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AEMC East Coast Wholesale Gas Market and Pipeline Frameworks Review

The development of the eastern Australian gas market can be traced through a number of stages, from initial opportunistic use of gas such as with the Roma gas fields as early as 1906 through to the current mega-investment in world-scale LNG export facilities.

However, the current success of the eastern gas market can be traced to the success of the ESSO BHP Gippsland Basin exploration program and discovery of gas in the Barracouta field in 1965 and associated development of pipeline infrastructure connecting Melbourne and rural Victoria to this resource constructed by the Victorian Government enabling the conversion of synthetic gas infrastructure to use a cheaper natural gas energy source by the early 1970's.

Over the subsequent 45 years, the gas market has changed dramatically through factors such as:

- privatisation of government owned gas transport infrastructure
- development of new gas fields accessing both conventional and unconventional gas sources, and
- construction of an interconnected gas transmission network connecting all the major population centres in south-east Australia from Hobart in the south to Rockhampton in the north and Adelaide to the west.

Initially much of the early transmission infrastructure was developed under the auspices of various Australian governments often with significant input from the private sector. More recently, and post-Hilmer competition reforms, there has been a return to private ownership of gas transportation infrastructure so that by 2015, the complete gas supply chain was privately owned and generally subject to limited economic regulation (with the notable exception of the Victorian wholesale gas market). The period since privatisation has coincided with the development of a truly interconnected and increasingly flexible gas transmission network. This network has been developed on the back of bilateral contracts in terms of transport contracts supporting pipeline development and between upstream producers and major downstream gas users.

The recent development of world scale export LNG facilities at Gladstone using Queensland coal seam gas (CSG) as input have been developed under this bilateral contracting market and light handed regulatory framework. The speed at which this new sector has developed perhaps overshadows the long history of the development of CSG in Queensland and the difficulties that early upstream producers had in finding markets for their gas. Indeed, early CSG marketing efforts suggested a limited market and resulted in downward pressure on gas prices (for example, the QGC 2005 gas sales to CS Energy and Incitec Pivot).

Further, this gas was able to be transported by APA on the Roma to Brisbane Pipeline through APA's willingness to develop innovative bilateral incremental expansion arrangements enabling timely and cost reflective pricing of expanded pipeline capacity.

The important point is that any consideration of current perceived market constraints or failings needs to be assessed in the context of the ability of market participants to respond to emerging issues in innovative ways that deliver cost effective market based solutions.

What cannot be changed of course, is that once a path to accessing international gas markets is established (as is the case with the Gladstone LNG facilities in terms of the eastern gas market), then the convergence of transport and processing adjusted domestic prices with international prices will be inevitable.

In the context of the current review the Stage 1 Draft Report notes the review is focused on:

> "…the means of exchange for gas: how physical and financial transactions take place between buyers and sellers."

In considering issues surrounding the exchange of gas (and the need for regulatory intervention), it is important to bear in mind that:

- domestically, gas is a fuel of choice – there are economically available substitutes for most uses of natural gas. This places a natural constraint on any possible misuse of potential market power and provides a relatively transparent price cap in terms of the maximum price likely to be paid by a well-informed purchaser
- gas purchasers are in the main, large well-informed market participants with significant negotiating power
- in eastern Australia, most natural gas is used in technologically mature sectors (such as electricity generation, manufacturing, residential use, and of course the emerging LNG sector). Of these, forecasts suggest that gas fired electricity generation will be flat or declining, manufacturing is likely to be declining through a combination of ongoing de-industrialisation in Australia and a lack of competitiveness for high gas use businesses such as fertilizer manufacturing or other industries reliant on gas as a feedstock, and there is an ongoing trend for decreasing residential gas use
- growth in eastern Australian gas demand is effectively export LNG demand and does not reflect underlying domestic demand, and
- ongoing and accelerating concerns over use of non-renewable energy sources and the impact of carbon emissions are likely to place further pressure on domestic use of natural gas.

It is in the context of a declining or static eastern Australian domestic market for natural gas that any new structural or regulatory changes to the gas sector need to be considered. That is, any significant regulatory impost that imposes material costs on market participants is likely to exacerbate the declining competitiveness of gas in the eastern Australian gas market.

This concern is reflected in analysis such as the SCER Regulatory Impact Statement Decision Paper on Gas Transmission Pipeline Capacity Trading dated December 2013 which noted the difficulty in identifying clear benefits from major policy interventions and recommended the option of a low cost focus on improved information as being the preferred policy option. Clearly, it is critical that any imposts are subject to careful and detailed cost benefit analysis before being introduced.

While it is recognised that a bilateral contract market can limit information supply and price discovery, it needs to be recognised that there is already a significant amount of transactional information available and therefore, that the key issue should be the identification of information shortfalls that restrict the ability of market participants to finalise deals (and therefore limit liquidity within the market).

In this context, it is important to recognise emerging market responses. For example, APA have developed a web based capacity trading platform. This is a classic example of a market response to emerging issues and opportunities. It is likely that in the absence of APA developing such a platform that a third party would have sought to do so, based on emerging opportunities to provide gas across the network and capture international

parity prices. This opportunity has really only become significant in recent times with investment in pipeline infrastructure ensuring bi-direction physical interconnection between demand and supply centres.

The key issue going forward is therefore likely to be related to identifying whether there really is a market failure issue with respect to either misuse of market power or lack of information to support market transactions.

As already discussed, it is our view that the nature of market participants, characterised by a limited number of well informed businesses facing a range of alternative economic substitutes and a transparent international reference price means that any residual issues are relatively minor at worst.

The success of the bilateral contracting arrangements commonly seen in the sector are evidence of the lack of need for change in this context.

However, it is recognised that information disclosure is the lubricant that ensures efficient markets and that any cost-effective mechanisms that ensure timely information disclosure are likely to be beneficial. As such, we support arrangements aimed at ensuring information disclosure on a consistent and meaningful basis

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