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Mr John Pierce  
Chairman  
Australian Energy Market Commission  
Level 6, 201 Elizabeth Street  
Sydney NSW 2000

Dear Mr Pierce

### **GPR0003: Pipeline Access Discussion Paper**

Santos is pleased to provide the following comment on the Australian Energy Market Commission's (**AEMC**) Pipeline Access Discussion Paper. Further details are required to successfully articulate the case for change and to identify some of the potential benefits and pitfalls that the changes in pipeline capacity may deliver.

This submission outlines the key areas that Santos believe need to be considered for the Final report.

### **Industry or regulatory led implementation**

As an overarching rule, Santos believes that regulatory or government intervention into the gas markets should only occur when there is a clear market failure. It is also our expectation that given the chance, the market will be able to design and implement a more efficient capacity trading regime with lower transaction costs than Government alone.

While we believe that all industry participants (as opposed to solely pipeline owners), through an industry council or such governance model is the preferred approach, there is a role for Government's to play to ensure that the resulting design and implementation meets the COAG vision. The industry council governance model is more flexible and adaptable so any future improvements can be implemented within shorter timeframes.

Santos does believe that the governance arrangements and role for governments and industry will change depending on the phase of implementation. At the initiation stage where all parties are working to ensure that appropriate agreements are in place, working through the complex details will require significant effort from all players. Contrast this with the operational phase of the process where industry will be utilising the systems and processes established and governments may move to more of an observer and reporting role. Any governance framework should be able to adapt to the requirement of the time, limiting unnecessary expenditure.

## Standardisation

Santos believe that standardisation of contracts has a role to play in facilitating the secondary trading market, as is evidenced in all highly traded commodity products including wholesale electricity contracts in the NEM. These contracts evolved over time when buyers and sellers required a shorter more standardised form contracts to facilitate trading. It is important to note that this has not replaced the bilateral contract market, although the vast majority of trades are now conducted using highly standardised contracts. In this case it was the market driving the standardisation to reduce transaction costs and facilitate arbitrage opportunities, not governments.

It is also important that the existing contracts that have been negotiated between buyer and seller are remain. Santos strongly objects to any requirement that would result in existing GTAs, compression or other contracts required to forcibly change terms. GTAs and compression contracts are often long term agreements lasting 10-15 years. Any existing agreements will require grandfathering to ensure that the value negotiated into the contracts is not lost. This does not preclude both parties renegotiating the terms in the contract if it is of mutual benefit.

In the future, there is benefit to more closely aligning the terms in the primary capacity contracts to the terms in the secondary capacity contracts, so one party is not bearing more of the risk than the other. In the event of major differences between primary and secondary contracts the primary capacity owner will need to evaluate whether the level of risk is acceptable and can be appropriately mitigated.

On a go forward basis, Santos believes that the best outcomes will be achieved by industry with some Government involvement to determine the most appropriate level of standardisation, acknowledging that there will still require an element of flexibility depending on the end use of the gas. While we appreciate some of the AEMC suggestions on which key terms and conditions (service dimensions, contractual and financial) and how the contracts might be standardised, Santos believes due to the timeframes for the current consultation, the industry council approach is a more appropriate way to consider the more detailed areas of standardisation.

Santos also agrees with the AEMC that for secondary trading via any trading platform and auction that the use of operational transfers would be the appropriate transfer mechanism. Bare transfers are still a valuable tool for some shippers, therefore this mechanism should be maintained and used outside of any trading platform, similar to the more bespoke contracts in other commodity markets. The ability to for parties to conduct bilateral negotiations and trade outside a trading platform, with mutually agreed contracts is an important feature of the market that should be maintained.

### *Receipt and delivery point flexibility*

Another benefit to secondary trading would be to increase the flexibility of receipt and delivery point allocation. Santos is supportive of restricting the reason for refusal of receipt or delivery point changes to technical reasons only, as oppose to a commercial trigger that is prevalent in some transportation agreements as well. The cost of changes, when they are allowed also do always not seem to be in line with the cost of providing the service. Administration fees in certain pipelines are a hindrance to enabling more flexibility and our ability to on sell our capacity to those who may seek it.

Secondary trading will potentially be a dynamic market, requiring quick turn arounds to enable participants to gain arbitrage opportunities. Ensuring there is a known timeframe for

pipeline operators to respond to delivery and receipt point changes would enable more certainty for all users of secondary and primary capacity.

### **Capacity trading platforms**

Santos believes that as the market demand increases for secondary trading in capacity, more investment in the development of a trading platform may be warranted. Although at this early stage in the in the process, there may be benefit in restricting the portfolio of products to those that are valued the highest, or in the highest demand. Overinvesting at an early stage could actually damage the development of the market. Concentrating on the transportation of high demand sectors and services should be the first priority.

When there is demand for an exchange based trading platform, it should cover the whole market and not be separate platforms covering specific pipeline operators assets. The purpose of an exchange traded trading platform is to facilitate trade so gas can flow from one point of the market to the other, this will invariably require access to a number of different pipelines and owners. Moving between multiple platforms would hamper the ability to match buyers and sellers.

### **Reporting obligations**

In such a thinly traded market, almost all published information will expose companies to the risk of commercially sensitive information being widely available. Measures will need to be put in place to minimise the risk of this information being published. As stated in previous submissions only information that will increase trading liquidity should be considered and the reporting of the counterparty name for example, does not meet this test.

Considerations should be made to aggregate the information or apply threshold test prior to publishing wherever possible. Publishing of too much sensitive information in the initial stages of secondary trading may result in less counterparties willing to transact, hindering or slowing the liquidity and development of the market. Once there is critical mass and there are more trades completed and reported this issue will become less sensitive. For this reason there may be benefit is having some transitional arrangements in play to limit the amount of information reported until there is a more liquid market.

### **Auction for contracted but un-nominated capacity**

Santos welcomes the additional detail that the AEMC has provided on the potential options for an auction for contracted but un-nominated capacity, however apart from acknowledging the options, Santos does not believe that it is the right time to offer its perspectives on the auction design. Any auction, if approved will need to be the subject of further and more appropriate consideration.

In particular, further and careful consideration will be required on the question of what services should be exempt from an auction mechanism. Santos considers that infrastructure that is the subject of a no-coverage determination under the National Gas Law, or that is developed to service a single project, should not be subject to a mandatory auction for contracted but un-nominated capacity. These comments apply to equally to pipelines and associated infrastructure, including compression.

In addition it should be noted that the AEMC's characterisation of the allocation of the auction residue fails to acknowledge that there is capacity that a shipper is unable to sell due to its contractual rights to a customer to enable flex in their load, whether it be for peaking gas fired generation or seasonal shape. This commitment will result in the shipper having a

direct incentive not to sell the capacity as it may be required to meet a contractual or market event (as is the case for peaking generation).

The primary capacity owner in many cases has underwritten the pipeline and pays the pipeline operator their full return on their investment. There is a clear financial incentive for shippers to sell any capacity prior to the nomination time if there is a known excess of capacity, to state otherwise as appears to be the case in this and previous discussion papers is not an economic reality. Santos believe the beneficiary of any auction residue should fall to the party that has effectively underwritten the asset, the shipper, and not provide an additional income stream to the pipeline owner.

### **Interaction with existing nomination and re-nomination rights**

Santos supports the efforts of the AEMC with further consideration in the discussion paper acknowledging the value that many existing shippers extract from the renomination facility in their GTAs. The flexibility that renominations provides assists both gas users and the national electricity market. The proposed option "*Day-ahead auction with interruptible capacity*" most closely aligns in a practical sense with the interpretation and actions, which have set the precedent on renominations under the existing GTAs. This approach would allow existing shippers to renominate in a similar fashion ensuring contractual and physical continuity, therefore believe this is the most appropriate option.

Santos also agree with the AEMC that there should be a priority order of capacity, with capacity purchased via a day ahead auction having a lower priority and be curtailed before shippers holding firm capacity.

### **Impact of auctioning hub services**

Santos has concerns with the potential extension of the auctioning on un-nominated capacity to hub services and compression specifically. There are key differences between a compression service and pipeline service, with one key difference is the nature of the service and the redundancy of the service. Compression services have lower inherent availability than pipeline services due to the nature of the equipment required to be operated to deliver the service.

It is this difference for compression services that leads to the requirement to contract against both the nature of the service (compression) plus the availability of this service. To achieve higher levels of availability, this is typically delivered through an additional compression unit that is not directly utilised. This additional compressor or part of a compressor has the sole purpose of providing the higher reliability than typically delivered by the rotating equipment within the existing system, being the concept of N+1 (N compressors plus an additional 'compressor to deliver higher reliability'). The additional physical compressor is there to meet a contractual reliability requirement. If this additional compressor is not available due to it being sold in an auction, there will be an impact to the reliability of the contracted compression service. Any reduction to the reliability of the contracted service may result in risk to the contracting parties and potentially breach the reliability threshold of the existing contract.

This reliability support capacity should therefore not be considered as part of any proposed auction as this has been purchased via the reliability levels in the current contracts and auctioning this would directly reduce the service purchased via existing contracts. Therefore any auction for hub services, should only occur after the reduction due to compression supporting availability.

## **Closing comments**

With all of the approaches outlined in the discussion paper, there still remains a significant amount of work to convert these identified initiatives into actionable changes to the regulatory framework or market rules. There are many ideas and questions that Santos have not been able to answer due to the timeframe for submissions, although we expect that we will be able to provide further opportunities to comment prior to any of these moving into rules or procedure changes.

Should you have any questions in relation to this submission, please contact me at [matt.sherwell@santos.com](mailto:matt.sherwell@santos.com) or on (08) 8116 5824.

Yours sincerely

Matt Sherwell

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