AEMC PIPELINE ACCESS DISCUSSION PAPER (PROJECT NUMBER: GPR0003)

1. INTRODUCTION AND SUMMARY

QGC welcomes the opportunity to comment on the Australian Energy Market Commission (**AEMC**) Pipeline Access Discussion Paper (**the Paper**). Overall, we largely support the package of pipeline access reforms being proposed by the AEMC to facilitate the COAG Energy Council's Vision to improve the operation of the East Coast Gas Market, including enabling the transportation of gas to flow to where it is needed most. In particular,

- **QGC largely supports an industry-led approach** to implementing the package of proposals. This will deliver more efficient and targeted outcomes for participants as well as broader market benefits. Regulatory solutions are only necessary in addressing identified market failures.

- **An exception is the auction for contracted, but un-nominated capacity (the auction).** In our view, there is benefit in some form of regulatory involvement to balance the likely divergent interests of industry stakeholders. In the first instance, this should be as light-touch as possible and largely guided by industry-led processes. While the exact model can be determined in the next phase, the Wallumbilla Gas Supply Hub (**GSH**) is an example of a workable solution across industry and market bodies.

- **A set of high-level design principles** would assist in guiding the development of the specific auction framework. As such, it is too early to form firm views on most of the detailed elements raised in the Paper. Although, we appreciate the AEMC raising these issues early in the process, which should advance the development of these complex concepts through the next phase.

- **There is merit in prioritising implementation of the auction to pipelines that directly link traded markets.** If designed appropriately this measure has the potential to unlock significant net market benefits that will enable gas to be transported to where it is needed most. The measure would also help to address the major impediments to secondary capacity trading – that is, the lack of incentives on incumbent shippers to release short-term capacity and for prices to reflect outcomes expected in a "workably competitive market".

- **The AEMC has demonstrated that any risks resulting from the auction such as re-nomination rights can be appropriately addressed**. While the detailed arrangements will need to be subject to further industry consultation, QGC prefers the combined option where firm and interruptible capacity is released. This balances the need for "firmness" to support gas trading and flexibility for incumbent shippers.

- On other relevant issues:
    - QGC has a strong preference for "bare transfers" to be the standard transfer mechanism under any standardised contract.

    - While we support the development of capacity trading platforms, these should not be mandatory - there is an on-going role for bi-lateral contracts.

    - Trade reporting should not require the disclosure of confidential information.

2. RATIONALE FOR THE PACKAGE OF CHANGES

Prior to addressing the detailed implementation arrangements raised in the Discussion Paper, we consider it helpful to provide a short update on our recent experiences and observations regarding the East Coast Gas Market. The points raised below suggest that aspects of the current pipeline frameworks are materially impacting the efficient operation of the gas market.

- On a number of occasions, QGC has observed market conditions which demonstrate that gas has not been able to move to where it is needed most, at least partially due to the lack of appropriately priced transport. Such examples include:
    - Opportunities for QGC to sell gas to domestic customers (above LNG netback equivalent prices) have been uncommercial once transportation costs were incorporated into the economics on numerous occasions.
    - Offers from domestic participants to sell gas to QGC to meet LNG demand, which were mutually commercially beneficial on the basis of the underlying gas price, but became materially uneconomic once transportation costs were incorporated.
    - Material pricing spreads between respective trading hubs in the East Coast Gas Market have been observed from time to time.
- QGC does not consider that an absolute lack of transport capacity has inhibited its ability to trade gas. However, the price at which such services are available has potentially led to sub-optimal economic outcomes (e.g. the pipeline arrangements are likely to be limiting the level of trading activity and overall liquidity of the market).
- Where trades are executed with customers, the current pipeline frameworks potentially impeded the gas flowing to the customers who needed the gas the most (i.e. other customers may have valued it more, but it was unable to flow due to transportation costs).
- The level of interest in gas trading over the recent summer, either through the Australian Energy Market Operator (AEMO) operated Wallumbilla GSH or bi-laterally, provides a very promising sign that this trading point could develop into a liquid market with improved capacity trading arrangements.
- For context, in circumstances where unused pipeline capacity is obviously available, QGC has observed:
    - That transportation costs on third party pipelines in Queensland alone are generally materially higher (on a $/GJ basis) than the cost of shipping LNG from Queensland to customers in Asia.
    - That “as available” transportation costs on third party pipelines in Queensland can represent 25 per cent (or more) of the market price for gas.

3. IMPLEMENTING THE INITATIVES

QGC appreciates the AEMC raising the issue of how practically the reforms will be progressed and whether these should be industry or regulatory led (or a combination). We consider these issues are very relevant to finalising the Stage 2 recommendations. At this stage in the process (noting the AEMC has undertaken a very detailed review), it is

important that industry (and other stakeholders) is provided with a reasonable level of certainty regarding the nature of the reforms and that the implementation arrangements will deliver meaningful market change.

The AEMC's consideration of these issues appears in part to be driven by the suggestion of the pipelines owners (APA and Jemena) and their industry association (APGA) committing to quickly implementing most of the recommendations in the Stage 2 Draft report.

While there are advantages and disadvantages with this approach, we acknowledge the willingness of pipelines operators to offer suggestions on mechanisms to progress the recommendations. In this context and in responding to the AEMC's issues and questions raised in the Paper, QGC wishes to make the following points:

- With regards to the proposed auction - This measure has the greatest potential to unlock significant market benefits, however, industry stakeholders have competing interests and their incentives are not necessarily aligned. As such, regulatory involvement is important to ensure efficient market outcomes.
    - While there are benefits in an industry- or pipeline-led approach in terms of early implementation, stakeholders require confidence that overall objectives will be reflected in the final design.
    - It appears there is a lack of incentives for a number of incumbent market shippers where existing capacity is concentrated to deliver an outcome consistent with the intended reforms.
    - Pipelines owners' do not necessarily have the commercial incentives to ensure the trade in capacity is maximised and that prices are set efficiently through the auction process.
    - While there have been some developments such as the pipeline trading platforms established by the pipelines, for reasons raised in previous submissions[1], these initiatives have not translated to meaningful levels of trade. As such, we do not consider that the "threat of regulation" (Option 2) would be sufficient to deliver the desired outcomes.
- QGC prefers the conceptual frameworks outlined under Options 3 and / or Option 4 as they balance the need for direct regulatory involvement with practical industry input. The exact model, however, can be determined in the next phase.
    - A variant on Option 4, in the form of a "Wallumbilla GSH style" framework, may offer greater scope to advance the implementation phase, manage the timely assessment of ongoing changes and appropriately involve industry. It would also avoid the requirement to progress changes through the "Rule change process", allowing for greater industry involvement and more timely developments.
- With regards to the other reform proposals such as standardised contract and capacity trading platforms, competing interests across industry stakeholders are likely to be lower

1. There exist countervailing incentives on some shippers not to sell capacity. This is due to a range of factors including: this activity is not "core business", transaction costs are likely to exceed the revenue, there is a risk of being "short" and avoiding/limiting competition.

2. There is also an incentive for pipeline owners to offer capacity at prices above the level expected in a "competitively workable" market.

and the overall outcome improved if they are developed by those with the technical expertise to do so. As such we consider these issues could be more successfully led by industry.

4. STANDARDISTION OF CAPACITY PRODUCTS AND CONTRACT TERMS

QGC supports the general move to standardisation of capacity products and welcomes the AEMC commencing a discussion on how improvements in this area could create greater flexibility in trading secondary capacity. We recognise standard contracts are already available (e.g. the AEMO standard contract), but these are not used extensively, possibly due to the contractual terms being too prescriptive. In this regard,

- In terms of priorities, it is too early to finalise the exact form of the contract. At this point in the process, focus on this issue could possibility distract from the timely introduction of the auction. It would be preferable to defer detailed consideration of these issues until the next stage in the process.

- The current arrangements are not necessarily limiting the level of secondary capacity trading, which we consider are due to the lack of incentives on shippers to release capacity and the prices offered by pipeline owners for "as available" services.

- With regards to the issues raised in the Paper, one of the most significant points for consideration as we move into the next phase relates to the transfer method (i.e. bare or operational).

    - QGC has a strong preference for "bare transfers" to be the standard mechanism, as it reduces commercial and operational complexity and cost.

    - We understand that "bare transfers" would require nominations to be provided via the primary capacity holder and could require disclosure of confidential information. In practice this information would be supplied to the primary capacity holder through the capacity trading agreement and as such does not raise any substantial confidentiality concerns.

      The only time this would not be the case is if the capacity was on-sold a number of times in the secondary market. In this situation, the final shipper would not necessarily have an agreement with the primary capacity holder. As such the transfer of nomination requirements to the original shipper could present confidentiality concerns. The potential for this outcome, however is low, at least in the near to medium-term. As this is not a significant risk it would be preferable to focus on reducing cost and complexity.

5. CAPACITY TRADING PLATFORMS AND SECONDARY TRADE INFORMATION PROVISION REQUIREMENTS

On the issue of capacity trading platforms, QGC holds similar views to those expressed on standardisation capacity products. We support the overall concept, however, we do not necessarily view it as an immediate priority and would prefer that the detail is developed in the next phase of reform implementation. We do not consider the lack of a trading platform as the major impediment to secondary capacity trading. As mentioned, the major impediment is the lack of incentives on incumbent shippers to release short-term capacity and for prices to reflect outcomes expected in a "workably competitive market". The auction, if designed appropriately, should address these issues.

Furthermore, we would be concerned if mandatory requirements were introduced for all secondary capacity to be transacted through the platform. There will be an on-going role for bi-lateral trades and the inability to transact in this manner could discourage some participants from trading.

With respect to secondary trade reporting:

- As a principle QGC supports information disclosure to the extent it creates market efficiencies, is relevant and does not disclose commercially sensitive information.

- At a high level, we largely agree with the AEMC's suggested approach to secondary trade reporting (i.e. publishing specific information on prices, contract duration, receipt and delivery points and quantity) but would have concerns if there was a requirement to publish the underlying contracts.

    - As is our view on other matters regarding market disclosures, these issues need to be worked through carefully and the detailed implications for parties well understood and addressed. Given this is not straightforward we do not expect firm recommendations from this current process, but that the detailed issues will be considered through the next stage of development and in consultation with affected parties.

- The confidentiality of the parties to the trade, however, should be preserved. We understand that the premise for wanting this information is to assist parties assess undue discriminatory access. Equally, this is market sensitive information and could commercially disadvantage a shipper's position in the gas market and impact their willingness to trade. It was for these reasons that individual shipper volumes are not published on the Gas Bulletin Board (although this is not the case for single shipper pipelines) and it would be inconsistent with reporting frameworks applied in other East Coast Gas Markets (either bi-laterally or through the facilitated markets such as the Wallumbilla GSH).

  Furthermore, we view the issues in the US as slightly different, as capacity is largely traded through very deep and liquid standardised markets with a large number of buyers and sellers, rather than through bi-lateral contracts.

  Overall, the need for sensitive information should be clearly demonstrated and other options fully explored to address concerns (e.g. information is confidentially provided to a third party).

- We consider these points equally relevant to primary capacity reporting. Given that primary capacity is often contracted for long periods, we consider information reporting could be even more sensitive (relative to secondary capacity) and requires further industry consultation on the costs and benefits.

6. AUCTION FOR UN-NOMINATED CAPACITY

Rationale for the auction (including the costs and benefits)

QGC considers this is the principle measure (that if designed appropriately) will likely unlock significant net market benefits enabling gas to move to where it is needed most. It should address the major impediments to secondary capacity trading being the lack of incentives on incumbent shippers to release short-term capacity and for prices to reflect outcomes expected in a "workably competitive market. In this regard,

- In QGC's view, it unrealistic to expect that the overall (direct and indirect) costs and benefits of major policy reform, such as contemplated by the AEMC, can be meaningfully quantified. It is more relevant to focus on clear observations of inefficient market outcomes and the increasing level of demand for capacity driven by the transitioning gas market. Looking at market indicators (such as market turnover/churn) in other gas markets (e.g. Europe and US) where substantial reforms have been previously introduced is also to be helpful in understand the benefits.

- On the direct costs, we do not view these as substantial, as many of the system requirements are likely to be in place with the pipelines having developed capacity trading systems and AEMO already operates the wholesale gas markets. The Trayport system facilitating the Wallumbilla GSH allows for capacity trades to be listed.

- As discussed below any risks can be managed appropriately.

Auction Design Principles

The Paper raises some very detailed issues around the design elements of the proposed auction and QGC welcomes the AEMC's early identification of these issues. As this is a complex area of economic theory (requiring in-depth analysis) we do not consider any firm decisions should result from this initial consultation process. Rather, it is our expectation that stakeholders will commence consideration of these points, which will advance development during the implementation phase - allowing the auction to be introduced in-line with the proposed timeframe (i.e. 2018) if not earlier.

Furthermore, whilst at a high level the AEMC's preliminary preferences on the design elements seem reasonable they appear to have been formulated based on a "bottom-up" approach. Rather than focus on this level of detail, we suggest it would be more helpful for the AEMC to define a set of high level principles as a primary action. These would:

- Provide clarity on the overall auction framework, which is important to stakeholders in this stage of the process and would guide the next phase of implementation.

- Allow for a more meaningful assessment on whether the AEMC's initial views align with the overall objectives of the auction (i.e. to promote economic efficiency through enabling gas to move to where it is needed most) and are practical.

While QGC is still developing and expanding its views on the relevant design principles, some high level concepts are offered in Table 1.

Table: 1 Possible Auction Design Principles

	Possible Design Principle	Comment/description
1.	Maximise participation and competition	Maximise the number of participants involved in the auction and ensure it reflects "true demand" for short-term capacity.
2.	Maximise available capacity	The objective is to maximise available capacity ahead of revenue or profit.
3.	Price outcomes reflect supply and demand fundamentals	Generates prices that reflect the underlying supply and demand dynamics for short-term capacity across the system and avoids "winners curse".
5.	Publication of relevant information	Information disclosed, during the auction, supports efficient decision making, but should not commercially compromise individual participants.
6.	Not subject to market manipulation	The capacity release and bidding rules should avoid the potential for market manipulation and market conduct requirements should apply (similar the Wallumbilla GSH).
7.	Maximise flexibility and minimise risk	Maximise the opportunity for participants to acquire their full set of desired pipeline segment(s) and minimise the risk of unintentionally acquiring unnecessary capacity.
8.	Minimise costs	This includes participant and operational costs. This could be achieved through utilising existing bidding, settlement and prudential systems.

Other Issues

QGC is strongly of the view that that it is too early to provide detailed input on the specific auction design characteristics. We do however, provide comment on a number of issues that are relevant to developing the design principles and its broader application:

- **Scope of the auction** – The design should facilitate a multi pipeline auction to enable gas to flow from Queensland to the southern markets (and vice versa) across a number of pipelines with relative ease. A single pipeline auction design would not maximise the opportunity to access unutilised capacity (at least cost) across the integrated East Coast gas network. There are various scenarios where players may seek capacity on a number of pipelines each with a different owner/operator (e.g. in the future a party may seek to transport gas from the Northern Territory (along the proposed Northern Gas Pipeline via Queensland to Adelaide).

- **Institutional settings** – For these reasons and others, we consider the auction should be conducted by an independent third party operator and agree that AEMO appears the natural choice to conduct the auction. Furthermore, there is potential to reduce other costs by aligning settlement and prudential arrangements with the other markets it operates such as the Wallumbilla GSH.

  Hub services – Longer-term, there might be value in extending the auction to other services. QGC does not consider access to hub services (and or storage) is currently materially impacting the level of gas trading and liquidity. Our primary concern is around access to sufficient pipeline capacity. The priority should be developing a workable solution for pipes and, where possible, "build-in" sufficient flexibility to enable the systems etc. to be extended to other services. The decision to extend the arrangements would need to be subject to further industry consultation.

- **Pipeline and service participation in the auction** – We understand the overall purpose of the auction is to enable gas to move to where it is needed most. As such it is unclear why the auction should not be applied to pipes that are less than 100 percent contracted. The clearing price should represent the lower level of utilisation, which provides an important signal to users and the short-term nature of the auction should not undermine the pipeline contracting longer-term volumes.

  We also agree with the AEMC's initial view that there is limited value in applying it to pipelines that service a single user and in our view this should capture the LNG facilities. Principally, we view the auction as supporting trading at key locations where liquidity is expected to develop and would be applied to the pipelines that link those traded markets. As such, we were surprised by the comments made by some stakeholders regarding the application of the auction to the LNG pipelines for the following reasons:

  - These are point-to-point pipelines built to service individual LNG plants. There is no traded market for gas at the downstream end of these pipelines and we do not expect there to be in the future, given that LNG processing capacity is used solely by the owner/operator of those facilities.

  - The market benefits of applying the auction to these pipelines are unclear. Given the physical and commercial characteristics of the LNG facilities downstream of these pipelines, we do not expect that including these pipelines in the auction would result in any increased market liquidity.

  These LNG export pipelines are also subject to a 15 year no coverage exemption. It is unclear how the auction would be applied in this context. This may take some time to resolve and unnecessarily delay the introduction (and the flow-on benefits) of the auction more broadly.

7. IMPLEMENTING THE AUCTION

Interaction with shipper rights

For reasons already discussed, QGC strongly supports the introduction of the auction. It is designed to enable access to unutilised, but contracted pipeline capacity while seeking to avoid the loss of existing property rights. QGC recognises a small number of stakeholders have raised issues with re-nomination arrangements and that the AEMC has proposed a number of potential options. In response, we make the following points:

- **We suggest the AEMC investigate further the nature and extent of the issue to ensure the design aspects can be appropriately structured**. While the concern with re-nomination has been raised, it is unclear from information to date as to the extent of these concerns. For example it is uncertain how much capacity is subject to contractual re-nomination rights that extend beyond those contained in a typical Gas Transportation Agreement (GTA) and if they are available how often they are used (e.g. perhaps it is only utilised on a small number of days throughout the year).

  It is only once the AEMC and other stakeholders have a more comprehensive understanding of how the renomination process is applied in practice by shippers and pipelines that appropriate arrangements can be structured.

  Furthermore, QGC would have significant concerns if adjustments were made that significantly reduced the availability of day-to-day unutilised capacity to allow for shipper

renomination flexibility that is not a formal contractual requirement. It would be inappropriate to limit the volume of capacity made available to the market on a daily basis to "accommodate" re-nominations that may not occur often and / or are not a specific contractual requirement.

- **Notwithstanding these points, we welcomed the AEMC proactively seeking feedback on options to address potential concerns** and undertaking a preliminary assessment against a set of defined criteria. This clearly suggests that through further consultation, in the next phase, an appropriate set of arrangements can be structured to accommodate any material concerns raised by shippers. This range of options is comprehensive and similar to the concepts initially considered by QGC (and likely by other stakeholders).

- **Based on a high level understanding, we would agree with the AEMC that Option 3 appropriately balances the tradeoffs, at least in the short-term.** With regards to the other options, we would rank Option 2 ahead of Option 1, and Option 4 is our least preferred option. Table 2 below provides our initial views (further to the points identified by the AEMC) on the options in order of preference. It covers the benefits, issues and comments on implementation issues. It is evident from this that there are a range of issues to be further developed, which will require detailed industry consultation to determine the most appropriate arrangement.

  We also consider there could be benefit in revisiting the "OverSell and Buyback" mechanism in the context of the issues raised. This mechanism was designed to address this specific issue and avoids the need for complex ex-post compensation process. We note it has been in operation for over 20 years in the UK gas market and had been effective in transitioning the sector through various price cycles.

  Other issues

  Curtailment order – Presently we do not view this as a significant risk due to the current pipeline utilisation factors. Nevertheless, we appreciate arrangements need to be in place to manage such events. Under Option 3 (QGC's preferred arrangement for considering renomination rights) "firm" capacity either acquired under contract or through the auction should be treated equally and curtailed on a prorated basis. Conversely, interruptible capacity would be first in the curtailment order.

  Reserve price – At this point, QGC does not have any concerns with the overall approach suggested by NERA Economic Consulting (**NERA**). We consider the reserve price should reflect the Short-run Marginal Cost (**SRMC**) and NERA have suggested this equates to the incremental cost of gas used to run compressors. This issue can be considered further in the next phase of development.

  Quantity to be auctioned – Based on the information available QGC agrees with the approach suggested by the AEMC in terms of determining the quantity of capacity to be auctioned. However, we reserve our position on this matter until the detailed design is settled. Any measures introduced to manage renominations may impact the overall regulatory requirements.

  As available rights – We agree the concept of "as available" capacity could be inconsistent with the proposed auction. We recognise that parties currently hold such rights and how these are most appropriately transitioned should be considered during the next phase of development.

Table 2: Assessment of options to address renomination flexibility

Most preferred			Least Preferred
OPTION 3	**OPTION 2**	**OPTION 1**	**OPTION 4**
Combination of Firm and Interruptible Capacity	**Interruptible Capacity**	**Withhold Capacity**	**More Frequent Auction**
BENEFITS			
Enable all unutilised capacity to be included as part of the auction. Agree with the AEMC that this option most appropriately balances off the tradeoffs across the range of options.	While this does not offer a firm product, it is likely to be reasonably effective in the near term due to the lower risk of curtailment (based on current analysis, most pipes do not operate at full capacity). Price of capacity should reflect the level of service, thus encouraging greater commodity trading.	Offers a "firm" product, which is important in supporting trading in the underlying commodity and promoting liquid gas markets. Observations from international gas markets suggest that a level of firm capacity is important to the establishment of a viable futures market.	Capacity is offered on a firm basis. Avoids the need for estimating potential volumes withheld for the purposes of the auction.
POTENTIAL ISSUES			
Need to establish a methodology to determine the ratio of interruptible capacity to firm. The methodology should be linked to the underlying primary shipper flow expectations and reviewed on a regular basis. If inadequately developed, it suffers from similar issues to Option 1 – in that a higher proportion is released on an interuptable basis, reducing the quality of the product and the effectiveness of the auction in promoting liquidity. Deriving compensation arrangements could be involved and time consuming and delay the introduction of the auction.	Longer term it may hinder the development of the futures markets if market dynamics change (flows shift) and curtailment risk increases (i.e. physical congestion emerges as a significant issue).	It is not our preference to withhold a proportion of capacity from the auction. Practically, it is more than likely that a conservative view will be applied and a greater proportion of capacity is withheld from the market than necessary (i.e. reducing the efficiency gains of introducing the auction). Deriving compensation arrangements could be involved and delay the introduction of the auction.	It may limit the overall effectiveness of the auction if significant proportions of capacity are withheld to the later rounds of bidding. It may not give players sufficient time to enter the gas market. Creates additional operational complexity and uncertainty Could be subject to market distortion, as capacity holders may seek to delay renominations to later in the day to avoid capacity being sold in earlier rounds. Potentially costly in terms of operating the auction.
IMPLEMENTATION COMMENTS			
The ratio of interruptible to firm should fall overtime as the market transitions and forecasting capability improves or other options are developed.	Good interim arrangements, but the ongoing need should be reviewed as part of the 2020 proposed pipeline review.	Volumes should reduce overtime as the market transitions and forecasting capability improves and or other options develop.	This option could be workable if limited to two rounds and the second round is not delayed beyond a reasonable period to enable parties who have purchased capacity to manage any trading positions.