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Ms Sara Atukorala
Australian Energy Market Operator
GPO Box 2008
Melbourne VIC 3001

Dear Ms Atukorala

Thank you for the opportunity to comment on the proposed procedure change in relation to Wholesale Market Authorised Maximum Daily Quantity (AMDQ) Procedures.

APA Group (APA) was a key proponent of this procedure change, and supports the AEMO proposal currently subject to consultation. APA considers that the proposed revised AMDQ Procedure will contribute to the achievement of the National Gas Objective by improving the ability of shippers to manage risks arising from the operation of the Declared Wholesale Gas Market (DWGM), by improving the ability of shippers to trade gas across the different markets in eastern Australia. These aspects are discussed further below.

Management of risks under the DWGM

As discussed in the AEMO supporting documentation, shippers currently face uncertainty as to whether they will be able to ship gas between the DWGM and adjoining contract carriage pipelines. This uncertainty remains even where those shippers have invested in the risk management products available under each market structure that are designed to manage this uncertainty, being Authorised MDQ or AMDQ credit certificates (collectively referred to as AMDQ) in the DWGM, and firm transportation services on an adjoining contract carriage pipeline.

The uncertainty arises as shippers do not have direct firm capacity rights under the DWGM, but are able to assign AMDQ to a system withdrawal point (SWP) that gives them tie breaker rights during scheduling. This AMDQ assignment is a risk management mechanism that delivers a 'firm-like' service at the SWP, provided the shipper bids into the market accordingly. This risk management mechanism only operates effectively, however, if it can be used in concert with firm rights on an adjoining pipeline. Current arrangements mean that this is not always possible.

In the absence of a procedure covering this matter, the current AEMO practice is to assign AMDQ to a SWP on a first come first served basis, without regard to contractual or volume arrangements on the interconnected pipeline. This potentially allows a shipper to assign AMDQ to a SWP even where that shipper does not have a right to capacity on the adjoining pipeline. This assignment would block the ability of another shipper that did have a firm contractual right on the adjoining pipeline from assigning AMDQ to the SWP, and therefore would block the ability of that shipper from achieving firm transportation across the DWGM and into the interconnecting pipeline. This would erode ability for AMDQ

assignment to a SWP to manage scheduling risk within the DWGM as per its original design intent.

Impact of uncertainty on efficient market operations

The uncertainty over the ability to transport gas on a firm basis across the DWGM into interconnecting pipelines leads to a number of issues that the proposed procedure change is seeking to address. The AEMO supporting documentation discusses some of these issues, on all of which APA concurs. APA considers that there are further issues related to economic efficiency and the potential for market power that are also relevant. These are:

- The potential for distortions in shipper decisions over gas transportation options due to the potential inability to secure firm transportation across the DWGM;
- The potential for inefficient expansion of a SWP to deliver additional capacity to be available for AMDQ assignment;
- The potential for individual shippers to exercise market power through their use of AMDQ at a SWP; and
- The erosion in the value of firm contractual capacity rights on adjoining gas pipelines.

These are discussed below.

*Distortion of shipper transportation decisions*

Differences in the risks or risk management opportunities associated with gas transportation across the DWGM compared to other contract carriage pipelines has the potential to distort shipper decisions as to how they will transport gas to different markets, potentially away from choosing the lowest cost provider. This potential, and its impacts, can best be demonstrated through an example.

In shipping gas from the Victorian offshore gas fields to Sydney and NSW regional centres, shippers have the choice of using the Eastern Gas Pipeline (EGP), or a combination of the Victorian Transmission System (VTS) and the Moomba to Sydney Pipeline (MSP). Where the risk properties of the service offered via each of these transportation routes are comparable, a shipper seeking firm capacity is likely to choose the lowest cost service offering. This drives competition between the EGP and VTS/MSP routes, and reduces costs to shippers overall.

A lack of firmness (or the potential for lack of firmness) in transportation across the DWGM means that shippers may choose more expensive transportation options, and these additional costs will be passed on to end use customers. This would not be the most efficient outcome if the reason for the lack of firmness across the DWGM was related to shortcomings in market design or procedures that meant that existing risk management products could not operate as intended, as is the case in relation to the current allocation of AMDQ to SWPs.

*Inefficient expansion of SWPs*

The amount of AMDQ that can be allocated to a SWP is limited to the firm capacity of the SWP. Firm capacity on the adjoining pipeline system is therefore effectively limited by the capacity of the SWP – this means that firm contracts on the adjoining pipeline (where fully contracted) will match the SWP capacity.

In circumstances where one shipper has allocated AMDQ to a SWP and that shipper does not have firm transportation rights on the adjoining pipeline, that shipper can effectively crowd out a second shipper that does have firm contractual rights on an adjoining pipeline from having firm capacity (ie tie breaker rights) across the DWGM.

To gain firm capacity at the SWP, the second shipper may be forced to expand the SWP to create more capacity for AMDQ to be allocated to that SWP and match that shipper's firm rights on the adjoining pipeline.

This would be an inefficient outcome if the first shipper did not utilise its capacity at the SWP, or uses that capacity only rarely. Under these circumstances, the expanded capacity at the SWP is likely to be underutilised.

*Potential for misuse of market power through allocation of AMDQ*

A shipper that requires firm capacity at a SWP to match a corresponding right on an adjoining pipeline has a number of options to achieve that firm capacity. Where the SWP has capacity available for AMDQ allocation, the shipper would simply allocate that capacity. If there is no capacity available, then the shipper may seek to expand the capacity of that SWP, as discussed above. Another option is to contract with the party that does have AMDQ allocated to that site to either transfer AMDQ, or to provide gas at that site.

In this last option, there is potential for a market participant to exercise market power by claiming AMDQ capacity at a SWP with the intent to force another party to contract with them, or operate without firm capacity rights at that SWP.

A circumstance where this may arise is where a self-contracting user of the DWGM needs access to AMDQ held by a retailer at a SWP. That self-contracting user may be forced to contract for gas through that retailer to gain access to firm capacity.

Alternatively, a small retailer may not be able to gain firm access to capacity to fulfil a contract with an end user outside of the DWGM, potentially limiting that retailer's ability to expand operations outside of the DWGM, and limiting the end user's retail options to those retailers with firm rights.

These outcomes would not be in the long term interests of consumers as they are likely to limit competition and increase overall costs to participants.

*Erosion of value of firm contractual capacity rights*

A final issue is the potential for a shipper that does not have firm contractual capacity rights on an adjoining pipeline to effectively convert an 'as available' contract to a firm contract through the allocation of AMDQ to a SWP. This is because, as discussed in the AEMO supporting documentation, a shipper with allocated AMDQ will be scheduled in priority to a shipper without allocated AMDQ (in a tie breaker situation) even where that shipper does not have firm contractual rights on an adjoining pipeline.

In these cases the shipper with allocated AMDQ can be assured that they will gain access to the adjoining pipeline as they have blocked access for the shipper that would otherwise have priority under contract. This erodes the value of firm contractual rights on the adjoining pipeline.

Revised guidelines contribute to the efficient allocation of capacity

The proposed procedural changes can be expected to ensure that capacity at SWP is allocated on the basis of sound economic principles.

As discussed in the AEMO supporting documentation, AMDQ allocations are only relevant where there is a constraint, and where there is a tie breaker situation and one of the shippers in the tie has allocated AMDQ to the SWP. This means that:

- When there is no constraint (the majority of the time) all shippers that bid to withdraw at the SWP at a price above the ex ante clearing price will be scheduled, without any consideration of rights on the adjoining pipeline;
- Where a shipper with an AMDQ allocation at a SWP does not bid to withdraw gas at a SWP, ADMQ allocations are not relevant and therefore rights on an adjoining pipeline are not taken into consideration in scheduling; and
- If a shipper with no contractual rights or only 'as available' rights bids above the ex ante clearing price and above the price bid by the holder of AMDQ at the SWP, the 'non-firm' shipper will be scheduled in preference to the shipper with an AMDQ allocation where the SWP is constrained.

This means that constrained pipeline capacity will be allocated to the party with the greatest willingness to pay over the longer term, as demonstrated by bids into the DWGM and investment in firm capacity rights in the adjoining pipeline. Over the shorter term, constrained pipeline capacity will be allocated to the party with the greatest willingness to pay *on the day*, demonstrated by bidding behaviour in the DWGM, which may exceed the willingness to pay of the holder of firm pipeline capacity on a given day.

Alternative solutions to problem

Current DWGM rules require market participants to bid in good faith. In practice, this requirement could be interpreted to mean that market participants cannot bid or use AMDQ in a way that leads to some of the issues outlined above or in the AEMO supporting documents. This protection is not complete, however, and issues can only be addressed after the fact; in practice, after the damage to competition may have been done.

In circumstances where it can be established that a particular approach would be consistent with the good faith provisions, it is more efficient to codify that practice in procedures to ensure that all parties have certainty over market operation, and in this case the ability to effectively trade across markets. APA considers that this is such a case.

Working towards an integrated gas market

The interconnected gas infrastructure in eastern Australia must be supported by integrated market arrangements for it to operate efficiently. This involves ensuring that the different market models in place in eastern Australia operate together to ensure that shippers can transport and trade gas in an efficient market.

Barriers to this transport and trade, for example by ineffective risk management products across market interfaces, can operate to undermine market efficiency, reducing the scope for competition for pipeline services and for gas supply. This would not be in the long interests of consumers.

APA considers that the proposed AMDQ Procedure will improve market arrangements to support the transport and trade of gas across the interconnected grid.

If you would like any further information, please call me on 02 9275 0020.

Yours sincerely

Alexandra Curran
Regulatory Manager