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**Submission to Commission -  
MSO Rules Re-Authorisation**

**Response by VENCORP to Submissions to ACCC  
Issues Paper**

**VENCORP  
19 August 2002**



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## MSO Rules Re-Authorisation

### Response by VENCorp to Submissions to ACCC Issues Paper

### 19 August 2002

#### 1 Introduction

Thank you for the opportunity to comment on submissions made on our application dated 17 May 2002 for renewal of the authorisation of the Victorian Market and System Operations Rules ('**MSO Rules**') ('**2002 Application**'). Submissions have been made by AGL Energy Sales & Marketing Limited ('**AGL**'), Energex Retail Pty Ltd ('**Energex**'), Esso Australia Pty Ltd ('**Esso**'), GasNet Australia (Operations) Pty Ltd ('**GasNet**'), TXU, Visy Pulp and Paper Pty Ltd ('**Visy**') and the Energy Users Association of Australia ('**EUA**').

VENCorp notes that the submissions raise no new issues. All of the substantive matters noted in the submissions have been previously considered by the Commission, subjected to regular reviews by VENCorp and the Gas Market Consultative Committee (GMCC), and the majority are already covered in our application documentation.

VENCorp's comments on the submissions are structured as follows:

- Overview (section 2).
- Proposals to replace market carriage with contract carriage and the appropriate role of the Commission (section 3).
- Options considered for the market design (section 4).
- The Allen Consulting Report<sup>1</sup> on the Victorian gas market (section 5).
- Concerns with the Authorised Maximum Daily Quantity (AMDQ) mechanism (section 6).
- Assertions made by Esso in support of their proposals to replace market carriage with contract carriage (section 7).
- Lack of demand side signals (section 8).
- Matters that can be addressed within the MSO Rules change process (section 9):
  - relief from failure to comply with scheduling instructions;
  - interruptible gas; and
  - exclusions of VENCorp liability
- Role of allocation agents under the MSO Rules (section 10).
- Board representation (section 11).
- Duration of the authorisation (section 12).

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<sup>1</sup> 'Review of the Victorian Gas Market', a report by Allen Consulting Group, April 2001, commissioned by EUA

## 2 Overview

Of the seven submissions made to date, there were positive comments by three gas retailers (AGL, TXU and Energex) and one direct market participant (Visy), and negative comments from one producer (Esso). GasNet's submission dealt only with the duration of the authorisation. The EUAA restates previous assertions from the report they commissioned by the Allen Consulting Group<sup>2</sup>.

Four of the submissions supported reauthorisation for a ten year period, representing a unanimous view of those Market Participants that made submissions. Each stressed the public interest in providing an environment of certainty and stability for the MSO Rules. VENCORP understands that the Department of Natural Resources and Environment also supports a ten-year period to avoid conflicts with the review of VENCORP's and GasNet's access arrangements in 2007, and the statutory review in 2007 of VENCORP's role as required by Gas Industry Act.

Only Esso argued for a fundamental change from market carriage, and a two year authorisation. The EUAA and GasNet proposed a five-year authorisation, aligned with access arrangement revisions.

Three broad themes emerge from the submissions:

- Esso proposes that the Commission require a change to an undefined system of contract carriage.
- Some concerns are raised with the AMDQ mechanism and liability arrangements.
- TXU proposes that the Commission require as a condition of authorisation a transition to hourly locational pricing, together with a well-defined transportation capacity rights system ("hourly / locational pricing").

Brief comments on each of these follow. More detailed comments are made later in this submission.

### 2.1 Requiring a transition to contract carriage

VENCORP notes the comments on this issue made at section 2.7 of our 2002 Application which deal with this matter at length.

Esso's submission raises the following issues:

- the proposed role of the Commission in making decisions on market design;
- reliance on the report by the Allen Consulting Group as the basis for decisions on substantive matters; and
- assertions in relation to the effect of the MSO Rules on the present system of AMDQ, upstream investment and liquidity in the gas market, which are unsubstantiated and, in some cases, do not accurately reflect the existing arrangements.

In asking the Commission to require a change to contract carriage, Esso is effectively asking the Commission to assume a policy-making role. VENCORP submits that this is

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<sup>2</sup> *ibid*

the proper role of Government. Victorian Government policy supports the MSO Rules and the role of VENCorp as an independent system operator (see section 3).

VENCorp disputes the conclusions drawn by Esso which rely on the report by the Allen Consulting Group. This report is based on unsubstantiated assertions and does not (and did not purport to) provide an alternative contract carriage model which could form the basis for decisions to replace the MSO Rules (see section 5).

Esso's claim that the MSO Rules constrain upstream investment is based on assertions that Minerva, Yolla and Patricia Baleen gas will be sold outside Victoria into South Australia and New South Wales<sup>3</sup>. This is inconsistent with VENCorp's information<sup>4</sup>. To the extent that gas will be sold interstate, it reflects the relative supply and demand position in the respective State markets (see section 7.1).

In relation to Yolla gas, Esso states that this gas will be required to bid in to the Victorian pool under the MSO Rules but "it is owned and operated by a significant Victorian gas retailer (Origin Energy) which may offset some of its risk through vertical integration." VENCorp points out a retailer securing new sources of gas to hedge its future risks is an appropriate and expected outcome from price signals provided by the Victorian gas market.

VENCorp disputes Esso's view that market carriage prevents long term contracting. Market participants can and do enter into long-term contracts, and this has been an all pervasive aspect of the arrangements surrounding market since its commencement. (see section 7.)

## 2.2 Concerns with AMDQ mechanism and liability arrangements

The submissions raise some specific concerns with the present market design, including with the AMDQ mechanism (see sections 5 and 6), and issues associated with liability (see section 9). In relation to AMDQ concerns raised by Esso, VENCorp points out that:

- existing AMDQ rights are in fact tradeable and able to be purchased (Esso states incorrectly that market participants can only obtain AMDQ - such that the rights do not belong to the customer – by paying for a pipeline extension or expansion); and
- AMDQ credits are available for interstate injections.

In some cases, submissions have asked the Commission to impose specific rule changes as a condition of authorisation.

VENCorp acknowledges that some of the matters raised may need to be addressed, with potential solutions identifiable within the current market carriage framework. These matters should be progressed through the well-established rule change process.

<sup>3</sup> Page 3, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>4</sup> VENCorp notes calls for upstream reform in submissions by Energex and AGL to the ACCC Issues Paper on MSO Rules Re-Authorisation. See also comments by Duke Energy International at page 7 of its submission dated April 2002 to the COAG Energy Market Review.

### 2.3 TXU's proposed transition to hourly/locational pricing

TXU asks the Commission to mandate, as a condition of authorisation, a move to locational hourly pricing by 1 December 2004<sup>5</sup>.

VENCORP takes the opportunity to once again put on record that it fully supports initiatives that are designed to promote stronger pricing signals and more competitive market-driven outcomes. VENCORP also acknowledges that the current single zone/daily pricing model has limitations, which may well be better addressed by more sophisticated pricing and associated financial transmission rights models. Nevertheless, a considerable amount of work is still required to define the appropriate changes to the market design and the appropriate timing for implementation.

Changes to the current market design to move in this direction will require extensive consideration of detailed design issues, detailed cost/benefit analysis, and extensive planning for implementation. Such analysis and planning will require close consultation and involvement by industry. Victorian Government involvement may also be required.

Further discussion in this regard is provided under section 4.7.

## 3 Proposal to replace market carriage with contract carriage - the role of the Commission

Esso submits that the Commission require:

- the abolition of market carriage within 2 years and replacement of this with an as yet undefined system of contract carriage;
- removal of VENCORP as independent system operator;
- establishing a new system of governance for the market; and
- (presumably) privatisation of VENCORP gas market-related assets and operations.

Esso's comments arise in the context of determining the counterfactual for the MSO Rules<sup>6</sup>.

As detailed in section 2.7 of VENCORP's 2002 Application, a market carriage system, the MSO Rules and VENCORP's role as the independent operator of the Principal Transmission System ('PTS'), are enshrined in Victorian statute. Significant legal, regulatory and operational procedures have been put in place to support the MSO Rules and a market carriage system. In making its 2002 Application, VENCORP has requested that the Commission provide a competition authorisation under the Trade Practices Act ('TPA') of the MSO Rules. The Commission is not being asked to determine whether Victoria should adopt a contract carriage system.

VENCORP submits that the structural changes proposed by Esso are matters of policy, and that Esso is therefore asking the Commission to perform a policy-making role (and is incorrectly assuming, VENCORP believes, that the Commission has the power to

<sup>5</sup> Page 2, Submission by TXU to ACCC Issues Paper on MSO Rules Re-Authorisation, 17 July 2002.

<sup>6</sup> We concur with the comments of Energex, TXU and AGL that the relevant counterfactual is a modified version of market carriage, which may or may not address all market participants' concerns about potential breaches of the TPA, and may or may not work as effectively as the current arrangements.

mandate the adoption of a contract carriage system). There has recently been considerable comment in the context of the establishment of the NEM Ministers Forum and the COAG Energy Review, including by members of the Commission, as to the inappropriateness of the Commission assuming a policy-making role. It is accepted that policy-making is the function of Governments.

The Victorian Government policy on gas market design and the role of VENCorp was recently confirmed by the Minister for Energy and Resources as follows<sup>7</sup> :

- The market and associated commercial arrangements for the supply and sale of natural gas have worked relatively smoothly and successfully.
- Government regards VENCorp as performing a valuable role in ensuring the security and reliability of gas supply to Victorians. VENCorp's role also assists in providing transparency and accountability in the operation of the Victorian gas market.
- No major problems have emerged since the market commenced operations in March 1999.
- Major revision of the market design or the roles and functions of VENCorp after a relatively short time therefore do not seem warranted, and could impact adversely on investment certainty in the industry.
- VENCorp's operation of the wholesale gas market is overseen by an independent Board comprised of representatives of all participants in the gas market.
- The GMCC provides a robust forum for addressing issues raised by gas industry participants and other stakeholders.
- Members of the gas industry are encouraged to continue contributing to the development and improvement of the Victorian gas market by participating in the work of the GMCC.

As noted in section 2.7 of our 2002 Application, a change in policy to remove VENCorp as independent system operator and the adoption of a contract carriage system would require significant amendments to the Victorian statutory framework as well as contracts, processes and systems put in place by market participants.

At this time, Government policy is unequivocal in its support for the current arrangements and the continuation of a market carriage system. Accordingly, Esso is essentially asking the Commission to limit its authorisation of the MSO Rules to 2 years in the hope that the Victorian Government and participants agree to move to a contract carriage system in that time. VENCorp submits this is unlikely and therefore a 2 year authorisation is only likely to cause significant uncertainty, consequential loss of investment, delay of industry reform such as the move to full retail competition, and result in increased costs to participants and end consumers.

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<sup>7</sup> Hon Ms Candy Broad, Minister for Energy and Resources, Address to the Australian Gas Industry Forum, 26 June 2001.



## 4 Market design options

### 4.1 Overview

Some submissions note concerns which stem from the current single zone daily price mechanism, and the system of AMDQ and AMDQ credits ("single zone daily price model"). There is nothing new in this debate. The issues were considered in detail during initial market design, and have been the subject of rigorous review since the market commenced. To date, general consensus has consistently been that, whilst the arguments are recognised, the question is one of timing and that a shift to locational hourly pricing has not been warranted to this point of time. As will be discussed, there have been significant developments since the last major review in 2000/01 that may cause this view to be further challenged in the near future.

This section discusses:

- the physical properties of the Victorian Principal Transmission System (PTS);
- previous decisions taken on market design, considered in 1997 and in the 2000-01 Market Review;
- implications of single zone daily pricing;
- the uplift allocation methodology;
- experience with the current market design; and
- decision making on future market design.

Specific issues raised by TXU and Esso in relation to AMDQ are considered in the next section.

### 4.2 Physical characteristics of the PTS

As described in the 2002 Application<sup>8</sup>, the PTS has important and undeniable characteristics which distinguish it from other pipeline systems in Australia. These include:

- a meshed network with several different sources of gas supply and a very large number of off-take points;
- little spare transport capacity on peak days, which is affected by where the gas is sourced on any given day;
- little spare linepack capability in the system to manage imbalances on many days of the year - the entire system capability often needs to be fully utilised just to manage the diurnal swing in load and the resultant divergence between hourly rates of supply and demand;
- a large component of highly temperature-dependent heating load resulting in large daily swings in demand; and
- strong limitations (contractual, commercial and physical) on the ability to significantly alter rates of flow from main gas field producers throughout the day.

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<sup>8</sup> Section 3.2.4 of our 2002 Application

The PTS is also required to facilitate full retail competition ('FRC') in a fully deregulated and non-government owned downstream environment.

In addition, over time there is expected to be:

- an increasingly significant and growing gas fired power generation component;
- increased peak day demand;
- increased connection of new sources of gas (e.g. Yolla); and
- more off-take points and interconnections with other pipeline systems

The above characteristics must to be considered when examining the current market design, and when assessing unsubstantiated assertions how other, as yet undefined, arrangements could be utilised for addressing the requirements on the PTS.

### **4.3 Previous decisions taken on the market design**

Government adopted the simplified single zone daily pricing model for initial implementation of the market after having initially contemplated a locational and hourly pricing model following extensive analysis and consultation, which is all on public record. The perceived additional complexities associated with hourly and locational pricing did not justify its adoption at that time. The subsequent 2000-01 Market Review confirmed the original position; instead, industry focused on introducing a number of refinements to the single zone daily pricing model to address specific short term issues.

The 2000-01 Market Review was an open, consultative process led by an industry working group, comprising retailer and pipeline owner representatives reporting to the GMCC<sup>9</sup>. Comprehensive issues papers, submissions from interested parties and reports of the findings were published and at this point still remain available via VENCORP's website.

In considering the option of introducing hourly/locational pricing, the 2000-01 Market Review concluded that a number of complex issues would need to be resolved, including the detailed arrangements for transmission rights; the issue of converting AMDQ rights to financial transmission rights; and management of inter-temporal balancing issues with hourly pricing.

However, since that last review,

- Two new and significant gas fired power stations have been built and commissioned in Victoria, with the prospect of further developments in the next few years.
- in the last 2 years the Victorian gas system has become progressively tighter for management of peak demands and more complex to manage; and
- new sources of supply have been committed and are expected to be introduced within the next 2 years.

Each of these factors provide both strong support for the current market carriage approach and, equally, strong drivers for further evolution of the implementation of this market construct.

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<sup>9</sup> All participants and representatives from users groups, including EUAA, were invited to participate in this working group.

#### 4.4 Implications of single zone daily pricing

A single zone daily pricing model can result in:

- less than optimal allocative efficiency properties for:
  - managing within-day events on a competitive and decentralised basis;
  - providing efficient locational signals for production, consumption and investment; and
- inefficient signals for demand side response (such as gas fired generators); and
- participants' potential inability to fully hedge against exposure to price risk from congestion costs, as pricing for transportation is not fully firm.

These limitations were recognized at market commencement as being a trade-off between sophistication of market pricing arrangements and simplicity of market operation, at a time when within day constraints were expected to be infrequent and insufficient to warrant a more sophisticated pricing model. It is important to note that, as such, these are not inherent features or limitations of the market carriage arrangements. Rather, they are the product of the physical characteristics of the Victorian gas transmission system, which may increasingly result in difficulties with any daily balancing regime. Indeed, modifications to the current market carriage arrangements would appear to offer the only identified viable market-based solution to manage more these within day constraints more efficiently.

The current implementation incorporates features which partly address these matters, for example via AMDQ and uplift allocation principles. These requirements may be better addressed by more sophisticated pricing and associated development of financial transmission rights models. While the materiality of these matters has not yet eventuated in practice at present, in VENCORP's view these matters nevertheless require continued focus and attention for the future (refer section 4.7).

#### 4.5 Uplift allocation methodology

The intention of the uplift allocation methodology is to allocate, as far as practicable given the inherent difficulties of such an approach, the costs of congestion to "cause". Therefore, the arrangements attempt to assign uplift payments to the events (and thence parties) which led to them.

This allocation is determined by reference to exceedence by market participant's customers of their AMDQ where relevant, and offset with a market participant's AMDQ and AMDQ credits. Where ancillary payments are not readily attributed to actions by individual participants then uplift charges are allocated to market participants based on their usage of the PTS (using withdrawals on that day to allocate the costs).

AMDQ and AMDQ credits provide both financial rights (in the form of limited uplift protection) and physical rights (by prioritising treatment of customers in times of curtailment due to transportation issues).

Key features of the AMDQ and AMDQ credit arrangements are:

- All AMDQ was allocated at market commencement
- The AMDQ was initially allocated fully to customers, not the incumbent retailers

- The initial allocation of AMDQ to customers directly facilitates full retail competition, as new retailers do not have to acquire AMDQ or obtain AMDQ credits in order to contest customers. The customers carry their AMDQ with them on transfer; therefore, it does not protect the incumbent retailers in a contestable environment, but does protect the end users and promote retail competition.
- AMDQ and AMDQ credits are all fully transferable and therefore fully tradeable and purchasable; any party is able to approach the current holders i.e. customers, other retailers etc. to negotiate terms for acquisition of the rights on mutually agreeable terms and conditions. This is contrary to the assertion made by Esso<sup>10</sup>.
- AMDQ and AMDQ credits underwrite expansions and extensions of the PTS, as parties can contract with GasNet to augment the system and acquire the associated incremental AMDQ or AMDQ credits. This is contrary to the assertion made by Esso<sup>11</sup>.

As noted, AMDQ and AMDQ credits derive their value under the current arrangements from both the financial value they can offer via uplift hedging, and their physical value during curtailment. They provide a right through which the market place can create incentives for the pipeline owner to augment the system. In this way, the rights provide a signal for more focussed investment by the pipeline owner rather than simply relying on investment driven by the incremental tariff revenue resulting from increased volumes.

#### 4.6 Experience

The experience of the last three years has highlighted the following points.

Firstly, the particular characteristics of the PTS outlined in section 4.2 of this submission (and in section 3.2.4 of our 2002 Application) have in practice been important. Re-scheduling is often required during the day due to the combined effect of limited linepack and the need to respond to supply and demand conditions which change during the day. VENCORP believes that many of the criticisms to date of the current market arrangements have not given sufficient attention to the requirements for addressing the physical constraints and characteristics of the PTS, and the complexities of its operation in a competitive, open-access environment.

Contrary to Esso's assertion<sup>12</sup>, the introduction of interconnection and storage have not alleviated the need for very careful balancing of the PTS, but rather have increased the level of complexity that needs to be managed. Esso have raised the matter of dealing with non-firm gas in their submission<sup>13</sup>, and these issues tend to provide further evidence of the need to manage increasingly complex operational and commercial matters in a transparent and competitive market based manner (see section 9.2).

<sup>10</sup> Page 3, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>11</sup> Page 4, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>12</sup> Page 6, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>13</sup> Page 8, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

Secondly, as projected by modelling decisions undertaken as part of the 1997 market design, uplift risks have so far proved to be small. Only about \$1.3m in total of uplift payments has arisen to date, representing a net exposure of only a fraction of a cent per GJ for any market participant. Since 1997, VENCorp has undertaken five independent actuarial reviews of uplift risk to date, which further quantify and explain the risks involved. These studies, which have been made available to the Commission, confirm that under present circumstances, uplift risk is relatively small and the quantum continues to be low.

Thirdly, VENCorp notes the events of Monday 22 July 2002 where VENCorp declared a level 5 emergency and issued directions for load curtailment due to a threat to system security. This incident arose due to the combination of a number of factors including unexpectedly cold weather, limitations on gas storage injections due to gas quality requirements; and unexpectedly high gas consumption of gas fired electricity generators. This was due to high prices in the electricity market due to cold weather, electricity transmission outages, and outages of coal fired generation capacity. The gas spot price for the day was \$9.20/ GJ with a preliminary estimate of ancillary payments being in the order of \$164,000.

The incident illustrates how strongly integrated the wholesale gas and electricity markets are at times of coincident events, and the emerging critical influence of gas fired electricity generators in the gas market.

#### **4.7 Future decisions on market design**

VENCorp acknowledges that while the potential economic inefficiency and commercial risks from the currently simplified pricing design of the market are limited at present, they are likely to increase in the future as the market further evolves, particularly with the advent of more peaking gas generation and impending connection to new sources of supply.

As noted in section 2.3:

- Changes will entail resolution of detailed design issues, completion of cost/benefit analysis, and extensive planning for implementation. Such analysis and planning must include close consultation and involvement by industry, and probably Victorian Government.
- Market participants have reasonable commercial incentives to pursue change when appropriate, and the means by which to do so (rule change process prescribed in the MSO Rules and the GMCC) within the current regulatory framework.
- A consultative approach will lead to higher levels of industry, user and government understanding and commitment, and better resolution of the issues surrounding the commercial interests of existing participants.

At present, there are a range of views as to the urgency for change. Energex states<sup>14</sup> that, at this time, the costs and complexity of settling the market on a nodal basis outweigh the perceived deficiency of single market zone. AGL states<sup>15</sup> :

*“To the extent that there are valid concerns about these, or other features of the MSOR, surely the remedy lies in the existence of effective Code review and change processes. AGL would caution against the imposition of regulatory conditions where the market already has effective mechanisms for identifying and dealing with detrimental features.”*

In contrast, TXU considers that changes should be initiated immediately, to introduce hourly/locational pricing within two years<sup>16</sup> .

The current market design is considered by most participants to be effective and still adequate for the present needs of the market place. In VENCORP’s view, while the current market-based approach under market carriage is fundamentally sound, the current single zone/daily pricing model has limitations for addressing the longer term needs and further evolution of the market design is inevitable – the primary questions being ones of timing and direction. Further development of the market design being considered at present is:

- In the short term: a review is now under way of the manner by which uplift is allocated, examining a more effective allocation of the costs of constraints. Additionally, it is intended to examine more market based ways of managing linepack within the current framework. These initiatives have the potential to enhance market efficiency, and to lead to improved incentives for investment.
- In the longer term: a more substantive development of the pricing arrangements and associated allocation of property rights will need to be considered.

In our view, the current processes for change (GMCC and MSO Rules change process) are perfectly adequate for addressing these needs within the current framework. Importantly, these processes also provide an appropriate manner of addressing the interests of participants, particularly those for whom changes to the current arrangements may have significant commercial ramifications.

In VENCORP’s view, strong drivers for change are created with rising peak gas demand and increased gas-fired electricity generation which will give rise to more material instances of within day events. VENCORP believes that participants can and will seek to change the MSO Rules when and as they consider that the issues are sufficient to justify change.

VENCORP believes that in matters such as these, relating to the design of the market within the current market carriage framework, changes are most appropriately driven by industry and market participants.

<sup>14</sup> Page 12, Submission by Energex to ACCC Issues Paper on MSO Rules Re-Authorisation, 17 June 2002.

<sup>15</sup> Page 3, Submission by AGL to ACCC Issues Paper on MSO Rules Re-Authorisation, 28 June 2002.

<sup>16</sup> Refer section 2.4 of Submission by TXU to ACCC Issues Paper on MSO Rules Re-Authorisation, 17 July 2002.

## 5 Report by the Allen Consulting Group

Esso have relied on the report by the Allen Consulting Group to support their position that market carriage should be abolished and replaced by contract carriage.

The EUAA submission also refers to the report by the Allen Consulting Group, and asks the Commission to consider the concept of a nationally consistent gas market, implying a potential move to contract carriage for the PTS. However, the EUAA submission acknowledges the need for further work to be undertaken to develop a viable alternative based on contract carriage.

Further, while VENCorp is sympathetic to the concept of harmonisation of gas trading arrangements to the extent necessary to facilitate inter-state trade and inter-basin competition and, importantly, interaction with the national electricity market, it is by no means clear what is meant by the request by EUAA for a “*nationally consistent gas market*”.

The physics of gas transportation are quite distinctly different to those of electricity, such that the requirements for a single set of operating rules for the entire interconnected national transmission network are not as great. It may be appropriate that different gas pipeline systems with different physical characteristics should operate under different balancing arrangements, even if they are interconnected (as is the case, we understand, in overseas markets such as the U.S.A.). This need not and does not present material barriers to inter-pipeline gas flows or trades – either between Victoria and New South Wales currently, or in many other places around the world.

Further, the features of a contract carriage model as espoused in the report, or as implemented in its various forms elsewhere in Australia (noting again that there is no single, consistent “contract carriage model”), are clearly inadequate to meet the present and future requirements of Victoria where, based on the submissions to the Commission, the main issues to be addressed are those associated with providing improved locational and within day pricing signals.

VENCorp make the following key points on the report by the Allen Consulting Group<sup>17</sup> :

- The report does not give any regard to the unique characteristics of the PTS. The report implies that the PTS either has similar characteristics to other pipelines that operate under a contract carriage model<sup>18</sup>, or that these characteristics are irrelevant and can be ignored. Many industry participants however have publicly acknowledged the importance of these characteristics

<sup>17</sup> See ‘*The Victorian Gas Market: Debunking the Myths*’, The Australian Gas Journal, September 2001, for further discussion.

<sup>18</sup> Traditional balancing models are based on fundamental premises of being able to apply simplicity for the transportation model to define contract paths and being able to manage this within the physical tolerances of the pipeline, and that rights to capacity can therefore be defined simply in physical terms. These models tend to rely on long distance, high capacity pipelines transporting gas (i.e. large linestock capability), with the following resultant attributes: flows are predominantly in one direction to simplify both operations and pipeline rate/incentive design, and mostly point to point from distant production fields to the local distribution centre, and the pipeline can store large amounts of spare gas as linepack. Capacity management is therefore well suited to a basic priority-of-treatment or queuing approach and contract path definition is feasible. The pipeline has sufficient linepack capability to enable longer term (weekly) tolerances and daily balancing. Combined with steady long term contracts, this enables parties to “borrow” gas from the pipeline on one day and make it up (or trade off the imbalance) on the next day (or later) at the same underlying contract price.

(for example Duke Energy<sup>19</sup>, GasNet<sup>20</sup>, and AGL<sup>21</sup>). The report provided no analysis of how a contract carriage model would address these issues (nor point to any models operating in practice) that would address these specific characteristics<sup>22</sup>.

- The report contains comments and assertions that are not substantiated by analysis of actual market outcomes. For example, the report asserts that the current market arrangements pose an impediment to investment in Victoria and/or to interstate trading of gas. Yet the report itself states that “*no firm evidence is available*”<sup>23</sup>, whereas analysis of available data on actual flows over the interconnect does not provide any evidence that the MSO Rules have created a barrier to trade as suggested by this report, and in fact suggest the reverse is true<sup>24</sup>;
- The report did not provide (and did not claim to have developed) an alternative model, stating<sup>25</sup> “*Implementation of any alternative model would require significant detail to be developed*”.
- The report did not provide any analysis of the costs of its propositions, stating<sup>26</sup> that “*It is not possible to estimate with any certainty the costs of operating the system under a contract carriage regime*”, and therefore did not attempt to undertake any cost/benefit analysis of the (as yet undefined) proposals it suggested.

VENCORP also notes that AGL, TXU and Energex, all of whom were listed among the parties who commissioned the report, have made submissions to the Commission which are dismissive of that report.

In summary, VENCORP believes that it is incorrect to imply that the report by the Allen Consulting Group for the EUAA is an authoritative review of the Victorian gas market,

<sup>19</sup> Page 2, Submission by Duke Energy International to ACCC on GasNet’s access arrangement revisions, 13 May 2002.

<sup>20</sup> Page 10, ‘*Consultation paper on proposed tariff design for the Victorian gas transmission system*’, paper prepared by NERA for GasNet for consultation on tariff designs for proposed revisions to its access arrangements, November 2001.

<sup>21</sup> Page 3, Submission by AGL to ACCC Issues Paper on MSO Rules Re-Authorisation, 28 June 2002.

<sup>22</sup> Key design features that any contract carriage model for the PTS would need to address include:

- allowing for the complexity of the meshed network behaviour of the PTS;
- defining physical capacity; and
- managing limited linepack.

The meshed network features are illustrated by the fact that the systems is already marginal on supply from underground storage, LNG and the interconnect at peak times. On peak days, gas may be sourced from four physically disparate locations on the Victorian system, and on shoulder seasons the direction of gas flow is determined by market conditions. The difficulty in defining capacity has been confirmed through studies undertaken by VENCORP as part of the Annual Planning Review. These indicate that the capacity of the system is dependent on where gas is sourced. Limitations on linepack are such that it that can require hourly balancing at critical times. This is illustrated by comparing the power failure at Moomba in August 1999 and that for Longford in July 2000. In the Moomba case, the system was operated largely on linepack for over a day before limited curtailments commenced whereas in the Longford case, LNG was required within two hours to avoid curtailments, and continued long after the facility was restored to production.

<sup>23</sup> Page 5, ‘*Review of the Victorian Gas Market*’, report by Allen Consulting Group, April 2001

<sup>24</sup> Section 6.1.5, page 36, of VENCORP’s 2002 Application.

<sup>25</sup> Page 19, Note 12, ‘*Review of the Victorian Gas Market*’, report by Allen Consulting Group, April 2001

<sup>26</sup> Page 8, ‘*Review of the Victorian Gas Market*’, a report by Allen Consulting Group, April 2001



or that it provides any justification for an alternative model which could be used as the basis for decisions to replace the MSO Rules.

## 6 Concerns with AMDQ

This section addresses:

- concerns with AMDQ trading (raised by TXU);
- concerns with securing AMDQ and impediments to interstate trade (raised by Esso).

### 6.1 TXU concerns with AMDQ trading

TXU raises a concern with AMDQ trading, noting that customers appear reluctant to release AMDQ in situations where they are not using it.

The same issues have arisen with shippers holding onto their capacity rights on other Victorian gas pipelines operating under contract carriage arrangements, and indeed in other States under contract carriage arrangements. VENCORP suggests that in the case of the PTS this reflects a retailer/customer relationship issue, rather than any direct criticism of the inherent and underlying arrangements.

It is VENCORP's view that retailers are the natural aggregators in the market, and are therefore the best suited to ensuring that the benefits of AMDQ are optimised by making use of the diversity benefits from aggregation, especially those arising from AMDQ. It should be possible for retailers to acquire the AMDQ rights held by customers in exchange for certain benefits by which they could re-package a deal for the customer, such as protection from uplift risk and certainty of pricing. The existing arrangements do not hinder, and are in fact directed towards, facilitating just such an activity.

If there is any matter relating to the processes by which AMDQ can be transferred, the matter can be more properly addressed via the existing MSO Rules change and consultative processes which are currently actively reviewing these matters at present.

### 6.2 Esso concerns with securing AMDQ and interstate trade

Esso submitted<sup>27</sup> that the MSO Rules force prospective users to seek uneconomic extensions/expansions, even where there is existing spare capacity on the system. The submission stated that the only way in which a market participant can obtain firm pipeline capacity (AMDQ) to back a delivered gas sale is through paying for a pipeline extensions or expansion. This, the submission stated, is because the AMDQ belongs to the end user.

To clarify the matter, the correct position is that rights to existing AMDQ are, in fact, tradable and transferable. Contrary to the statement that "*a gas producer or retailer is unable to obtain capacity rights*", any market participant can buy or otherwise acquire the existing AMDQ from the current holders and assign it to any site of their choice or hold it as a purely financial hedge. Or, they can arrange for the pipeline owner to

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<sup>27</sup> Page 3, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

undertake an expansion and acquire the incremental AMDQ created from this investment under contract, but clearly this is not the only option.

Retailers such as AGL, Origin and Energex, who represent a significant portion of potential buyers of gas, have not raised any fundamental problem with the market design in this regard. VENCORP has subsequently discussed the matter with Esso, and we understand that their concern has now been resolved.

Esso also submitted that in many instances gas users may prefer to offset their risks through contracting gas on a delivered basis, and that under these circumstances, gas sellers can best minimise their risk and provide the highest level of service to customers through contracting directly with the pipeline operator<sup>28</sup>.

Unfortunately, Esso has provided little substantive detail in their submission to support this position, or to accurately describe comparable processes on interconnected contract carriage systems. In the absence of any more detailed information, it is difficult to make anything more than very general comments in response: VENCORP understands that most retailers are equipped to provide a bundled product which results in a firm delivered price to end users. There is clear evidence of activities, such as vertical integration, occurring in the existing retailers to manage these needs.

Uplift risks have been accepted to date by participants, with acceptance based in part on studies which indicate that the risk is relatively small, and that material net uplift risks are related to low probability scenarios, and on the basis of practical experience to date in the live market which has tended to validate these modelling studies.

VENCORP draws the Commission's attention to sections 6.1.5, 6.6.1 and 6.6.2 of the 2002 Application.

In particular, VENCORP notes that:

- AMDQ Credits are available for interstate injections in the PTS;
- perceptions of contracting difficulties in dealing with a market carriage system are misplaced<sup>29</sup>;
- evidence of interstate trade across the Victoria–NSW interconnect at Culcairn indicates that the differences in the models in each state, and specifically the MSO Rules, do not represent any substantive barrier to trade<sup>30</sup>; and
- the MSO Rules appear to promote interstate trade given there is no requirement for retailers to book or acquire capacity on the PTS.

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<sup>28</sup> Page 3, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>29</sup> Refer to pages 36 – 39 of VENCORP's 2002 Application.

<sup>30</sup> *ibid*

VENCORP also notes that the alleged “barriers to trade” arising from the MSO Rules should be seen within the context of experience with the interface between contract carriage pipelines. For example, NERA in a report prepared for BHP Petroleum noted that Duke Energy spent around \$28 million to effectively loop an entire segment of the existing trunk network in NSW. NERA noted<sup>31</sup>:

*“the section of the Eastern Gas Pipeline between Wilton and Horsley Park represents the most blatantly uneconomic bypass case we’ve witnessed anywhere in the world.”*

As noted in the 2002 Application, experience in Victorian pipeline systems operating outside the MSO Rules indicates that where an existing customer with an unchanged load wishes to transfer (such that there will be no net increase in gas throughput), that transfer is impeded because:

- a new retailer cannot compel an incumbent retailer to relinquish its capacity rights;
- in the absence of pipeline augmentation, the pipeline owner will offer only interruptible supply to a new retailer; and
- if the customer accepts interruptible supply, the former incumbent retailer may sell the firm capacity rights to another customer.

This contrasts with the market carriage model applied by the MSO Rules to the PTS, where there is no requirement to contract for pipeline capacity and no ability for “incumbent” retailers to fully contract capacity and prevent access to new entrants.

## 7 Esso assertions in support of transition to contract carriage

As discussed in section 3, VENCORP believes proposals to abolish market carriage and the transition to contract carriage are matters of policy to be considered by Government; and that the appropriate counterfactual to be considered by the Commission is not contract carriage, but a modified form of market carriage.

Nonetheless, VENCORP considers it is appropriate to comment on unsubstantiated assertions made by Esso regarding:

- the effect of the MSO Rules on upstream investment; and
- the MSO Rules and long term producer/retailer contracts.

### 7.1 Effect of MSO Rules on upstream investment

Esso asserts that the MSO Rules are a deterrent to upstream investment, stating<sup>32</sup> that:

- Yolla gas will be required to bid in to the Victorian pool under the MSO Rules but that *“it is owned and operated by a significant Victorian Gas retailer (Origin Energy) which may offset some of its risk through vertical integration”*;
- public information suggests that Minerva and the Yolla fields have been committed to South Australian users; and

<sup>31</sup> See NERA report for prepared for BHP Petroleum, 2000, quoted in the report *“Final Recommendation on the Coverage of the Eastern Gas Pipeline”* by National Competition Council, June 2000.

<sup>32</sup> Page 5, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

- Patricia Baleen gas will flow to NSW users.

VENCorp makes the following comments on these assertions:

- In relation to Origin Energy's Yolla gas, VENCorp notes that a retailer securing new sources of gas to hedge its future risks is an appropriate and expected outcome from price signals provided by the Victorian gas market. VENCorp has consistently noted that the relevant risks associated with the AMDQ mechanism are the net risks (exposure to uplift charges net of ancillary payments) rather than the gross exposure to uplift charges. Vertical integration is one means by which market participants can offset their risk position, but there are also other means (such as purchasing AMDQ in the secondary market or purchasing gas from alternative gas sources and suppliers and receiving either ancillary payments or AMDQ credits for those gas injections).
- Esso assert that Minerva, Yolla and Patricia Baleen are committed to users outside Victoria. VENCorp is unaware of definitive information that would confirm these assertions. Confidential discussions with a range of market participants, lead us to question the accuracy of Esso's statements.
- The level of exploration for gas, development activities and prospective commercial activity in Victoria is at historically high levels.
- Over the short to medium term, Victorian gas supply needs are substantially met by the existing Gas Sales Agreement<sup>33</sup> ('GSA') between Esso/BHP and Gascor, which continues until 2009. This contrasts with South Australia, which presents significant current opportunities in terms of needs for both gas supplies and transmission capacity, and NSW where there are opportunities for additional gas supply.
- Gas prices vary significantly between states, with higher prices experienced interstate than in Victoria. Therefore, it is not surprising that producers would, in the short term, seek to sell gas into higher priced markets outside Victoria.

VENCorp contends that the wholesale market cannot compel upstream competition per se, but rather facilitates delivery of reform benefits to consumers. VENCorp concurs with the following comments from retailers:

AGL at page 3 of its submission:

*"The benefits of the MSOR may largely be described as facilitating the realisation of benefits from other reforms in the gas supply chain. Those reforms, including customer choice in the retail gas markets, open access to essential infrastructure, and greater competition in upstream gas supply, require concerted effort to achieve optimum results. AGL does not subscribe to the view that market carriage or the MSOR of themselves promote reform in the other areas, rather that they help to deliver the benefit of those reforms to consumers.*

*Conversely, AGL does not regard the absence of active trading in the wholesale gas market as evidence of any failure on the part of market carriage or the MSOR. Rather, that is the result of difficulties for new entrants to the market in gaining access to gas supplies in Victoria and uncertainty over the form and timing of retail contestability."*

Energex at page 7 of its submission:

*"On the matter of significant changes, ENERGEX's position is that perhaps one of the more substantive aspects in the development of the market has been the slow emergence of new*

<sup>33</sup> A long-term producer contract covering the sale of gas.

*injection sources since the initial authorisation. In considering this issue, we would caution the Commission against viewing this dynamic as evidence that there is active upstream competition. On the contrary, it is our view that the principal driver for this behaviour has been the need for existing, wholesale gas market participants to manage market risk in the face of a largely non-competitive upstream market.”*

Energex at page 10 of its submission:

*“...we maintain that the degree of public benefit that could be expected from a wholesale market based on this form of access regime (or, indeed any other form of access regime) has been severely limited by the lack of upstream reform in gas generally. Efficient wholesale markets rely on upstream competition to provide real and sustainable savings to end consumers. To date the dominant position of the current wellhead producers and the inability of new entrants to successfully negotiate contracts with these suppliers (invariably negotiated through jointly marketed arrangements) have significantly restricted the public benefits available regardless of the form of access regime.”*

TXU at page 1 of its submission:

*“In fact the single greatest inhibitor of dynamic competition in the Victorian gas market, and indeed the South East Australian gas market, is not the market model but continues to be the lack of upstream competition.”*

## 7.2 MSO Rules prevent long term producer – retailer contracts

Esso implies that the MSO Rules prevent long term contracts between retailers and producers stating that<sup>34</sup>, compared with traditional contract carriage, the MSO Rules do not provide sufficient certainty or a balance of minimised risks and liabilities to encourage upstream investment and competition.

VENCORP comments as follows:

- The MSO Rules do not preclude nor hinder long term contracts with producers. In fact, the majority of gas is currently supplied and sold under long term contracts – for example, the GSA and associated sub-sales agreements would be considered to constitute long term contracts with producers in any context.
- The MSO Rules provide an efficient market-driven system for operational balancing and management of capacity. The retailers can and do bid gas into the market, with this gas supplied under a variety of supply arrangements with producers, including under long term supply contracts. The retailers can and do trade gas through the spot market to supply their customers under contract.
- Submissions made to the Commission and to the COAG Energy Market Review Panel<sup>35</sup> suggest that retailers are seeking new supply contracts, but have faced reluctance from the incumbent producers to enter into contracts. Reluctance by producers to enter into long-term contracts could be for various reasons, including optimisation of commercial positions within the southeast Australian gas market.

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<sup>34</sup> Page 5, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>35</sup> Page 7, Submission by Duke Energy International to COAG Energy Market Review, April 2002.

## 8 Demand side signals

Energex asserts<sup>36</sup> that demand side response is not in practice supported and encouraged by the underlying market design principles. This is incorrect. The existing market construct is ideally suited to this need. VENCORP acknowledges that the current implementation of this construct, a single zone daily pricing model, has limitations in this regard but this implementation is by choice and the fundamental approach is not invalidated by the current implementation.

VENCORP believes that, as experience in the electricity market shows, promoting an efficient demand side response is a complex matter involving both market design, commercial issues, and political issues. Key issues include the need for high quality information flows, mechanisms to give advanced warning, commercial arrangements to provide demand side participants with commercial certainty as to the benefits received, and the implications of requiring customers be exposed to the very signals that are required to promote the aspired response.

VENCORP believes that (provided there are adequate market pricing signals to which they can respond) gas-fired electricity generators currently provide the most practical source of potential demand side response in the short term because:

- owners of gas fired electricity generators have access to alternative sources of electricity production to meet contractual commitments and in some cases, to alternative fuel sources;
- peaking gas fired generators have very flexible operating profiles; and
- the owners of gas fired generators are sophisticated participants, with the trading capability to respond to pricing signals.

On balance, and within the context of the current implementation of a single zone, daily pricing market, VENCORP believes that it does not seem warranted for it to dedicate its resources to specific demand side policy initiatives at this time.

In VENCORP's view, the focus would be better placed by first examining initiatives such as development of locational and inter-temporal pricing which could provide more direct market based signals for promoting the development of demand side response in the longer term.

## 9 Other matters that may be addressed within the MSO Rules

This section discusses the following matters raised by Esso in relation to the MSO Rules:

- Relief from failure to comply with scheduling instructions.
- Interruptible gas.
- Exclusion of VENCORP liability.

In VENCORP's view, these concerns should be addressed through the existing processes for review and amendment of the MSO Rules.

<sup>36</sup> Pages 8 and 9, Submission by Energex to ACCC Issues Paper on MSO Rules Re-Authorisation, 17 June 2002.

## 9.1 Relief from failure to comply with scheduling instructions

Esso asserts<sup>37</sup> that the MSO Rules do not provide balanced force majeure provisions in response to failures by producers that are direct market participants.

There would be significantly greater flexibility and reduced exposure to producers under an hourly spot market, with adjustments made as circumstances change. This may enable greater flexibility for producers to 'rebid' in a manner analogous to the generator rebidding provisions in the National Electricity Code.

Esso asks the Commission to impose revisions under any authorisation of the MSO Rules, to provide relief for liability for failure to comply with scheduling instructions. VENCORP believes that it is inappropriate and unnecessary for the Commission to impose any such revisions because:

- Esso is able through the MSO Rules rule change process to promote rule changes to address its concerns, through a transparent consultative process that captures relevant industry and consumer interests;
- Esso has to date chosen not to avail itself of opportunities available to it<sup>38</sup> under the MSO Rules to propose rule changes;
- VENCORP is willing to provide assistance and facilitation to identify and promote any such proposed rule changes provided they are consistent with the objectives of the MSO Rules;
- whether or not the current position is optimal, changing it involves by necessity a realignment or transfer of risk from the current status, and therefore should be examined in a properly consultative manner.

In these circumstances, VENCORP does not consider it appropriate for the Commission to seek to resolve the issue through conditions imposed in authorising the MSO Rules.

## 9.2 Interruptible gas

Esso asserts<sup>39</sup> that the MSO Rules do not specifically allow "interruptible" gas to bid to the pool. Esso are referring to quantities of gas which can only be confirmed on the day, and then are only provided on a non-firm basis. In this context they would, understandably, seek to limit liability for non-delivery. The arrangements are not yet known, however, reasons for non-delivery during the day of quantities offered on a non-firm basis could include either technical reasons (such as plant capability or the ability of the system to accept the gas), force majeure type events, and it may be that producers would prefer this to extend to commercial reasons (such as finding a better market for the gas).

Under the current daily market arrangements, offers for gas injections are required to be made in good faith at the start of the day and, because of the nature of a daily pricing market, rebidding during the day is not permitted. There may be potentially significant market issues associated with daily pricing if parties are able to withdraw gas offers made at the start of the day or offer additional gas supplies in response to

<sup>37</sup> Pages 6 and 7, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

<sup>38</sup> Producers have had a direct seat on the GMCC since market commencement.

<sup>39</sup> Page 7, Submission by Esso to ACCC Issues Paper on MSO Rules Re-Authorisation, 19 July 2002.

changing commercial circumstances. An hourly pricing market would assist in this regard and facilitate the injection of non-firm gas.

Nevertheless, if these potential issues can be addressed, VENCORP is willing to facilitate any proposals by Esso, or others, to allow gas to be offered into the market on an “interruptible” or non-firm basis within the context of the current daily pricing construct.

The clear path and most straightforward manner for addressing this matter is via the GMCC and, if rules changes are needed, via the MSO Rules change processes.

### 9.3 Exclusion of VENCORP liability

Esso states<sup>40</sup> that the MSO Rules provide total protection to VENCORP for liability, whereas standard industry provisions provide for a balanced sharing of liabilities.

VENCORP makes the following comments in response:

- Clause 1.2.2 of the MSO Rules provides that:
  - VENCORP is not to be liable for any loss or damage suffered or incurred by a Participant or any other person as a consequence of any act or omission by VENCORP, except:*
    - (a) *as expressly provided for in these Rules;*
    - (b) *to the extent that VENCORP can and does recover compensation from any Participant or any other person in respect of any such loss or damage, after deducting its costs, if any, of recovering that compensation; and*
    - (c) *to the extent that VENCORP can and does recover compensation under a policy of insurance in respect of any such loss or damage, after deducting its costs, if any, of recovering that compensation.*
- VENCORP’s understanding is that other pipeline systems in Australia involve (often comprehensive) exclusions from liability for the operator. The implied proposition that contracts would be used to assign extensive liability to the operator does not seem to correspond with industry practice elsewhere.
- Ultimately, the costs associated with any pipeline operator bearing higher levels of liability will be borne by end use customers. These costs are either costs associated with some form of insurance, or with higher returns to compensate for risk accepted by pipeline companies.
- The current risk balance reflects market and customer views developed during the market design phase. A participant compensation fund (PCF) was established at the outset of the market and the fund was capped at \$2m. Contributions to the fund ceased as of October 2001. VENCORP has now collected \$1m plus interest. As there have been no claims to date, the Commission has agreed to cap the PCF at the current level, to be reviewed if or when the fund reduces to less than \$1m. This suggests that Esso’s assertion regarding acceptability of the limitation on VENCORP’s liability is not supported by experience to date.
- The current risk balance could be altered through the MSO Rule change process, subject to approval by the Board of Directors of VENCORP. More protections could be offered to producers or other participants, ultimately at

<sup>40</sup> *ibid*



additional cost to customers, for example through development of internal risk pooling or purchasing of external insurance.

- At the time of the initial authorisation of the MSO Rules in 1998, the Commission required VENCORP to undertake a review of the MSO Rules provisions limiting VENCORP's liability. As a result, in 1999, VENCORP commissioned Ernst & Young to undertake a study to review these arrangements. In the course of this review, Ernst & Young contacted and/or interviewed a range of participants (including Esso, BHP, gas retailers and end user groups), along with representatives from government and the Commission. A report was produced and provided to participants, reporting findings on the scope and potential impact of VENCORP actions that may result in potential liabilities, and proposing further review of options for the allocation and management of these liabilities. The overwhelming response from participants was that further review or action was not warranted.

VENCORP accepts that it would be appropriate to devote resources to re-examining the allocation of VENCORP liability, if there were general support for this within the industry. However, consensus within the industry is that VENCORP liability is not a high priority issue at present, particularly given recent reviews of this issue.

## 10 Role of Allocation Agents at common injection points

Visy have noted<sup>41</sup> some concerns they hold with the arrangements for allocation of injections at Longford under the currently existing contract for this purpose (Longford Allocation Metering Agreement).

VENCORP notes that their issue is primarily with the existing agreement rather than the MSO Rules per se. Nevertheless, we offer the following explanation about the role of allocation agents under the MSO Rules to assist with considerations in this area.

The MSO Rules require that an allocation agent be appointed to define allocations at points where multiple parties are injecting. However, the MSO Rules do not prescribe who should undertake the role.

The reason for requiring this "allocation" role is straightforward. The operator measures the total input, not the allocated amounts, in its meters when it takes delivery of gas. At any point where multiple shippers are delivering gas through a common point to a connected pipeline (i.e. there is physically one connection point, one meter, but multiple parties flowing gas), someone needs to perform the role of defining whose gas is being delivered at that point for balancing and billing purposes.

The amounts of gas flowing at such common points are usually allocated according to contract (as is the case for the PTS). It is therefore critical that the party defining the allocation of gas deliveries/receipts does so in accordance with the contracts at the point, and must be able to resolve any disputes in this regard.

VENCORP is not a party to any of the gas supply contracts at common injection points, and industry has been quite adamant in setting up arrangements which avoid the need for the independent system operator to become involved in such contracts. Instead, all VENCORP needs is for some authoritative party to advise it how the gas is to be

<sup>41</sup> Page 1, Submission by Visy to ACCC Issues Paper on MSO Rules Re-Authorisation, 23 July 2002

allocated for the purpose of market settlement. This party needs to understand the contractual requirements, which are outside of the market.

The party making the decision on the “allocations” must be able to “enforce” the resultant decision, i.e. should be the party who is common to the contracts at the point. If the party is the one who is delivering the gas (e.g. an interconnected pipeline operator, or a producer or storage facility owner), then they are the obvious ones to define the allocation. Where the party is not the one who is responsible for the delivery, then there is a need for another legally binding agreement to commit the parties to the decision (hence an allocation agreement).

VENCORP notes that the MSO Rules already provide for sub allocations, to provide for additional flexibility.

## 11 Board representation

Energex notes that it has some concerns with what it perceives to be a lack of independent retailer representation on the Board of Directors of VENCORP.

Appointments to VENCORP’s Board are made by Government under the Gas Industry Act 2001, and hence this is a matter of Government policy.

## 12 Duration of authorisation

As with the National Electricity Code, there is no legal or practical requirement to link price reviews under access arrangements to competition authorisation<sup>42</sup>.

Moreover, to the extent practicable, costs associated with regulatory consultation should be minimised. Nevertheless, there will be a measure of overlap between the statutory review of Part 8 of the Gas Industry Act 2001, and the next access arrangement revisions. Section 205 of the Gas Industry Act 2001 requires a review of Part 8 (including the role of VENCORP) in 2007<sup>43</sup>, with the Minister<sup>44</sup> to report to Parliament by 31 December 2007.

VENCORP strongly believes that the public interest is best served by avoiding any further duplication associated with the authorisation. In support of this, VENCORP notes the following key dates:

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<sup>42</sup> The National Electricity Code is authorised for a period of 10 years.

<sup>43</sup> Section 205 of the Gas Industry Act 2001 provides:

- (1) The Minister must cause a review of this Part to be undertaken in 2007 by the ACCC or another person nominated by the Minister.
- (2) The person undertaking the review must report in writing to the Minister on the outcome of the review on or before 31 December 2007.
- (3) The matters to be addressed in the review are whether or not there is a continuing need for VENCORP, or a similar statutory authority, with particular regard to--
  - (a) the competitiveness of markets for and in relation to gas; and
  - (b) such other matters as the Minister determines.

<sup>44</sup> That is, the Minister responsible for the Gas Industry Act 2001.

Date	Details
September 2006 – March 2007	VENCorp and GasNet develop revised access arrangement proposals
March 2007	VENCorp and GasNet required to submit revised access arrangements, <b>based on existing statutory framework</b> , i.e. with VENCorp to continue to operate the GasNet principal transmission system on a market carriage basis
January to December 2007	The statutory review of the role of VENCorp must take place <b>during</b> 2007, reporting to the Minister by end December. The review may be conducted by the ACCC, or someone else appointed by the Minister. Privatisation policy issues would need to be considered (i.e. if ISO assets are to be transferred to GasNet). Also, would need to consider status of privately-owned storage facilities that are integral to PTS system security
December 2007	Service Envelope Agreement between VENCorp and GasNet may be varied by agreement, or by default, will continue on same terms and conditions. The agreement will not be terminated: clause 5.3.1 of the MSO Rules refers
2008 – 2009	<p>Government to make decisions regarding market structure. If considered necessary to change the role of VENCorp:</p> <ul style="list-style-type: none"> <li>– an alternate model would need to be developed</li> <li>– statutory amendments would be required to the Gas Industry Act</li> <li>– assets and liabilities would need to be transferred</li> <li>– industry contracts and regulatory instruments would require review</li> <li>– revised access arrangements would need to be developed and approved. New instruments or contracts may require competition authorisation</li> </ul>

VENCorp has sought a 10 year authorisation of the MSO Rules to provide a logical order to regulatory and review processes. It will also avoid the costs and risks associated with market uncertainty, and minimise overlapping, potentially conflicting processes.

GasNet's submission calls for a 5 year limit on the authorisation, based on GasNet's incorrect assertion<sup>45</sup> that:

*"...there is no certainty as to whether and on what terms VENCorp will be able to obtain the availability of the gas transmission system from GasNet....it is entirely possible that....either:*

- (a) *GasNet will not be required to make available the gas transmission system to VENCorp; or*
- (b) *if GasNet does make the gas transmission system available to VENCorp, it will be on very different terms to those currently embodied in the Service Envelope Agreement."*

This assertion is inconsistent with:

- Government's stated policy intent<sup>46</sup>;

<sup>45</sup> Page 3, Submission by GasNet to ACCC Issues Paper on MSO Rules Re-Authorisation, 11 July 2002.

<sup>46</sup> See for example, the comments by Minister for Energy And Resources, Hon Ms Candy Broad, to the Australian Gas Industry Forum on 26 June 2001.

- the Gas Industry Act 2001, which requires that VENCORP continue to act as an independent system operator with a statutory obligation to control the operation of the principal gas transmission system: section 160(1)(c);
- the requirements of section 5.3.1 of the MSO Rules that a valid service envelope agreement be in place at all times; and
- the carry over provisions of the Service Envelope Agreement itself, which provide for the agreement to continue in force until replaced with another acceptable to both parties.

In short, VENCORP believes that GasNet cannot unilaterally elect to cease to make the PTS available to VENCORP for operation under the MSO Rules. Similarly, GasNet's obligations to make the system available for VENCORP to operate do not end in December 2007. Within the statutory framework, it is not open to VENCORP and GasNet to agree to terminate VENCORP's role as independent system operator of the PTS. Any change from this position would require statutory amendments.

Therefore, VENCORP submits that the assertion put by GasNet is incorrect and their argument for limiting the authorisation to 5 years is unsupported.

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