the period 2013 to 2017, the AER determined that AMDQcc is a pipeline (reference) service²⁰ and set a reference tariff for AMDQcc. The reference tariff for AMDQcc was based on the costs of issuance of AMDQcc²¹ and was set at \$0.0125 per GJ.²² A reference tariff had not previously been

²⁰ AER final decision, APA Gas Net, part 2, p.22;

²¹ AER final decision, APA Gas Net, part 2, p.22

²² AER final decision, APA Gas Net, part 2, p.262

set for AMDQcc. At the time of the access determination for the 2013-2017 access arrangement period, all AMDQcc for the period 2013-2017 had been allocated through APA's tender process prior to the AER determining that AMDQcc was a reference service. However, any AMDQcc that becomes available during the current access arrangement period would be subject to the reference tariff set for AMDQcc. As a result of the price set for the AMDQcc reference service, the price effect as set out above is limited.

The current practice of the AER setting a reference tariff for AMDQcc may be altered as a result of the Commission's decision on the reference service and rebateable service definitions rule change request.²³ The National Gas Amendment (Reference service and rebateable service definitions) Rule 2012 No. 2 provides some discretion to the AER in deciding which pipeline services that are sought by a significant part of the market should be classified as a reference service and, therefore, a reference tariff set. As a result, in the future the AER has the discretion in determining if a reference tariff will be set for AMDQcc. If the AER determines that it will not set a reference tariff for AMDQcc, then the price effect as set out above may no longer be limited.

1.5 The rule change request

AEMO's rule change request raises three issues with the current rules:

- the structure of the rules hinders easy interpretation;
- there is no basis for deciding the type of market benefit instruments created as a result of an extension or expansion; and
- there is uncertainty in relation to the party responsible for undertaking the allocation process for authorised MDQ.

These issues are further described in Chapter 3 of this rule determination.

To address the matters identified above, AEMO proposed a number of amendments to Part 19 of the NGR in its proposed rule.

The rule change request seeks to bring the rules in line with the current practice. AEMO's proposed rule includes the following components to address the issues identified by the rule change request:

- authorised MDQ only relates to the historic capacity of the Longford to Melbourne pipeline at the time of commencement of the Victorian DWGM;
- any market benefit instruments created as a result of an extension or expansion of the Victorian DTS will be AMDQcc;

²³ AEMC 2012, Reference service and rebateable service definitions, Rule Determination, 1 November 2012, Sydney

- AEMO is responsible for undertaking the allocation process for authorised MDQ; and
- APA is responsible for undertaking the allocation process for AMDQcc.

In addition to the amendments proposed to address the issues identified by AEMO in its rule change request, two other amendments are proposed by AEMO to improve the operation of the Victorian DWGM:

- a mandatory notice requirement of twenty business days prior to AEMO or APA, as the case may be, undertaking its allocation process for market benefit instruments; and
- a requirement for AEMO to offset any proceeds received from its allocation process against the operating costs of the Victorian DWGM.

AEMO considers that clarifying the type of market benefits instrument created and the party responsible for undertaking the allocation process for the market benefit instruments is necessary. AEMO considers that its proposed changes would have a positive impact on efficient investment in the Victorian DTS and result in operational improvements.

1.6 Commencement of rule making process

On 10 September 2015, the Commission published a notice advising of its commencement of the rule making process and a consultation paper prepared by AEMC staff.²⁴ Submissions on the consultation paper were due by 8 October 2015, with three submissions received in total.

On 10 December 2015, the Commission published its draft rule determination and draft rule, which was a more preferable draft rule. Submissions were due on 28 January 2016, with 5 submissions received. All submissions are available on the AEMC website.²⁵

Where relevant to the discussion, the Commission has summarised the issues raised in submissions as part of its analysis in Chapters 4 and 5, with any outstanding issues summarised and addressed in Appendix A.

1.7 Review of the Victorian Declared Wholesale Gas Market

On 4 March 2015, the Victorian government and the Council of Australian Governments' Energy Council (COAG Energy Council) requested the AEMC to initiate a review of the Victorian DWGM. Under the review, the AEMC is to consider:

²⁴ This notice was published under section 308 of the NGL

²⁵ www.aemc.gov.au

- **Effective risk management in the Victorian DWGM:** the ability of market participants to manage price and volume risk in the Victorian DWGM and options to increase the effectiveness of risk management activities;
- **Signals and incentives for efficient investment in and use of pipeline capacity:** whether market signals and incentives are providing for efficient use of, and efficient timely investment in, pipeline capacity on the Victorian DTS;
- **Trading between the Victorian DWGM and interconnected pipelines to maximise the efficiency of trade:** whether producers and shippers can operate effectively across the different gas trading hubs on the east coast without incurring substantial transaction costs;
- **Promoting competition in upstream and downstream markets:** whether the Victorian DWGM arrangements continue to facilitate market entry and promote competition in upstream and downstream markets and how this could be improved.

The Commission published its draft report in relation to its Review of the Victorian DWGM on 4 December 2015.²⁶

The Commission's draft recommendation in the draft report is to replace the existing market carriage arrangements with an entry-exit system for allocating capacity. An entry-exit system would allow network users to book capacity rights independently at each entry and exit point to the system, supporting the development of gas trading liquidity and risk management tools. Moreover, demand for entry and/or exit capacity would create market-driven signals for investment in the Victorian DTS, where these signals are currently limited.

Under an entry-exit system, revenue earned by APA would be regulated, on a similar basis to today. However, requiring users to purchase capacity at entry and exit points will change the risk allocation of that investment as the user bears at least some of the costs (and risks) associated with their decisions. Allocating risk in this way creates incentives on users to ensure their decisions on access are well informed and ultimately efficient.

At this time the review process is on-going and no final recommendations regarding changes to market design have been made. Further any changes flowing from the review of the Victorian DWGM will need to be adopted and implemented by the Victorian government and the COAG Energy Council.

²⁶ AEMC, 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

2 Final Rule Determination

The Commission has decided to make a final rule, which is a more preferable rule. The final rule clarifies what type of market benefit instrument is created as a result of an extension or expansion and the party responsible for undertaking the allocation process of the market benefit instruments.

The final rule is attached to and published with this final rule determination. Having regard to the issues raised in the rule change request and by stakeholders in submissions, the Commission is satisfied that the final rule will or is likely to better contribute to the achievement of the National Gas Objective (NGO) than the existing rules or AEMO's proposed rule.

This chapter outlines:

- the Commission's rule making test for changes to the NGR;
- the Commission's assessment framework for considering the rule change request; and
- the Commission's consideration of the final rule against the NGO.

Further detail on the legal requirements for making this final determination is set out in Appendix B.

2.1 Rule making test

Under 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 NGO²⁷ 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.”

The NGO captures three dimensions of efficiency:

- productive efficiency (efficient operation): means goods and services should be provided at the lowest possible cost to consumers;
- allocative efficiency (efficient use of): means that the price of goods and services should reflect the cost of providing them;

²⁷ NGL, section 23

- dynamic efficiency (efficient investment): means arrangements should promote investment and innovation in the production of goods and services so that allocative and productive efficiency can be sustained overtime, taking into account changes in technologies and the needs and preferences of consumers.

The Commission considers that the relevant aspects of the NGO in the context of this rule change request are:

- efficient use of the Victorian DTS by market participants; and
- efficient investment in the Victorian DTS.

2.2 Assessment framework

The Commission has considered the following principles in assessing the rule change request:

- **Regulatory certainty:** improved regulatory certainty improves confidence in the operation of the market by AEMO, APA and other market participants. Greater certainty in relation to the classification of new market benefit instruments created as a result of an extension or expansion and the party responsible for undertaking the allocation process may provide market participants with increased confidence in the operation of the market;
- **Increased information provision:** generally, greater information provision allows all parties to make more informed decisions regarding how they will operate their businesses and how they will behave in the market. A mandatory notice provision which requires AEMO to provide a minimum notice period prior to the allocation process for authorised MDQ and AMDQcc occurring may assist market participants in making more informed and efficient decisions in relation to their participation in the allocation process and the market;
- **Efficient allocation process:** the allocation process employed in respect of authorised MDQ and AMDQcc may impact on decisions made by AEMO, APA and other market participants. There are two aspects related to the allocation process considered as part of this rule change request:
 - the impact on possible investment signals and/or incentives in the Victorian DWGM; and
 - the impact on price certainty and ensuring users only pay for services for which they use given the lack of firm capacity rights under the Victorian DWGM's market carriage model, thereby promoting efficient use of the system by users.

In undertaking this assessment, the Commission considered the long-term costs and benefits of the final rule compared to the counter-factual of not making the proposed changes to the NGR. As part of this the Commission considered the costs in light of the benefits that may accrue if the final rule is only in place in the short-term as a result of

any changes in the Victorian DWGM flowing from the Commission's review. The Commission acknowledges that APA, market participants and AEMO may incur some costs as a result of the final rule. APA indicated that the implementation and administrative costs would outweigh the benefits²⁸; however, EnergyAustralia indicated that it did not foresee material costs for market participants as a result of the rule²⁹. The Commission is of the view that the costs incurred by AEMO to develop and test the necessary procedures and systems are not substantial. As a result, even in the short-term, the Commission is of the view that the benefits provided by the final rule outweigh the costs.

2.3 The Commission's final rule

The Commission has decided to make a final rule, which is a more preferable rule. The Commission considers there are two aspects of the final rule.

The first aspect has been referred to as the 'non-controversial aspect' as no stakeholder expressed concern with these aspects of the rule change, they are in line with the current practice in the Victorian DWGM and are generally in line with the rule proposed by AEMO.

The second aspect of the final rule has been referred to as the 'controversial aspect' as stakeholders have differing views on this aspect of the rule change, it is a departure from current practice and AEMO's proposed rule. Further, it is related to the Review of the Victorian DWGM currently being undertaken by the Commission.

Non-controversial aspects of the final rule: the final rule:

- clarifies the type of market benefit instruments created in respect of extensions or expansions of the Victorian declared transmission system by providing that:
 - authorised MDQ will relate only to historic capacity on the Longford to Melbourne pipeline at the time of commencement of the Victorian Declared Wholesale Gas Market;
 - AMDQcc will be created in relation to all extensions or expansions where new market benefit instruments are created.
- provides that AEMO will be required to use the proceeds from its allocation process to offset the operating costs of the Victorian DWGM; and
- provides that the AEMO will provide a minimum of twenty business days' notice prior to undertaking the allocation process of either authorised MDQ or AMDQcc.

²⁸ APA submission to the draft determination, p.1

²⁹ EnergyAustralia submission to draft determination, p.1

Controversial aspect of the final rule: the final rule:

- clarifies the party responsible for undertaking the allocation process by providing that:
 - AEMO is responsible for undertaking the allocation process for all authorised MDQ;
 - AEMO is the party responsible for undertaking the allocation process for AMDQcc where the costs of the extension or expansion that created or creates AMDQcc are included in APA's opening capital base for an access arrangement period or is included in its approved capital expenditures for an access arrangement period;
 - the APA is the party responsible for undertaking the allocation process for AMDQcc where the costs of the extension or expansion that created or creates AMDQcc are not included in its opening capital base for an access arrangement period or in its approved capital expenditure for an access arrangement period.

As the final rule affects the allocation of powers, functions and duties between AEMO and a declared transmission system operator, AEMO's consent to the making of the rule is required. AEMO provided its consent to the final rule in writing to the Commission on 18 March 2016.

2.4 Summary of reasons

The Commission considers that the current provisions in Part 19 of the NGR relating to the creation and allocation of authorised MDQ and AMDQcc are unclear and create regulatory uncertainty. This is in line with AEMO's assessment of the NGR in the rule change request. The Commission considers that the final rule will or is likely to, better contribute to the achievement of the NGO than the current provisions and AEMO's proposed rule.

Non-controversial aspects of the final rule

Having regard to the non-controversial aspects raised in the rule change request, the Commission is satisfied that the final rule will, or is likely to, contribute to the achievement of the NGO because it will provide regulatory certainty to AEMO, APA and market participants in respect of the type of market benefit instruments created from an extension or expansion of the Victorian DTS.

Compared with current market arrangements, this will improve confidence in the market by AEMO, APA and market participants as the interpretation and functioning of the rule will be clearer. Greater certainty in the regulatory arrangements will allow the relevant parties to make better informed decisions in relation to the use of, and investment in, the Victorian DTS - providing for more efficient outcomes, with the

resulting benefits flowing through to consumers in respect to the prices paid for natural gas.

The final rule will provide increased information provision to market participants. The requirement for AEMO to provide twenty business days' notice prior to undertaking the allocation process will provide market participants an opportunity to make informed decisions about their participation in the allocation process. This may lead to a more efficient use of the system by market participants and more efficient investment in the Victorian DTS by APA, thereby contributing to the achievement of the NGO.

Given that under the final rule, APA will only undertake the allocation process related to extensions or expansions of the Victorian DTS that are not included in its capital base (either as approved capital expenditure during an access arrangement period or as part of its opening capital base for an access arrangement period), mandating a minimum notice period for its allocation of AMDQcc is not considered appropriate. Subject to the terms of its access arrangement, the Commission is of the view that APA should have discretion to determine the process by which it undertakes the allocation process for AMDQcc in these circumstances (e.g. it may choose to allocate AMDQcc to a market participant as part of an agreement by a market participant to fund the relevant extension or expansion).

Further details of the Commission's reasoning related to the non-controversial aspect of the final rule are set out in Chapter 4.

Controversial aspect of the final rule

Having regard to the controversial aspect of the rule change request, the Commission is satisfied that the final rule will, or is likely to, contribute to the achievement of the NGO for the following reasons:

- the final rule may provide a more transparent and efficient allocation process by:
 - clarifying the type of market benefit instruments created, including providing for the alignment of the term of AMDQcc with the term of APA's access arrangement period when the AMDQcc is subject to AEMO's allocation process;
 - clarifying who undertakes the allocation process for market benefit instruments thereby improving regulatory certainty; and
 - having the effect of unbundling AMDQcc from take or pay contracts³⁰, which may help to ensure that:
 - market participants (and as a result, consumers) only pay for those transportation services they actually use given the lack of firm capacity right under this market carriage model; and

³⁰ Unbundling AMDQcc from take or pay contracts focuses on the link between the two and not the entry, use or other characteristics of take or pay contracts in an entry/exit system.

- the price paid for authorised MDQ and AMDQcc more clearly reflect the value that market participants assign to the rights associated with holding the market benefit instruments, thereby providing better signals to APA and market participants.

A more transparent and efficient allocation process for AMDQcc may lead to more efficient use of and investment in the Victorian DTS by ensuring that a market participants demand for and the price paid for AMDQcc reflects market participants assessment of the benefits associated with holding the market benefit instruments and ensuring appropriate investment in the system - providing for more efficient outcomes, with the resulting benefits flowing through to customers via the prices paid for natural gas and use of system charges.

The Commission is also satisfied that the final rule will, or is likely to, better contribute to the NGO, compared to the proposed rule submitted by AEMO, as a result of:

- AEMO undertaking the allocation process for AMDQcc. This will remove the opportunity for APA to over-recover on its regulated assets through either the 'price effect' or 'volume effect' (these are discussed in section 1.1.1) related to AMDQcc. The Commission is of the view that AMDQcc is not an appropriate instrument for over-recovery when APA has the opportunity to earn its regulated revenue amount on the extension or expansion that creates the AMDQcc;
- the unbundling of AMDQcc from the take or pay contracts. This will allow market participants to make decisions to participate in the AMDQcc allocation process based on their demand for the benefits provided by AMDQcc alone. This may provide investment signals regarding what system augmentations may be warranted. As a result of the unbundling, this signal may be reflected through the demand and price for AMDQcc. The demand and price will be determined without market participants having to take into account the costs they are prepared to incur for a take or pay contract;

The Commission considers the final rule, in relation to the allocation process is in the long term interests of consumers and contributes to the achievement of the NGO. It will, in the Commission's view, promote a more transparent and efficient allocation process for AMDQcc and provide regulatory certainty to market participants regarding the party responsible for undertaking the allocation process.

Although the Commission has made recommendations in its draft report³¹ in the Review of the Victorian DWGM that would, if implemented, result in authorised MDQ and AMDQcc being replaced by an entry-exit system, the Commission is of the view that the final rule will contribute to the NGO at this time and is in the long-term interests of consumers. The benefits of implementing the controversial aspect of the

³¹ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, draft report, 4 December 2015, Sydney

final rule, even if it is in operation for the minimum period of APA's next access arrangement period, outweigh the costs of implementation and operation.

The Commission's detailed reasoning related to the controversial aspect of the final rule is set out in Chapter 5.

2.5 Strategic priority

This final rule determination relates to the second of the AEMC's strategic priorities: promoting the development of efficient gas markets (the gas priority). This final rule would provide certainty to market participants in relation to the type of market benefit instruments created as a result of an extension or expansion and the party responsible for undertaking the allocation process. This rule determination also takes into account the findings and recommendations made by the Commission in its draft report in the Review of the Victorian Declared Wholesale Gas Market.³²

The final rule is likely to promote efficient development and use of the gas market by allowing market participants to make more informed decisions regarding their participation in the market, providing price certainty and ensuring users pay only for the services they use given the lack of firm capacity rights under the Victorian DWGM market carriage model. Ultimately, this is likely to contribute to the achievement of the NGO, as it may ensure efficient investment in the system and avoid increased overall costs to consumers, all else being equal, by ensuring they only pay for the services used.

³² AEMC, 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

3 AEMO's rule change request

3.1 Problem identified by AEMO

AEMO considers that there are at least three issues with the current provisions in the NGR, which it is seeking to resolve through the rule change request:

- **structure of the rules:** AEMO indicates that the current rules are difficult to interpret with significant cross-referencing and nesting of clauses, as well as gaps in the rules. AEMO submits that the current difficulties with the rules have arisen, in part, due to the incorporation of the original Victorian Market and System Operation Rules into the NGR. AEMO indicates that the requirement in the rules to move from rule to rule and rely on the non-application of provisions creates an unnecessarily complex rule structure and hinders easy interpretation of the rules;³³
- **basis for deciding market benefit instrument type:** AEMO provides that the current provisions of the NGR do not provide a basis for determining if an extension or expansion creates authorised MDQ or AMDQcc. As a result, the classification of new market benefit instruments is done by way of an agreement between APA and AEMO;³⁴
- **party responsible for undertaking the allocation process for authorised MDQ:** AEMO indicates that APA always undertakes the allocation process for AMDQcc and that AEMO always undertakes the allocation process for authorised MDQ. However, there is one exception to this under the current provisions that provides that if authorised MDQ is created and the costs of the extension or expansion are not included in APA's capital base, then APA would undertake the allocation process for the authorised MDQ created.³⁵

3.2 Solution proposed by AEMO

AEMO proposed to address the issues it identified in its rule change request through amendments to Part 19 of the NGR. AEMO's proposed rule would bring the rules in line with the current practice. AEMO's proposed rule includes the following components:

1. **Clarifying the type of pipeline market benefit instruments created when there is an extension or expansion of existing pipeline capacity:**
 - confirmation that authorised MDQ relates only to historic capacity by amending the definition of authorised MDQ in rule 200 to include specific

33 AEMO rule change request, p.4

34 AEMO rule change request, p.5

35 AEMO rule change request, p.5

reference to authorised MDQ relating to the capacity of the system injection point at Longford as at 15 March 1999;³⁶

- providing that all new capacity created through an extension or expansion on the Victorian DTS, including an extension or expansion of the Longford to Melbourne pipeline, would create AMDQcc. This will be achieved through the inclusion of a specific reference to AMDQcc in subrules 329(1) and 329(7);³⁷

2. Clarifying the party responsible for undertaking the allocation process when an extension or expansion creates new market benefit instruments:

- removing the link between the classification of new market benefit instruments with the determination of the AER relating to costs of the extension or expansion being allowed or disallowed into APA's capital base. This is accomplished by removing subrules 329(2) and 329(3);³⁸
- providing that APA is the party responsible for undertaking the allocation process for all AMDQcc and then directing AEMO to allocate the AMDQcc to market participants. This is achieved through an amendment to subrule 329(4);³⁹

3. Clarifying the use of the allocation process proceeds received by AEMO:

- including a specific requirement, as subrule 330(7), that any proceeds AEMO receives as a result of its allocation process must be used to offset the operating costs of the Victorian DWGM;⁴⁰

4. Requiring minimum notice periods prior to the allocation process being undertaken:

- including a requirement that twenty business days' notice be provided by AEMO or APA, as the case may be, to market participants prior to the allocation process for authorised MDQ or AMDQcc, being undertaken. This is accomplished through the inclusion of two new clauses in the rules, 329(1) in relation to AEMO and 330(4)(b) in relation to APA.⁴¹

³⁶ AEMO rule change request, p.9

³⁷ AEMO rule change request, p.8

³⁸ AEMO rule change request, p.8

³⁹ AEMO rule change request, p.8

⁴⁰ AEMO rule change request, p.9

⁴¹ AEMO rule change request, p.9

AEMO indicates that the final rule will address the issues it has identified as follows:

- the amendments will result in rules that are easier to understand by:
 - removing all references to the status of full or part inclusion in APA's capital base and AER determination of part capacities;
 - simplifying cross-referencing between the various clauses of the rules; and
 - removing redundant clauses.⁴²
- the proposed rule will clarify the basis for deciding instrument type, as follows:
 - although authorised MDQ and AMDQcc fulfil identical roles in the market, authorised MDQ will be restricted to the original tranche created at the commencement of the Victorian DWGM;
 - any future capacity resulting from system augmentations will create AMDQcc and undergo the allocation process of APA; and
 - specifically provide that any future market benefit instruments made available in respect of pipeline extensions or expansions will be in the form of AMDQcc.⁴³

3.3 Stakeholders' views

The Commission received five submissions from stakeholders on the draft rule determination and draft more preferable rule. Submissions were received from AEMO, APA Group, EnergyAustralia, GDF Suez and the Public Interest Advocacy Centre.

APA Group, EnergyAustralia and GDF Suez had also provided submissions on the Commission's consultation paper.

The submissions on the consultation paper indicated that stakeholders viewed the current provisions relating to the creation and allocation process for market benefit instruments as unclear and subject to various interpretations. The submissions to the consultation paper highlighted that stakeholders had differing views on the party who should be responsible for undertaking the allocation process for AMDQcc. A summary of the key issues raised by stakeholders in their submissions to the consultation paper are set out in Appendix A.

AEMO, EnergyAustralia, GDF Suez and the Public Interest Advocacy Centre expressed support for the draft more preferable rule. APA expressed support for the non-controversial aspects of the draft more preferable rule but does not support the controversial aspect of the draft more preferable rule. A more detailed summary of the

⁴² AEMO rule change request, p.5

⁴³ AEMO rule change request, pp. 5-6

key issues raised by stakeholders in their submissions to the draft rule determination, and the Commission's response, are set out in Appendix A.

4 Commission's assessment of non-controversial aspects of final rule

4.1 Problem identified by AEMO

The Commission is of the view that the existing rules regulating authorised MDQ and AMDQcc are unclear and create regulatory uncertainty for AEMO, APA and other market participants. The Commission considers that there are controversial and non-controversial components to the issues raised by AEMO.

The issues identified by the Commission as non-controversial include:

- clarifying the type of market benefit instruments created when there is an extension or expansion of the Victorian DTS;
- clarifying the use of allocation process proceeds by AEMO; and
- requiring minimum notice periods prior to AEMO undertaking its allocation process.

Stakeholder submissions to the draft rule determination supported for the non-controversial aspects of the rule change request and indicated that these aspects "will improve the clarity and transparency of the authorised MDQ and AMDQcc allocation process."⁴⁴

4.2 Type of market benefit instruments created

The current rules provide that when the costs of an extension or expansion are not wholly included in APA's capital base, either authorised MDQ or AMDQcc is created. However, there is no guidance in how AEMO and APA are to determine which of the two types of market benefit instruments are created.

The final rule, consistent with the draft rule, clearly provides that authorised MDQ relates only to the historic capacity of the Longford to Melbourne pipeline when the Victorian DWGM commenced and that all extensions and expansions that create market benefit instruments will result in the creation of AMDQcc.

This is in line with AEMO's proposed rule and the historic practice that has occurred since AMDQcc was introduced. The AEMC has determined this aspect of AEMO's proposed rule contributes to the achievement of the NGR as it provides clarity and certainty to market participants.

By clearly articulating that all new market benefit instruments created are AMDQcc, certainty is provided to the market that is missing under the current provisions of the NGR. This certainty may provide greater confidence to AEMO, APA and market

⁴⁴ GDZ Suez submission to draft determination, p.1

participants in relation to expectations when new market benefit instruments are created in the future.

Further, given the nature of authorised MDQ and AMDQcc, the Commission sees a benefit in new extensions and expansions resulting in AMDQcc which operate for a set term⁴⁵ rather than an indefinite term in the case of authorised MDQ. The specific term of AMDQcc provides market participants an opportunity to participate in the allocation process either when new AMDQcc becomes available or when the previous term of AMDQcc draws to close.

This process allows for market participants to examine the circumstances of their operation at the time of the allocation process, including:

- examining past congestion on the system;
- projections for ongoing or increased congestion during the term of the AMDQcc; and
- any planned extensions or expansions;

to determine their participation in the allocation process. This would involve a determination of the quantity of AMDQcc that they will seek, as well as the price they are willing to pay for it.

This process will also provide some ongoing signals to AEMO and APA in relation to market participants' assessment of the benefits of holding AMDQcc for the next term. This ability to reassess the need to hold market benefit instruments is not readily available with authorised MDQ as a result of authorised MDQ's indefinite term.

4.3 Notice period

The NGR are silent on the notice that must be provided to market participants prior to an allocation process occurring. Stakeholders indicated that they were not aware of any past issues that arose under the current practice in respect of notice, but no stakeholder has to date expressed any concern with a requirement for a minimum notice period.

The final rule provides that AEMO will provide twenty business days' notice prior to undertaking the allocation process.

Given that APA will only undertake the allocation process relating to AMDQcc for which the costs of the extension or expansion are not included in its capital base (either as approved capital expenditure during the access arrangement period or in its opening capital base) the Commission has determined that a minimum notice period will not be required. This determination is based on the arrangement between APA

⁴⁵ AMDQcc has always been for a set term but the set term has been determined through APA's allocation process; however, the final rule prescribes that where AEMO undertakes the allocation process for AMDQcc the term shall be set so as to match the remaining term of APA's access arrangement period.

and the market participants being a private relationship for which the parties should be able to negotiate the necessary terms and conditions.

Although the current provisions of the NGR are silent in regards to notice, it is the Commission's understanding that notice has historically been provided to market participants prior to AEMO or APA undertaking its allocation process. The final rule prescribes a mandatory notice period for AEMO when it undertakes the allocation process to provide greater certainty to market participants over the practice that will be followed prior to an allocation process occurring.

The inclusion of a mandatory notice period, and the mandatory notice period being set at twenty business days¹, will ensure market participants have a reasonable period of time to make informed decisions regarding their participation in the allocation process. This may lead to a more efficient use of the system by market participants. In turn, this may lead to benefits in the long term interests of consumers., in terms of prices and investment in the system and is likely to contribute to the achievement of the NGO.

Further, more informed decisions by market participants regarding their participation in the allocation process may lead to better signals to AEMO and APA regarding the demand for AMDQcc. This may assist in determining whether there is any basis for further investment in the system. An appropriate level of investment in the system is in the long-term interests of consumers, not only in terms of ensuring that consumers do not pay for over-investment in the system but also ensuring that under-investment does not result in increased uplift charges and system congestion.

4.4 Use of allocation process proceeds by AEMO

The NGR are silent in relation to the use of the proceeds AEMO receives from undertaking the allocation process for market benefit instruments. Historically, AEMO has offset the proceeds from the costs of operating the Victorian DWGM.

AEMO in its proposed rule, and in the Commission's final rule, this historic practice will be implemented as a requirement. Through this requirement there will be certainty that the proceeds from the allocation process go to the benefit of those market participants who participate in the Victorian DWGM rather than for the benefit of the broader market for which AEMO has a role and incurs costs.

4.5 Conclusion

The Commission considers that the non-controversial aspects of the final rule clearly contribute to the NGO. In this regard, the final rule provides regulatory certainty to AEMO, APA and market participants in relation to the types of market benefit instruments created from an extension or expansion.

Further, it provides regulatory certainty in relation to the use of proceeds from the AEMO allocation process which will have an impact on market participants' overall costs payable to AEMO in relation to the operation of the Victorian DWGM. In

addition, these aspects of the final rule improve timely provision of information regarding when an allocation process will occur. This provides the opportunity for market participants to make informed decisions regarding how they will participate in the allocation process of AEMO.

The benefits of regulatory certainty and timely provision of information leads to long-term benefits for consumers in terms of the prices consumers pay for gas. This results from market participants having more confidence in the operation of the market, which may lead to less risk being priced into consumer contracts. In addition, ensuring market participants have sufficient time to make efficient decisions regarding participation in the market may result in lower costs or fewer price increases, all else being equal, for consumers.

The Commission is aware that recommendations in the Review of the Victorian DWGM may result in authorised MDQ and AMDQcc being replaced and the final rule becoming redundant. However, given that there are expected to be minimal implementation and administrative costs associated with the non-controversial aspects of the final rule, the Commission is of the view that even in the short-term the benefits of these aspects of the final rule outweigh any possible costs and therefore, contributes to the achievement of the NGO.

5 Commission's assessment of controversial aspects of final rule

5.1 Problem identified by AEMO

The rule change request submitted by AEMO is not simply a clarification of the NGR. Rather, AEMO's proposal would sever the link in the NGR between the costs being included in APA's capital base with the party responsible for undertaking the allocation process. This link in the NGR applies to both authorised MDQ and AMDQcc and hence AEMO's rule change proposal has implications for both.

Therefore, the Commission is of the view that the controversial aspect of the final rule is not who should be the party responsible for undertaking the allocation process for authorised MDQ but rather who should be the party responsible for undertaking the allocation process for all market benefit instruments.

The Commission considers that the NGR attempts to ensure that APA is not able to over-recover on regulated assets through the sale of AMDQcc given that AMDQcc relates to market benefits and not to specific services provided by APA's assets. The decision as to which party is responsible for undertaking the allocation process, whether for authorised MDQ or AMDQcc, is linked directly to the issue of possible over-recovery.

This is not to say that APA does not have the ability to over-recover on services provided through its assets, whether included in its regulated asset base or not, but rather that in respect of AMDQcc and the specific market benefits provided by these instruments, over-recovery, where possible, should be limited.

5.2 Party responsible for undertaking the allocation process

The Commission is of the view that the link between whether the costs of the extension or expansion are included in APA's capital base and the party responsible for undertaking the allocation process for AMDQcc should be maintained. This would result in:

- AEMO undertaking the allocation process for AMDQcc where the costs of the extension or expansion are included in APA's capital base; and
- APA undertaking the allocation process where the costs are not included in its capital base.

The determination of whether maintaining this link under the NGR is appropriate requires the Commission to balance the possible impacts on APA's incentives and investment signals, price certainty and the desirability of consumers only paying for the services they receive given the lack of firm capacity rights in the Victorian DWGM market carriage model. On balance, the Commission is of the view that this link should remain.

5.2.1 APA submissions

APA was the only stakeholder whose submission indicated opposition to the controversial aspect of the rule change request. APA has indicated that without its ability to bundle a take or pay contract with AMDQcc:

- there is no certainty as to the amount of injection capacity and therefore the future revenue stream associated with the asset;⁴⁶
- there will be under-investment in the Victorian DTS as the bundled contracts are critical to underwriting injection capacity;⁴⁷ and
- revenue certainty will be undermined by separating the decisions between actual injections and the market benefits of AMDQcc.⁴⁸

Further, APA argues that:

- the system of bundling AMDQcc with the take or pay contracts provides a signal regarding the quantity of AMDQcc needed and whether further investment is required; and
- the bundling of AMDQcc with the take or pay contract provides market discipline by ensuring that market participants only bid for the quantity of AMDQcc they can actually use.⁴⁹

The main issues raised by APA appear to relate to demand forecast risk/revenue certainty, investment incentives and investment signals each of which will be addressed in turn below.

5.2.2 Demand forecast risk

As indicated in section 1.2, the Victorian DTS is a fully regulated pipeline and APA is subject to an access arrangement. As part of this process, APA submits its access arrangement application and the AER makes a determination on the amount of regulated revenue that APA will earn on its regulated assets by setting reference tariffs. The regulated revenue amount is composed of various elements, including but not limited to, capital expenditure, operating expenditure, depreciation, and an allowed rate of return.

The opportunity to collect the regulated revenue amount is provided through the tariffs charged to market participants for the services provided through APA's regulated assets. To determine the tariffs in the Victorian DTS, APA applies the following principles:

⁴⁶ APA submission to draft determination p. 5

⁴⁷ APA submission to draft determination, p. 4 and p.6

⁴⁸ APA submission to draft determination, p. 7

⁴⁹ APA submission to draft determination, p.7

- the system is divided into withdrawal zones, where a charge is levied on the withdrawing users, and injection zones, where the charge is levied on injectors;
- the injection zone charge recovers the cost of the injection pipeline. The withdrawal charge recovers the cost of transmission from the injection pipeline to the users;
- the cost of transmission through the withdrawal zones is based on a forecast of physical flows;
- costs are allocated to 1 in 2 winter peak flows and annual flows in the ratio of 60 per cent to peak and 40 per cent to annual;
- withdrawals are charged within 25 withdrawal zones;
- within each withdrawal zone there are up to three tariff classes. These tariff classes are Tariff-D and Tariff-V which are supplemented in some circumstances by a cross system tariff;
- injection tariffs are charged at each of the injection zones;
- the injection charge is levied on the ten peak injection days over the winter at each injection zone;
- the withdrawal charge is levied on the actual flows each month (an 'anytime' charge). A different withdrawal charge applies to each tariff class; and
- to provide a smoother payment scheduled for users, injection charges are forecast annually for each injector and levied monthly based on a profile.⁵⁰

These tariffs therefore take into account the regulated revenue amount to be collected and the forecasted demand through the system. Therefore, if actual demand is greater than forecast demand, APA may over-recover on its revenue and if the actual demand is less than forecast demand, APA may under-recover on its revenue⁵¹.

This possible under- or over-recovery of revenue as a result of the difference between forecast and actual demand is the demand risk faced by APA and is inherent in the price-cap form of regulation. APA is exposed to upside when actuals exceed forecast demand and downside when actuals are below forecast demand. APA as a for-profit entity and owner of the pipeline, has an incentive to manage this risk efficiently.⁵²

⁵⁰ APA GasNet Australia (Operation) Pty Ltd, Access Arrangement Submission to the AER, 1 January 2013 to 31 December 2017, March 2012, pp. 191-192, <http://www.aer.gov.au/system/files/APA%20GasNet%20submission%20-%20public%20-%20March%202012.pdf>

⁵¹ It should be noted that under the current regulatory regime, APA is not prohibited from earning revenue over its regulated revenue amount.

⁵² This form of regulation differs to, say, a revenue cap where consumers bear the demand risk and the regulated entity is guaranteed its revenue in the current regulatory period (although without potential upside when actual demand is above forecast).

The bundling of AMDQcc with a take or pay contract provides a risk mitigation mechanism for APA to address the demand forecast risk it faces. When AMDQcc is bundled in this fashion, a purchaser of AMDQcc will pay the price for AMDQcc along with an amount for transportation services on the full capacity associated with the AMDQcc purchased even though the market participant is not guaranteed any firm capacity right to use the pipeline. For example, if 100 TJ of AMDQcc is purchased, the market participant would also pay the contracted transportation cost on the 100 TJ whether they actually ship 100 TJ or a lesser amount.

Therefore, APA is able to ensure that its demand forecast risk is minimised if not eliminated through the use of the bundled take or pay contracts. This risk mitigation measure protects APA from under-recovery of revenue and transfers the risk associated with under-recovery on the investment to market participants and therefore customers.

In cases where APA over-recovers as a result of under-forecasting demand on the pipeline, the bundled take or pay contracts mechanism does not in and of itself require the over-recovery to be refunded back to market participants. However, historically, where APA has over-recovered as a result of the bundled take or pay contracts, it has refunded the over-recovery back to market participants as part of its annual tariff variation mechanism.

Therefore, the bundled take or pay contracts allow APA to be protected from under-recovery of its regulated revenue amount.

It is acknowledged that there may be some necessity for demand forecast risk to be minimised to ensure efficient levels of investment in the Victorian DTS and provide some level of revenue certainty for APA. In the Commission's view, the final rule, will have no impact on private investment in the Victorian DTS. However, the final rule may have implications on investment related to regulated assets if APA were faced with increased levels of demand forecast risk associated with its regulated assets and was unable to implement any risk mitigation measures.

However, the Commission is of the view that the mechanism of bundling AMDQcc with take or pay contracts is only one possible risk mitigation measure that can be used by APA to manage demand forecast risk and provide some revenue certainty to APA. For example, the Commission is aware that APA's revised access arrangement 2008-2012 provided a price control formula that bounded its actual revenue risk⁵³ arising from differences between forecast demand and actual demand, by placing 5.5

⁵³ It is recognised that such a mechanism results in the price-cap regulation which generally applies with the addition of some of the characteristics of revenue cap regulation. Price-cap regulation and revenue regulation are designed to allocate risks to various parties; however, due to the interactions of the two types of regulatory framework, the allocation of risk may be impacted and would need to be assessed by the AER as part of its access arrangement decision to ensure it is or remains appropriate.

per cent bounds on revenue variations.⁵⁴ The Commission is aware that APA removed this component of the price control formula in its subsequent access arrangement and is not indicating that such a mechanism should be re-instated nor is the Commission commenting on the appropriateness of this mechanism. However, the Commission considers that this mechanism illustrates that there are other mechanisms, some of which have been used by APA in the past, which can provide demand risk mitigation.

APA, as a for-profit entity, is in the best position to design and implement a risk mitigation measure that best meets its corporate strategy and risk policies. However, the Commission is of the view that the removal of the bundled take or pay contracts as a risk mitigation measure to manage demand forecast risk does not mean APA will have no other mechanisms available to manage this demand forecast risk.

5.2.3 Funding of investment in the Victorian DTS

The minimisation of demand risk and bundled take or pay contracts to ensure that forecasted demand eventuates thereby providing revenue certainty, may be factors considered by parties when assessing whether funding may be provided for a particular investment in the Victorian DTS. Although the issue of the funding of an investment has not been specifically raised, APA did indicate that the removal of its ability to bundle AMDQcc with a take or pay contract may impact the underwriting of investment by market participants and result in under-sizing of extensions or expansions.⁵⁵

Where an extension or expansion is approved by the AER as part of an access arrangement, APA would have the benefit of an AER decision approving the capital expenditure on a forecast basis. This access arrangement decision, including any mechanisms incorporated to manage demand forecast risk, would provide assurances to possible investors or lenders in respect of the return that could be obtained on the investment.

The Commission is satisfied that the final rule better contributes to the achievement of the NGO than the rule proposed by AEMO because:

- the signal provided by AMDQcc may be strengthened when not bundled with a take or pay contract; and
- the access arrangement decision provides a level of assurance regarding the revenue to be earned on any investment (and takes into account the allocation of risk to the regulated entity in respect of that investment and the risk mitigation measures in place) during the access arrangement period.

⁵⁴ Final decision - GasNet Australia - revised access arrangement 2008 - 12, p. xxv, <https://www.aer.gov.au/system/files/GasNet%20final%20decision%20-%2030%20April%202008.pdf>

⁵⁵ APA submission to draft determination, pp. 7-8

In its submission, APA indicated that without the bundled take or pay contracts the forecast revenue stream feeding into the investment test would be lower and therefore the level of conforming capital expenditure would be lower. This would result in the system being chronically undersized. APA sets out the following example to demonstrate this:

“... Assume that a shipper has a new load (say, for a new food processing facility) with a winter peak demand of 10 TJ/day for the three peak agricultural harvest months of the year, but an average demand over the balance of the year of only 3 TJ/day. The shipper requires the transmission system operator to build an expansion that will service the 10 TJ/day peak demand. With an AMDQ take-or-pay provision, APA VTS has sufficient certainty on the revenue stream to be able to justify a 10 TJ/day expansion in the context of Rule 79. Without the take-or-pay certainty, APA VTS would only be able to forecast revenues associated with the average load of 4.75 TJ/day (10 TJ/day over 3 months and 3 TJ/day over 9 months). APA VTS would only be able to forecast a revenue stream sufficient to justify an expansion to serve 4.75 TJ/day - clearly insufficient to meet the shipper's peak demand needs.⁵⁶”

The Commission recognises that the bundled take or pay contracts in such a circumstance as the one outlined above, would provide revenue certainty that would provide an input into the new capital expenditure criteria for conforming capital expenditure under rule 79 of the NGR ("conforming capital expenditure test") and may result in APA being able to clearly establish that the investment is efficient. However, the Commission is of the view that the outcome outlined by APA in the above example is not the necessary outcome of the unbundling of AMDQcc from a take or pay contract.

The final rule does not preclude APA and a market participant from entering into a take or pay contract where it is in their commercial interests to do so. Therefore, in situations like the one outlined above, the market participant and APA could reach an agreement whereby a take or pay contract is entered into to ensure that the extension or expansion is built to allow the shipper to satisfy its requirements during peak times.

It is acknowledged that a take or pay contract that is not bundled with AMDQcc would not provide any firm capacity rights to the shipper and they would have to purchase any AMDQcc available through the AEMO auction procedure. However, given that in such a circumstance the forecast demand is based solely on the one shipper, it would be expected that demand for AMDQcc associated with that extension or expansion would be from that shipper alone. If other shippers had a demand for the AMDQcc associated with that extension or expansion, then it would or should have been reflected in the demand forecast. According to APA's argument, this additional demand from other shippers would then result in increased capacity for that extension or expansion.

⁵⁶ APA submission to draft determination, p. 6

The Commission is of the view that numerous elements may be used to justify an extension or expansion, including but not limited to, demand forecasts and take or pay contracts. However, the presence of a take or pay contract alone may not always result in a finding that an investment is efficient. In cases such as the example outlined by APA above, it may be efficient for the shipper to enter into the take or pay contract to ensure that the extension or expansion is built to meet its demand forecast; however, it may also be efficient for the shipper to examine other options to meet its peak demand without over-sizing the extension or expansion; i.e. gas storage solutions.

If investment is found to be efficient, the tariff set on the pipeline would aim to recover the regulated revenue amount, and therefore would not assume that demand would be equivalent to the peak demand but rather be based on the total demand which would include peak and non-peak demand. This does not mean that the AER would never approve an extension or expansion that satisfies peak demand but rather that the tariff, which may include a peak demand tariff, would be set to allow recovery of the investment required to meet peak demand, if the investment test has been satisfied, through the total demand through the pipeline.

It is acknowledged that the conforming capital expenditure test may be more easily satisfied when there are bundled take or pay contracts, but in the Commission's view, this is not the only information that APA can rely on to establish that an investment is needed and efficient. Nor does the Commission see that a bundled take or pay contract is the only way to ensure that an investment that meets peak demand is determined to be efficient and meet the investment test.

APA also indicated that imposing a term on AMDQcc that matches the term of its access arrangement would restrict the revenue stream feeding into the investment test. The Commission is of the view that this issue only arises where APA bundles AMDQcc with a take or pay contract. As the Commission is of the view that AMDQcc should not be bundled with a take or pay contract when the costs of the extension or expansion are included in APA's capital base, this argument would then relate to demand forecast risk and the investment test issues as addressed above.

5.2.4 Investment incentives

Under the current practice where APA undertakes the allocation process for AMDQcc, there appears to be mixed investment incentives.

On the one hand, when there is increased congestion or increased risk of congestion, the price for AMDQcc would be expected to increase as the price of AMDQcc is based on market participants' determination of the value of the market benefits provided. As a result, the 'price effect' received by APA from the tender process would be expected to increase.

APA has indicated that pursuant to its last access arrangement, the AER set a reference tariff for AMDQcc at a nominal amount. As a result, there is no extra revenue from the

'price effect' and little scope for benefits to the market from changing the allocation process.⁵⁷

However, pursuant to the Commission's decision in the Reference and Rebateable service definition rule change request⁵⁸, the AER has the discretion not to set a reference tariff for AMDQcc in the future. As a result, the argument raised by APA that the 'price effect' is removed only relates to the current period and may not be valid in the future where a reference tariff for AMDQcc is not set by the AER. Therefore, the issue of over-recovery through the 'price effect' remains a live issue, in the Commission's view, as the AER may set a reference tariff for AMDQcc above a nominal amount or may not set a reference tariff for AMDQcc at all.

On the other hand, when extensions or expansion of the Victorian DTS are completed under the current practice, it would be expected that the price of AMDQcc would decrease as the expected congestion and related benefits of AMDQcc would not be as highly valued by market participants. However, in this case APA would earn its regulated revenue or the bundled take or pay contract amount on the new extension or expansion.

On the one hand, the 'price effect' provides an incentive not to build an extension or expansion. On the other hand, the ability to earn the regulated revenue or bundled take or pay amount on the approved extension or expansion provides an incentive to build that extension or expansion. The two incentives appear at odds. Therefore, the removal of the 'price effect' minimises the conflicting incentives and may result in efficient decisions regarding future investment in the Victorian DTS.

The other aspect of the investment incentive issue, relates to whether there is an investment incentive to build an extension or expansion without the revenue certainty provided by the bundled take or pay contracts. This issue is distinct from the issue of the conflicting investment incentives faced by APA as a result of the practice of bundling AMDQcc with a take or pay contract.

APA suggests that without revenue certainty, investment in the Victorian DTS will not occur or will be under-sized as there is not a sufficient incentive for investment in the system. This implies that the regulated revenue amount in and of itself is an insufficient incentive for APA to invest in the Victorian DTS.

It is recognised that an element of this argument is that APA may not earn its regulated revenue amount if its demand forecast is higher than actual demand. However, as noted above, the Commission is of the view that this risk can be mitigated through mechanisms other than the bundled take or pay contracts. Therefore, as demand forecast risk can be mitigated, the issue is whether the regulated revenue amount is an insufficient incentive to ensure efficient investment in the Victorian DTS.

⁵⁷ APA submission to draft determination, p.3

⁵⁸ AEMC 2012, Reference service and rebateable service definitions, Rule Determination, 1 November 2012, Sydney

The regulated revenue amount afforded to APA through its access arrangement includes an allowed rate of return on its regulated assets. A key factor in the AER's determination of an appropriate allowed rate of return is how risk is allocated between APA and market participants. The approach to risk allocation is based on the principle that risk allocation and accountability for investment decisions should rest with those parties best placed to manage those risks.

If there is an insufficient incentive to invest in the system, this would imply that the allowed rate of return set by the AER is insufficient given the risks faced by APA. The Commission is of the view that the allowed rate of return and the regulated revenue mechanisms deployed by the AER provide an investment incentive to APA to ensure efficient investment is undertaken, especially in light of APA being able to mitigate some of the risks it faces in operating its business through various mechanisms that it can design and implement. Further, the Commission is of the view that where APA provides that the allowed rate of return and regulated revenue amounts are insufficient to allow efficient investment, then the access arrangement process and not this rule change request is the appropriate venue for those issues to be resolved.

The Commission is of the view that the process associated with the Victorian DWGM and any uncertainty whether its final recommendations will be adopted and implemented by the Victorian government and the COAG Energy Council may impact on participants' behaviour and incentives to invest during that process. In the absence of the questions raised by the review process including implementation of any recommendations, the Commission considers that the final rule results in a positive impact on the operation of investment incentives in the Victorian DWGM. This positive impact is not negated as a result of any short-term impacts flowing from the uncertainty relating to the outcome of the review of the Victorian DWGM.

5.2.5 Impacts on investment signals

There may be implications in relation to APA's incentives and the management of demand forecast risk from the final rule, but the Commission does not consider that these implications outweigh the benefits of the final rule, given the other avenues and mechanisms available to APA. The Commission has assessed these implications and weighed them against the alternative impacts of making AEMO's proposed rule or making no rule.

These alternative impacts include benefits that flow, given the lack of firm capacity rights, from market participants only paying for the services they use and the signals that may be provided from the allocation process for AMDQcc when it is not bundled with a take or pay contract.

In its submission to the draft rule determination, the Public Interest Advocacy Centre indicated that the current process related to AMDQcc allocation is not transparent and that the move to unbundle AMDQcc from the take or pay contracts is a positive step

towards ensuring that customers are not paying more than they should for distribution and transportation services.⁵⁹

In circumstances where AEMO undertakes the allocation process for AMDQcc, a holder of AMDQcc would not be required to enter into a take or pay contract in order to obtain the market benefits associated with AMDQcc. Therefore, they would only be required to pay the reference tariff on transportation services on the amount of gas they actually ship. This provides an opportunity for market participants (and by consequence, consumers) to only pay for the transportation services they actually use rather than the amount associated with the quantity of AMDQcc they hold which provides the holder with no firm capacity rights.

That being said, the final rule will not prevent APA and market participants from entering into a take or pay contract where there are commercial reasons for doing so. This contract would not, where AEMO is responsible for undertaking the allocation of AMDQcc, also provide the market participant with AMDQcc and its associated market benefits.

Where AMDQcc is unbundled from a take or pay contract⁶⁰, the market participant would be able to make a decision regarding the quantity of AMDQcc they may want to hold separate and apart from the question of the whether they want to enter into a take or pay contract, and the quantity associated with said contract. This ability of a market participant to make a decision regarding these two distinct benefits, in the Commission's view, contributes to the achievement of the NGO through the efficient use of and investment in the system and more so than AEMO's proposed rule.

The Review of the Victorian DWGM recognised that the market may not contain adequate investment signals and that the current basis for determining investment based on demand forecasts and regulatory judgment may just as likely result in over-investment as under-investment.⁶¹ However, any signal that may exist should be designed to provide the best signal possible given the limits of the current market design and operation.

The effect of the final rule in unbundling of AMDQcc from take or pay contracts means that AMDQcc would only reflect market rights and market system benefits to holders. As a result, the allocation process and the decisions made by market participants in relation to the allocation process may provide a clearer signal related to the benefits and value of those benefits associated with AMDQcc. These decisions can be made without also having to consider the requirement to enter into a take or pay contract (which provides no firm capacity rights) for the same quantity of AMDQcc being

⁵⁹ Public Interest Advocacy Centre submission to draft determination, p.5

⁶⁰ The unbundling of AMDQcc from a take or pay contract is an effect of the final rule and focuses on the link between the two and not the entry, use or take or pay contracts in an entry/exit system.

⁶¹ See the discussion regarding investment signals and demand forecast in the Victorian DWGM Discussion Paper, AEMC 2015, Review of the Victorian Declared Wholesale Gas Market Discussion Paper, 10 September 2015, Sydney

sought. AMDQcc alone may provide a better investment signal to the market regarding extensions and expansions that may be needed in the Victorian DTS.

APA raises several issues relating to investment signals in its submissions to the draft determination. APA indicates that the pricing structure imposed on AMDQcc by the AER, i.e. setting it a nominal price, means that any investment signal provided by AMDQcc is muted. Further, APA argues that separating the decisions of actual injections and the market benefits of AMDQcc will negate the investment signal and that the bundling of AMDQcc with a take or pay contract provides a strong signal of how much AMDQcc is required while providing discipline so as to ensure that market participants only bid for the quantity of AMDQcc they can actually use.

The Commission is of the view that the issue of the investment signal being muted as a result of the AER decision setting a reference tariff for AMDQcc at a nominal amount is addressed through the final rule. Any possible impact that the setting of the reference tariff for AMDQcc may have had on APA's investment signal is removed as a result of AEMO undertaking the allocation process, if there is in fact any impact.

Secondly, the Commission does not see how the investment signal is negated by removing the ability of APA to bundle AMDQcc with a take or pay contract. The signal is provided by demand for AMDQcc and this demand will be evidenced where AMDQcc is unbundled from a take or pay contract and market participants participate in a clear and transparent auction process to obtain it.

Lastly, the Commission recognises that market participants may choose to oversubscribe to AMDQcc; however, a market participant may have also chosen to oversubscribe to the bundled AMDQcc take or pay contracts. AMDQcc under the final rule will be auctioned by AEMO according to a procedure to be developed by AEMO. Therefore, it is expected that market participants will be required to pay a fee for AMDQcc that is based on the demand for it and an over-subscription would result in them paying for more AMDQcc than they require or could use. The price paid for AMDQcc, especially where there is significant demand, should provide market participants with market discipline to ensure they make efficient decisions regarding the amount of AMDQcc they are willing to acquire and pay for.

5.2.6 Take or pay contracts

It should be noted that the final rule results in the unbundling of AMDQcc from a take or pay contract but will not necessarily mean that market participants would no longer be able to enter into a take or pay contract. There remains the opportunity for market participants and APA to agree to such a contract where there are commercial reasons for such a contract.

However, it does mean that AMDQcc which is subject to AEMO's allocation process would not include the requirement for the market participant to enter into a take or pay contract. As indicated previously, this may result in market participants not having to pay for transportation services that they have not used and for which they have no firm capacity right to use.

APA argues that the unbundling of the take or pay contracts from AMDQcc will crystallise the free-rider problem that exists in the Victorian DWGM; namely that the shipper commits to paying for the capacity but has no rights to it whatsoever. It is recognised that there is the possibility of a free-rider problem in the Victorian DWGM given the lack of firm capacity rights; however, the Commission is of the view that this relates to the broader design of the Victorian market, which is being addressed through the Commission's Review of the Victorian DWGM in a holistic manner, and that the bundling of AMDQcc is not the appropriate mechanism to try and address this possible issue.

Further, the take or pay contracts provide a way for APA to mitigate demand risk. Once again this demand risk protection can be addressed through other mechanisms that can ensure that investment can proceed and does not crystallise a free-rider problem which problem, if it exists, relates to broader issues than demand forecast risk minimisation.

5.2.7 Regulated revenue

The economic regulatory regime under the NGR does not prohibit APA from earning an amount in excess of its regulated revenue. However, the Commission is of the view that the unique attributes of authorised MDQ or AMDQcc (ie risk mitigating market benefits) results in an instrument which should not provide a basis for excess recovery, to the extent possible, for APA.

In circumstances where APA is earning regulated revenue on the underlying asset associated with the authorised MDQ or AMDQcc, the Commission considers that the market operator (AEMO) should be the party responsible for undertaking the allocation process associated with these market benefits instruments.

5.2.8 Timing of extensions or expansions

The final rule requires AEMO to undertake the allocation process for AMDQcc when the costs of the extension or expansion are included in APA's approved capital expenditures for an access arrangement period or its opening capital base. As a result, if the costs of an extension or expansion are approved by the AER on a forecast basis in APA's access arrangement and it starts to earn regulated revenue on the asset, AEMO would undertake the allocation process.

The inclusion of the element of the final rule regarding the approved capital expenditures was included to address a concern raised by APA in submissions to the consultation paper indicating that inclusion in the opening capital base would cause difficulties in relation to when investment would occur. As the issue was not raised in its submissions to the draft determination, the Commission is of the view that by including the approved capital expenditures element in the rule, the concern raised by APA has been addressed in the final rule (which is the same as the draft rule in this regard).

The following table shows some examples of the operation of the Commission final rule assuming that in 2019, during the 2017-2022 access arrangement period, APA expanded the Victorian DTS. This would result in additional capacity and corresponding new AMDQcc being created. Depending on whether the costs of the extension or expansion were to be included in APA's access arrangement application for 2017-2022, whether it is approved by the AER on a forecast basis or included in the opening capital base for the 2022- 2027 period, the following table provides some examples of who may be able to undertake the allocation process for the AMDQcc created:

Table 5.1 Example of rule operation

Costs of extension or expansion:		APA able to collect regulated revenue on forecast amount approved by AER	Cost of extension or expansion included in the opening capital base for 2022 -2027 period	Party responsible for undertaking allocation process
included in access arrangement application for 2017-2022	approved by AER on a forecast basis for 2017-2022 access arrangement period			
Yes	Yes	Yes	Yes	AEMO
Yes	Yes	Yes	No	AEMO undertakes allocation process for AMDQcc with term 2019-2022 APA undertakes allocation process for AMDQcc with term starting 2022 and beyond
Yes	No	No	No	APA
Yes	No	No	Yes	APA undertakes allocation process for AMDQcc with term 2019 -2022 AEMO undertakes allocation process for AMDQcc with term starting 2022 and beyond
No	No	No	No	APA
No	No	No	Yes	APA undertakes allocation process for AMDQcc with term 2019-2022 AEMO undertakes allocation process for AMDQcc with term starting 2022 and beyond

5.2.9 AEMO's auction process for AMDQcc

Under the final rule, AEMO will be required to establish an auction procedure for the AMDQcc for when it undertakes the allocation process. The Commission is of the view that it is not necessary to outline specific principles that should be incorporated into the auction procedure. The Commission is of the view that AEMO may want to assess its current allocation process to determine if the auction procedure for authorised MDQ is fit for purpose in relation to the auction for AMDQcc. Further, AEMO may want to assess whether the authorised MDQ auction procedure is the best mechanism for ensuring efficient signals, as much as these signals may be provided by the auction of AMDQcc.

In particular, it appears that AEMO's auction design for authorised MDQ provides some incentive for market participants to decrease their demand (and jointly cap it at the available amount), in an attempt to ensure that the price is set at zero dollars. This is a result of the auction design whereby if there is more authorised MDQ available than demand from market participants, all participants receives the authorised MDQ they have request for zero dollars. Therefore, there may be some incentive for market participants to underbid their demand in order to receive the market benefits of authorised MDQ for zero dollars.

EnergyAustralia in its submissions provided that an open and transparent auction for the allocation of both authorised MDQ and AMDQcc would provide information to the market.⁶²

APA in its submissions raised several issues related to AEMO's allocation process for AMDQcc. The first is that having AEMO undertake the allocation process at the end of the current access arrangement period would result in any signals being provided too late to be incorporated into APA's access arrangement. Secondly, APA has assumed that the results of any auction undertaken by AEMO would be confidential and as a result any investment signal would provide no value to APA.

The Commission is of the view that any auction procedure for AMDQcc adopted by AEMO should provide an open and transparent process. It is recognised that some of the information provided by bidders during the auction process may be confidential, however, there is information relating to the outcomes of the auction process that can be made public. Further, the process should be open and transparent but ensure that sensitive business information is kept confidential. This clear and transparent process which protects sensitive information should result in efficient auction outcomes.

It is expected that AEMO through its consultation process will be able to develop a procedure that is open and transparent and provides the necessary information related to demand of AMDQcc to allow any investment signal provided by the auction of AMDQcc to be known to AEMO, APA and market participants.

⁶² EnergyAustralia submission to the draft determination, p.1

Further, AEMO does a long range planning report, the Victoria gas planning review⁶³, with input from APA. AEMO will have access to all of the information relating to the auction of AMDQcc including that information that is confidential. Therefore, it is expected that this information would be incorporated into the information that AEMO uses in its planning report of the Victorian DTS. The Commission is aware that APA is not obligated to undertake any extension or expansion of the Victorian DTS even where AEMO's planning report indicates a need for augmentation and that APA can choose to seek approval for an extension or expansion that is not included in the planning report prepared by AEMO. Nonetheless, the information provided by the auction of AMDQcc may still form an input into the planning document and APA can determine, based on its own business processes, whether to apply for augmentations included in the report.

The decision of market participants to purchase AMDQcc for a term is based on their assessment of the benefits it provides to them over the term. One element of this determination by market participants is knowledge of the future plans by APA to expand or extend the system thereby impacting the value of the market benefits associated with the AMDQcc they may hold. This information about planned extensions or expansions would be included in APA's access arrangement application.

The final rule does not prescribe when the auction for AMDQcc must be held. However, the value that market participants ascribe to AMDQcc relates to its future value and not its historic value. Although one determining factor in the value is the levels of congestion in the past, this information is used to inform market participants' thoughts on the levels of congestion that it may be exposed to in the future.

Historic congestion on the system provides information to AEMO and APA in relation to extensions or expansions that may be needed on the system. This information may be used in the planning of extensions or expansions that may be included in APA's access arrangement application. Any planning undertaken prior to an access arrangement application being submitted by APA is not a short-term exercise. For example, the Victoria gas planning review⁶⁴ completed by AEMO working with APA is produced every two years or when a significant event occurs. The information in the planning review may form the basis for some of the augmentations proposed by APA in its access arrangement application.

Further, the access arrangement application has to be prepared and submitted up to a year before the current access arrangement period expires. Currently, APA is required to submit its next access arrangement application by 1 January 2017 and it would commence 1 January 2018. Therefore, the demand for AMDQcc and the price paid for AMDQcc gives a confirmation signal regarding the need for that investment which is already included in APA's application and provides information about areas of the network where market participants view that congestion may arise in the future. This

⁶³ AEMO Gas Statement of Opportunities, Attachment B: Victorian Gas Planning Review 2015, <http://www.aemo.com.au/Gas/Planning/Gas-Statement-of-Opportunities>

⁶⁴ www.aemo.com.au/Gas/Planning/Gas-Statement-of-Opportunities, 2015 Gas Statement of Opportunities - Attachment B Victorian Gas Planning Review

information can then be incorporated into the planning undertaken by AEMO and in APA's subsequent access arrangement applications.

The final rule differs slightly from the draft more preferable rule in respect to the provisions addressing AEMO's allocations of AMDQcc (in rule 329G). In particular, the process was amended to clarify that AEMO may undertake the auction in a single stage process (where it obtains information on both demand and price), rather than a double stage process (where it first obtains information on demand and then price as part of the second stage). It is the Commission's view this will assist in ensuring an efficient auction which maximises the returns from the auction process and provides the strongest signal possible regarding the value for AMDQcc.

5.3 Review of the Victorian DWGM

In parallel to this rule change request, the Commission is undertaking a Review of the Victorian DWGM at the request of the Victorian government and the COAG Energy Council. The Commission's draft report was published on 4 December 2015.⁶⁵

The Commission's draft recommendation is to replace the existing market carriage arrangements with an entry-exit system for allocating capacity. An entry-exit system would allow network users to book capacity rights independently at each entry and exit point to the system, supporting the development of gas trading liquidity and risk management tools. Moreover, demand for entry/exit capacity would create market-driven signals for investment in the Victorian DTS, where these signals are currently limited.

Under an entry-exit system, revenue earned by APA would be regulated, on a similar basis to today. However, requiring users to purchase capacity at entry and exit points will change the risk allocation of that investment as the user bears at least some of, the costs (and risks) associated with their decisions. Allocating risk in this way creates incentives on users to ensure their decisions on access are well informed and ultimately efficient.

If the Commission's recommendations in the final report reflect those in the draft, and the Victorian government and COAG Energy Council supports the implementation of an entry-exit system in the Victorian DTS, the current market carriage regime will be replaced, and authorised MDQ and AMDQcc will no longer be relevant instruments in the market. Depending on when and if this occurs, the final rule may be in effect for a short period of time only. The Commission acknowledges that there will be costs associated with implementing the final rule, however, the Commission is of the view that the benefits of the final rule outweigh these costs.

EnergyAustralia indicated that there should be no implementation costs associated with the final rule for market participants. APA provided that the implementation and administrative costs associated with the rule would outweigh any potential benefits

⁶⁵ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, Draft Report, 4 December 2015, Sydney

associated with it. Further, APA provided that in the interest of limiting reform fatigue, it would be sensible to not adopt the controversial aspect of the draft more preferable rule and allow a market participant to reinvigorate the rule change request if the reforms in the review are not implemented.

AEMO will incur costs as a result of the final rule in relation to the process to be followed in developing and consulting on a new auction procedure for AMDQcc. There may also be costs associated with administering the auction process. However, the Commission is of the view that these costs are not prohibitive and do not outweigh the benefits of the final rule. Further, the auction design procedure developed by AEMO may also be applicable if the entry/exit regime recommended by the Commission is implemented.

Further, APA's current access arrangement is in place until 31 December 2017 and its access arrangement application for the period commencing 1 January 2018 is to be submitted by 1 January 2017. Therefore, the Commission is of the view that the issues raised in this rule change request should be addressed prior to the commencement of APA's next access arrangement period. The Commission is of the view that even if the final rule is in place in the short term, it better meets the NGO than the rule proposed by AEMO or making no rule for the reasons set out above.

5.4 Conclusion

The Commission has examined the rule change request, the issues identified by AEMO, the solution proposed by AEMO, stakeholder input, the recommendations made in the Draft Report in the Review of the Victorian DWGM and its own assessment and have determined to make the final rule.

It is acknowledged by the Commission that the final rule diverges from current practice and the proposed rule provided by AEMO in its rule change request in respect of the party responsible for undertaking the allocation process for AMDQcc. The Commission is of the view that the potential for over-recovery of revenue from AMDQcc is effectively addressed by clarifying the requirements in the NGR rather than relying on APA's historic practice of refunding some of this over-recovery back as part of its annual tariff variation mechanism.

The Commission considers that the market benefits associated with AMDQcc and the signals provided to the market from market participants' demand for these market benefits should be based on a market participant's assessment of the benefits of these instruments alone rather than an assessment of the bundled AMDQcc.

The final rule is preferable to the current practice and the rule as proposed by AEMO given:

- the lack of transparency in the current AMDQcc allocation process undertaken by APA;

- inadequate regulatory oversight of the AMDQcc allocation process and the revenue received from this process; and
- the historic use or lack thereof of the take or pay contracts in the AER regulatory process.

Further, the Commission is of the view that AMDQcc represents market benefits which, under the current regulatory framework, should be dealt with by AEMO, as market operator, where APA is earning its regulated revenue amount on the assets which create the AMDQcc. The market benefits provided by authorised MDQ and AMDQcc are unlike other services provided in the Victorian DWGM and this unique nature is what gives rise, in part, to the Commission's decision that these instruments are not an appropriate mechanism for APA to have the potential to earn additional revenue.

The final rule will result in the unbundling of AMDQcc from take or pay contracts and therefore, market participants (and by consequence, consumers) would only be required to pay the reference tariff for transportation services they actually use and not for an amount associated with quantity of the take or pay contract given that the take or pay contract, under the Victorian DWGM market carriage model, cannot provide any firm capacity rights to the market participants.

Although it is necessary to balance various aspects in determining the outcome of the rule change request, the Commission is satisfied that the final rule in respect to the controversial aspect of the rule change request, will or is likely to, better contribute to the achievement of the NGO than the rule as proposed by AEMO. The final rule has the potential to improve the investment signals provided by AMDQcc, where these investment signals exist, thereby improving efficient investment in the system.

Although the Commission has made recommendations in its draft report in the Review of the Victorian DWGM⁶⁶ that would, if implemented, result in authorised MDQ and AMDQcc being replaced by an entry-exist system, the Commission is of the view that the final rule will contribute to the achievement of the NGO for the time it is in place. The benefits of implementing the controversial aspect of the final rule, even where it only operates, for a minimum, during the next access arrangement period, outweigh the administrative and implementation costs associated with it.

⁶⁶ AEMC 2015, Review of the Victorian Declared Wholesale Gas Market, draft report, 4 December 2015, Sydney

6 Transitional Arrangements

The Commission is aware that the final rule is a marked departure from the current practice of AEMO, APA and market participants. As such, the Commission has considered the appropriate transitional arrangements to ensure that any policies or procedures that may be required can be developed and operational prior to operation of the rule. As well, the transitional arrangements provide clarity and certainty to parties regarding responsibilities between the time the final rule is implemented and when it will become operative.

APA's current access arrangement expires 31 December 2017 and any revised access arrangement application must be lodged with the AER by 1 January 2017. Therefore, it is expected that the implementation of the final rule will be able to be taken into account in APA's revised access arrangement application.

The transitional provisions provide:

- APA must not set the term for any AMDQcc for which it undertakes the allocation process for a period longer than its current access arrangement period (31 December 2017). This provision will take effect immediately;
- any AMDQcc for which a term has already been set for a period beyond the revision commencement date specified in APA's current access arrangement period, will continue to have effect and upon expiry will be subject to the allocation process as prescribed in the final rule;
- AEMO will prepare and implement the AMDQcc auction procedure by 30 September 2016;
- AEMO will prepare and implement the register of authorised MDQ and AMDQcc by 30 September 2016; and
- the remaining provisions of the final rule will commence on 25 October 2016.

AEMO indicated that it does not anticipate any significant issues as long as the new AMDQcc auction procedures do not have to be adopted for at least six months from the date of the final rule. The transitional provisions provide AEMO with more than six months to adopt the AEMO procedures and implement the register. As such, the Commission views that there are no issues with the transitional arrangements from an implementation standpoint.

It is expected that through the transitional arrangements, the final rule will be in place so that as the current term of AMDQcc expires, the allocation process prescribed in the final rule will be undertaken with minimal AMDQcc being subject to the current practice. However, it is noted that some AMDQcc may potentially become available between the date the final rule comes into force and when the operative provisions of the final rule commence.

Abbreviations

AEMO	Australian Energy Market Operator
AER	Australian Energy Regulatory
AMDQcc	authorised maximum daily quantity credit certificates
APA	APA VTS Australia (Operations) Pty Limited
Authorised MDQ	authorised maximum daily quantity
COAG Energy Council	Council of Australian Governments' Energy Council
DTS	declared transmission system
DTS SP	declared transmission system service provider
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
Victorian DTS	Victorian declared transmission system
Victorian DWGM	Victorian Declared Wholesale Gas Market

A Summary of issues raised in submissions

A.1 Summary of submissions to consultation paper

Stakeholder	Issue	AEMC Response
EnergyAustralia p.1	There should be no distinction between authorised MDQ and AMDQcc.	The distinction between authorised MDQ and AMDQcc is beyond the scope of this rule change and the overall structure and operation of the Victorian Declared Wholesale Gas Market is being considered as part of the review currently being undertaken by the AEMC. More information on the Review of the Victorian DWGM is available on the AEMC website at www.aemc.gov.au
EnergyAustralia p.1	Under the current process and the proposed rule, there is a possibility of over-recovery on regulated assets.	The AEMC is proposing a draft rule which would reduce the possibility of over-recovery by APA on regulated assets by requiring AEMO to auction all authorised MDQ and AMDQcc where they relate to an extension or expansion for which the costs have been included in APA's approved capital expenditures during an access arrangement period or its opening capital base.
EnergyAustralia pp. 1 & 3	AMDQ cannot currently be applied to controlled withdrawals from the South West Pipeline. AMDQcc should be applied to controlled withdrawals and uncontrolled withdrawals.	The AEMC considers that the issue of whether AMDQ can be applied to controlled withdrawals from the South West Pipeline is out of scope of this rule change request. Further, the AEMC Review of the Victorian DWGM will consider opportunities to impact the efficient operation of the market.
EnergyAustralia p.2	AEMO's auction may result in participants paying different amounts for the same product and may result in some users being disadvantaged.	The AEMC is of the view that given the draft rule, that AEMO should assess its current allocation process to determine if it remains appropriate. In addition, the Commission has asked for stakeholder input on whether it is necessary, if AEMO's allocation process should be amended, whether the rules should include principles to guide the development of a new allocation process.

Stakeholder	Issue	AEMC Response
GDF Suez p.1	The current rules are unclear in describing how authorised MDQ and AMDQcc should be established and allocated by AEMO and APA.	The AEMC is proposing a draft rule which would clarify how authorised MDQ and AMDQcc is established and allocated.
APA pp. 1, 2 & 3	The interpretation prescribed by the AEMC in its consultation paper in relation to the current rules is incorrect, the AEMC has not considered the timing elements associated with the current rule and concluded that the rules provide a clearer allocation methodology than is actually the case.	The AEMC is proposing a draft rule which addresses the timing issue raised by APA by providing that AMDQcc is to be allocated pursuant to AEMO's allocation process when the costs of the extension or expansion that create the AMDQcc is included in APA's approved capital expenditures during an access arrangement period or its opening capital base. In addition, the draft rule provides clarity in relation to the type of market benefit instrument created and the party responsible for undertaking the allocation process.
APA pp.5, 8-9	<p>The current practice and AEMO's proposed rule provides clear incentives to invest in new injection pipeline capacity whereby investment is support though contractual commitment to purchase new AMDQcc prior to construction of any expansion.</p> <p>A change in the allocation process may lead to less investment in the Victorian DTS and where investment occurs it may be delayed or be based on conservative estimates of demand (which may lead to it being undersized).</p>	The AEMC is of the view that the Victorian DWGM may not contain adequate investment signals and that the current basis for determining investment which is based on demand forecast and regulatory judgment may just as likely result in over-investment as under-investment, whereby consumers bear this risk. Further, the AEMC is of the view that the unbundling of AMDQcc from the pre-payment of the reference tariff for transportation services may provide a clearer signal regarding what investment may be needed in the Victorian DTS. Further, although the current practice of bundling AMDQcc with the pre-payment of the reference tariff for transportation services provides some demand forecast protection, there are other mechanisms that APA may be able to include as part of its access arrangement to provide it with similar protections.
APA p.5	The efficiency of APA's process used for allocating AMDQcc is outside of the scope of the rule change request.	The AEMC is of the view that it was important to understand the process used by APA to allocate AMDQcc, but agrees that the rules should not include any guidance or direction on the process to be used by APA.
APA	APA is not able to over-recover on regulated assets under the current practice as a result of a	Although APA has indicated that under the current environment there is no over-recovery, the AEMC is of the view that the rules should be

Stakeholder	Issue	AEMC Response
pp. 6-7	reference tariff being set for the allocation of spare AMDQcc. Further, under a price cap form of regulation, regulated service providers can earn more than the regulated revenue decision through outperformance, including through volume and price outperformance.	drafted to ensure that where APA earns the regulated revenue amount on the extension or expansion, it does not have the potential to also earn either the 'price effect' or 'volume effect' from undertaking the allocation process of AMDQcc.
APA p.9	Notice periods for the allocation of AMDQcc have not been a material issue in the past but to the extent it provides market certainty it is supported.	The AEMC draft rule provides a mandatory minimum notice period prior to the allocation process to be undertaken by AEMO. However, given that APA will only undertake the allocation process for AMDQcc not related to regulated assets, the AEMC has determined it is not necessary to include a requirement for APA to provide a minimum notice period.

A.2 Summary of submissions to draft rule determination

Stakeholder	Issue	AEMC response
AEMO (p.1)	<p>AEMO raised issues related to the drafting of the draft more preferable rule including:</p> <ul style="list-style-type: none"> the period for which AEMO must allocate available AMDQcc; the requirement for AER determinations on the inclusion of the cost of expansions within the capital base, in particular the timing of communication of those determinations; the requirement for the amendment of the service envelope agreement before allocation of 	The AEMC has worked with AEMO to address its concerns relating to the drafting of the draft more preferable rule and incorporated, where appropriate, changes to the final rule to address implementation concerns.

Stakeholder	Issue	AEMC response
	<p>AMDQcc can occur;</p> <ul style="list-style-type: none"> • allocation of AMDQcc by AEMO at the direction of the declared transmission system (DTS) service provider; and • the transitional period for the implementation of the new rule. 	
APA Group (p.1)	APA agrees that the implementation and administrative costs associated with the draft preferred rule would outweigh any potential benefits associated with it.	The Commission is of the view that the benefits of the final rule outweigh the costs that may be incurred in implementing and administering the rule.
APA Group (pp.2-3)	<p>It is not appropriate to make the proposed rule at this time, on two grounds:</p> <ul style="list-style-type: none"> • the access arrangement includes AMDQcc as a Reference Service with a Reference Tariff; and • the reforms of the DWGM contemplated by the AEMC would mean that any benefits associated with this rule change would have a relatively short time to be realised and recover the costs of implementation. 	<p>The Commission is of the view that the benefits of the final rule outweigh the costs that may be incurred in implementing and administering the rule, even in the short-term.</p> <p>Although AMDQcc is currently a reference service with a reference tariff, the AER has the discretion to not set a reference tariff for AMDQcc during the next access arrangement determination. This issue is discussed further in section 5.2.4.</p>
APA Group (p.4)	<p>To the extent that guiding principles for AMDQcc auctions depart from an open auction, i.e. with no limits on price, they will blunt any pricing signals generated.</p> <p>Without a price signal to constrain demand, there is considerable scope for over-subscription of this (nearly) free good. This would suggest that</p>	<p>The Commission is of the view that any auction procedure adopted by AEMO for AMDQcc should be open and transparent and be designed to provide the best signal possible for the auction. AEMO will undertake a consultation process on its procedure where stakeholders, including APA, can have input on the design of the auction for</p>

Stakeholder	Issue	AEMC response
	AMDQcc should be allocated on the basis of an expression of interest with a pro-rating mechanism if more is requested than is available.	<p>AMDQcc.</p> <p>Section 5.2.5 addresses the issue related to over-subscription in more detail. Section 5.2.9 addresses the issue related to AEMO's auction design for AMDQcc.</p>
APA Group (p.4)	The allocation of AMDQcc combined with contractual take or pay requirements is critical to underwriting injection capacity in the VTS.	The Commission has addressed the issues of demand forecast risk, revenue certainty and investment incentives in section 5.2.2 thru 5.2.5.
APA Group (p.4)	The bundling of AMDQcc is with a take or pay contract and there is no pre-payment of the reference tariff for transportation services but rather the holder is required to pay a contracted amount for the transportation services.	<p>In its draft determination, the Commission referred to the practice of bundling as the bundling of AMDQcc with the pre-payment of the reference tariff for transportation services; however, APA indicated that this reference provided a misconception that market participants were required to pay an amount up-front equal to the capacity associated with the AMDQcc. The Commission, in using the phrase 'pre-payment of reference tariff for transportation services' was not commenting on the actual payment structure between APA and market participants, but rather, was simply indicating that AMDQcc was bundled with transportation services. Therefore, to ensure no misconception regarding the payment structure, the Commission will refer to the bundling of AMDQcc with a take or pay contract. In the Commission's view, this represents a change in terminology between the draft determination and the final determination but does not represent a shift in the underlying concept of AMDQcc being bundled with transportation services nor the analysis associated with the same.</p>

Stakeholder	Issue	AEMC response
APA Group (p.5)	In order to satisfy the investment test, APA needs to have confidence in the future revenue stream to be generated from an expansion of a given size (and cost).	This issue is addressed in sections 5.2.2. thru 5.2.5 of this final rule determination.
APA Group (p.6)	The proposed preferred rule indicates that APA VTS should be allowed to allocate AMDQcc only in circumstances where an expansion is not included in the forecast capital expenditure for the access arrangement, and only then until the expansion capex is included in the regulated capital base. This curtails the term of the AMDQcc contract to a maximum for five years.	Once the costs of an extension or expansion are included in the regulated asset base and APA has the opportunity to earn regulated revenue on that amount, it is the Commission's view that AMDQcc and the proceeds from the sale of AMDQcc should not be for the benefit of APA. As such, the contract term of five years is appropriate as after that time, APA will have the opportunity to earn its regulated revenue amount on the asset.
APA Group (p. 8)	Severing the relationship between a take or pay provision and the allocation of AMDQcc rights crystallises the free rider problem - the shipper commits to paying for the capacity (so the investment can proceed), but has no rights to it whatsoever.	It is recognised that there is the possibility of a free-rider problem in the Victorian DWGM given the lack of firm capacity rights; however, the Commission is of the view that this relates to the broader design of the Victorian market and that the bundling of AMDQcc is not the appropriate mechanism to try and address this possible issue. Further, where there is a market-led investment where the costs are not included in APA's capital base, APA and the market participant may enter into a bundled take-or-pay contract or make some other arrangement to ensure the market-led investment proceeds.
APA Group (p.8)	By having the auction for AMDQcc at the end of the current access arrangement period, the information would not be available to APA to include in its access arrangement application.	This issue is discussed in detail in section 5.2.9 of this final rule determination.

Stakeholder	Issue	AEMC response
EnergyAustralia (p.1)	Under the current system, where retailers are unwilling to accept demand forecast risk from customers for the access arrangement period, under-investment in the system may be expected. Improved collaboration between AEMO, APA and market participants, and customers to forecast usage accurately and identify constraints early will ensure capacity is expanded in an efficient and timely manner.	Bundled take or pay contracts are used by APA to manage its demand forecast risk and transfers management of that risk to market participants. Under the final rule, the effect of the rule is the unbundling of AMDQcc from the take or pay contract which results in APA facing the demand forecast risk. However, as indicated, APA may design other mechanisms to manage this risk which may include some transfer to market participants, where it is found that they are the appropriate party to manage the risk. Improved collaboration between the parties may serve to provide APA with greater certainty regarding its forecasts and efficient investment in the system.
EnergyAustralia (p.1)	Whether the draft rule should be made, given that any changes may be transitory, will depend on the costs regarding system and process implementation by AEMO.	The Commission is of the view that any costs that may be incurred as a result of the final rule are not cost-prohibitive and that the benefits will outweigh these costs, even in the short-term.
EnergyAustralia (p.1)	EnergyAustralia is in support of a more transparent gas market. An open and transparent auction for the allocation of both authorised MDQ and AMDQcc will provide information to the market and support the transition to the proposed entry-exit system.	The Victorian DWGM is not an overly transparent market. The Commission is of the view that any auction procedure implemented by AEMO should be clear and transparent to the extent possible. This is discussed in more detail in section 5.2.9.
GDF Suez (p.1)	It is desirable that the gas rules establish well-defined principles that can be interpreted and implemented by the relevant parties.	The final rule clarifies the type of market benefit instruments created from an extension or expansion of the Victorian DTS, the minimum notice period prior to AEMO undertaking the allocation process for authorised MDQ and AMDQcc, the use of proceeds from the allocation

Stakeholder	Issue	AEMC response
		process by AEMO and the party responsible for undertaking the allocation process for authorised MDQ and AMDQcc. The Commission is of the view that these changes will serve to provide ease of interpretation and implementation.
Public Interest Advocacy Centre (PIAC) (p.2)	Through the bundling of AMDQcc with take or pay contracts, there is the potential for APA to over-recover costs.	The ability of APA to over-recover through the bundling of AMDQcc with a take or pay contract has been removed in the final rule in relation to AMDQcc that results from regulated assets. This issue is discussed in more detail in 5.2.4.
PIAC (p.4)	It would be more efficient if AEMO was responsible for the allocation of all market benefit instruments regarding of the status of the asset's inclusion in APA's regulated capital base or expenditure.	Where an asset is not included in APA's regulated capital base or approved capital expenditure, APA would not earn regulated revenue on that asset. As a result, it is the Commission's view that APA, and not AEMO, should have the benefit of any AMDQcc sold in respect of these types of assets so as to allow the recovery of any investment made.
PIAC (pp. 4-5)	The current process of bundling AMDQcc with a take or pay contract, and refunding back double payments received for transportation services by APA is not transparent. The draft more preferable rule does not specifically include the unbundling of AMDQcc from take or pay contracts in the provisions and there should be a clear provision to unbundle AMDQcc.	<p>Where AEMO undertakes the allocation process for AMDQcc that AMDQcc would be unbundled from a take or pay contract given that AEMO cannot enter into take or pay contracts with market participants. As a result, through the operation of the provisions requiring AEMO to undertake the allocation process for AMDQcc, AMDQcc is unbundled from the take or pay contracts.</p> <p>Where APA undertakes the allocation process for AMDQcc (as the costs are not included in approved capital expenditures or opening capital base), the costs are a private investment and as</p>

Stakeholder	Issue	AEMC response
		such, APA is able to recover those costs through any mechanism available to it, including the bundling of AMDQcc with a take or pay contract.
PIAC (p.5)	If the AEMC determines that the costs of the rule change outweigh the benefits, the current rules should be more strongly enforced and participants should use the process set out in the current rules rather than the informally adopted process that leaves the allocation of AMDQcc with APA.	The Commission is of the view that the benefits of the final rule outweigh the costs and as such, there is no issue in respect of enforcement of the current provisions.

B Legal requirements under the NGL

This appendix sets out the relevant legal requirements under the NGL for the AEMC to make this final rule determination.

B.1 Final rule determination

In accordance with sections 311 and 313 of the NGL, the Commission has made this final rule determination and associated more preferable final rule, in relation to the rule change request submitted by AEMO.

The Commission's reasons for making this final rule determination are set out in Chapter 2.

A copy of the more preferable final rule is attached to and published with this final rule determination. Its key features are described in section 2.4 of this final determination.

B.2 Power to make the rule

The Commission is satisfied that the more preferable final rule falls within the subject matter about which the Commission may make rules. The more preferable final rule falls within section 74 of the NGL as it relates to regulating the provision of pipeline services, AEMO's declared system functions and operation of a declared wholesale gas market.

The more preferable final rule will not apply in Western Australia as it does not fall within the subject matters about which the Commission may make rules under the National Gas Access (WA) Act 2009 of Western Australia.

B.3 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;
- the fact that there is no relevant Ministerial Council on Energy (MCE) Statement of Policy Principles;⁶⁷

⁶⁷ Under section 73 of the NGL, the AEMC must have regard to any relevant MCE Statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated Council is now called the COAG Energy Council.

- stakeholder submissions received during the first and second rounds of consultation; and
- the Commission's analysis as to the ways in which the more preferable final rule will or is likely to, contribute to the NGO.

B.4 Power to make a preferable rule

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

As discussed in Chapter 2, the Commission has determined to make a more preferable final rule. The reasons for the Commission's decision are set out in section 2.5 and Chapter 4 (non-controversial aspect) and Chapter 5 (controversial aspect).

B.5 Civil penalty and conduct provisions

The Commission's more preferable final rule does not amend or omit any clauses that are currently classified as civil penalty or conduct provisions under the NGL, or the National Gas (Victorian) (Declared System Provisions) Regulations.

The Commission does not recommend that any provisions of the final rule be classified as civil penalty or conduct provisions under the NGL or the National Gas (Victorian) (Declared System Provisions) Regulations.

B.6 Declared system functions

The Commission may only make a rule that has the effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of AEMO's declared system functions.⁶⁸ The Commission is satisfied that the more preferable final rule is compatible with AEMO's declared system functions as the final rule will clarify the process for the creation and allocation of market benefit instruments in the Victorian DWGM. In particular, the amendments will clarify when AEMO is the party responsible for undertaking the allocation process for authorised MDQ and AMDQcc and how the proceeds from its allocation process are to be used.

⁶⁸ See section 295(4) of the NGL

B.7 Allocation of powers, functions and duties

The Commission may only make a rule that affects the allocation of powers, functions and duties between AEMO and the declared transmission system service provider if AEMO has provided its consent to the making of the rule.⁶⁹

Although the more preferable final rule continues to align the party responsible for undertaking the allocation process with the inclusion or non-inclusion of costs associated with the extension or expansion that created the AMDQcc in APA's capital base, it does represent a departure from the current practice. Further, the final rule clarifies the roles of AEMO and the declared transmission system service provider in respect to the party that undertakes the allocation process for AMDQcc.

As such, as the final rule affects the allocation of powers, functions and duties between AEMC and a declared transmission system service provider, AEMO's consent to making of the rule is required. On 18 March, 2016, AEMO provided its consent to the final rule.

⁶⁹ See section 295(5) of the NGL.