AEMC STAGE 2 DRAFT REPORT

EAST COAST WHOLESALE GAS MARKET AND PIPELINE FRAMEWORKS REVEIW

1. INTRODUCTION AND SUMMARY

QGC welcomes the opportunity to comment on the Australian Energy Market Commission (**AEMC**) Stage 2 Draft Report (**the Report**) on the East Coast Wholesale Gas Market and Pipeline Frameworks Review (**the Review**). Generally,

- **We support the overall direction** of the Review. It is founded on encouraging industry led solutions, which are essential to delivering the COAG Vision of a liquid wholesale gas market and enabling gas to move to where it is needed the most.

- **The reform programme is time critical** to support the ongoing transition of the East Coast Gas Market. As such, future milestones should be monitored and unnecessary additional delays avoided.

- **Success will depend on how well these reforms are implemented** over the next 3 to 5 years. This represents a significant reform agenda and the challenge will be how to translate the recommendations into meaningful regulatory change. There must be clear objectives to guide the next phase to ensure the final design reflects the inefficiencies identified through this review.

- **To ensure focused delivery, the AEMC should have an on-going and direct role** in overseeing the implementation. The AEMC is well placed to provide advice given the practical knowledge and insight it has secured into gas market development on the East Coast and internationally.

- **A post 2020 capacity trading review is important to allow a flexible approach**. As the market is still in transition, it is difficult to definitively assess whether the reforms are sufficient and appropriately targeted. Given the inter-relations, there is benefit in broadening the scope to cover market design and information.

On the specific recommendations:

- **Capacity trading** – We support the capacity auction concept and consideration should be given to extending these over the near-term horizon. Priority should be given to implementing the arrangements on pipelines that are “strategically significant” to domestic trading points.

- **Wholesale market design –** Consideration should be given to developing a high level conceptual design for a northern hub to allow for the timely implementation if required. In the near term there is benefit in converting the Short Term Trading Markets (**STTM**) to balancing.

- **Information** – QGC supports the principle that information transparency promotes efficient price discovery and rational economic behaviour. It should be structured in a form that does not commercially comprise individual parties regardless of size or market. To ensure this principle is reflected in the final recommendations, there is benefit in undertaking a detailed examination of the LNG facility proposals.

2. PIPELINE CAPACITY MARKETS AND WHOLESALE MARKET DESIGN

QGC considers there are three key market development objectives that will underpin the delivery of the COAG Energy Council's Vision for a liquid and transparent East Coast Gas Market.

1. Enabling gas to move freely to where it is needed most.

2. Ensuring that the underlying price of gas across both the short and long term reflects supply-demand conditions, signals the need for new investment and is not subject to distortions caused by inefficiencies in market or pipeline capacity arrangements.

3. Concentrating liquidity by creating a market design that encompasses the broadest set of potential buyers and sellers as is practical.

1. Capacity trading

Collectively, we expect the AEMC package of recommendations (to improving access to secondary capacity through competitive auctions, trading platforms and information) to materially contribute to achieving these objectives. While further reforms may be necessary, they represent a good starting position and provide a balanced and proportionate approach, to encouraging an industry led response to capacity trading. In particular:

- **We welcome the AEMC's findings** that some aspects of the current pipeline frameworks are impacting the efficient operation of the gas market and in light of the changes taking place, with LNG, there is a priority to resolve these issues.

    - **The nature of LNG production** (which experiences planned and unplanned swings in production that occur "within-day" and across the short term planning horizon) will lead to short-term volatility. This presents new risks and opportunities for market players. Market frameworks need to adapt and enable participants to manage some of their gas supply and demand balancing through more liquid spot markets and or short-term structured products.

- **There are clear indicators that "available short-term gas" is not able to flow to the customers who need it the most** and market distortions are present (quantitative example were provided in earlier QGC submissions). In particular , we agree that:

    - There exist countervailing incentives on some shippers not to sell (or hoard) 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.

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

- **These concerns over pricing structures for pipeline capacity, however, apply more generally than acknowledged by the AEMC** and also need to be addressed. It applies on a "day ahead" basis as pipeline owners are the only sellers of capacity after nomination cut-offs. We also observe that short-term capacity, beyond this period, is also being offered for sale at a premium to the firm price (likely due to contractual arrangements with “foundation” shippers (i.e. due to the operation of “most favoured nations” clauses)). Given that businesses seek to optimise short-term positions at least a week ahead this issue equally needs to be addressed.

While the publication of information, on primary capacity trades, (including price) may assist in highlighting the nature of the issue (when compared to offers in the market), more fundamental reform is necessarily to change market behaviours (at least in the near-term). We understand this issue is within the scope of the Australian Competition and Consumer Commission (**ACCC**) East Coast Gas Enquiry and expect any relevant findings to be reflected in the AEMC’s final Report.

- **Some form of mechanism is necessary** to overcome the identified issues (within the timeframes required by the market) as there is little incentive for “self-initiated” industry led reform.

- **We support the high level conceptual design of the proposed capacity auction.**

    - It is market based and by enabling pipeline owners to receive the revenue from the auctions, encourages shippers to engage in capacity trading ahead of the mechanism being applied.

    - The short-term nature of the market should also ensure that propriety rights and the incentives for long-term investment in pipelines are not compromised.

    - We are unclear why it 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.

    - Recognise that a number of contractual issues need to be considered, however, we fully expect these issues to be managed through more detailed consultation.

- **BG-Group’s international experience confirms** that similar measures were introduced successfully into other markets and have materially assisted liquidity and competition.

While the high level design appears sensible and workable, success will depend on the implementation and this will take place following finalisation of the Report. To ensure, however, there is clear direction on design expectations and priorities there is benefit in providing greater clarity on the following issues.

- **Application to “strategically significant” pipelines** – to minimise the overall implementation costs (and ensure the timely delivery of the reform programme), consideration could be given to initially applying the auction to capacity on pipelines that interface with key trading points. We would anticipate that an appropriate model for the East Coast would be defined through the implementation process.

  This would enable the mechanism to be introduced as soon as possible, allowing additional time to resolve more complex questions relating to the treatment of “covered” pipelines and those with “greenfield” exemptions.

Introduction of the Moomba Hub also gives priority to delivering an effective capacity trading regime. As previously stated by QGC, without sufficient access to market priced short-term capacity, liquidity could be split and competitive overcomes (i.e. holders of capacity may be able to influence price outcomes) could be comprised.

AEMO has proposed a "bid-offer" spread product across the Wallumbilla and Moomba trading points, which in part provides a "synthetic" option/alternative to pipeline trading. While this is a welcomed development, it does not replace the need for physical capacity trading. Given the current low levels of liquidity it could be equally subject to manipulation and other factors (e.g. seasonality), which could influence efficient price determination.

- **Week ahead trading and alignment of Wallumbila GSH products** – The capacity auction, as designed, should promote liquidity in the "day ahead" (and potentially intra-day) market. While this provides a starting position, as mentioned, businesses seek to optimise short-term positions at least a week ahead. In-line with the approach, the GSH suite extends to weekly and monthly products and the Bulletin Board requires the reporting of detailed outlooks on a rolling 7 day basis.

  On this basis, we suggest considering options for extending the auction process beyond "day ahead" and to align with the Wallumbilla GSH product offering.

- **Nomination and renomination arrangements** – For the auction to be workable, we would expect that shipper nomination cut-off timeframes would need to be standardised. These should be set allowing sufficient time for the auction process to be completed and participants to undertake any subsequent intraday or "day ahead" trading either through the traded markets or bi-laterally. There may also need to be consideration given to extending the trading hours for the GSH to accommodate any additional trading.

  While some contractual terms under existing Gas Transportation Agreements (**GTA**) may need adjusting, there are no identified reasons to suggest this would not be achievable. GTA variations are typically progressed during the ordinary course of business. Furthermore, the alignment of nomination timeframes has been previously contemplated in the context of linking to the release of information in the National Electricity Market (**NEM**). Moving forward new GTA's would reflect these changes.

  We note a number of stakeholders have raised concerns about the ability to renominate after completion of the auction process. We consider these issues can be addressed through the consultation process. Once stakeholders have a better understanding about nature of how the renomination process is practically applied by shippers and pipelines, appropriate arrangements can be structured.

2. *Wholesale gas trading markets*

In QGC's view the introduction of a well-functioning secondary capacity trading scheme could avoid the need to develop detailed market design concepts (including specifying trading points) for the East Coast Gas Market. Rather, trading locations could naturally evolve at locations where buyers and sellers consider it best suits their needs. Given, however, the immediate challenges facing the market it is important if there is an obvious pathway forward steps are taken to move towards it as soon as possible. In this regard, QGC supports the AEMC's high level findings suggesting that:

- Given the size of the East Coast Gas Market, multiple trading locations could unnecessarily split liquidity.

- The appropriate pathway for the future development of the market is to concentrate trading at two points – in the north (by continuing to evolve Wallumbilla) and the south through enhancements to the Victorian Declared Wholesale Gas Market (**DWGM**).

- To reduce complexity and transaction costs, the trading arrangements across the two points should be harmonised as much as possible.

With respect to the northern region, we agree there is value in maintaining a physical trading point at Wallumbilla (particularly if the Moomba Hub proceeds as proposed) and determining whether AEMO proposed Optional Hub Services and the capacity auctions are effective in building liquidity.

Given, however, the overall size of the market it is unclear whether collectively these arrangements will be sufficient to enable the formation of a creditable reference price. In order to concentrate liquidity in the northern region, further steps are likely to be necessary. To maximise liquidity in the near term and ensue any further market reforms are timed appropriately we suggest the existing recommendations are expanded to include the following:

- Investigate the conversion of the STTM's to balancing markets earlier than planned. While relatively thin markets, they could be contributing to the lack of liquidity in upstream markets. We suggest at a minimum converting the Brisbane STTM to balancing, which would shift wholesale trading to the Wallumbilla GSH. As the Brisbane STTM is serviced solely by the Roma to Brisbane Pipeline (**RBP**), it should not create significant issues for market participants or reduce competition in downstream markets. More than likely it will open up opportunities for those without capacity on the RBP.

- Along with detailed reform of the DWGM, work commences on a high level conceptual design for a virtual trading point around Wallumbilla (including how Moomba is most appropriately incorporated to maximise liquidity). As a starting point, QGC has previously outlined a proposal for a virtual hub across Wallumbilla and the Pipeline (**SWQP**).

3. INFORMATION AND THE BULLETIN BOARD

QGC supports the principle that information transparency promotes efficient price discovery and rational economic behaviour. It should be structured in a form that does not commercially comprise individual parties regardless of size or market. As such, we support the concept of establishing the Bulletin Board as a "one-stop-shop" for gas market information subject to ensuring the published data is relevant and it is clear how it will support developing liquid markets. We provide the following comments with respect to the recommendations:

1. Large users

- QGC supports the AEMC in considering this issue and addressing relevant information gaps. With the establishment of the Curtis Island Demand Zone, LNG export pipeline flows and capacity information are available on the Bulletin Board. Other large user consumption and capacity levels should also be available.

- We note that the AEMC considers that the publication of large user's nominations, forecast and actual flows will be appropriate in most cases, but there might be circumstances in which it could have unintended consequences on competition in other markets (e.g. a gas-fired generator participating in the NEM

- We recognise LNG operations have an impact on the domestic market, however, in contrast to the AEMC's view, the impact of the reporting arrangements described above are also relevant in the context of the LNG market. BG Group operates in international LNG markets and we have concerns about the publication of short and medium-term capacity and pipeline flow on an individual basis.

- The East Coast will become a sizeable global exporter of LNG and while volumes may have been fully contracted, the impact of short-notice production changes could have a material impact on global markets. As such, the requirement to source spot cargos, to meet contractual obligations due to an outage, could have LNG price implications.

- Furthermore, we are also aware that LNG traders across the Asia Pacific region actively monitor the Bulletin Board and these types of arrangements do not apply in other LNG exporting countries.

- As this is a complex issue, there is considerable benefit in working further with stakeholders,, to ensure the final recommendations provide outcomes that allow for the market to be appropriately informed of changes without comprising the confidentiality of individual players. One such option would be to publish the aggregate changes with delayed reporting for individual players.

2. *Cost Allocation and Frequency*

- We welcome the AEMC's recommendation to remove the Bulletin Board cost allocation methodology from the National Gas Rules and allow AEMO to manage this in-line with other fee arrangements.

- Through our participation in international markets, we understand the benefits of more frequent market reporting. We see benefits in the context of the Eastern Australian Gas Market if applied to relevant data sources that support trading and view that a trial is reasonable step to gain a better understand of the costs and benefits. We, however, suggest it could be more usefully applied to the Moomba to Sydney Pipeline (**MSP**) and the Moomba to Adelaide Pipeline (**MAP**).

3. *Reserves*

In accordance with Queensland Government[1] requirements, QGC reports bi-annual proven and probable reserves. We understand this detailed reporting framework is not necessarily in place in other east coast jurisdictions and it is the AEMC's intention to establish a uniform and central reporting framework for the East Coast Gas Market.

In principle, QGC does not have any concerns with the recommendation to place this information on the Bulletin Board provided it does not extend beyond what is currently reported and does not create confidentiality issues for producers. We appreciate that the intention is to minimise the impact on those already reporting to the Queensland Government. In this regard:

- To avoid duplicative reporting, we have a strong preference that the AEMO sources the information directly from the Queensland Department of Natural Resources and Mines (DRMN) website.

- AEMO's reporting timeframes align directly with those required by DRMN. Not only is this important to reduce regulatory burden, it ensures the consistency of the information reported.

- AEMO publication timeframes align directly with those applied by DRMN. DRMN delay the publication of data by six months to preserve confidentiality.

- QGC undertakes the reserve calculation process annually (which reflects general industry practice). As such, the second round of reporting reflects published reserves less production. As production is publically available, it would seem reasonable to consider shifting to an annual reporting cycle.

- Under the Queensland Government framework the reserve calculation methodology is not reported or published. For comparative purposes, consideration could be given to publishing this together with the reserve data

[1] As stipulated under the Petroleum and Gas (Production and Safety) Regulation 2004 and administered by the Queensland Department of Mines and Energy (DRMN)

- As part of the development of the annual Gas Statement of Opportunities (GSOO), The Australian Energy Market Operator (**AEMO**) collects and publishes reserve information. In finalising this recommendation and to avoid duplication we suggest the AEMC liaise with AEMO to understand what information is already available.

4. Uncontracted reserves

With respect to uncontracted reserves, QGC does not favour this option for a number of reasons and is concerned that it could potentially misinformed stakeholders. Determining "Uncontracted reserves" is not a straight forward process:

- "Uncontracted reserves" is not a value that is readily calculated and given the complexities it can involve some level of subjectivity in its application. As such, attempting to produce meaningful data that can be reliability used (and compared) by stakeholders is very unlikely.

    - It may also be more readily calculated by some businesses rather than others depending on the nature of their individual contractual and other project developmental arrangements. Furthermore, specific reserves are not necessarily linked to specific contracts, rather are tied to long-term projects/developments.

- It may be more informative to consider reporting information on 2C resources, which indicates "best estimate" of a company's technically recoverable resources for its discovered but uncommercialised gas fields.

- Reserve levels are unlikely to factor in determining a business' short to medium term gas position and as such the availability of supply.

- Further to these points "producers" are not the only holders of gas supply. Other parties e.g. retailers hold gas to trade or manage positions. We expect this will grow with liquidity as new parties enter the market such as intermediaries. Limiting this form of reporting to producers reduces the usefulness of this information to those seeking to understand the availability of gas.