

Submission

AEMC East Coast Wholesale Gas Market and Pipeline Frameworks Review

BHP Billiton welcomes the opportunity to make a submission into the Australian Energy Market Commission's (AEMC) review of the East Coast Wholesale Gas Market and Pipeline Framework.

BHP Billiton is a leading diversified resources company with a workforce comprising approximately 123,800 employees and contractors, working at 130 locations in 21 countries. We are among the world's top producers of major commodities including iron ore, metallurgical and energy coal, conventional and unconventional oil and gas, copper, aluminium, manganese, uranium, nickel and silver.ⁱ Our operations supply customers and meet the resources demands of developed and emerging economies around the world.

BHP Billiton holds significant investments in Australian oil and natural gas including offshore Victoria and Western Australia. As the largest producer of gas for the Australian domestic market, and as a major gas user, we have expressed our support for the gas market reforms that create a framework for robust competition and greater transparency that allows supply to flow into the market where there is demonstrated demand.ⁱⁱ

This submission responds to the AEMC's Public Forum Paper by outlining our views on:

- current developments in the domestic gas market;
- the role of facilitated markets, including the promotion of transparency and development of spot markets; and
- the role of network infrastructure both in terms of pipeline and storage capacity.

Current Developments in the eastern Australia gas market

We note that the Australian domestic gas market continues to be well supplied, as increasing connectivity between Australian domestic gas and LNG markets drives the development of new resources and export projects. In eastern Australia three LNG projects and associated coal seam gas projects will approximately triple the size of the east-coast market, materially influencing the supply and demand situation.

Consistent with this general trend, the majority of BHP Billiton's available east coast gas is supplied to the domestic market under term contracts. Moreover, over the last 24 months, BHP Billiton has concluded multiple term gas sale agreements in eastern Australia.

These agreements have been to different market sectors (retail, industrial, power generation), for large and small gas quantities. This demonstrates that natural gas continues to be available and contracted in the eastern domestic gas market and parties have been able to agree mutually acceptable terms including price. It is imperative that markets are allowed to continue to operate transparently to facilitate the most efficient development of potential new gas supply sources. Restraints on resource access and development will result in escalating costs and prices. Accordingly, government intervention in resources and energy markets should only be in response to a demonstrated market failure.

Role of markets

Compared with gas markets in the United States and the UK, the eastern Australian gas market does not display the characteristics of a mature market place. The market in eastern Australia continues to be dominated by long term confidential bilateral transactions. Increased market transparency and liquidity will improve the market's ability to respond more rapidly to market developments and to send timely signals to encourage a response. The focus of Australian government policy should be on creating a framework for robust competition and greater transparency that supports the continued development of this important market.

In this regard, BHP Billiton supports the current market reform initiatives that are being progressed across Australian gas markets including the:

- Gas Statement of Opportunities ;
- Gas Bulletin Board;
- development of trading hubs (such as Wallumbilla); and
- development of Short Term Trading Markets (STTM) in eastern Australia and more recently studies to develop the concept in Western Australia.

These initiatives should be harmonised (by leveraging the processes, systems and implementation experience of the Australian Energy Market Operator) across all States so common processes and standards can be developed by industry participants. This will further support the transition to more liquid markets over time.

Spot market development

BHP Billiton supports the development of spot markets across global commodity markets and is active in promoting market transparency, development of standard contracts and short-term sales in Australia.

While the STTM and Victorian Declared Wholesale Gas Market (DWGM) daily imbalance markets are often compared with international spot markets, these comparisons are not valid. Whilst these short-term market mechanisms set a clearing price for the daily imbalances, they have few features of a wholesale spot market, including daily, day ahead, monthly and seasonal prices and ideally parallel financial markets facilitating financial risk management services. We support the concept of transitioning or complementing the STTM and the Victoria spot market with a common supply hub model to promote development of wholesale market liquidity. At the same time there is a need to ensure that the regulatory environment in which those markets operate does not inhibit market entry. The transparency and liquidity in the UK and United States markets has taken over 20 years to develop, and whilst signs are encouraging, particularly in eastern Australia, there are significant hurdles to the domestic development of a liquid wholesale gas spot market, such as:

- the small size of the market compared to international markets; and
- barriers such as the complexity associated with entering the existing Victorian imbalance market;

Given these limitations the government will continue to have a key role in driving energy market reform through policy settings that advance these outcomes.

Role of network infrastructure

Increasing interconnectivity of gas pipelines and development of gas storage projects is a relatively new development in Australia. For the gas pipeline industry this has led to the emergence of a two tier regulatory framework for ‘covered’ and ‘uncovered’ pipelines. As consolidation takes place in the gas pipeline industry – against a backdrop whereby ‘covered’ and ‘uncovered’ pipelines can both operate in an interconnected system – there is potential for inefficient transportation market outcomes as pipeline operators preferentially position one regime over the other. We believe there is an opportunity for Australian energy regulators to consider a more uniform approach to gas pipeline regulation in a manner similar to that which applies in other markets such as the UK and the United States.

The role of gas storage facilities in supporting fully functioning gas markets is important, particularly in the context of highly seasonal demand. Typically, early in the development of markets, effective storage is supplied through additional capacity at upstream facilities. As oil and gas fields and markets mature market pricing mechanisms subsequently develop to recognise seasonal (and even daily) differences in prices and an environment is created to incentivise investments in gas storage facilities over upstream investment. Storage capacity could effectively maximize the deliverability by injecting during low demand seasons and extracting during high demand (winter) seasons. This can also effectively reduce capital requirements associated with new supply development as it will enable new facilities to produce at constant rates and simultaneously improve security of supply and have significant potential to support market liquidity. Over time these factors can lead to the development of sophisticated gas storage networks, such as in the United States and the UK.

The eastern Australian gas market is at the early stage of gas storage development – the Western Underground Gas Storage facility in Victoria has been in operation since 2002.

Other new storage facilities are being progressed and these facilities will assist with the ramp-up associated with the development of Queensland’s LNG industry. The Wallumbilla supply hub will also assist the development of seasonal pricing. BHP Billiton also supports the need for greater price transparency in regards to pipeline capacity trading, line-pack (Park and Loan) services and the cost of storage services.

Conclusion

BHP Billiton supports the COAG Energy Council’s vision for the establishment of “a liquid wholesale gas market that provides market signals for investment and supply.” We believe that societies and economies can be strengthened by policy and regulatory settings that are risk-based and support an open and competitive process rather than protecting individual interests or competitors.ⁱⁱⁱ

The AEMC’s review should make an important contribution to this vision by setting out a road map for the continued development of the East Coast wholesale gas market including proposals to enhance market design and gas transportation arrangements.

ⁱ On 17 March 2015, the BHP Billiton Board recommended shareholders approve the creation of an independent global metals and mining company based on a selection of BHP Billiton’s high-quality aluminium, coal, manganese, nickel and silver assets (Demerger of South32). BHP Billiton shareholders will have the opportunity to vote on the Demerger of South32 at the scheduled General Meeting on 6 May 2015. Further information can be found at www.bhpbilliton.com/demerger

ⁱⁱ Energy Quest data ranked BHP Billiton no. 1 domestic gas production in the 12-months to June 2014 with 16.3% of domestic gas production.

ⁱⁱⁱ Hilmer Report 1993, *National Competition Policy: Report by the Independent Committee of Inquiry* AGPS, Canberra; Business Council of Australia, *Action Plan for Enduring Prosperity* July 2013; BHP Billiton submission to the Competition Policy Review Panel, June 2014