

22 August, 2017

Australian Energy Market Commission
PO Box A2449
Sydney South, NSW 1235

To whom it may concern,

Submission to the Review into the scope of economic regulation applied to covered pipelines.

Chemistry Australia is pleased to provide this submission into the Review into the scope of economic regulation applied to covered pipelines.

Gas pipelines and broader gas infrastructure play a vital role in supplying gas for industry and other consumers to transform into high value-adding materials in demand by a growing economy.

Gas pipelines have an increasingly important role to play in delivering the National Gas Objective (NGO) of: “promoting efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price quality, safety, reliability, and security of supply of natural gas”. To ensure the intended outcomes of the NGO are maintained, pipeline regulations and relevant frameworks need to be focused on supporting those consumers being 21st Century, globally competitive.

Chemistry Australia (formerly the Plastics and Chemicals Industries Association) is the peak national body representing the business of chemistry in Australia. Chemistry Australia members include chemicals manufacturers, importers and distributors, logistics and supply chain partners, raw material suppliers, plastics fabricators and compounders, recyclers, research organisations and a number of leading Australian universities.

Our members and their broad customer base are major industrial, base load gas consumers for chemical feedstock and process energy use. Nationally, chemistry feedstock alone accounts for 10% of domestic demand. Feedstock gas is highly differentiated from other forms of gas use in that it is a non-substitutable input into chemistry value-added manufacturing, and forms a very high percentage of inputs and input costs. Gas is also used for a broad range of heat, steam, power co-generation and other industrial process needs throughout the broader sector.

The Australian economy needs to be globally competitive and an attractive place to invest. The characteristics of the Australian gas transmission infrastructure, including its pipeline network, and the regulations that help manage its operation, need to stand up to global scrutiny in order to attract investment from companies seeking to add value to Australia’s gas resources. The Australian domestic gas market itself must be globally competitive.

Proposals to improve the relevance and competitiveness of Australia’s gas transmission infrastructure are welcome. For pipelines to play their role in meeting NGO outcomes, access and regulatory environments must be fit for purpose in the new market dynamic of domestic demand supply requirements and LNG exports.

Reforms must focus on the New Horizon

It will be important that the gas pipeline regulatory regime and framework reforms focus on what is the New Horizon for gas market participants and consumers. The framework must be effective enough to assist gas users address the unprecedented supply and price pressure on their existing operations to remain viable, incentivise new capital investment, as well as reinvestment. This includes Australia being able to attract global investment funds for facilities that use gas for its chemical feedstock value as well as its heat, steam, power generation and other industrial process needs.

The \$118BN of damage forecast by Deloitte Access Economics¹ to the Australian manufacturing sector, and the loss of 15,000 jobs, as a result of the domestic market's transition to global export markets is happening here and now. The Australian domestic gas market needs urgent action to ensure that more gas from more gas suppliers flows into a more competitive and transparent market. This includes the broad range of gas transmission infrastructure elements, including its pipeline network.

Chemistry Australia's desired outcome is defined as:

"A domestic gas market that is deep in capacity, liquid in supply, competitive, transparent, informed and with good price discovery".

The role of pipelines in a competitive domestic market

The regulation and operating frameworks for pipelines need to be relevant for 21st Century, globally competitive Australian gas consumers.

It is important to recognise the comparatively simple gas market conditions in 2001 being significantly different to the complexities that all market participants, including domestic consumers need to operate with today. In particular the impact of East Coast LNG exports, soon to be double the volume of domestic demand, having fundamentally changed the role gas pipelines play in supporting NGO outcomes for domestic users.

Chemistry Australia notes the progression of pipeline -related reforms set out in the AEMC Issues Paper. The Hilmer review in 1993, the 2001 Parer review and introduction of the NGL, and more recent reports by the Australian Competition and Consumer Commission and Dr. Vertigan's report to the COAG Energy Council include the role of pipelines to meet the long term interests of consumers.

The ACCC and Dr. Vertigan's report note issues in relation to pipeline operators having, and exercising, superior market positions, information asymmetry and market power which in some instances is resulting in inefficient outcomes and impeding the establishment of a liquid wholesale gas market.

It is not unreasonable to consider that as the domestic gas market continues to lack certainty of supply, and with unprecedented prices well in excess of LNG netback, that information asymmetry and other characteristics of exercisable market power will continue to be barriers to an efficient, liquid and competitive domestic market. These factors exacerbate the challenges of consumers needing to adapt to how they operate to improve price discovery, secure gas supplies from existing or new suppliers and bring the gas to market. This can include becoming upstream market participants to better manage supply and price risk.

These new horizon needs will be critical to participants being able to play an informed and competitive role in future gas markets. Issues for inclusion in the range of pipeline and transmission related services include:

¹ *Gas market transformations – economic consequences for the manufacturing sector* – Deloitte Access Economics, July, 2014.

- The full network for which a shipper requires access to
- Midstream infrastructure services such as compression station and hubs
- Processing at network nodes and processing plans
- Multiple pipelines, jurisdictions, and transfer points. This is a significant shift from previous, simple bi-lateral contracts

Access to competitive pipelines is critical for securing forward gas for forward business

Gas pipelines will need to play an increasingly critical role in what COAG Minister agree is the new market dynamic. This includes supplying gas for industry to transform Australia's resources into high value adding materials in demand by a growing economy. For large industrial gas consumers, this includes feedstock gas, which is non-substitutable, and which forms a significant proportion of inputs and inputs costs.

The ongoing need for market certainty for domestic industrial consumers regarding gas supply, price and contract terms means that gas pipelines will need to be in a position, and properly calibrated, to play more of a role in delivering a competitive gas market for users, consistent with the NGO. This needs to take into consideration:

- Bringing new volumes of gas to the market from current sources
- Bringing new gas to market from new sources
- Enabling current gas wholesale and retail users to change their access arrangements including shifting upstream to become active market participants
- Assisting companies continuing to use traditional bi-lateral contract methods where they choose with increased clarity regarding pricing and costs.
- Assisting companies needing to deal with new market dynamics impacting contract prices and terms including:
 - Single direction and multi-directional flows
 - Changes to seasonality considerations
 - Park and swap
 - Increasing levels of take or pay clauses
 - Minimal swaps vs higher levels of swapping
 - The full network for which a shipper requires access to
 - Midstream infrastructure services such as compression station and hubs
 - Processing at network nodes and processing plans
 - Requirement for multiple pipelines, jurisdictions, and transfer points. This is a significant shift from previous, simple bi-lateral contracts
- Assisting companies or group of companies engaging in the market in new ways to deal with the increased complexities of access and security, price discovery and risk management. This may include:
 - companies or groups of companies taking on new roles or functions within the supply chain such as working with upstream explorers on new supplies and needing pipeline access to get this to market.
 - New types of aggregation models and options
- Assisting the needs of small, medium and larger buyers with varying degrees of market knowledge and experience.
- Fairly and transparently deal with the complexities of pipeline asset pricing, particularly given the monopoly dynamic.

- Helping meet the Australian government’s “reasonable price” model articulated as part of the Australian Domestic Gas Security Mechanism

Information provision and performance indicators

It is reasonable that the needs of both pipeline operators and shippers / consumers are met in the design and provision of key information and performance indicators. Issues Paper Question 10 (performance indicators) and Question 13 (providing information) are relevant here. The type and provision of information and performance indicators should be calibrated against the New Horizon needs set out earlier in this submission. They should also prevent outright, or if not then minimise, the need for an arbitrated outcome.

The information and data needs, therefore, will need to exhibit a number of key characteristics to overcome the well documented asymmetry issues in the marketplace, including:

1. Dealing with asymmetries inherent where pipelines operate as effective monopolies
2. Providing a basis for meaningful contracts between parties and not be a foil to run down the current-term contract clock that might result in shippers being wedged into unfavourable prices and / or terms. Selective, irrelevant or limited information may have the potential to game the market and wait out buyers by shifting unresolved contracts into expensive arbitration arrangements. Paradoxically, shippers may never know the cost / benefit break-even point of arbitration vs the cost of contract increases given they don’t have access to adequate pricing information in the first place.
3. Assist companies continuing to use traditional bi-lateral contract methods where they choose with increased clarity regarding pricing and costs.
4. Assist companies needing to deal with new market dynamics impacting contract prices and terms including:
 - a. Single direction and multi-directional flows
 - b. Changes to seasonality considerations
 - c. Park and swap
 - d. Minimal swaps vs higher levels of swapping
 - e. The full network for which a shipper requires access to
 - f. Midstream infrastructure services such as compression station and hubs
 - g. Processing at network nodes and processing plans
 - h. Requirement for multiple pipelines, jurisdictions, and transfer points. This is a significant shift from previous, simple bi-lateral contracts
5. Assist companies or group of companies engaging in the market in new ways to deal with the increased complexities of access and security, price discovery and risk management. This may include:
 - a. companies or groups of companies taking on new roles or functions within the supply chain such as working with upstream explorers on new supplies and needing pipeline access to get this to market.
 - b. New types of aggregation models and options

6. Assist the needs of small, medium and larger buyers with varying degrees of market knowledge and experience.
7. Fairly and transparently deal with the complexities of pipeline asset pricing, particularly given the monopoly dynamic.
8. Deal with concerns about charging fees for phantom services, which may not be delivered

Arbitration

Question 14 relates to arbitration. The previous section here notes the importance of information provision that should prevent outright, or if not then minimise, the need for an arbitrated outcome. It also recognises the role of the recent work of the Gas Market Reform Group improving arbitration arrangements for non-scheme pipelines. Chemistry Australia agrees that this will be a valuable process to learn from and enhance arbitration arrangements from.

Chemistry Australia notes that the arbitration mechanism should be the last resort for contract resolution, rather than an expected part of the contract process. Factors for consideration in the design and improvement of arbitration services include:

- Arbiters will need access to a suitable level of market operational knowledge to consistently effect a trusted, binding outcome
 - Parties should not be able to sell capacity or services under arbitration to third parties
-

Chemistry Australia hopes these insights and recommendations provide useful feedback into the review of pipeline regulations.

We would be pleased to provide or discuss any additional information you may require. Please feel free to contact me at: pbury@chemistryaustralia.org.au, or on 03 9611 5410.

Kind regards,



Peter Bury

Director – Strategy, Innovation and Research