

2 July 2015

The Australian Competition and Consumer Commission
East Coast Gas Inquiry
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Lodged electronically

Submission re: East Coast Gas Inquiry

Hydro-Electric Corporation (Hydro Tasmania) welcomes the opportunity to provide comments on the Australian Competition and Consumer Commission (ACCC) East Coast Gas Inquiry. We are well placed to comment as we are a second-tier participant in the gas wholesale market with a growing gas retail business as Momentum Energy Pty Limited (Momentum) in Victoria.

Hydro Tasmania participates in the wholesale gas market through its subsidiary AETV Pty Ltd (AETV) which was transferred from Aurora Energy Pty Ltd to Hydro Tasmania under Ministerial direction from Government of Tasmania in June 2013. Hydro Tasmania has been managing the wholesale gas supply contracts, transport contracts and associated customer contracts since the transfer of AETV.

We have structured our submission into two separate Annexures; Annexure One: Answers to these Questions contain no confidential information and Annexure Two: Confidential Answers to Questions contain information that Hydro Tasmania requests to be kept confidential to protect its commercial interests.

Some of the specific information requested by the ACCC in response to the issues paper cannot be provided by Hydro Tasmania due to confidentiality restrictions within our contractual arrangements. Where this is the case Hydro Tasmania has provided general information, where possible, and specifically noted that we are unable to provide the requested information due to our confidentiality obligations.

Where we believe that Hydro Tasmania does not have any unique information for the ACCC to consider or we do not have experience in the specific issues raised in the questions, we have not provided a response to those questions.

If you need any further clarification regarding our submission please contact the undersigned.

Yours sincerely



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Annexure One: Responses to Questions

Q.3 Are there currently any factors that are significantly restricting or limiting the ability or incentive for gas producers to explore for, or develop, new gas reserves? If so, explain.

- Lack of community support for non-conventional gas development and some Government restrictions (such as NSW and Victorian Moratorium) places a significant deterrent to developing of non-conventional gas fields
- High project development cost when compared to international developments and cost & time overrun experienced in most Australian gas projects are deterrents for new gas developments
- In addition the following gas market factors would act as a significant deterrent to a new gas supplier:
 - There is no liquidity in the market to be confident of having certainty of availability of demand and prices.
 - The gas market demand is mostly locked in with high Take-or-Pay (TOP) by existing gas suppliers for future years and as such the window of opportunity for aligning any development is very narrow and creates unacceptable risks for new entrants.
 - There is limited, if any, transparency in the primary market to encourage a new entrant to venture in this relatively small and opaque gas market. The need for ACCC to use its information gathering power to get meaningful information about the dealings in the gas market is evidence enough to show how difficult it must be for a new entrant.
 - There is a history of long term warehousing of reserves in this market where the resources found have taken decades to make it to the market which is not encouraging for new entrants.

Q.5 Has the development of LNG export facilities created opportunities for gas suppliers to exercise market power in any location in Eastern Australia? If so, explain where and how.

- The development of LNG export facilities, in Eastern Australia has affected the competitiveness and shift in balance of power in the domestic gas markets for the following reasons:
 - These LNG projects are developed on the back of unconventional CBM gas reserves that can be developed incrementally in modules as compared to unconventional resources.
 - The development capital for the upstream part of the project in a conventional supply for LNG is also fully invested upfront as compared to unconventional resources.
 - Some of the proponents committed to these projects without sufficient reserves and upstream development backing to meet their LNG demand.
 - Some of the proponents are vertically integrated and do not have to compete in an open market for gas
- These conditions have led to a domestic market with fewer sellers and all major domestic buyers seeking to contract at the same time as the start of LNG exports, provide such opportunities for sellers.
- As all negotiation in the gas markets in Eastern Australia are held between buyers and sellers on a bilateral basis under strict confidentiality regime, it is not possible for us to provide any specifics of perceived or observed behaviours of sellers and buyers.

Q.7 What factors dictate whether it is commercially viable for gas users to employ strategies (such as vertical integration or sponsorship of new entry) to respond to the changing environment?

- Oil and gas production has a long development process from exploring for the resource to commercial production, which can range between 6 years to 15 years. The development process also carries significant uncertainty of commercial success.
- The investment in gas production has a different risk profile and need for technical expertise than a gas user's normal business.
- Investment decisions based on just a perception of scarcity would concern most investors in new resources. As is evident from the outcomes in other commodity markets higher cost developments in a market where more economic resources are not fully contracted but just not available at competitive prices would be seen as a significant competition risk.

Q.8 What opportunities are available to gas users for switching to alternative types of energy sources in response to rising gas pricing? What factors affect the ability of gas users to do so? How likely is this outcome? To what extent is any response from gas users likely to affect the broader dynamics of the domestic gas industry?

- Fuel switching options are available to some of the gas users but not all. Changing fuel sources very often requires a significant capital investment which in some cases has been undertaken in eastern Australia as recent as last decade to switch to gas from other fuels.
- In addition to capital investment by gas users in switching fuel to gas, the significant investment in infrastructure, such as transmission pipelines and distribution network, to switch to gas carries the risk of being stranded and wasted.
- As explained above, the time required to bring new gas resources to the market is somewhere between 6-10 years for conventional resources and 3-6 years for unconventional resources. There remains a possibility that change in government policy for development of non-conventional resources could lead to oversupply of gas in the domestic market within 4-6 years. In which case, another round of capital investment for switching from gas on top of an already wasted investment of switching to gas last decade will make the investment climate in the eastern Australia economy extremely unattractive.

Q.11 Are there any other regulatory barriers which create significant difficulties in accessing new gas reserves?

- A moratorium/development ban by NSW and Victorian Government for onshore gas and unconventional gas developments has adversely impacted the ability of new entrants to bring on new supply and provide some supply competition.

Q.18 Have industry participants encountered any difficulties in obtaining offers of gas supply, or been involved in any failed negotiations for supply of gas? If so, describe the negotiation, providing comments on what concerns arose about the process of negotiation and how this was different to previous negotiations.

- Given the change in gas market dynamics and reduced/limited supply competition, it can be deduced that the issues and hurdles encountered by a gas buyer have significantly increased.
- Negotiations between gas suppliers and gas buyers are held under cover of mutual confidentiality obligations which prohibit us from commenting in specific terms of those negotiations including success, failure or differences on those negotiations from the past negotiations.

Q.19 Are there differences in the behaviour of gas suppliers in relation to negotiations for supply from, or to, different geographic regions? If so, provide details.

- As stated above, we are unable to comment on specific behaviours of gas suppliers in this submission.

Q.20 What are the key factors affecting the terms on which gas suppliers are willing to offer gas to users? Explain the effect of these factors on gas suppliers.

- All supply terms are confidential and cannot be disclosed in this submission.

Q.24 Are buyers that enter into oil-linked gas supply agreements able to effectively hedge their exposure to changes in oil prices? If so, how? If not, why not?

- Buyers can hedge their exposure to oil prices and the associated foreign exchange exposure using forward trades for multiple years.

Q.25 How do non-price terms and conditions offered by gas suppliers in new gas supply agreements differ to previous agreements? Provide examples with reference to recent gas supply negotiations, successful or unsuccessful. To what extent have any changes affected the business of gas buyers?

- All terms and conditions of gas supply in previous gas supply agreements and any new offers for future supply are provided under strict obligations of confidentiality. We are unable to disclose those terms in this submission. Given that the market dynamics for supply competition differ from the circumstances in previous agreements, the terms and conditions would reflect the negotiating circumstances.

Q.30 Is there adequate information publicly available about production capacity to supply LNG and domestic users? If not, what key sources of information are missing and what kind of issues does this create for market participants?

- No, there is little reliable information in regards to the production capacity to supply LNG and domestic users.
- Only historical and current production rates from the gas fields can be obtained from the Gas Bulletin Board, which does not provide any outlook for supply availability in future years.
- There is no reliable information available on how much of gas production is scheduled to be used in LNG supply and how much is available for sale in domestic markets. The non LNG related facilities in the southern market also do not provide an outlook (4-7 years) of how much gas supply is available for contracting at a point in time and what is the total capacity available and production capability for the same period.

Q.31 What information do gas users need for the purpose of being able to confidently engage in gas supply negotiations? How would it be used?

- A transparent up to date view of available supplies from all gas suppliers for a 4-7 year outlook in the primary market for gas.
- A market reflective reference price would allow buyers to understand where gas has been traded and reduce the information imbalance between buyers and sellers.

Q.35 To what extent are the pricing outcomes observed in facilitated trading markets likely to be relevant to the future negotiation of long term gas supply contracts?

- There is no relevance of pricing outcome observed in facilitated trading market to future negotiation of long term contracts. A simple example is that prices in Qld facilitated markets have ranged from \$1-\$4 for most of the ramp up period of LNG production, yet the

buyers have been reporting in media their inability to secure long term gas at prices as high as \$7 to \$9.

Q.36 Is the further development of existing or additional facilitated trading markets likely to result in better outcomes for market participants? If so, how?

- Facilitated trading markets do play a small but useful role in managing daily operational issues and balancing of demand and supply. As such further development of these markets is beneficial for market participants.
- The lack of a liquid and transparent primary market is a more serious problem in Eastern Australia. Further expanding the secondary market will not solve the difficulties faced in the primary market.

Q.37 To what extent are international comparisons relevant to the supply of gas and associated services in Eastern Australia? Are there any lessons from reforms in the US, the EU or elsewhere that may be relevant for Australia? What reforms or measures adopted in the US or the EU are not likely to work in Eastern Australia, and why? Are there any intermediate trading models between the US/EU trading markets and bilateral contracting that could improve information flow and increase trading liquidity in Eastern Australia?

- The Australian market is very small with only handful of independent (not vertically integrated) players, particularly on the supply side. Once broken down to different geographical markets in Eastern Australia, there are often only one or two suppliers which have a majority, if not all, of the market share for a region. Further vertical integration of gas suppliers in a market already lacking depth has exasperated the issues of liquidity and transparency.
- There are not many parallels that can be drawn to the international markets but the National Electricity Market (NEM) has managed to overcome some of similar hurdles of small market with few participants. The NEM is far from perfect but when compared to gas markets is light years ahead in that regard.

Q.48 Are you aware of any instances where pipeline capacity was sought but not made available or alternatively not able to be procured in time? Provide details, including whether that capacity was sought from pipeline operators or shippers.

- We are unable to comment due to confidentiality restrictions.

Q.54 Are there any provisions in gas transportation agreements which limit or impede effective capacity trading? What are those provisions and how do they work to limit or impede capacity trading?

- We are unable to comment due to confidentiality restrictions.

Q.59 Are there particular upstream activities which are more difficult to co-ordinate than others? Provide details of any difficulties experienced in achieving co-ordination and explain whether, and how, these difficulties affect the level of upstream and / or downstream competition in the supply of gas or other ancillary services.

- There is a disconnect in the operation of wholesale gas markets in Eastern Australia. The services and terms offered in the primary market do not match or align with the terms and operation of the secondary facilitated trading market, which is again different in each region. This creates significant unproductive coordination of gas supply. Examples are intra-day markets, non-uniform gas day times, different nominations, bidding and settlement processes for each regional market.

Q.61 Does the need to co-ordinate between the different carriage models affect decisions made by market participants as to whether to engage in the transportation of gas in and out of Victoria? If so, how?

- Yes, the different carriage models discourage free movement of gas between markets due to operational and commercial complexity.