



Argus Media's response to the Australian Competition & Consumer Commission (ACCC) East Coast Gas Inquiry 2015

Argus Media (Argus) welcomes the opportunity to comment on the East Coast Gas Inquiry 2015. Argus focuses its comments on recommendations for promoting greater price transparency in gas markets. There are three brief sections to our response:

1. **About Argus** - an introduction to Argus as an independent Price Reporting Agency.
2. **International gas markets** – providing context for the Australian market.
3. **Australia's gas markets** – recommendations for promoting greater price transparency, and building liquidity.

1. About Argus

- Argus is an independent media organisation with more than 700 full-time staff and whose activities include publication of price assessments for physical energy and related commodities. Data provided by Argus are widely used for indexation in physical trade, and as a settlement price for derivatives contracts. Companies, governments and international agencies use Argus for analysis and planning purposes.
- Argus' services are created by an international editorial operation with news bureaus located in the world's principal energy centres under the editorial direction of an editor-in-chief, who reports to the chief executive and who has responsibility for the quality of content. Its well-trained journalists operate according to a rigorous and transparent Editorial Code of Conduct and an Ethics Policy (available at: www.argusmedia.com/About-Argus/How-We-Work) that align with the highest standards of journalistic best practice, including the avoidance of conflicts of interest. The company began operations 45 years ago, and has been active in Asia-Pacific for almost 30 years.
- Argus is not a financial services company. It is an independent media organisation that reports on energy and commodity markets, but is not a participant in the markets and has no vested interest whatsoever in the level of prices in those markets. Its worldwide reputation and continued business success depend on maintaining that independence.
- Argus' prices are used extensively in energy supply contracts and derivatives markets around the world. For example, the Argus Sour Crude Index (ASCI) is the price benchmark for Middle East crude exports to the US, and Argus is used as an official oil price reference by many governments around the world. Argus is the principal provider of price indexation for physical and derivative coal markets internationally. Increasingly, European companies are signing gas supply contracts based on gas hub indexation, rather than oil indexation. Argus' prices for the Dutch gas market (TTF) now form the basis of several key European gas supply contracts.
- Argus is committed to transparency in its own operations including through making public its submissions and responses to public consultations. As a corporate function, Argus maintains an active public policy programme to keep abreast of relevant public policy developments internationally, hence our interest in responding to the ACCC inquiry.

2. International gas markets – providing context for the Australian market

- International gas markets are shifting away from oil indexation towards gas-to-gas pricing. In Europe, weak demand resulting from the recession, and surplus LNG no longer required by the US, are two factors that have contributed to the move away from oil indexation. Gas sold on gas-to-gas pricing now accounts for around half of the gas sold in Europe, a significant increase from only a few years ago.
- Oil indexation is a weak instrument for generating a competitive natural gas price, undermining the ability of gas to compete with other fuels. The oil linkage is coming under increasing pressure as oil's role in power generation becomes more limited, and it is coal, nuclear and renewables that compete with gas as a fuel feedstock to generate power. The gas industry will continue to question the validity of oil-price linkage, as it seeks a reliable reference that is capable of reflecting supply and demand fundamentals in the gas markets themselves.
- LNG producers often argue that oil indexation is needed to underpin huge investments in LNG infrastructure. But some large gas infrastructure projects in Europe have been built on the basis of the UK's NBP prices, highlighting that it is a liquid price reference, rather than an oil indexed formula, that is a prerequisite for investment purposes.
- A move away from oil indexation to gas-to gas-pricing in Asia is likely to be driven by evolving approaches to risk management. These include the development of financial markets, increased cross participation of buyers in upstream projects and sellers in downstream projects, and a growing number of portfolio players with flexibility. The emergence of a liquid and transparent Asian gas spot market is essential in driving the move away from oil indexation. The IEA notes in its recent report *The Asian Quest for LNG in a Globalising Market* that the following steps are needed to create an Asian gas hub:
 1. A hands-off government approach
 2. Unbundling of transport and commercial activities
 3. Price deregulation at the wholesale level
- In Europe, a number of physical and virtual gas hubs have emerged, with pricing points such as the Netherlands' TTF becoming increasingly liquid in recent years due to developing interconnections and the move away from oil indexation.
- In Asia, the regulatory landscape is gradually shifting. China is implementing domestic gas pricing reforms, India is looking to reform energy prices, and Indonesia is removing fossil fuel subsidies, enabling domestic prices to move closer to market prices. International gas markets are structurally changing and moving towards market pricing. The role of oil indexation will therefore continue to come under pressure.
- A vibrant physical market is needed in order to build liquidity in the financial markets. In the case of the UK gas market, strong liquidity in the OTC forward market was critical to enabling a paper-traded market to successfully emerge. The involvement of trading houses and financial players such as investment banks and hedge funds was another important element underpinning the success of the paper market in Europe.

3. Australia's gas markets – the role of price transparency in building liquidity

- The Australian east coast natural gas market is changing rapidly. Queensland began loading its first LNG cargo at the end of 2014 at Gladstone, marking the first time the east coast domestic gas market will directly compete with Asia-Pacific consumers for supplies. East

coast spot and Argus forward prices moved sharply higher as a result of the start of exports, responding directly to supply and demand fundamentals in the international gas markets.

- Ramp gas supplies from the Gladstone LNG plants are increasing, as plant operators intensify upstream processing ahead of further trains starting up in the coming months. But this ramp gas is not driving Wallumbilla spot prices as low as last year, since operators have more outlets available to absorb the excess volumes.
- As the east coast gas market moves into this new era of competition with high LNG demand centres such as northeast Asia and China, a liquid and transparent spot market that reflects regional supply and demand fundamentals is key to ensuring competitive east coast gas prices. Australia's state and federal energy ministers said at the end of 2014 that improving gas market transparency and gas price discovery is an integral part of the next phase of reform for the country's east coast gas market.
- Argus publishes over 10,000 price assessments on a daily basis, many of which have become established as a leading price reference in the energy and commodities markets, bringing transparency to otherwise opaque markets. Argus frequently produces new price assessments in markets where there is a clear need for independently published, transparent pricing for commodities.
- One such example is in the Australian domestic gas market, where many fixed-price long-term gas contracts on the east coast are expiring, leaving scope to replace these with contracts indexed to transparent price references. Oil-indexed LNG netback pricing is starting to work its way into east coast gas supply contracts, but this is not a long-term answer. As oil indexation continues to fade out in Europe, and comes under increasing pressure in Asia, Australia's domestic gas market needs to look at alternative pricing structures, such as gas-on-gas pricing. Wallumbilla could become a key gas pricing point for the east coast, given its position between Gladstone, Brisbane and more southerly Australian demand centres. The east coast gas market should look to Europe particularly as a guide for reform, given the developed nature of Europe's regulatory regime.
- In June 2014, Argus launched the first month-ahead index for Australia's east coast Wallumbilla natural gas market in the *Argus LNG Daily* market report. The index, known as the Argus Wallumbilla Index, or AWX, addresses the need to improve price transparency in the east coast gas market. It is designed to offer the Australian gas industry a reliable weekly price reference for natural gas traded at Wallumbilla for delivery on a month-ahead basis. It appears in a weekly east coast Australian markets page in *Argus LNG Daily*. Please see Appendix 1 attached.
- Argus Gladstone LNG netback pricing allows the Australian gas industry to compare the value of a cargo in the international export market with the AWX. Please see Appendix 2 attached.
- Whilst price transparency will help to drive liquidity in the east coast gas market, the start-up of LNG plants at Gladstone will play a key role in boosting liquidity. The plants need to balance their gas portfolios, sometimes on a daily basis, and the Wallumbilla gas hub could enable this. But addressing pipeline capacity issues and a lack of gas storage is also key to driving liquidity in the east coast market, as these mechanisms give market participants the flexibility needed to take trading positions.
- East coast gas pipeline capacity is currently sold at a fixed price, but introducing an auctioning model, similar to those used in the European gas markets, would allow for more flexible pricing structures, and help drive liquidity in the east coast gas markets, as it has done in Europe.

- East coast gas storage sites are very limited, with only two facilities offering third-party access. Open-access underground gas storage facilities are critical to enable counterparties to balance their physical positions. Mature gas markets such as those in the US, Europe and Canada have vastly more open-access underground gas storage facilities than Australia.
- In Europe, a number of forward OTC gas markets have emerged, with the two key ones being the NBP and the TTF. The east coast gas markets of Wallumbilla, Victoria and the Short Term Traded Markets (STTMs) are structurally very different. Some form of standardisation in these markets could help to promote liquidity across the east coast.
- Developments in international gas and energy markets have demonstrated that the development of liquidity in the physical market is a prerequisite before a paper-traded market can successfully emerge. Most recently in the Asian LNG markets, we have seen the swaps market fail to establish itself because liquidity is not yet sufficient in the physical market. As in Europe, the participation of trading houses and financial players is key to enabling an Australian east coast financial gas market to evolve.

4. Conclusion

- Price transparency can best be promoted by encouraging independent media organisations such as energy Price Reporting Agencies to produce price assessments that most accurately reflect the supply and demand fundamentals of a freely operating, non-price regulated market. A good example of this is the AWX, an independent price assessment of Wallumbilla's east coast natural gas market.
- Argus urges the ACCC to be aware of the role that independent Price Reporting Agencies such as Argus perform in bringing transparency to otherwise opaque energy markets. These organisations should be left to function without government interference, oversight or regulation.
- Moreover, the government and government agencies should have an important role to play in enhancing price transparency by:
 - publicly encouraging market participants to report comprehensive transactional and market information to Price Reporting Agencies
 - avoiding the adoption of legislation that might deter the flow of information to Price Reporting Agencies (i.e. which might have a chilling effect on the market)
 - adopting independent price assessments such as the AWX for tax reference purposes
- International gas markets are shifting away from oil indexation towards gas-to-gas pricing. Oil-indexed LNG netback pricing is starting to work its way into east coast gas supply contracts, but this is not a long-term answer. As oil indexation continues to fade out in Europe, and comes under increasing pressure in Asia, Australia's domestic gas market needs to look at alternative pricing structures, such as gas-on-gas pricing. A liquid and transparent spot market is essential if market participants are to become comfortable using gas-on-gas pricing in their long-term contracts. The east coast gas market should look to Europe particularly as a guide for reform, given the developed nature of Europe's regulatory regime.
- Price transparency will help to drive liquidity in the east coast gas market, and the start-up of LNG plants at Gladstone will play a key role in boosting liquidity. But addressing pipeline capacity issues and a lack of gas storage is also key to driving liquidity, as these mechanisms give market participants the flexibility needed to take trading positions.

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- A vibrant physical market is needed in order to build liquidity in the financial markets. In the case of the UK gas market, strong liquidity in the OTC forward market was critical to enabling a paper-traded market to successfully emerge. The involvement of trading houses and financial players such as investment banks and hedge funds was key to the success of the paper market in Europe.
- Argus is available to provide further information and details as required to support the ACCC consultation.

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