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Briefing note

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Proposed reforms in the Australian gas market: Potential impact on GTAs

Proposed government reforms in the gas sector may, if implemented, result in major changes to gas transportation agreements (**GTAs**) to facilitate trading in pipeline capacity. Regulators have highlighted a number of concerns with GTA provisions that may restrict incentives of pipeline owners and shippers to grant access to spare capacity, and are currently seeking feedback on proposed reforms.

Key issues

- There are two major government regulatory reviews of the Australian East Coast gas markets. Their terms of reference and scope are very wide-ranging; potential changes to GTAs are only a small part of the reforms being considered.
- Regulators are concerned that long-term firm access GTAs limit the ability and incentives to trade capacity efficiently.
- If the AEMC's suggested reforms are followed, some changes will be required to, at least, future GTAs. Both regulators and industry participants have signalled that grandfathering of existing GTAs, a transitional period and/or compensation is possible.
- The proposed reforms are driven, in large part, by the emergence of LNG exports in Eastern Australia. The recent weakness in this sector may reduce government and business incentives to implement extensive reform – incremental market-led reform may be more likely.

Background to proposed reform

The emergence of LNG exports in Eastern Australia has the potential to transform the domestic gas market in Australia. New infrastructure and trading tools have already emerged in response to the new source of demand from LNG exports; for example, capacity trading facilities such as the Wallumbilla gas supply hub operated by the Australian Energy Market Operator (**AEMO**) and the online capacity trading platforms established by major pipeline owners, APA Group, SEA Gas and Jemena.

Despite these innovations, there is concern among market participants and Australian governments that the current gas market does not provide sufficient flexibility and opportunity for trading in pipeline capacity. Anecdotal evidence is that capacity trading occurs but is limited. The ability to quickly trade gas, and hence access markets over pipeline infrastructure, is expected to become increasingly necessary with the increased volatility brought about by LNG exports from Australia.

In light of these concerns, Australian governments have instituted a new series of reviews of the gas market. In December 2014, the Council of Australian Governments (**COAG**) Energy Council published its *Australian Gas Market Vision* and asked the Australian Energy Market Commission (**AEMC**) to consider the design, function and roles of facilitated gas markets and gas transportation arrangements and what reforms may be necessary to achieve its Vision.[5] One of the outcomes of the Vision is to increase flexibility and opportunity for trade in pipeline capacity. The AEMC was also asked by the Victorian Government to review the Victorian wholesale gas market arrangements.

In April 2015 the Federal Minister for Small Business directed the ACCC to hold an inquiry into “the competitiveness of wholesale gas prices and the structure of the upstream, processing, transportation, storage and marketing segments of the gas industry."

Why two reviews?

The AEMC does not have the power to compel market participants to provide information. In contrast, the ACCC can require a participant to provide commercially confidential information and thereby gain information on aspects of the gas markets that may not be available to AEMC. It is likely that the AEMC and COAG will use the ACCC's findings to inform their decision making.

AEMC Review

The AEMC's review is in two stages. Its Stage 1 Report, issued on 23 July 2015, analysed the gap between the current market arrangements and what is required to support COAG’s Vision. One of the key Stage 1 findings was that long-term bilateral GTAs, common throughout Eastern Australia other than Victoria, had facilitated significant new investment in pipelines, but that these arrangements may not be flexible enough to allow efficient reallocation of capacity.

Stage 2 of AEMC's review is in progress and is in two streams. On 6 August 2015, it published a discussion paper around potential wholesale gas market designs discussing, in particular, the role of gas hubs and how physical imbalances can be managed. Submissions on this discussion paper closed on 10 September 2015.

On 18 September 2015, the AEMC published a discussion paper on Pipeline Regulation and Capacity Trading. The objective of the paper is to stimulate discussion around the arrangements for pipeline regulation and capacity trading in the context of COAG's Vision. It uses EU and US regulation and capacity trading arrangements as guidelines to potential reform in Australia. Potential reform of aspects of the current transportation arrangements were raised in this paper. Submissions on the discussion paper are due on 16 October.

GTA provisions of concern to AEMC

AEMC highlighted concerns with restrictive provisions in GTAs that limit the incentive or ability of either capacity holders' or pipeline owners' incentives to compete with each other for capacity. These provisions included:

- early nomination cut-off times in GTAs that favour capacity sales by the pipeline owner over sales by shippers;
- restrictions on ability to change receipt and delivery points without renegotiation of the GTA;
- requirements to negotiate allocation agreements at delivery/receipt points;
- fees and charges levied by pipeline owners;
- direct prohibitions on the pipeline owner selling capacity to another party;
- most favoured nation provisions which give foundation shippers the right to prices offered to other shippers; and

- requirements that pipeline owners rebate some or all revenue received from capacity sales to capacity holders.

Potential reform of GTAs

AEMC identified three broad approaches to address inefficiencies in capacity allocation, each of which have potential impacts on GTAs (a table setting out the major characteristics of each approach is reproduced in the appendix):

- **Approach A:** Facilitate trading between parties to address transaction cost issues. Under this approach it suggested that standardisation of capacity rights could serve to increase liquidity in the capacity market and reduce transaction costs.
- **Approach B:** Improve the incentives of capacity holders in the provision of capacity, including by prohibiting contractual provisions in GTAs which limit capacity trading by pipeline owners.
- **Approach C:** Improve the incentives of pipeline owners in facilitating access to capacity, including by prohibiting contractual provisions in GTAs which limit capacity trading by shippers.

AEMC is seeking feedback on these proposals, and has acknowledged that standardisation and amendment of existing GTAs is likely to be administratively complex, with significant legal and financial implications. It has asked for specific feedback on the following:

- Should standardisation apply to contracts between pipeline owners and shippers, between shippers or both?
- Should existing GTAs be grandfathered or allowed a transitional period?
- Should some form of compensation be paid to pipeline owners and/or shippers if changes are made to GTAs?
- Which provisions of GTAs should be standardised (e.g. credit requirements, delivery and receipt point requirements, capacity timing)? Where is customisation beneficial?
- Should standardisation be voluntary or regulated?
- Are incentives to underwrite new additional capacity reduced if GTAs are changed to implement further capacity trading?

Submissions are due on 16 October 2015.

ACCC East Coast Gas inquiry

The ACCC is conducting a 12 month inquiry into the competiveness of the East Coast Australian gas markets. It released an Issues Paper on 4 June 2015. Submissions closed on 3 July 2015. Public hearings were heard in Melbourne and Sydney in July and August 2015.

One of the areas of inquiry is the terms and conditions in gas transportation agreements. The ACCC asked market participants, "*Are there contractual terms and conditions in gas transportation contracts that are limiting competition in the supply of pipeline services (including secondary trading of capacity)? If so, explain what those terms are, the rationale for them and their effect on pipeline users.*"

The ACCC received 36 submissions from participants, including pipeline owners, major users, industry bodies, producers and regulators. As to be expected, there was a range of views on GTAs and their impact on competition. A consistent theme of many submissions, even those that considered existing GTAs did limit competition and supported change, was the need for phased transition that recognises existing property rights and minimises adverse impacts on current and future investment.

What next?

Submissions on AEMC's Pipeline Capacity Discussion Paper are due on 16th October 2015. AEMC's Stage 2 report will set out recommendations for medium and long term adjustments to the east coast gas markets. The draft report is due to be provided to COAG's Energy Council before its December 2015 meeting, and due to be released in 2016 following a response from the Energy Council to the draft report.

The ACCC's final report is required to be submitted to the Minister for Small Business by 9 April 2016.

Table: Approaches to address inefficiencies in the allocation of capacity

Approach A – Facilitate trading between parties	Approach B – Improve the incentives of capacity holders in the provision of capacity	Approach C – Improve the incentives of pipeline owners in facilitating access to capacity
Standardisation of capacity rights	Compulsory capacity reallocation mechanisms	Changes to the economic regulation of pipelines
Pipeline owners required to offer spare firm capacity in a transparent, open process	Prohibit contractual provisions in GTAs which limit capacity trading by pipeline owners	Prohibit contractual provisions in GTAs which limit capacity trading by shippers
Information about available capacity and trades to be published through a bulletin board	Reserve capacity for short term trades	
Voluntary surrender of capacity mechanism		

Source: Table 4.1: Approaches to address inefficiencies in the allocation of capacity, AEMC, *Pipeline Regulation and Capacity Trading Discussion Paper: East Coast Wholesale Gas Market and Pipeline Frameworks Review*, 8 September 2015, Sydney, p. 33.

Contacts

Mark Pistilli
Partner
T: +61 2 8922 8001
E: mark.pistilli@cliffordchance.com

Nadia Kadic
Counsel
T: +61 2 8922 8095
E: nadia.kalic@cliffordchance.com

Dave Poddar
Partner
T: +61 2 8922 8033
E: dave.poddar@cliffordchance.com

Joni Henry
Counsel
T: +61 2 8922 8090
E: joni.henry@cliffordchance.com