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TRANSCRIPT OF PROCEEDINGS

**AUSTRALIAN COMPETITION AND CONSUMER COMMISSION**

**MR ROD SIMS, Chairperson**

**MR ROGER FEATHERSTON, Commissioner**

**DR JILL WALKER, Commissioner**

**EAST COAST GAS INQUIRY HEARING**

**PUBLIC TRANSCRIPT**

**ACCC HEARING ROOM**

**LEVEL 35, THE TOWER, 360 ELIZABETH ST, MELBOURNE**

**FRIDAY 31 JULY 2015**

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CHAIRPERSON SIMS: Good morning and welcome. As you can tell by this layout, there's a bit of formality that attaches to this, for which I almost apologise. But this is a public hearing pursuant to subsection 95R of the Competition and Consumer Act as part of the inquiry we're doing for the east coast gas market. I'm Rod Sims, chairman of the ACCC and Commissioner Jill Walker, Commissioner Roger Featherston, we're the ones conducting the inquiry. I'll just let the staff who are here, introduce themselves, starting with Dale at the end.

MR RENTSCH: Dale Rentsch.

MR JOSE: Jeremy Jose.

MR PHILP: Brenton Philp.

MR LLEWELLYN: Jeremy Llewellyn.

CHAIRPERSON SIMS: The hearing today is obviously open to members of the public who, of course, are situated well back there, sorry about that. I really welcome people being here. Today we're taking sworn evidence from people who have said they want to come forward and do so, so it won't be possible to hear evidence from other people today. If anyone else is interested in giving evidence, they can approach the staff and do so in the way that our colleagues from the Energy Users Association are doing today. So if you're here as an observer, please refrain from asking questions or interrupting the hearing. I'm afraid your role is observe.

A few other preliminaries. This matter is being recorded and the transcript will be made available to you. I assumed you've all got a copy of the notice for witnesses? Okay, thank you. So as you can see, this is a public inquiry. If you wished to provide any evidence or say anything that you want to be treated as confidential, you can make a request for confidentiality and if that's agreed, then we can close the hearing and take that evidence in private. But otherwise, of course, this is all in public. Have you already provided any documents to the staff or Commission for the purposes of the hearing or in relation to the inquiry in general?

MR BARRESI: No, no we haven't, not to the Commission, no.

CHAIRPERSON SIMS: Okay. Do you have any additional documents to provide now?

MR BARRESI: No, not with us, no.

CHAIRPERSON SIMS: Okay. Before commencing and this is my final bit of formality, I need to remind you that it's a criminal offence to give evidence that you know to be false or misleading. Do you understand that?

MR BARRESI: Yes.

CHAIRPERSON SIMS: Yes, thank you. Now the Commission requires you to give your evidence on oath or affirmation.

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CHAIRPERSON SIMS: Thank you, Phil. Could you - sorry, Phil, I'm not doing this very well.

MR BARRESI: No worries, that's all right.

CHAIRPERSON SIMS: It's difficult.

MR BARRESI: You're right.

CHAIRPERSON SIMS: Before we do this, I should have said, can you just state your name, address and occupation, Phil?

MR BARRESI: Phillip Barresi, 555 Lonsdale Street, Melbourne. CEO of the Energy Users Association of Australia.

CHAIRPERSON SIMS: Thank you and I'll get everybody else to do that once they either swear or give the affirmation.

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CHAIRPERSON SIMS: Name please and--

MR GRENNING: Mark Ross Grenning, Director EUAA, 555 Lonsdale Street, Melbourne.

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CHAIRPERSON SIMS: Thank you and again, if you could state your name?

MR WOOD: Jonathan Richard Wood, group manager, Sustainability at Crown Resorts, 8 Whiteman Street, Southbank.

CHAIRPERSON SIMS: Thank you, very much. With that done, gentlemen we are - over to you, we're very much here to listen and learn from what you've got to say, so thank you very much. If you could make some opening comments, that would be extremely helpful, so we can get your perspectives and we'll ask questions either as we go or at the end.

MR BARRESI: Thank you very much, Commissioner Sims. Thanks for the opportunity to make a presentation before the inquiry and it please the commissioners I'll make a short opening statement and then hand over to our two board members, who will also be speaking on behalf of the EUAA and not their employer. EUAA represents many of the large energy users in Australia in the commercial and industrial resources sector. Now I'm losing my voice. Our members account for a significant proportion of the gas consumed in the eastern Australian gas market. Reliable access to affordable energy, including gas, is essential to the continued success of large manufacturing and generation businesses and jobs they support.

I understand that a number of our members have made submissions and have either met with your in private or public. This oral submission is designed to reflect the views of the broader EUAA membership and as consistent with the in-confidence evidence that you'll receive from our members. EUAA does not seek any confidential information from its members and is well aware of our Competition Act obligations. We welcome the inquiry for many reasons. Not the least, there's a fundamental limitation of all the recent gas market inquiries and their inability to lift the confidential veil, so often used to prevent access to information.

The independent observer of the developing gas market over recent years must be wondering what is happening when the public position of producers, the major consumers seems to be so different. They both cannot be right about the state of the domestic market. EUAA's objective, like the ACCC, is to see an efficient, competitive gas market in eastern Australia. We also agree with the COAG Energy Council's gas market development plan which talks about encouraging competitive supply, transparency and price discovery, risk management as the key areas of focus. We believe in a competitive market, is best able to achieve the national gas objective of the market and the long term interests of the consumers. EUAA continues to marvel at the ability of those who are not consumers who think they have inside knowledge on what it actually means.

Many of our members have confronted these issues of the tightening - what they perceive as a tightening of the gas market for many, many years. The uncertainty of the last few years has certainly not diminished with the current state of play with the export - the gas exports that are taking place in Australia. With those few words with the commissioners, I'll hand over to Mark Grenning, who will expand on some of the issues that we would wish to cover.

MR GRENNING: Thank you, Phil. I'd like to begin by correcting perhaps some misconceptions that seem to be made about consumers in the gas market and to emphasise that, our members recognise that there are major changes going on in the gas markets of eastern Australia. That provides the context for their sourcing strategy. They well recognise the days of $3-$4 per gigajoule of gas are long gone. They well recognise that exploration and development costs have risen. There are three LNG projects in Queensland which require enormous amounts of gas to underpin their economics. Also they well recognise that the Australian gas market is relatively undeveloped, compared to the US or EU gas markets. There's limited sellers, there's limited pipeline system, there's a negligible spot market.

So we want to emphasise that we recognise these characteristics of the market and that frames our comments today and it frames our approach to - our members' approach to their sourcing strategy. So given that, let me talk about our members' experience as they try to source gas in the eastern Australian market over the last few years. Firstly, they send out an RFP and they'd be lucky to get one bid. Although it is probably only a coincidence that offers seemed to have increased to our members since the announcement of this inquiry. Perhaps that's coincidence.

Secondly, when they do get a bid, it's very unlikely to be capable of acceptance and I use the words "capable of acceptance" deliberately and let me explain. Generally, these offers involve prices well above LNG netback and we can have an argument about how that should be calculated, but I think you'd conclude - a reasonable person would conclude it's well above LNG netback. Secondly, they have very restrictive non price terms. Very high take or pay, limited availability - limited flexibility with ACQ/MDQ. Limited flexibility in banking and trading. The term offered is generally quite short and generally the offer is only open for a very short time. One member received an offer soon before they appeared before your inquiry and it was withdrawn soon after they appeared before your inquiry.

So what we have is not just a price that's well above LNG netback, but other conditions that effectively, when a consumer looks at an offer from a producer, they do an evaluation of the price and non price factors and come to a conclusion that starting with a price well above LNG netback, adding in the cost of the restrictive conditions, that the price ends up being significantly above LNG netback and hence just not competitive. The nature of the deal, where they have it only open for a short period of time, that's why I say we do not believe it's a proper market, offering offers that are capable of acceptance. All this is before we start to engage with the processing and delivery infrastructure owners with their own sets of constraints on competition and barriers to entry.

This is the basis for why the EUAA is saying the market is not competitive. No liquidity, knowledge asymmetry, eg, what are the uncommitted reserves, given the lack of publicly available information? No transparent price discovery with the result that allocative and dynamic efficiency are compromised. We don't believe that there is any east coast gas market. What we believe is that there are three separate uncompetitive gas markets. Queensland is dominated by LNG. New South Wales is dominated by a lack of reserves, due to constraints on development. Victoria is dominated by suppliers who a couple of years ago wished they were LNG producers and today are probably thanking their lucky stars they aren't an LNG producer.

Our members see governments, apart from Western Australia, opposed to domestic reservation. At the same time, they've seen an ACCC, that has over the last five to ten years, approved the acquisition of smaller producers, particularly in Queensland, which has effectively produced a de facto reservation for LNG. Well over 90% of reserves in Queensland are effectively reserved for LNG. The EUAA mounted strong submissions over that five, seven year period, opposing the applications for acquisition of those smaller producers in Queensland. The ACCC decided against the EUAA position on the basis that those acquisitions did not substantially lessen competition. We believe the evidence in the market today substantiates the EUAA position in our submissions of that time.

Our members see that they are effectively bearing LNG reserves risk when they either do not get offers or get offers at way above LNG netback. We say that we are effectively bearing LNG reserves risk because of the nature of the contractual - reserves requirements for the LNG projects, means that the producers don't have any gas spare to offer to our members and if they do offer to their members, they're effectively saying, we have a risk that offering this gas to you will mean that we'll be unable to meet our contractual obligations under LNG export contracts, so you Mr Domestic Consumer are going to have to pay a huge premium to offset that reserves risk and risk that we'll not be able to meet our take or pay requirements under our LNG contracts.

Some players like to describe the situation as a transitional or short term disequilibrium. These advocates suggest that the market is not broken and high prices will bring forth the required additional supply. We do not accept that argument. If you want to see a transitional disequilibrium that's generally defined in economics, you'd probably look at the disequilibrium that resulted from the Varanus Island or Longford Gas interruptions. We have a situation where suddenly gas is not available. The market seeks to adapt to that through, for example, government rationing of gas to certain user classes under State legislation and users adjusting in the short term by say, substituting diesel for gas. Then the market adjusts itself, Varanus Island and Longford cases repairs were made to equipment and gas eventually flowed. That's what we see as a transitional disequilibrium.

What we're seeing now is fundamentally different from that. The reason we see it as fundamentally different from that is because the time taken for the market to adjust to the situation is much, much longer and we think probably five to seven years. The reason it's five to seven years is that we see that there are considerable barriers, political and commercial and regulatory, to enabling these reserves to be available to the market. If there was only a temporary transitional period, then markets should internalise this transactional risk or disequilibrium in demand and supply. But what we've seen, we believe, is both a market failure and a non market failure, producing something that's quite different from a transitional disequilibrium and a quite severe impact on our members.

Numerous barriers prevent this supply coming within five to - and the basis for us saying it will take five to seven years. In Queensland, LNG developers are focusing on ensuring their LNG reserves for their projects. Both large and small E&P companies basically lack resources, particularly driven by the lower oil price now. Larger companies are restricting capital and smaller juniors simply can't get capital given the oil price. There's constraints around joint marketing, which limit the ability to explore and develop. There's no hedging available in a spot or financial market, because producers are not interested in participating in these spot markets and we'll say some comments about that later.

If you're a junior developer of gas resources in Australia, looking to sell that to large users in Australia, you've got to wonder given these larger users have existing gas contracts but, they can't get renewals. You're going to take five to seven years to find new reserves. Is that customer still going to be there in five to seven years? It wouldn't surprise us to understand that juniors think, well maybe they won't be around, so I could be finding a lot of gas and not being able to sell it. I'll just call on my colleague Jonathan Wood now to explain a bit more about those barriers.

CHAIRPERSON SIMS: Thank you, Mark.

MR WOOD: There are five barriers to entrants which we'd like to highlight here today. The first being government restriction on new gas exploration. Both the Victorian and New South Wales Governments have placed restrictions on new gas developments. The risks of an inappropriate or poorly regulated gas development has raised serious concerns amongst potentially affected communities. On the other side, industry players have been prevented from developing a productive resource that could help to meet future gas demand in Australia. Furthermore, the restrictions have illogically not differentiated between conventional and unconventional gas exploration and the current impasse in both States is unsatisfactory for all and creates knock on effects for broader gas development.

Actions by governments to remove unnecessary technical and regulatory barriers to development will be important in bringing on additional gas supply, enhancing upstream project completion and improving market outcomes. The EUAA recommends that both State and Federal Governments, working with industry and communities, should develop a clear nationally consistent regulatory framework for gas development that balances the needs and concerns of these respective groups.

The second barrier to new entrants is existing gas leases not being utilised. We don't believe that gas producers who underutilise their leases and sit on their resources, fosters a competitive market. We recommend that the government conducts a full review of all existing gas lease arrangements and ensures the gas is explored and developed appropriately. We also recommend that stringent conditions be included in all new leases to ensure available gas reserves are utilised to their full potential.

The third barrier is inability to access pipeline capacity. In the current market, there is substantial risk that a party wanting to obtain pipeline capacity and a party willing to sell, cannot find each other. Furthermore, because of the high cost for buyers and sellers to find each other, the pipeline owner has little incentive to offer competitive prices to buy or sell capacity. By offering an alternative mechanism to buy or sell. A market, could lower the price of pipeline capacity. The EUAA recommends that the barriers to efficient supply be removed by freeing up trading of pipeline capacity. The development of capacity markets would help to encourage competition and efficient transactions, and lower the price of both pipeline capacity and gas.

MR GRENNING: So that's our views on the barriers that we see and some of those barriers have led our members, who cannot get offers from the traditional upstream suppliers, to actually trying to deal directly with the juniors themselves. However they, in turn, have come up against other regulatory legal and commercial barriers, eg, access to processing and pipeline facilities, and the lack of an aggregator around to aggregate a number of juniors' reserves into the one contract to give a large user confidence on the deliverability under a contract. And we understand that two of our members have given explicit, in confidence, evidence to the ACCC regarding that particular matter.

Let me finish my section by commenting on perhaps the craziest irony in the current market. Recent broker commentary has highlighted a problem that Sinopec has as a participant in APLNG project in Queensland. Apparently it is unable to sell all of its contracted take or pay obligation in the Chinese market and so is being forced to sell the gas it's taken from APLNG at a discount in the spot market. This is when domestic users in Australia are not given the opportunity to buy at the Sinopec price. So enormous capital has been spent by the LNG developer, they're receiving a much lower oil linked price than expected. Their customers may have to discount the price further to sell the volume they cannot use themselves and domestic users are struggling to get gas at any price.

MR WOOD: Just to clarify, the fourth and fifth barrier to entrants as covered by Mark. The fourth was the inability to access existing gas processing plants and the fifth was the lack of liquid trading hubs and the EUAA welcomes the extension of gas trading hub to Moomba and that additional gas trading hubs be developed throughout the network.

MR BARRESI: I think we've covered a fair number of the questions that were certainly posed in the issues paper, Commissioners and we're happy to take questions at this point.

CHAIRPERSON SIMS: All right, thanks very much for all that. I'll just keep the ball in play, there's quite a lot to discuss there, but I'll just ask one question and then I'll pass to the Commissioners. But if there's any silence, I've got a few more questions. Just on the - do you mind taking some of those issues one at a time. But the capacity trading on pipelines, there is some capacity to do that now as, I understand, or there is on a voluntary basis. Could you perhaps just spell out a bit more, as much as you can, what you'd like to see?

MR GRENNING: Yes, there is some flexibility on that at the moment. I suppose we're - the message we're getting from our members and again we have to tread carefully about what's confidential and what's not confidential.

CHAIRPERSON SIMS: Correct.

MR GRENNING: But the message we're getting from our members is that it's just a very difficult, complex, negotiation process that is not an efficient way of doing things.

CHAIRPERSON SIMS: No, I understand that, I mean - and we've heard from your members who have been very generous with their time, but what do you think the solution is? Any thoughts on how that might - if the capacity trading on pipelines might be better done, any changes you'd like to see made?

MR GRENNING: The change I think--

CHAIRPERSON SIMS: It's a complex question, I know.

MR GRENNING: Yes, sorry.

CHAIRPERSON SIMS: But I wouldn't mind any highlevel thoughts from you.

MR GRENNING: I think it's more flexibility around the access principles that enables - my understanding is that some pipelines have effectively closed access for a period of time, which is effectively shutting off our members from their ability to do contracts with juniors to then - so they might even fund exploration, fund development, be able to get it to the surface and then find that the pipeline is just totally closed for the next ten years or a processing facility is totally closed, because it's privately owned and there are enormously complex arrangements around one large facility, where there are different bits of that one large facility, subject to different legal or commercial constraints around access.

CHAIRPERSON SIMS: Yes.

MR GRENNING: That's what they're really pulling their hair out about, because of the complexity of that. If there was one entity that they could negotiate with for all of that, to get access and then bring that junior's case to them - to their - to their facility, to their factory, that would be most welcome.

CHAIRPERSON SIMS: But is that something for the market to bring out or something for the government to do? Sorry, Phil?

MR GRENNING: Yes.

MR BARRESI: Sorry, I was just going to add to that and I think you've seen our submission that we made to the AEMC.

CHAIRPERSON SIMS: Yes.

MR BARRESI: We actually highlighted it in that submission and I take it that while things might have changed since then, the access arrangements, the national access regime arrangements still hadn't been certified by all the States. There was a commitment to do that, and we're still waiting for all the States to come board. That certainly wouldn't help to have a much clearer and consistent position and uniform infrastructure access regulations.

CHAIRPERSON SIMS: Yes.

COMMISSIONER FEATHERSTON: I take it that in terms of access to pipelines, your members would generally be looking for sort of long term arrangements, rather than benefiting too much from you know, short term, as available capacity?

MR GRENNING: Yes, yes, definitely, because they're looking for firm supply.

COMMISSIONER FEATHERSTON: Yes.

MR GRENNING: So it's not much use having a firm supply of gas and an unfirm or as available supply pipeline or processing capacity.

COMMISSIONER FEATHERSTON: Yes. In terms of the practicalities, I understood the evidence that the offers were either not necessarily available or are not capable of acceptance. But in terms of your members, again, have you observed a difference in terms of their willingness to accept shorter term contracts? Or is it still a situation where they would be looking for long term supply arrangements?

MR GRENNING: Our members generally prefer longer term. Historically the gas market in Australia has been long term bilateral contracts which have traditionally been on the basis of a new field developed, it could be a depletion contract or generally a long term contract and the prices reflected the development costs. So they're looking - the developer quite rightly is looking for a return on that development and in the past, it's insisted on a long term contract, for those very investment return reasons. Certainly our members are happy to consider shorter term than those 10 or 20 year contracts, but the terms that they've told us that they've been getting are quite short term and it's simply only delays an inevitable difficult decision about whether or not the business should continue.

COMMISSIONER FEATHERSTON: Yes.

MR BARRESI: One of the barriers to accepting the short term contract is some that - quite a few of our members have sunk a lot of capital investment into their production processes, whether it be gas, as an energy source, or gas a feedstock and the unreliability of having gas - sorry, the certainty of having gas at a fixed price over a longer period just makes those sorts of investments a little bit more risky.

COMMISSIONER FEATHERSTON: Yes, I understand.

CHAIRPERSON SIMS: Sorry, I'll just jump in again and then I'll pass to Jill and others, but - so I guess - I mean, there's almost - to be simplistic about it, sort of two ways to go. You can have the long term market that Mark was describing, which of course has been the traditional market. The alternative, I guess, is having a much more effective short term market where you can financially hedge, to give yourself whatever you need in terms of certainty.

I mean, do you have a sense of whether - and I'll put this in the extreme, just to get a sense from you, I'm just trying to clarify one to the other. But whether we need more effective mechanisms to reinstate the long term market we had, in your terms, or whether we need to just turn the corner and accept that we've got a more short term market, but put in place what is needed to make that effective. I mean, the electricity market of course is very short term, five minute bidding and 30 minute and all the rest of it. But other mechanisms that allow that to give people what they need. So do you have any sense of that and if so, what role for government versus letting the market sort it out itself?

MR GRENNING: Some of our members, including one I used to work for, operates in a variety of gas markets around the world. They're quite happy doing contracts in the United States on Henry Hub pricing, because you have a very efficient physical and financial hedge market. That is driven by the Henry Hub system having an extensive pipeline network. So you have options if one pipeline is not able to deliver. Also by the fact that all the producers are happy to supply product in that market. You can get short term or you can get a long term contract. In Australia, I think we're a long way from that. Our members are looking for long term security at a competitive - in a competitive market. If that competitive market means a high price, they're quite happy to accept it. If it means a low price, what they're wanting is a competitive, transparent market. I think the - that can be achieved, whether or not you have a long term contract story or a spot market story.

Our members had about three or four years in the sun, so to speak, for a competitive market around 2005 and there were a number of contracts put in place by our members for long term competitive supply in that typically restrictive, bilateral market arrangement. So I suppose I'm not sure I'm answering your question in the sense that whether it be a long term bilateral market or a competitive spot market, I think both can achieve the competitive outcome that we're looking for. I think the issue in Australia we have is that while the AEMO has done some fantastic work in setting up the trading hubs, they're only going to work if you have volume and at the moment we don't have volume either for a physical edge market and we don't have volume for a financial hedge market. Our members have the view that the producers have been either uninterested or unwilling to participate in that market in any long term way.

In the case of Queensland, it's because the participation in the market is simply dominated by ramp-up gases they've got ready for their LNG exports. So it remains to be seen, depending on the LNG market, whether or not there is enough gas made available to those spot markets to produce a competitive outcome that gives our members confidence for the long term contracts. Even though - give them confidence for their long term future, even though they might be buying on the spot market. At the moment, they don't have that on the spot market. It's really only an unders and overs market and they don't have it on the traditional contract market, because they're not getting offers.

CHAIRPERSON SIMS: So is there any role for government? I mean, how do you see this - do you have any sense of what you'd like to see done?

MR GRENNING: I think that the comments we talked about earlier, about breaking down those barriers, would be an excellent starting point and then how the market operates from there, I think is something that - we generally favour a market-based solution, with the appropriate structure, property rights legal structure in place to enable that market to perform and that's what we don't see at the moment.

MR BARRESI: Even participating in the trading hubs can be - can be quite a huge long term investment by a gas user. My understanding is that at Wallumbilla I think might only be eight users that are signed up to it. It's early days, the process, to get involved, it can be quite onerous taking anywhere between 18 months to two years, in terms of internal resources and that's if the organisation is willing to dedicate internal resources to do that. So there might be - there might be some opportunities there to make it easier for - for gas users themselves to be part of the trading hub solution.

MR GRENNING: The key in all this of whether or not you have an efficient market, is supply and the willingness of producers to offer that supply and that's what we're not seeing at the moment.

CHAIRPERSON SIMS: I guess though, just to - sorry, I'll come back in a second, but just - I mean, I guess I'm trying to understand and maybe it's in other submissions you've given elsewhere, but whether you see a role for government in sorting that through, if you - if we accept the world as you're putting it, that well describes the problem. I'm just trying to get a better sense of what you think the solution might be, who needs to do what. The supply is not available, is that something you want to deal with or--

MR GRENNING: Yes, so the barriers we talked about before, we think there's certainly a role for government in some of those. It's about reducing barriers for supply coming to the market. So it's in exploration and development of coal seam gas in New South Wales and Victoria, it's around--

CHAIRPERSON SIMS: I understand that one, that's - yes.

MR GRENNING: --pipeline access. It's around--

CHAIRPERSON SIMS: Sorry, but Mark - sorry.

MR GRENNING: Yes.

CHAIRPERSON SIMS: I understand the regulatory barriers that governments, as it were, imposed them, it's the role for government to do something about them, that one I've got.

MR GRENNING: Yes.

CHAIRPERSON SIMS: It's the - when you say - I mean, access, I guess, is that government access regimes, making gas available to hubs, is that something governments need to demand or require? I'm just trying to get a sense of the role for government in that way?

MR GRENNING: Perhaps a nuanced answer. We believe it's a role for government to facilitate that, but we would be very cautious about any role for governments directing that to happen.

CHAIRPERSON SIMS: Sorry, Roger.

COMMISSIONER FEATHERSTON: Yes, I was just going to explore your comment earlier Mark, that you thought there were three markets here.

MR GRENNING: Yes.

COMMISSIONER FEATHERSTON: You don't see that breaking down with the flow of gas between the different States and the reversal of the flow of some of the pipelines and so forth?

MR GRENNING: Not for some time, because again it gets back to a volume thing, because that was in the Cooper Basin flowing to Sydney, my understanding is now that's not flowing down the Moomba to Sydney pipeline, it's flowing back to Wallumbilla and back to Gladstone. So our description of a competitive market would enable flows going both ways, swaps being made between Victoria and Queensland, New South Wales and Queensland. That's driven by availability of volume in those States and we don't see that happening at the moment. We see an isolated market in Queensland where users in Queensland can't get bids from Queensland based owners of reserves. They certainly can't get swap arrangements from Victorian owners of gas reserves, because to do that, you have to physically do a swap with a Queensland producer and Queensland producers don't have the volume to do that, because they're shoving it in a ship.

COMMISSIONER FEATHERSTON: Yes, well I was interested in whether you are envisaging that making the market more competitive would actually involve, effectively, amalgamating those three separate markets in the one in order to provide greater liquidity and greater opportunities?

MR GRENNING: Yes, it would and that amalgamation - sorry, I'm sounding like a cracked record.

COMMISSIONER FEATHERSTON: No, no.

MR GRENNING: But greater competition and integration of those markets comes back to, where's the available volume to trade, to enable that market to develop and fundamentally at the moment, we don't have the volume, particularly in Queensland, for that competitive market to occur, meaning a total east coast competitive market. We have quite isolated markets, which are isolated for different, but related reasons.

MR BARRESI: Can I just go back to Commissioner Sims' comment about market - the government intervention. Let me say and I think you might have heard this from some of our members and this is not an EUAA position. But there are - there are members of ours that due to their inability to access gas, have called for short term transitional intervention by government, to ensure that supply is there at a reasonable price, until we get through this hump, whatever that - however long this hump is. As an association, we haven't endorsed that, but we certainly believe in the freedom of - yes, the market to sort this out, as long the regulations are in place to allow that sort of flexibility. But it would be remiss of me not to put that position that there are members who have totally opposite views on this whole issue of reservation, national economic interest tests, short term market intervention at price and supply levels.

CHAIRPERSON SIMS: I guess - I'll then pass to Jill, but I guess I understood the points about the - some people talk about national interest tests and reservation, I was more getting at trying to understand - so putting that - I understand that, put that to one side. I was more thinking of the role of government in trying to create some of those markets. I mean, governments can take various roles in what they require, in terms of how the hubs work, for example, what information is required? I was trying to get a sense of that, I guess, rather than the more - rather than those other options which I concede that lever there. But I was more interested in the role of government in helping generate more liquid market, if indeed there was a role. That's what I was trying to--

MR GRENNING: Well, certainly yes, as I said before, we greatly support the efforts of AEMO in making - because competitive markets require information transparency. They require - they work in favour of information being equally available to buyers and sellers and markets and what we have now is that - certainly a lot better than what it was a couple of years ago, with the markets at Wallumbilla, for example and in Victoria. But there's still a lot of asymmetry in that information and the prime one probably is, what are the reserves? As far as we're aware, there's no publicly available independent information on the level of P1, P2 and P3 reserves available. I'm sure the individual companies have those, but I think it would be great to inform the market to enable that amount of information to be publicly available.

CHAIRPERSON SIMS: Jill, do you have anything further?

COMMISSIONER WALKER: Just to clarify about the pipeline issue, because I seem to be hearing two things. One was about buyers and sellers being able to find each other and buy and sell capacity and one was about access, which seemed to me to be two slightly different things. Have I misunderstood that or‑‑

MR GRENNING: We would see them as related. It's - access allows you to do a buy and sell deal.

COMMISSIONER WALKER: But access to me - I think of access in terms of pipelines exercising - offsetting market power of pipelines, you know, in terms of getting reasonable access and reasonable terms. Whereas the buyers and sellers finding each other seems to me a sort of transparency issue.

MR GRENNING: I'm sorry, but--

MR WOOD: Yes, so I'd agree with both points. I guess there are two points we're trying to make, the first being a transparency issue, in terms of buyers and sellers trying to find each other. But then it's also a - I guess, a monopoly type arrangement type issue where because they are unable to find each other, then the pipeline owner is not - is a position where they don't - don't need to offer a competitive price for that capacity.

COMMISSIONER WALKER: Okay, so you see the two as compounding effects.

MR WOOD: Yes, exactly.

CHAIRPERSON SIMS: So one is making information available and the other one is--

MR WOOD: Taking advantage of it.

CHAIRPERSON SIMS: --a pt IIIA access regime mandated by government.

MR WOOD: Yes.

CHAIRPERSON SIMS: You're saying both.

MR GRENNING: Yes. Sorry, I misunderstood.

COMMISSIONER WALKER: That's all right, thank you.

CHAIRPERSON SIMS: I'd ask more (indistinct) any questions?

MR PHILP: May I? Just with regard to the trading hubs and your support for the Moomba trading hub that you mentioned earlier. My understanding that Wallumbilla has limited trades, as you've mentioned and their transaction costs that (indistinct), why do you think Moomba is going to provide a different outcome?

MR GRENNING: I don't have any specific knowledge about what's being traded or could be traded through Moomba, although I suspect the volume is going to be quite small anyway. But I think philosophically, the existence of more hubs the better, because it improves the price discovery and transparency of the market. But to have an efficient market, you need - sorry, I'm sounding bit a cracked record.

MR PHILP: No.

MR GRENNING: For an efficient market, you need volume and if you're not going to have volume, then that limits the effectiveness of that market. But we would argue that the greater markets that exist and those hubs that exist, the greater the transparency there in the market. So that's a good thing.

MR WOOD: So we would argue, it's not the solution, it's just part of the solution.

MR PHILP: Sure.

MR GRENNING: It's a facilitator.

MR WOOD: Yes, so it just has to be part of a competitive market solution. If you bring on that additional supply, by removing all the barriers that we mentioned, you will have that volume there and then part of that solution is the extension of Wallumbilla to other trading hubs.

MR BARRESI: And my understanding from what's been recounted to me by one or two members is that it may also make it just that little bit more easier for second and third year producers to - to trade their gas through the hub.

MR PHILP: Because it's physically located in a different place?

MR BARRESI: Yes.

MR PHILP: Yes.

MR LLEWELLYN: Just a follow up question, I guess a few times you've spoken about liquidity in trading hubs and one of the points you're saying is that producers aren't acting to increase the liquidity in the trading hubs or they're not putting liquidity into the trading hubs. I'm just interested, if you had a view on why that is? Why the producers might not be putting volumes into the trading hubs. Is it something to do with the hubs - so you've pointed out that users find them quite complicated or potentially there's a lot of complications to setting your business up to use the trading hubs. Do you have any thoughts on why - unlike the US, I guess and we talked about whether you can compare models from the US to Australia. Do you have any thoughts on why producers aren't potentially putting much volume into the hub?

MR WOOD: I was going to point to the lack of transparency in the deals that are being made. So that's certainly from our member's point of view, the lack of transparency is one of the reasons for their reluctance to enter into a trading arrangement.

MR GRENNING: And why aren't the producers doing it? Well I could speculate at all sorts of reasons, but I think the major one is that they'll only do it when they've got spare gas from their existing contractual arrangements and they've got spare gas recently because of ramp gas in Queensland and that as that ramp gas is more and more used to put on a boat and they're - if they're struggling to get the reserves to meet their contractual requirements under the LNG contracts, then I think they'll simply not have the volume to be able to trade much. You know, maybe they want to have some certain volume in there to create a price signal for the local market, for other purposes, for other contractual purposes in the future, but that remains to be seen. But I think the party best placed to answer your question is the producers.

MR LLEWELLYN: I understand that, I just thought I'd - its been mentioned a few times, and get your perspective.

MR GRENNING: All we see is the volume is not there in a way that can underpin a reasonable contract for a user. A user in the - and I've done them in the past, contracts on Henry Hub, there is enormous volume, enormous network of pipelines, so I have absolute confidence that I can do a deal with a pipeliner for a ten year contract based on a Henry Hub price and I know that I'm going to be able to get that gas. If I want to take a spot price, a floating price or I want to take a hedge on that, I can do that in the physical market. With the upstream producer, I can do it in the financial market. Plenty of instruments available and I know I'm going to get that volume. So I don't need a bilateral contract.

In Australia, I don't have that volume confidence. All I can do on a hub, and this is likely to be the case for many years to come, is that I can simply do an overs and unders story. Any little extra I might need today or might not need today, assuming my usually restrictive contract allows me to trade the unders and overs and that's usually not the case, that's the way I'm going to use the spot market. I cannot hang a billion dollar investment off a spot market where I need 15 TJs a day, if tomorrow I'm not sure I'm going to get 15, I might only get five.

MR PHILP: Then it sounds like part of that problem then is a pipeline one as well then? I mean, if you were to compare it to the Henry Hub, as you did and you said there's plenty of pipeline options--

MR GRENNING: That's correct.

MR PHILP: --well - which we may not have.

MR GRENNING: Yes and that - those pipeline options give me the option that there will always be the volume there. If there's a technical issue with delivery under a pipeline.

MR PHILP: Transportation volume.

MR GRENNING: Yes, there will be the transportation volume to get the molecules from some other location, because of the nature of the trading. I'll - my supplier will find that he can't push it through this pipeline, but he can push it through this other pipeline, through a swap arrangement.

MR PHILP: So is this problem a little circular, in that your members are looking for contracts for gas at the moment, because there's no liquidity within these spot markets. But to free up the liquidity for the spot markets, you need the gas available, which is being borne in the contracts?

MR GRENNING: A competitive market needs supply.

MR PHILP: Sure.

MR GRENNING: Whether that competitive market is seen through an RFP process that gets three transparent offers that are then capable of acceptance or whether that competitive market is seen through volume being offered through a hub, so I can now go out and do a five year transport contract, knowing that I'll be able to regularly source my 15 TJs a day on the spot market. Both forms, as I said before, our members would be happy to have, if there are a competitive market and what we see in Australia is that neither of those options are possible at the moment.

CHAIRPERSON SIMS: Just you mentioned that you had concerns about people sitting on leases and not exploring gas, but you're also describing the market where the LNG producers are desperate to get hold of gas where prices have gone up to your members, your members are willing to pay more, they just can't get gas. So if I was on a gas lease, why would I sit on it and where do you think that's occurring?

MR GRENNING: We wonder that too.

CHAIRPERSON SIMS: I'm glad it was a good question.

MR GRENNING: And we have wracked our brains as to why there are some significant reserves in Queensland that are the subject of another matter before the ACCC that as far as our members are aware, has never been offered to domestic customers in Queensland, but there's significant resources there--

CHAIRPERSON SIMS: But have they been offered elsewhere, so that they are being offered? Or are they being sat on?

MR GRENNING: All I can say is that they haven't been offered to our members. Whether or not they're being sat on, is for others to judge.

CHAIRPERSON SIMS: But the second point that Jonathan made was leases where there's reserves not yet - there's resources, sorry, not yet reserves and they weren't getting developed and so I thought there was a suggestion of use it or lose it. If people have leases that have gas resources, then why wouldn't they invest to turn them into reserves in the market you're describing?

MR WOOD: So unfortunately we can't provide evidence here today in terms of who is sitting on reserves and as Mark pointed to, we don't understand why they would do so, but anecdotally from our members, we are - we have a concern that there is a possibility that that is happening and that's why we requested the governments review the current leasing arrangements. So unfortunately we can't offer much more.

CHAIRPERSON SIMS: No, well, one option is if you do have more you want to provide confidentially that would be welcome, but I guess I was just trying to understand in a speculative, without naming names way, why they might do that in a market like this. You're describing a market that would (indistinct) supply.

MR GRENNING: Historically, in the Australian gas market, certain producers in the past have been renowned for sitting on reserves and not offering them.

CHAIRPERSON SIMS: That still begs the why question?

MR GRENNING: I can only presume, because they think they'll get a higher price in the future and the NPV of that equation suggests that they won't offer it today.

CHAIRPERSON SIMS: Right.

MR GRENNING: On that basis, in my long experience of the gas market in Australia and Queensland in particular, there are several notable producers who have done that consistently in the past and have not sought to offer that gas for reasons that I can only assume they'll think they'll make a higher return by leaving it in the ground. Our proposal is that - that the State Governments, who control this, should examine closely the conditions under which they give these leases and consider a review of the use or lose it provisions.

CHAIRPERSON SIMS: But you're saying it's commercially rational to sit on it, or it might be.

MR GRENNING: I can understand that as the reason given by the producers.

CHAIRPERSON SIMS: Yes.

MR WOOD: I would also offer an alternative reason by effectively gobbling up reserves, effectively that's what we were pointing to, that this becomes a barrier to new entrants, whereby you grab the reserves that are available and you sit on them and therefore - and most likely these are the more easily accessible reserves - new entrants to the gas market are unable to access these reserves.

CHAIRPERSON SIMS: So that's suggesting it's NPV positive potentially to have the reserves and in an attempt to exclude competitor sellers, yes, okay. Any other questions from my left or right?

COMMISSIONER FEATHERSTON: Yes, Mark, you mentioned at one point that it would be desirable for either aggregators or aggregation services to be available. I understand one of the pipeline owners has been offering aggregation services, although I understand that might have been only in recent times. Are your members aware of those services or have had any experience of them?

MR GRENNING: We're not aware - our members haven't told us of that recent experience. I personally had experience of that in a previous life. I put in place the first aggregator based contract for CSM in Queensland, it was a ten year contract put in place in 2003 where Energex was the aggregator for a number of coal seam gas producers and that was absolutely crucial in getting the CSM industry up in Queensland. Before that, it would not have got up, because the individual developers, which were either juniors or it was coal seam gas from coal mines, simply couldn't provide the guarantees, the credit quality, the deliverability that a large offtaker, that I was representing, sought. That was absolutely crucial in the development of the competitive market and when I said before that users in Queensland had three or four years in the sun, that was when it occurred, because you had an aggregator there who was willing to step in the middle, between juniors and a large user and provide that service. If that's occurring or about to occur now, we would welcome that.

COMMISSIONER FEATHERSTON: Thank you.

CHAIRPERSON SIMS: Any other questions?

MR RENTSCH: You talked about, I guess, transparency in information, asymmetry, those sorts of things. Do you have a view on who should be providing that information or how it should be provided, you know, 2P reserves, uncontracted 2P reserves, is this a role for government that should be putting it out there. Is it some sort of honest third party or a commercial provider ASX. Have you got a view on how that sort of information should be put out there?

MR GRENNING: No, no strong view.

MR BARRESI: No, not really. Just having information to start with would be a great help, I think. We just don't know the size of the reserves and that - that just prevents, you know, a lot of the decision making that needs to be made. Can I just say, Commissioners, one of the things and I made mention of it in my introduction, perhaps it's a good place for the meeting to end anyway, is to say that, the uncertainty that we had in the last few years, a lot of our members recognised, is often the finger is pointed as saying, well the users just simply want cheap gas like they had in the old days. Our members recognise that the world has moved on.

So it's not about going back to the $2-$3 gas scenario. They recognise that's - those halcyon days are over. It was a level of uncertainty that took place, but then there was also a glimmer of hope that maybe if they - if you're able to survive the next six or seven years, that the plateauing would take place and while the prices might be high, there would be some form of stability. Just a matter of getting over that hump. Now we're facing a new world with the uncertainty of the export dollars coming in, this further uncertainty is now being imposed against us. So it just seems to me that the ground is constantly shifting for the users, but they really don't know what they - what they're staring at tomorrow. Hence why there's a real need to sort it out sooner, rather than allow the transition period to see its way through.

MR RENTSCH: Thank you.

CHAIRPERSON SIMS: Anything else? Okay, thank you very much, Phil, Mark and Jonathan, that was extremely helpful and so we appreciate you sharing your thoughts and sharing your time with us this morning. Thank you very much.

MR GRENNING: Thank you.

CHAIRPERSON SIMS: I'll now conclude this hearing.

MR BARRESI: Thank you. Thank you, very much.

<THE WITNESS WITHDREW

SHORT ADJOURNMENT

CHAIRPERSON SIMS: Okay, sorry for that slight delay. Good morning, Tony, good morning, David.

MR BLOWERS: Good morning.

CHAIRPERSON SIMS: I've just got a few formalities I need to run through, before I invite comments from you and we start the session. So this is a public hearing, pursuant to subs (95)(R) of the Competition and Consumer Act, as part of our East Coast Gas inquiry. I'm Rod Sims, Chairman of the ACCC, and I'm joined by Jill Walker, Commissioner, and Roger Featherston, Commissioner. I might just get the staff to introduce themselves, going from left to right.

MR LLEWELLYN: Jeremy Llewellyn.

MR PHILP: I'm Brenton Philp.

MR JOSE: Jeremy Jose.

MR RENTSCH: And Dale Rentsch.

CHAIRPERSON SIMS: Okay, so the hearing today is open to members of the public, and I welcome everybody here in that capacity. Today we're taking sworn evidence from people who've come forward in wanting to do so, so it's not possible to hear evidence from other people today, so by all means, we welcome you as observers, but if the observers could please refrain from asking questions or otherwise interrupting while the hearing is in progress.

Now, I've got some preliminary matters to cover. This hearing is recorded, and the transcript will be available to you. I assume you both got a copy of the notes for witnesses, is that correct? Okay. Now, the hearing is public, as I've said. If you wish to answer any question in confidence, then we can adjourn the hearing and do that, if those grounds are reasonable, but otherwise, as indicated, this is all public. Have you already provided documents to this inquiry? You have not, and do you intend to in future?

MR WOOD: Only by reference to some reports--

CHAIRPERSON SIMS: Yes.

MR WOOD: --but not - not a separate submission.

CHAIRPERSON SIMS: Yes, and we've read some of those, thank you. Now, before commencing the hearing, I wish to remind you that it's a criminal offence to give evidence that you know to be false or misleading, do you both understand that?

MR BLOWERS: Yes.

CHAIRPERSON SIMS: Yes. And I'm now required to - we require you to give your evidence under oath or affirmation.

<DAVID BLOWERS, SWORN(10.20AM)

CHAIRPERSON SIMS: Thank you. Could you please state your name, address and occupation for the purposes of the transcript? Thank you.

MR BLOWERS: David Blowers. My address is 11 Urquhart Street, Castlemaine. My occupation is the Energy Fellow at the Grattan Institute.

<TONY WOOD, SWORN(10.20AM)

CHAIRPERSON SIMS: And could you state your name and occupation, please? Thank you.

MR WOOD: My name's Tony Wood. My address is 312 Barkers Road, Hawthorn. And I'm the Energy Program Director at Grattan Institute.

CHAIRPERSON SIMS: Thank you very much for that. Now, we're looking forward very much to hearing what you've got to say, and we'll expect there's time available to pose some questions and have a good discussion, thank you.

MR WOOD: Okay. Thanks for that. Just, firstly, Grattan Institute, as I - you may already be aware, is an independent think tank. We're basically focussed on Australian domestic policy. We have no commercial interests in the industry, nor in the outcome of the inquiry. We have published two significant reports over the last two years on the gas industry.

The first covered, broadly, the dimensions of what was going on, the dynamics of both the international gas industry and what it was going to - what was happening in Australia, and in that report we spent a lot of time discussing the dynamics of the industry with both suppliers and large consumers with the gas pipeline industry and so on.

And I'll come back to some of the conclusions we reached and some of the suggestions we made for government action, because given that we are a public policy think tank, our interest is what should governments not do or do, as opposed to what commercial interests might do.

The second report took that further, it was published last year, in which we looked fundamentally at the impact of rising gas prices on the domestic market. And in particular, we delved into the household impacts, and also middle size commercial businesses, because we found quite a different story emerging when we spoke to a lot of mid-scale manufacturers, and many of them were largely unaware of some of the dynamics that were occurring in the market.

I guess overall when we look at the gas market, the term dog's breakfast seems to us to come to mind, because it seems to me that we've got a bit of a mess in 2015. We have a relatively small market, a few points of physical supply, and really a small - relatively small number of suppliers, small number of major industrial customers and a small number of retailers and aggregators, and therefore largely for the last 20, 30 years, this market, not surprisingly, has been characterised by long term contracts and foundation customers.

It's arguably the most efficient way to develop a market like this, particularly when you've got large infrastructure with long term investment profiles. Clearly there are issues as to how do you transition from a contract market to something else. It's also true in Australia that consumption of gas varies widely, both for industrial consumers, there is a relatively small number of large consumers who are particularly gas intensive, and in the same way, there is a relatively small number of households who are very gas intensive.

The majority of them in Victoria; in other states gas is used very little. And in many parts of Australia, it's probably arguable that if it hadn't been for the history of towns gas and the history of a couple of large industrial facilities, many of these parts of urban Australia would never have got natural gas. It wouldn't have made economic sense to develop natural gas facilities in the first place.

So there's been a very unusual dynamic, and I think that contrasts quite a lot with the northern hemisphere. And finally, I guess, we've also seen, even though it hasn't got as much publicity in the last five years as electricity, gas prices have risen in real terms significantly over the last five years. As with electricity, largely driven by network price increases, although there was in mid‑2012 an uplift in gas prices caused by the imposition of the fixed carbon price, and equally, there was a small reduction in gas prices mid‑2014 when the carbon price was removed.

So you've got this market which is now going through, arguably, unprecedented change. That is a painful process. In addition to the issues that are very pertinent to the Commission's inquiry in relation to the dynamics and what's happening - and I won't go into that dynamic, because that's clearly going to be something you'll be informed of already - but I guess what we would note is that in addition to that, you've also got the climate change dynamic, in which the expectations that people had that gas would be part of the solution, and you've now got a situation where gas prices are moving up, and maybe gas is also being argued by many as being part of the problem.

And so that's looking - that's added to the complexity. You've also had the community backlash in concern in relation to coal seam gas development, which has had an impact on supply. And then finally, you've seen the Asian issue, which has been largely pushed by ongoing growth, but also by the Japanese difficulties with nuclear power stations.

So when we look at this, what we see is major and rapid shift. We've seen, when we talk to customers individually and collectively, we see enormous frustration. There are many you would argue who should be well informed and should be big enough and ugly enough to do their own deals. There are many we found when we spoke to individual consumers through a number of industry associations who represent customers who have been fundamentally taken by surprise.

One could argue whether that was their own fault or not, but the reality is there are many who had expected that the ongoing stability of gas prices which they'd seen for several decades would continue, and had seen no reason to think otherwise. And that frustration itself, I think, has significantly contributed to the sort of issues that the Commission is grappling with.

And even now, we have not seen the full impact of these projected price rises at small business and household level, and I'd suggest that when that starts to happen, the political implications might still yet to be seen. And the potential for governments to feel obliged to step into the market may even become stronger, because most of the pressure seems to be coming, so far, from large industry.

It is potentially the case that gas could become uncompetitive as a fuel in Australia in the not too distant future. In our second report, we identify that for many households in Australia, it is already uncompetitive. The only barrier to changing from gas to electricity is the cost of the appliances. For many people, that sunk cost is enough to let them stay on gas for a while, but the price of gas is already a challenge. The extent to which some states, particularly Victoria, have subsidised gas to the regions, seems to be only adding to the problem, and in our view was an unnecessary use of public funds to distort the market in a particular way.

So that's been making it even more complicated. The dash for gas is not happening with the removal of the carbon price, the introduction of the ongoing pressure from the renewable energy target and the high gas prices, we're not seeing gas - a shift to gas for power generation, which is what people thought was going to happen some years ago.

And all of this results in a lot of risk, and we would suggest that when we looked at this, a lot of the issues around the tension and negotiation around contracts is about risk. Who's taking what risk in a very uncertain market. Because what's unusual isn't so much that there's a spread of forecasts of future gas prices, it is the extent of the spread. The AEMO published not very long ago projections for gas in power generation, and the scenarios aren't even close to each other. They're just dramatically divergent. And when you've got that situation, the risk issues that you have to manage, and who's got to take that risk, tend to dominate the situation.

Out conclusions from all this tended to suggest, look, on the basis, it would appear to us, that the issue is not physical supply of gas. I mean the world won't run out of fossil fuels, and neither will Australia, any time soon, and probably never. The challenge is getting that gas to market when you've got such a significant shift taking place over such a short time.

When we did our analysis, we thought that - our conclusion was that yes, you could easily produce a set of projections which would suggest the east coast could be tight, and depending on what assumptions you made, you could allocate that tightness to any geography, but New South Wales is the obvious one because of the lack of domestic supply.

It seemed to us there are multiple - still are, and then were multiple commercial solutions to that situation that could be pursued. They include, you know, more coal seam gas development, more gas from the Cooper Basin, more conventional gas, pipeline expansion, potential for storage and the potential for just demand reallocation. Some of those have been pursued, new gas contracts have been written, but equally, the very existence of things like the moratorium in New South Wales and in Victoria adds to that uncertainty, because the risk of stranded assets would suggest that people are not going to make those commitments when there's a risk that those assets could be stranded.

So in our view there is no fundamental market failure in the sense that we would normally describe it. Price discrimination to try and do something about this seems to us a form of protectionism. We don't see the case for volume discrimination, that is some domestic gas reservation policy, when you don't have a volume problem. Most likely any of those interventions wouldn't work anyway, as they never do.

A national interests test, and we said this in our report, is - sounds appealing, but there's two problems with it: (a) is most people would normally define the national interests being in their interests, and secondly, it's probably too late anyway. And thirdly, if you had imposed a national interests test, of the sort that's been proposed, the sort of facilities that people are concerned about probably would have passed the national interests test anyway, back in 2002/3, when the assets were being first developed.

So doing something after the horse has bolted is often challenging. In terms of what government should do, it seems to us in 2015 disturbing that it's taken so long to move forward with a number of things, including the trading hub issue. It seems to us that this was an issue that was addressed in the 2012 energy white paper, and it's still sitting there.

One of the arguments against it was raised by some of market participants as being a similar risk to Libor. It seems to us that was largely a smokescreen in a way of almost pushing back on the development of the concept of some sort of price index. Yes, it's not easy to do, and there would be some issues with it, but we would think they could be managed. But what's disturbing is (a) a lack of progress on a price index, and (b) a lack of - what seems to be a lack of real progress on trading hubs.

How many they should be, where they should be located, I think, is a piece of analysis that has to be done, but certainly the indications we've had is that the volume of gas flowing through the Wallumbilla would suggest that the - sorry, traded through the Wallumbilla hub, is now suggesting that sort of model should make a big difference. Because fundamentally, this is about transparency and liquidity, it seems to us.

There is an issue, when we've spoken to a number of participants, this is anecdotal evidence only, in terms of the pipeline capacity. Again, the benefits of posted capacity and arrangements would seem to us significantly beneficial, and it's difficult to see any downside. There is a serious need for a consistent national regulatory framework for unconventional gas. The formal reviews that have been undertaken both in New South Wales and Victoria suggest that a regulatory regime should be developed.

Other countries, including the United States seem to have found ways to do that, and not having that in Australia seems to be a serious issue, even if the conclusion was that we should not develop unconventional gas in Australia. That would provide more forward certainty for market participants to go ahead and develop the next best commercial solutions, even if there would necessarily be more cost.

And finally, I think there is an argument that - and we didn't go into this in any great detail, but as to whether or not the resource rent tax arrangements we have in Australia are sufficient for the sort of problem we're talking about, because a lot of the debate that takes place is around whether we should be reserving that gas for us, and the question is: who is we and who is us? It seems to us that that definition of us could be more broadly defined, in which case you'd probably turn to a resource rent tax issue, rather than some form of specific market constraint.

So in conclusion, our view has been that this is a market going through dramatic change. The industry hasn't managed that particularly well, the consumers, particularly middle sized commercial consumers, have been appallingly ill informed. One could argue they should have gotten the information themselves, but I think there's some reasonable history as to why that isn't the case. And I think the way in which the industry's handled the unconventional gas development has contributed to the problem.

And therefore we are where we are. Most of our conclusions in terms of what governments should not do and should do are in our reports, and I think I've just emphasised some of those. So, thank you.

CHAIRPERSON SIMS: Thank you. I might just ask two questions. One's to get you to elaborate, and then I'll pass to others. So you're saying that we're not short of gas, there's no volume problem, how do you react when you hear industrial users say that they can't get offers, they can only get one offer, they're happy to pay a higher price, they realise that the world's changed, but they just can't get offers. How do you react to that, and do you think that's ‌‑ well, I'll leave it at that. How do you react to that, and what do you think is going on?

COMMISSIONER WALKER: And just to add to that, also, that if they can get offers, that the prices are actually above netback price.

MR WOOD: Yep. Because we look at that sort of information, the first question I have is well, why would that - who would say that, and why. Most people don't say anything or do anything like that without a rational reason for it. And it seems to me the core of it relates to that point I made before about risk.

When you see the divergence of price forecasts in relation to gas in this region - and, you know, the factors which will influence that are easy to identify, the movements of those individual factors, and the way in which they will combine together to influence what will become the price in five years' time are complex. To the point that, arguably, possibly - are not easily predictable, let's say.

Therefore the question is who's going to take the risk around what seems to be quite a large price divergence. And that's where I think the debate is, and when you get people talking about the sort of contract terms and the acceptability or otherwise of those terms, I would suggest the issue really is about who's going to take what risks, and under what terms they'll be taking those risks.

Now, you could argue who should take those risks, should they be - is it fair for a large producer to expect that a gas consumer should be sufficiently informed to be able to take that risk. Arguably not. But I'm not sure that leads to any obvious conclusions as to what government should do about it. I think it's the natural dynamic of the market.

CHAIRPERSON SIMS: Well, yes, but, sorry, let me just rephrase the question, perhaps. I mean under oath people are saying to us that they're just not getting offers, or if they are, they're getting one offer. Now, you can question whether those statements are true, and I think to some extent you are, but - so I guess you were just saying that you don't think that is the - I mean it's one thing to say who takes the risk, but--

MR WOOD: Yep.

CHAIRPERSON SIMS: --if who takes the risk is the issue, then you get four or five offers, and they've all got different risk profiles, and you have a negotiation over risk, but I guess when people say they're not getting offers, they're only getting one offer, it's take it or leave it, it's only there for a short period of time, I'm not sure that's a risk issue, is it?

MR WOOD: Well, we've had - to try and give you some specific examples, we did have some difficulty getting people to be prepared to be "on the record", although we do have some who were, and we quoted a couple of those in our report. Where, for example, in regional Australia, you would have effectively a single supplier, and the argument partly was, well, you've got a town like Echuca in Victoria, no other gas producers were going to put in the effort to set up a marketing team and set up the necessary facilities to deliver gas to Echuca, and so those consumers were basically given one offer, by their current supplier, and they were significantly higher, you know, the sort of numbers that you've seen quoted, but 60, 70, 80 per cent over two or three years.

A dramatic increase. Particularly for some manufacturers who may have in good faith, not expecting that, just recently invested in upgrading their facilities and were stuck with gas. And they are almost as stuck with the problem as some of the very large manufacturers. So I mean that dynamic is ‌‑ I think is real, and reflects to some extent the nature of the physical market. And you could argue that therefore, is that a competitive market?

Now, what we didn't see is in those cases, customers who've been prepared to, or gone to the effort of saying okay, well, now I'll go and talk - how do I go and encourage, you know, if I'm in Echuca, and my supplier is company X, well, why don't I go and get companies Y and Z to give me a quote? And they just - most of the time they said they hadn't thought about it yet, they were stuck, they were too busy, they were just frustrated.

In relation to the - and we saw a number of examples like that. One company that had a business in Mildura and in Toowoomba, company A supplied in Mildura and company B in Toowoomba, they wouldn't go the other way around. Company B, the supplier in Toowoomba, would not quote in Mildura and vice versa. Again, largely because they said look, it's not worth our risk, our effort to go and do so.

CHAIRPERSON SIMS: We've had examples where people say that they used to get three, four, five offers, and now they're getting zero or one. So it's not a question of traditional--

MR WOOD: Yep.

CHAIRPERSON SIMS: --always being reliant on one supplier.

MR WOOD: We've had exactly the same stories. When you talk to the other side, they would argue that we have made offers, that it's just all about the terms of the offer, and we - to be honest, on that particular issue, we heard exactly the dynamics you've described, Rod, and could not conclude that there was any evidence, for example, of collusion or obvious exercise of market power, in a sense, it just seemed to us that this is an industry that is stuck in a pretty hard place at the moment, and yes, the business - the customers were faced with a really horrible outlook.

The dynamic from the producers seemed to be more about, well, you know, if we've got - we are committing to large volumes, in some cases difficult to tell whether they're - to what extent they're commercially exposed in relation to the confidence with which they're going to meet their contractual obligations, they would have told you stuff about that I'm sure, and you could speculate otherwise. So are they really in a position where they can't offer gas, and why would they - if they could offer gas, why would they not? At a price that they'd be prepared to offer.

It just seemed to us that the idea that you would have - even though there are small numbers of producers - simply not making offers stretches credibility, even though we were told that. It just didn't seem to me to be - to us - to be a completely credible consistent outcome, even though we heard the same anecdotal stories.

CHAIRPERSON SIMS: All right. Interesting. As I say, we are taking evidence on oath with the various--

MR WOOD: Yep.

CHAIRPERSON SIMS: --people we're talking to. Tony, just to elaborate, and I may have missed it, so I apologise, I heard the points about trading hubs and price transparency, but you then - and this is where I may have missed it, but you then said there's got to be improvements to the regulatory regime, I think. Could you just elaborate - or maybe I've got that wrong. Perhaps you could just summarise, what do you think governments should do? I think that's - your focus on governments is particularly useful for us. What do you think governments should be doing?

MR WOOD: Right.

CHAIRPERSON SIMS: And I think I've got a pretty clear idea what governments shouldn't be doing.

MR WOOD: Right.

CHAIRPERSON SIMS: What should they be doing?

MR WOOD: Okay. There are two - a couple of which are mostly to do with the ones which are dealing with supply.

CHAIRPERSON SIMS: Yes.

MR WOOD: There is a - one of the difficulties in this country is that we do have a federal system. That has some benefits, but it also has some challenges, and so, you know, we seem to have a situation where we don't ‌‑  we are not capable yet of coming to a single consistent national framework on unconventional gas development, and that seems to us to be a very poor outcome. Comment on that was - that was my comment about regulation.

There is a need to develop a robust regulatory regime. At at the extreme, if that was a decision not to develop gas, now I can understand why it might be not to develop gas under certain conditions, in certain places in Australia, then so be it. But to us, the biggest issue wasn't the technical or environmental arguments about unconventional gas, the biggest issue was the uncertainty created by the moratoria.

And clearly in this state, the moratoria, which extended to conventional gas, seemed to be driven purely by short term political - and I don't mean political in a pejorative sense, I mean political in a real sense. I mean there was political pressure, and there still is, in regional Australia, against coal seam gas development.

So I mean I understand that, but it is very unfortunate that that's created this degree of uncertainty. It's the uncertainty that places a barrier to the development of other forms of conventional gas, arguably more expensive, but creates more uncertainty, and therefore that would be adding to the sort of issue we were discussing before about the capacity for, say, second tier producers to be able to make offers capable of being accepted by consumers.

And so to some extent that's also why you've seen some large consumers linking with - taking some upstream risk themselves by taking a position with the gas producers. I think the other two which we are specifically - and others have referred to these, but we looked at the trading hub question.

Clearly the amount of volume being traded through the short term trading mechanisms is very small, mostly overs and unders, whereas clearly the - there seems to be some evidence that over time the Wallumbilla Hub was developing, it needs to develop more quickly, and I don't know what governments can do to try and incentivise that, although AEMO would be the body, obviously, to pursue that. And equally, the issue of a published price index.

I think I said before it seemed to us this was an issue that had been raised now three or four years ago, very little progress seems to have been made, and it did seem that some of the participants in the current market were putting up some reasons particularly around, you know, Libor and there's some - the evidence was that, well, there would be the risk that the participants could manipulate the market, and therefore we should slow down.

And I think that is easy to say, but we would argue that creating some further momentum in that space would be important. And the same thing would apply to pipeline capacity. We certainly have - and I'm sure you've had anecdotal evidence that it was difficult to get information, even, about pipeline.

So how much ‌‑ so for example, if I've contracted ACQ or MDQ against the pipeline, but I only want it for ten or 15 days a year, I'd be in a very strong position to sell that gas for the rest of the year to other shippers, and yet those other shippers don't know who I am and can't find that capacity, even though some of the pipeline operators suggested that was working okay, there was plenty of arguments to say it wasn't working okay.

And it would seem to be hard to see a downside as to why having a more transparent market in that context wouldn't apply.

CHAIRPERSON SIMS: Is that something government would need to insist upon?

MR WOOD: Yes.

CHAIRPERSON SIMS: I mean--

MR WOOD: Yes.

CHAIRPERSON SIMS: --like (indistinct) and all that stuff.

MR WOOD: Yes.

CHAIRPERSON SIMS: Yes.

MR WOOD: Yes. And then the other one - and I confess to being ignorant on where this has got to - was the issue of joint marketing. It seemed to us this was a historically justified but now largely irrelevant arrangement that should be terminated. Whether it would make a fundamental difference - but I think a lot of the things we've been talking about aren't going to change the fundamentals of what's going on in the market.

What they would do is improve transparency and liquidity, and that would to some extent ameliorate what we found was just the sheer frustration and anger coming from the consumers as a result of the way this has been allowed to develop. So a lot of the - a number of the things that could be done are as much ‑ as is this inquiry - as much about opening up this market to greater transparency as fundamentally solving a supply and demand issue.

And, you know, I don't - the bit I don't recall is I understood that the Commission had extended the joint marketing arrangement for the Gorgon venture to this year. I'm not aware, because I haven't followed it up, to be honest, as to what the outcome of that has been. But it seems to me that joint marketing should be confined to the dustbin of history.

As the market moves from fundamentally a contract market towards something else, which may in the long term be a spot market, more like electricity, and may at some point even be imposed as a spot market, I'm not suggesting we should be there yet, but the journey, the transition is the difficult issue, as to how we - what are the steps along that journey, and the things I've talked about that government should do are part of the steps along that journey.

COMMISSIONER FEATHERSTON: You talk about transition, Tony, but I wasn't perfectly clear whether you saw or accepted that there was a current shortage of supply, or whether you were accepting that there may be a short term issue on supply, but in the long term you would have expected that to resolve itself, effectively.

MR WOOD: I think the answer to your question is yes. What I mean by that is the size of the market and the size of the reserves - and you know, you're always going to be dependent upon the published reserves, and the argument about 1P, 2P and all that stuff which just gets buried in technical jargon, to some extent, but on the numbers, it would suggest that - and given there's the potential for a lot of other gas which hasn't - I mean there was the report that was published the year before last on the potential for shale gas in Australia, so I don't think the issue was ever going to be an issue of molecules.

The question is how do you get the molecules out of the ground, at what price, to a market which, you know, historically has been very small. And that's what we've got, is this wrenching adjustment. And adjustments like this are painful, and what we're seeing is some of that pain. And it's real, I'm not in any way, you know, again, decrying that pain is real, and for some industries who have been used to 3 and 4 dollar gas, eight, nine, ten dollar gas is a big deal. But I think the issue is really going to be around price.

I don't think the arguments that well, the price was going to go up anyway, even if we hadn't had the LNG, maybe, but it wouldn't have risen as quickly and as sharply as we're seeing at the moment as a result of this adjustment. So I think there's that - that's real, and when you've got a still - a relatively immature market, I mean it wasn't that many years ago where we had four or five isolated gas markets, with, you know, individual - we had, you know, the Surat Basin supplying Brisbane, the Cooper Basin supplying Sydney and Adelaide, and the Gippsland Basin supplying Melbourne.

That's not very long ago. And the development in the infrastructure is still relatively immature and so you can't quickly move that from one to the other. But our argument would be that it's not - it's about how the market responds to that, rather than about is there physical gas. And that's why I think arguments for anything that even looks like domestic gas reservation are pretty weak. But again, you know, that's - the issue seems to be more about price and about risk.

COMMISSIONER FEATHERSTON: But there is that time dimension, obviously--

MR WOOD: Yep.

COMMISSIONER FEATHERSTON: --you can identify reserves in the ground, but there's obviously in many cases, you know, five or six years--

MR WOOD: Yep.

COMMISSIONER FEATHERSTON: --to actually produce gas and deliver it to the market.

MR WOOD: Indeed. When I first moved to Victoria, I was told by the then state government department that was responsible for supply that they weren't factoring gas into the long term supply of Victoria, because they were going to run out, based on 2P reserves. Now, that's an argument about as sophisticated as my kids saying when I get home tonight we're going to run out of milk. Go and find some more. So I mean--

COMMISSIONER FEATHERSTON: It may be simplistic, but by the same token, if you've got large industrial users, they might not be able to survive if they don't have physical gas for the time it would require to actually produce more molecules out of the ground.

MR WOOD: Yeah. Look, I think the - I've not yet - I've heard very, very powerfully presented arguments as to the dynamics of the negotiations between suppliers and customers. When you try and penetrate that - we've tried to penetrate that, and you've got, I suspect, greater disclosure mechanisms than we certainly have, it tended to sift through your hands. That, you know, a commercial deal could be done.

But, you know, it seems to me that you've still - if you've got a situation such as that a major manufacturer, particularly where gas is the feedstock, you don't have too many choices, and you're going from three or four dollar gas to ten to 12 dollar gas, this is a very unpleasant situation, and you may very well be in a situation where it no longer makes sense to manufacturer your widgets in this country. That was my comment before about the potential future of gas in this country, as a domestic source of energy.

I think it's a real question as to whether - what the nature of this will be when we have such a small market. And comparing our market with the US market, where you've got - you know, it's almost the reverse, doesn't help very much. So I think the - you know, the question is if it's true that we are faced with that dynamic as you describe, what the hell does government do about it? Is it appropriate for the government, on behalf of the community, for the government to take the risk on behalf of the community, that maybe gas - if the argument is this is a short term - and short could be four or five years, as you mentioned - a short term issue that gas will return to something maybe between $4 and $10, who - is it appropriate that the government on behalf of the community should take that risk? And I would say no.

CHAIRPERSON SIMS: Other questions?

MR JOSE: You mentioned joint marketing, I was just wondering the extent to which you examined the arguments that have been put forward in the public domain at previous inquiries as far back as Parer around the practicalities of doing - so separately marketing in a market such as the Australian one.

MR WOOD: Yeah. I should say, and I probably should have said at the outset, I've - in my own personal case, I've worked on both sides of the industry. I was - worked with Incitec Pivot as a consumer and with what is now Origin as a supplier, so I have - I should - that history informs to some extent by response to the question.

But I think the argument that as with contract markets it makes sense at a time, and as with, you know, even governments at times underwriting things like pipelines, as they have done, you can see - maybe you can see an economic argument at the time.

The arguments against it seem to be, as they often are in these cases, that it would be administratively costly, and those costs would be passed through to the consumer to remove the joint marketing, to no longer be allowed to put a joint market. I think that is a case that's difficult to justify, I think that again, to some extent where the market's got to now, there's been, you know, we've had individual marketing already in some cases, and it's as much about the perception as the reality in this particular case.

I'm not - we weren't convinced that, you know, removing joint marketing or the arrangement for joint marketing would somehow dramatically change the price outlook. But it would certainly start to move in this direction of greater transparency, and - not so much liquidity in that case, but transparency, and that seems to be when a market's going - when you've got a market with a small number of suppliers and customers, transparency is a big deal, and therefore the arguments in favour of greater transparency and therefore removing joint marketing seem to me to be much more powerful in 2015 than the arguments based upon what I would think was a relatively small cost that would be borne by the producers to market separately.

MR LLEWELLYN: Just on the question around information transparency and the frustrations that are being felt around the market, the AEMC's latest stage 1 report flagged a price index of some description being developed, potentially, at the end of the year.

We understand that might be by the ABS and it might be something which just shows a percentage change in prices over time. Did you have any thoughts, having said you worked on both sides of the fence for an industrial user, as to what level of detail of pricing information would be required? Is a whole of Australia aggregate price the sort of thing that would assist the industry, or not?

MR WOOD: I think that this is one of those evolution type questions, again, because what will have to be done is a balance between such a small data set that there's no - even though someone's aggregated it, it's pretty obvious where the numbers are coming from. You know, if it's one - for example, the most extreme, if it was one state, one supplier, one consumer, no one has to ‑ there's no point, really, and if it faces risks - including being commercially problematic.

The other extreme would be to say, well, what's the point of aggregating numbers that actually don't relate to each other? So for example east coast/west coast. You know, we've - it isn't - the issue isn't about the dynamics of the price. So I'll give you an example, in the Australian LPG industry, which I used to play - the contracts were written in a Saudi contract price.

Almost nothing to do with the dynamics of supply and demand in Australia. To some extent - in fact they were countercyclical. When the northern hemisphere price was going up because of the northern hemisphere winter, the southern hemisphere price was going down. But the issue wasn't about that, the issue was how do you link it to some sort of fundamental movement. Not where the absolute level is.

So it seems to me that an east coast price index ‌‑ now, whether or not it's one or two or three, this comes back to the trading hub question I suppose, but I would have thought between the number of contracts that are in place and the amount of information that's available, an east coast market index could be developed. With - initially it would be, you know, it wouldn't be precise, but it would be something that could evolve over time and become more sophisticated.

Immediately it'd happen, the market would adjust and find out ways, people would write contracts, they'd hedge around it, all the things you see with markets. It's when the - it's in the pre‑establishment of such an arrangement that all the criticism will come. Well, you can't do it this way, you can't do it that way, they'll give you all the reasons why it's a terrible idea, and there'll be all these risks. As soon as the government says we're going to do it, then as with all markets, industry gets on and plays the game.

So I think the issue is to make it reasonably simple to start with. I think the ABS is as good an example as any I've heard of, certainly my conversations with the AEMC I understand why they've suggested that, and it seems to me a good place to start. Would it be perfect to start with? No. But it would be a damn sight better than what we have today.

CHAIRPERSON SIMS: Today, just to follow up, where would you start on the trading hubs short term market problem? What would you like to see happen next?

MR WOOD: I think how - in Australia, whether or not you'd end up with two or three trading hubs, I mean I - we saw back in early 2000s, late 1990s, a number of the American companies that came and bought into the gas industry in Australia who wanted to move immediately to a spot market with multiple trading hubs, and without any local understanding whatsoever, I mean basically the industry in Australia basically chewed them up and spat them out, as far as I can see.

But that's changed. And I think the - I'd certainly start with the Wallumbilla trading hub. I think from what I - the anecdotal - the conversations we've had with some of the major producers and consumers and aggregators is that they're seeing more credibility around that, they are seeing more volume being traded through that market, and that could be pushed harder, and it just seems to me a great pity that it's taken so long.

CHAIRPERSON SIMS: Pushed harder in what sense?

MR WOOD: Well, in terms of--

CHAIRPERSON SIMS: Getting back to role of government.

MR WOOD: Yeah, I mean I think the government does have a role, through AEMO in particular, to you know - go back one step, the COAG Energy Council should be a vehicle for identifying and accelerating energy market reform. And in this case, these are the sort of issues that the COAG Energy Council can do something about. I mean--

CHAIRPERSON SIMS: Just what can they do--

MR WOOD: Well, I think what they should be--

CHAIRPERSON SIMS: --Tony, I'm just trying to understand.

MR WOOD: Yeah. AEMO should - the answer is - here's the answer.

CHAIRPERSON SIMS: Thank you.

MR WOOD: We want multiple trading hubs. We don't care whether it's one, two or three. We want AEMO to develop a plan in which we have a fully ‑ we have a trading hub arrangement in which the outcome is visible, transparent market.

We accept that there's going to be contracts around the edges for quite some time yet, maybe quite a lot, and we want AEMO - I would be saying AEMO should come forward with a report as to what needs to be done and what are the barriers to doing that, as a matter of urgency, and then the COAG Energy Council should be the vehicle to push that.

But AEMO should - there should be a defined outcome, which is an act of ‑ and transparent trading market. Whether or not you need to be specific about, you know, how much of the volume in the market, or - you know, there's ways of measuring that, is an issue that would have to be thought about, I haven't thought about that specific issue in particular, although I'm inclined towards it, to sort of - you know, we need to get from a - what is now around the short term trading hub a very small percentage of the market that's actually traded to - and I'm not saying it should be a hundred per cent by any means, but--

CHAIRPERSON SIMS: But government - sorry, I'm - but government potentially, I mean you could see a role for government in some way requiring volume to go through those hubs?

MR WOOD: Yep. Yeah, the outcome should be that there is now - the difference is - here we are now in 2020, we now have trading hubs in which a substantial proportion of the traded gas on the east coast of Australia is traded through that hub. Now - because the - you could go the - the other - positionas we did with the electricity market, of going to a spot market, 100 per cent, tomorrow.

And that's an alternative. I don't think it's yet a particularly attractive alternative, because I think that this market has still some ways to go, and the difficult question is whereabouts on that journey do we need to get to next. And therefore you do choose what appear to be somewhat arbitrary numbers. So it's a bit like 20 per cent of our energy by renewables by 2020.

There's no logic to it, it's just a marketing term, right, so what you need to say is, at some point, we think getting towards a 100 per cent, maybe, of the gas should be traded through a spot market. In the next - between now and 2020, five years' time, maybe the number needs to be 30 per cent.

CHAIRPERSON SIMS: Yes.

MR WOOD: That sort of - I'd choose some numbers that look like that, rather than - and there's no arithmetic precision about that. It's basically we are heading in a direction, and the pace of which may still - is difficult to tell. I mean, you know, we may find that once we get through this next five years things are substantially better and we don't have some of these problems, but I think that's what I'd be doing. And I think AEMO is the right vehicle to really push that, and the COAG Energy Council would be the way to push it.

CHAIRPERSON SIMS: Just to, though, follow that up, and I might - well, I'll put it this way, I mean in the electricity market, of course, you had the transition from government owned vertically integrated - so in a sense once you saw a transition, that you wanted a transition to a competitive market, in a sense the problem was in the hands of government, and government had to do something.

MR WOOD: Yep.

CHAIRPERSON SIMS: Here you've got largely, if not fully, privately owned commercial players on both sides of the market. But what I hear you to be saying, at the severe risk of putting words in your mouth, although I think these are more or less your words, that you do see a market failure in how we get from where we've traditionally been with long term foundation contracts to a more active trading market, and again, I'm putting words--

MR WOOD: Yep.

CHAIRPERSON SIMS: --in your mouth, it'll either take too long or won't happen, and the market needs this, so the government should step in and intervene, to put it in the clearest way, to address the market failure through some form of mandated market movement through those hubs. But that's what you're recommending--

MR WOOD: Yep.

CHAIRPERSON SIMS: --and you're saying how that's done, you can't go to 100, but you've got to pick some sensible number, and you've given the example of 30. That is a significant government intervention, I was just trying to make sure--

MR WOOD: Yeah.

CHAIRPERSON SIMS: --I've fully got all that.

MR WOOD: No, I think that's right. And I think the - if you look at - my understanding, and I'm not an expert on this, what happened in the US, they basically did impose a market, and there are costs, there are consequences of that. So if you were to overnight say we're going to go to a hundred per cent, effectively to create a version of the NEM, then there would be significant costs in the adjustment process.

I think we can see physical and commercial reasons why we don't have to do that, but of course it is more difficult so set these numbers. I think it is a - it is an intervention by the government that is entirely justified, and if there was a Hippocratic Oath for policy makers in energy, the first line of which says do no harm, this would be one in which I think it would create benefits, and not too much harm, and that's what we need to do.

And I think there's a - a lot of the other things that have been suggested would certainly breach that energy Hippocratic Oath. And we've seen that too many times in the energy sector, I would suggest.

CHAIRPERSON SIMS: And do you think that your experience, having been on the other side - I don't know which is one side and which is the other, but having been on the producer side with Origin, and obviously talking to producers, that producers would have major problems with government intervening in that way to set up a mini NEM, if I could use your term?

MR WOOD: Yeah, look, I --

CHAIRPERSON SIMS: Which I think is a good term, by the way, I think it--

MR WOOD: I think the - every time government intervention in any market is suggested there will be somebody who will identify the fundamental structural scaffold that's holding the sky up is about to be removed. Most of the time it's not true, and it's amazing how quickly as soon as a decision is taken on where the market's going to go next, the industry responds quickly, and markets get on with life.

The real trick for the government is to ensure that that sort of market intervention is thought through, so that the unintended consequences, of which there will be some, have been identified as best you can. Because if they're unintended, of course you don't necessarily see them, but we've seen a lot of evidence, for example, you know, the Queensland Gas requirement some years ago had the wonderful unintended consequence of being one of the drivers of the coal seam gas industry.

CHAIRPERSON SIMS: Yes.

MR WOOD: That wasn't what the intention was.

CHAIRPERSON SIMS: No.

MR WOOD: And the same thing has happened over and over again, so if you're going--

CHAIRPERSON SIMS: (Indistinct)--

MR WOOD: --to intervene in something--

CHAIRPERSON SIMS: --consequences.

MR WOOD: Exactly, yeah. So if you're going to do this, then I think - this is one where it's difficult to see downside, although I would expect that there will be - in the same way that industry participants argued when the idea of a posted price index was being suggested, oh, well, that's a good idea, except we're seriously worried about Libor risk. Now, it seemed to be that was an interesting but largely a smokescreen.

And I think there will - I'm sure there will be issues raised, but I can't see these days, in 2015, and actually back in 2001/2, as I mentioned before, I think it was arguable, particularly when we didn't have a lot of even the pipeline interconnections we have today, that there was hardly any benefit, and there would be a lot of costs associated with moving towards the sort of market that we've just been talking about.

I think today, even though we do have issues of supply and we do have issues with not perfect interconnection, the market has developed to the point that a ‑ we should be on that journey. And the next question is what's the next station. And I think the government needs to be - this is one role where government could be a catalyst for doing that.

CHAIRPERSON SIMS: I guess I hear you saying we're going there anyway, so there can't be too many costs in speeding it up.

MR WOOD: Indeed. And it would make - it would fundamentally make an enormous difference to what I think as being the major problem here is the transparency and the frustration that's been caused by things which are largely out of the control of many of the participants. But that doesn't mean that it's not real and not frustrating.

CHAIRPERSON SIMS: Have you guys done work on how all that - what that government intervention--

MR WOOD: No.

CHAIRPERSON SIMS: No, I understand. No, and that's perfectly sensible. Any further queries from the Bench, as it were?

COMMISSIONER WALKER: I've got one, just a follow up, going back to the joint marketing issue, I guess what I'm just - you were saying that all these different things are sort of adding a bit to liquidity and could add a bit to liquidity and transparency and making the market work better, how do you see that with the joint marketing, I mean given that they're jointly producing anyway, and in particular does it relate to the issue that you were talking about before in terms of the great dispersion of price predictions and risk and so on, is that how it would help, if you've got multiple players with different predictions?

MR WOOD: I think you might have answered your own question. That's where it sits, because when you look at it - and when we first looked at it, again, my background is coloured by this to sort of say, well, you know, these guys, as you said, they're all in this together anyway, so why would there be any difference?

It turns out that when you form a joint venture, there are certain parts of - there are certain reasons why you formed the joint venture. You're not the same company, right, you're not - there are different drivers. There's an overlap, but there's all the other parts of your businesses. So when you look at that, each of the - most of the time, I would suggest, the members of the joint venture, or the members of the joint development, will have some interests that are the same, which caused them to come together in the first place, which has developed this physical resource, but they'll also have a whole lot of other things going on.

So what that means is when they come to do their contractual and commercial arrangements, all of that together will affect how they put forward commercial arrangements for customers. And so therefore you will see differences. You won't necessarily see, well, they'll all offer exactly the same amount of gas, exactly the same price, exactly the same escalation, extremely the same dah dah dah, exclamation.

They won't, because there will be other things - some of it will be the same, because obviously they're going to use the same physical facility, but there'll be other bits, because of their own commercial interests are divergent. So ‌‑ and not negatively, but just realistically, commercially.

COMMISSIONER WALKER: Yes.

MR WOOD: So I would suggest that that means that you will see greater ‌‑ you will see some separation. Not necessarily on the absolute price, but as you've already heard, it is not only about price in this case, as a lot of this is to do with the term of the contract, the escalation clauses and the risk sharing that might or might not go on. So I think that's where the joint marketing makes sense. To remove it makes a lot of sense, and you would see an improvement in the way that market operates.

CHAIRPERSON SIMS: All right, well, if there's nothing else, look, thank you very much for your time and your thoughts. We have seen those other papers, they're very good reads, so thank you very much for your time, I'll now close this hearing, thank you.

<THE WITNESS WITHDREW

SHORT ADJOURNMENT

CHAIRPERSON SIMS: Shaun and Kieran, welcome. I've got a few formalities before getting you to make some statements and then having a good question and answer session. This is a public hearing pursuant to subs 95R of the Competition and Consumer Act as part of our East Coast Gas Inquiry. I am Rod Sims, chairman of the ACCC and on my right is Jill Walker and on my left Roger Featherston who are also commissioners and we're presiding over the inquiry. I'll get the staff assisting us to introduce themselves.

MR LLEWELLYN: Jeremy Llewellyn.

MR PHILP: Brenton Philp.

MR JOSE: Jeremy Jose.

MR RENTSCH: Dale Rentsch.

CHAIRPERSON SIMS: As I've explained earlier, probably equally to the same people assembled, but this is a public hearing but we're here to listen to those giving the sworn evidence and it's not possible to hear evidence from other people today so as I've mentioned earlier I'd ask those who are here to observe to refrain from asking questions or otherwise interrupting. If they want to appear as witnesses then we can certainly arrange that.

A few other preliminary matters. This hearing is being recorded. A transcript will be made available to you. I just want to confirm that you have received a copy of the notes for witnesses? Yes? I think a bit of a yes would be good for--

MR DONOGHUE: Yes.

MR COLE: Yes.

CHAIRPERSON SIMS: Thank you. Now as I say while the hearing is a public one if you have anything you'd like to say to us confidentially then please raise that and we can consider that and if necessary convene in a different way to hear that confidential evidence. Have you provided any documents to the inquiry or have you or will you?

MR DONOGHUE: We made a public submission.

CHAIRPERSON SIMS: Right, actually I think I've got that, yes. Just going past my script there. Now before the hearing commences I want to remind you that it's a criminal offence to knowingly give false or misleading evidence. Do you understand that?

MR DONOGHUE: Yes.

MR COLE: Yes.

CHAIRPERSON SIMS: Now we require you to give your evidence under either oath or affirmation.

<SHAUN COLE, AFFIRMED (11.33AM)

CHAIRPERSON SIMS: Thank you. Could I get you just to state your name, address and occupation, thank you?

MR COLE: Shaun Cole, 50 Market Street, Flinders Lane, Melbourne, Energy Supply Association of Australia.

<KIERAN DONOGHUE, AFFIRMED(11.33AM)

CHAIRPERSON SIMS: Thank you, could you please give your name, address and occupation as well?

MR DONOGHUE: I'm Kieran Donoghue, I'm the general manager of policy at the Energy Supply Association which is located at 50 Market Street, Melbourne.

CHAIRPERSON SIMS: Excellent, thank you for that. Now we'd very much like to hear from you and then we'll follow up with some questions, so over to you, thank you.

MR DONOGHUE: Thank you. We just have a brief opening statement so first of all I'd like to thank the Commissioners and staff for providing us with the opportunity to present at today's forum. The Energy Supply Association of Australia is the peak industry body for the station energy sector in Australia and represents the policy positions of the chief executives of 37 electricity and downstream natural gas businesses.

As such our members have interest in gas pipelines, distribution networks and storage assets, our gas shippers and retailers and are major users of gas as a fuel source for energy generation - electricity generation. While the association does not explicitly represent the interests of the upstream gas sector, a number of our member businesses also have upstream interests including in gas resource development and production. Nationally our member businesses own and operate more than $120b in assets, employ more than 59,000 people and contribute $24b directly to the nation's gross domestic product.

Much like the market itself the associations analysis and perspectives on the east coast gas market have been evolving over time. Since 2010 a key strategic priority for us has been to understand the changes underway on the east coast as well as the challenges and opportunities that come with it. The east coast gas market is undergoing an unprecedented level of change. Production costs are rising, political uncertainty is hampering onshore gas development and the LNG industry is challenging historical gas market dynamics.

As conventional gas resources diminish the LNG export industry will be a key driver of continued resource development in Australia and provides a level of demand and capital that will drive this development of significant and high priced gas resources and deliver significant economic benefits.

LNG exports also change the competitive environment beyond simply introducing a competing source of demand far in excess of current domestic demand, LNG exports are changing the contracting environments in other ways. They're opening the east coast to export markets which opens it also to convergence towards world prices. Contract terms may vary from previous market norms as competition to access supply increases.

In a transitional period with some uncertainty about the extent to which LNG project owners will self supply there is likely to be a weighting towards shorter term contracts as parties will be unlikely to wish to make long term commitments. These factors may lead to domestic gas buyers being asked to assume more risk both in terms of the overall gas price and volume of supply. The periods straddling LNG start up is particularly challenging in this regard since domestic buyers are being required to take a position on the future price path of domestic gas while the market is still in a state of transition.

Given the nature of these challenges it is clear that key to alleviating any supply in pricing pressures is continued resource development. It will also be important to ensure downstream gas market arrangements remain fit for purpose and continue to drive competition across the supply chain and facilitate access to supply.

Making up around 88% of the proven reserves on the east coast onshore conventional gas is posed to be a major contributor to domestic gas supply in the future. Unlocking the access to this gas is the issue. Development of these resources has been constrained to date mainly due to political uncertainty and overly restrictive planning laws and regulation frameworks. This is despite several independent inquiries making it clear the risk imposed by the onshore gas industry can be safely managed.

This environment has severe implications for the timeliness and diversity of supply. It creates barriers and risks to investment at a time when continued resource development is essential. With regards to the flexibility of downstream gas market arrangements we believe that broadly the facilitator markets and pipeline transportation arrangements are generally working as intended but there is scope for improvement.

The facilitated markets are generally considered to be beneficial to the extent they provide a market based mechanism for managing short term trading positions. They also assist with providing participants with access to gas in the initial phase of market entry. But the complexities and pricing risks associated with trading in these markets may diminish their overall value. They expose market participants to risks that cannot be effectively hedged. Differences between facilitated markets also create an added level of complexity for businesses operating across different jurisdictions.

Reducing transaction costs and minimising the risks associated with trading in these markets could support market development and ensure they deliver value to market participants in the future. This could also pave the way for the establishment of financial risk management products and ultimately a reliable price index.

Flexible and transparent access to pipeline capacity is also important for the development of a liquid and transparent commodity market, where access to capacity is impeded this creates the risk that the benefits of more flexible short term trades are missed. The value of these trades may grow as gas market dynamics continue to evolve.

However there are risks to be considered where the property rights of existing capacity holders are potentially compromised. It's unclear that implementing some form of mandatory trading would deliver the efficiency gains necessary to justify that level of intervention.

The trade facilitator model recently developed for the South West Queensland Pipeline, Roma to Brisbane Pipeline and the Queensland Gas Pipeline is an important initiative in this regard. It demonstrates the ability of industry to respond to changing market needs in a targeted and light handed manner. A key benefit of this is avoided regulatory intervention and unnecessary costs.

On this basis an incremental approach to reform has appropriate regard for existing contracts is sensible. This approach provides a better balance for risks and benefits relative to more heavy handed reform options and would likely be consistent with supporting industry led reform. There are a range of processes currently underway examining these issues and developing and mapping out any future market reforms continued industry engagement is

essential. Thank you.

CHAIRPERSON SIMS: Thank you. I've got a couple of questions and then others will, thank you. You mentioned that the markets moving to very short term contracts. Does it concern you that if you're a domestic user of gas to underpin investment you need long term contracts and how do we solve the problem if indeed you can't get them?

MR DONOGHUE: I mean it's clear that the initial development of the gas industry, both in sort of shoring up supply and demand was facilitated by long term contracts and that such contracts no doubt will continue to have value. In our role as users of gas I think it's hard to see how for example a new gas fired power station could effectively get financed without some clarity on the price and volume of access to gas. Long term contracts will be in a sense sort of the easiest and most reliable way of achieving that.

Obviously to some extent where there is a good deal of liquidity in the market if there are forward price curves then that may lessen the reliance on long term contracts, although it's not likely that you'd see those sort of go out beyond say five years and I'm sure there are - I'm not aware of any examples internationally of forward price curves that would go out the sort of ten or 20 year timeframe that might be useful.

But we - no, we don't currently have those conditions in any case so there definitely will still be key to the long term health of the gas market and the question is and we're in many ways less well informed then you are with the information you've received from market participants to evaluate the extent to which this appears to be a temporary dynamic due to a relatively short term period of uncertainty as the LNG market merges and that one will settle down in a couple of years if we have a - you know relative clarity on the likelihood of whether any new trains are going to be added, if there's relative clarity on the production rates of fields, particularly the fields that the LNG exporters are most reliant on and if we have clarity over the ability to access onshore potential reserves and resources particularly in states such as New South Wales and Victoria that are effectively blocking that. Then we could revert to a new paradigm where there is long term gas contracting.

We're not in a position to say definitively whether it's just transitional or whether this is something that's going to be endemic for the foreseeable future.

CHAIRPERSON SIMS: I guess just reflecting on the previous witnesses from the Grattan Institute and I'm verballing them badly although I think reasonably accurately because I did it when they were here. The argument that I think I heard them make was that we need to move from long term foundation contract markets given the inherent risks and change in the market, we need to move to a much more liquid transparent market. The comparison was made with the change that was done in electricity where a market was create, I mean very different circumstances.

MR DONOGHUE: Yep.

CHAIRPERSON SIMS: I think I heard the view that if that's where we've got to get to it's a bit difficult for market participants to on their own bring that about because someone might not do something before somebody else does something and in any event there's a free rider and all those other lovely economic term problems where someone does something but someone else doesn't but they enjoy what the other person's done.

I guess my question is I was picking up that perhaps you don't see a role for government, but let me just pose the question do you see a role for government to in a sense help engineer the shift to more active markets, given that as you say yourself there's really not much by way of an ability to hedge in this market. It's merely the normal ingredients of an active market, a transparent tradable market just aren't there?

MR DONOGHUE: I mean that's a - I think it's a very open question in terms of what the range of things that government might - governments might see that they could do to engineer a situation. So I think we would prefer to be - I guess to get down to some of the more specifics you know we're still oriented towards greater reliance on the markets and the industry to find a way through this transition.

We I think our industry remains to be convinced that heavy handed government intervention into many of the areas of the - across the supply chain would prove an effective solution. I mean there are - I mean some of the more obvious dynamics are the more restrictions are pushed - put on gas producers and potential gas producers, the risk is that you reduce their incentive to take the trouble to explore and produce from new sources.

So for reasons like that we have historically not been in favour for example of ‑ in favour of a gas reservation policy preferring to--

CHAIRPERSON SIMS: No, I was talking about create trading - sorry, go on.

MR DONOGHUE: I'm sorry, just telling specifically--

CHAIRPERSON SIMS: My question was quite specific about trading to actually help create the market. In some senses it's been government action that has created some of the facilitated markets that we've got now.

MR DONOGHUE: Yes.

CHAIRPERSON SIMS: Where governments require things in a sense. If you think about a market where everybody's required to put their gas through it, it's pretty hard to do that voluntary really.

MR DONOGHUE: Yep.

CHAIRPERSON SIMS: Round that question. I wasn't talking about the other issues. I think I anticipated your answer on those.

MR DONOGHUE: So in terms of specific trading I guess I'll perhaps start with commodity trading. I guess the issues are that the existing facilitated markets, particularly the STTMs have - by being mandatory have imposed costs on participants simply to effectively pass gas from one side of the market to the other. We did a calculation a few years ago, I'm not sure that it's - the figures would have materially changed, that if you sort of looked at the cost for per gigajoule of gas that actually changed hands at the STTM, given that everyone is paying the fees, it was around a dollar per gigajoule which seems to be a pretty high transaction cost.

Now we appreciate that to the extent that that provided some form of liquidity of the market that wouldn't have been there before that allowed perhaps new buyers to come in and buy gas on a more flexible basis which may in turn have sort of assisted competition in other markets such as the small retail market for gas, then you know it is possible that the benefits do outweigh the costs. But I guess I use that as an example of where that kind of intervention can be quite costly and induced a relatively small amount of trading at the margins.

CHAIRPERSON SIMS: I'm pushing a line just to have a discussion rather than have a view, which is my normal way for those who know me but probably misleading to those who don't.

MR DONOGHUE: Yep, sure.

CHAIRPERSON SIMS: Presumably those markets just wouldn't be there had the governments not done something. It's hard to see a private movement to set up STTM markets without government doing something, so without the government intervention that we've had we wouldn't even have these markets. I could listen to your explanation and I certainly understand your calculation there, there's very little volume at the margin traded.

MR DONOGHUE: Yep.

CHAIRPERSON SIMS: Therefore just divide that by the costs, $1 I understand that number. You could say on the three options I guess one is leave it as it is and that high cost continues. Another one says scrap it because of this high cost and another one says well force more volume through, that will lower the cost. Any comments on that?

MR DONOGHUE: Well one of the comments to the STTMs I'm not quite sure how the third option would work.

CHAIRPERSON SIMS: I'm not either and neither was our previous speaker but that's all right.

MR DONOGHUE: Yes, what I understand is that they have all that gas that sort of passes through that city gate has to be if you like offered to the market so it's the total volume of demand as opposed to say the voluntary hub at Wallumbilla where parties can trade and obviously government through the aegis of the Australian Energy Market Operator has you know caused that to be set up. The parties that don't wish to trade but simply wish to flow their gas through Wallumbilla are not obliged to pay the trading costs.

Wallumbilla's a good example of where the sort of getting sort of absolute liquidity at that hub is not just about the market design or whether it's mandatory or voluntary but also to some extent about the physical capability of switching the gas between different pipelines when certain parties have capacity rights on each of the relevant pipelines and not everyone else who wishes to trade automatically does. It's my understanding that it would be ‑ you'd actually have to build more pipelines at the hub in order to facilitate the maximum potential, sort of different flows of gas that might arise from - that might arise from trading so there's an actual material physical investment that would need to be made and the question is then how would it be recovered if it's - and the Australian Energy Market Operator is not a - if you like a risk taking organisation that would say well you know we'll underwrite it and effectively take the bet that we can recover it in voluntary market fees.

Again if you try to ensure recovery by you know imposing some kind of mandatory trading you know a la the NEM or the STTMs then again you're imposing costs on participants who simply wish to flow the gas through and we have some concerns about the value imposing those costs on participants.

CHAIRPERSON SIMS: I totally understand that. I guess the question for government is whether where we are is a comfortable place.

MR DONOGHUE: We certainly - we're supportive of I guess the framework by which the AEMC is examining the markets, but we're supportive of looking for opportunities to harmonise the markets, looking for opportunities to design the products traded at those markets in a way that are more amenable to developing a product index and a forward curve and you know think that those things would all be beneficial to the market over time.

Pretty much all that activity has tradeoffs so we - you know we're very careful about being cheerleaders for anything the government might do in the market development space because inevitably in doing so it is likely to impose costs on core participants and may affect existing property rights. Certainly if you wish to get more liquidity and transparency then it's hard to see how that would be done without affecting property rights to some extent.

CHAIRPERSON SIMS: I understand that, I mean the price index is of course one thing. The other thing is you mentioned a forward curve, well the forward curve's irrelevant unless there's volume around it.

MR DONOGHUE: Sure, yeah.

CHAIRPERSON SIMS: So to get volume will that happen through the market or does the government need to do something I guess is the question and I guess I'm hearing you to say you'd rather they stay out of that area.

MR DONOGHUE: On balance, yes.

COMMISSIONER FEATHERSTON: Can I understand the ESAA's position correctly that basically you think that the existing pipeline capacity arrangements are working reasonably satisfactorily and any enhancements to that or improvements in secondary trading is something that you think the market will develop? There's no need for any concerns in respect of those aspects of the market?

MR DONOGHUE: I mean I think we're comfortable with governments or government agencies kicking the tyres on the arrangements and you know it's - given that we're going through a change in dynamic it's - we don't see it as inappropriate that governments explore whether there are barriers under the existing arrangements that could be removed without materially impacting existing property rights.

The - we have developed a somewhat interconnected pipeline system through the - through the interest largely of long term parties writing long term contracts in order to underpin the financing of those assets and we think you know that's the - that's served the market well. We - you know we encourage the initiatives by the pipelines to establish voluntary secondary markets.

One thing that we have found quite challenging to get to grips with I guess is the real extent of those markets. There is the opportunity to offer secondary capacity or to purchase it. It appears to be happening to a relatively limited extent at the moment and it's very hard for us to get a real grip on whether that's a fair reflection to the underlying demand for that changing capacity or whether there are other barriers that might be inhibiting participants from contracting that capacity to the fullest extent.

To put it another way when there is notionally spare capacity because the existing capacity holders don't wish to use all their capacity are those normally the times when other parties want to or does the demand tend to coincide with effectively the lack of supply at peak gas flow times?

We discussed this with our members and we find it's very challenging to get to the bottom of that and you're no doubt better informed in many ways than we are from the evidence that's been provided to you confidentially.

COMMISSIONER FEATHERSTON: It's been suggested to us for example that greater transparency in that regard would actually facilitate people with an ad hoc capacity coming together with people who have a demand for capacity.

MR DONOGHUE: I think that's certainly a question we'd be happy to sort of work through as part of the reviews. You know we're an industry that's subject to a very high level of information provision from governments and it tends to only go in one direction. For that reason we're reluctant to simply say yes, more transparency because that always entails an information provision requirement on market participants and there are costs to doing that. Sometimes they may appear to be nugatory compared to the potential benefits but we know we're reluctant to get too enthusiastic about additional regulation on the sector. We're certainly happy to work through a consideration of the costs and benefits of doing so.

COMMISSIONER FEATHERSTON: On another topic did you want to comment upon joint marketing arrangements? I understand the ESAA's position on that is that you believe that joint marketing should not be permitted is that right?

MR COLE: No, I guess we have a slightly more nuanced position than that. I think in - we've generally had a reasonably strong perspective in Western Australia given I guess the different market characteristics over there. There's a heavy reliance on one dominant producer. The market is not quite as developed I guess as the east coast is. So from that perspective it's not entirely clear to us what sort of impact joint marketing is having on the east coast. In that sense I guess we would take more of a principled approach to it, that sort of takes into consideration I guess the ability of producers on the east coast to manage their risks and to that extent what is - to what extent is joint marketing having an impact on competition within the region.

So I guess we wouldn't be definitive in saying that that we have a problem with it but we just think that those are the factors that need to be taken into consideration.

MR DONOGHUE: I think with a reference to Western Australia as an example, there would seem to be sort of something of the chicken and egg is our understanding that the rulings to date have been predicated on the lack of an effective market in Western Australia. It also seems to us that allowing joint marketing doesn't do anything to help that - help that market along by you know maintaining that concentration of suppliers.

We know that in the interim since the last decision made by the Commission you know there has been a bulletin board and other sort of basic arrangements put in place in Western Australia so we'd certainly be very interested to see how the Commission approaches any sort of joint marketing renewal application in the future.

COMMISSIONER FEATHERSTON: All right, thank you.

CHAIRPERSON SIMS: Questions?

MR LLEWELLYN: I had a question. Just on resource development, perhaps one of your less nuanced positions might be you have some strong views around concerns as to the commerciality of resources are assessed. That's just something I picked up in the submissions that you've made recently that--

MR DONOGHUE: Is that particularly with reference to retention lease applications?

MR LLEWELLYN: That's right. I was just interested in exploring further what sort of - your concerns are around the transparency if it is that of the process or sort of changes you think could be made in that area. I just go further, in terms of information transparency issues across the sector, is that one of your members strongest concerns?

MR DONOGHUE: Again I mean I think it's an area that we'd sort of observe particularly at play in Western Australia and I'm not aware that it's emerged quite so much on the east to date although that doesn't mean it won't in the future. It was our understanding that retention lease applications were ‑ appeared subject to very little sort of tension in terms of the proponent, had very wide scope to present the case as to why they wanted to retain the lease which involved you know effectively saying it's not quite commercial for us to develop now but we believe it will be you know at a point in the future and you know we felt there would be value in those claims perhaps being more thoroughly tested.

I mean to be clear we see a legitimate role for holders of leases to seek to extend the lease and again coming back to the point about long term contracts it seems consistent with that that producers may wish to sort of meet long term contracts by progressively working their way through different leases that they - different leases that they have.

But clearly if in practice there's no real practice of retaining leases that means that supply is becoming constrained and that is having - that is impacting on the competitive dynamics then you know we think there is a role for considering what lease retention is doing to the market. It's our understanding that there hasn't really - that kind of - sort of hasn't been applied to retention leases in the past in a practical sense.

CHAIRPERSON SIMS: Any other? Well I had one while people are thinking. I'm just curious. I think we all understand the issues with the barriers to development of gas. They're pretty visible.

MR DONOGHUE: Yep.

CHAIRPERSON SIMS: And to quote Jeremy's term I think your position on that is not going to be nuanced is a way of putting it. I accept all that.

MR DONOGHUE: Yep.

CHAIRPERSON SIMS: I'm just interested I guess in whether you judge with your knowledge of the market that would have made any difference, anything that's happened there would have made any difference to where we are right now. Now you could ask me back why does that matter, I'm not sure why but I guess I'm just thinking out loud that whatever barriers there are to development would affect production in the future and they've been in place so long whether it's only two or three years in the future but nonetheless the situation we've been in over the last year or two presumably and this is a question I'm sorry to put it that way, would that have been much affected by all of this or was this, where we are now something that was inevitable?

MR DONOGHUE: I mean I guess depending on sort of how you view the timing it's possible that some of the transitional challenges we're going through that some of the prospective new resources might not have come on, on time, given that it takes time to do that. Although you know particularly - that's particularly I guess the case in Victoria where we have a moratorium before anyone's really sort of had a chance to try and get any production going.

Probably a bit more pertinent in New South Wales where you know what were you know existing projects in the sense of there being already development activity in not - hasn't always got to production. Where we're seeing those being constrained, I mean those options are going to be - the lack of those options are going to be sort of felt more in the near term.

But certainly in the long term it's hard to imagine that giving greater opportunity to a range of potential participants, we know that some of the junior players have been focusing on attempting to access some of those onshore facilities. Hard to see that it wouldn't have done anything other than improve the competitive dynamic of supply. I think we'd certainly firmly reject the counterview that has been put that any molecule of gas that's developed onshore east coast is just going to get vacuumed up to Gladstone. I just don't think that's a plausible assessment of the opportunities. So we would - our view would be that it's you know - it will have a detrimental impact on domestic supply.

CHAIRPERSON SIMS: Why are you so strong on the fact that it would not get vacuumed up to the - to use your term, to the LNG market?

MR DONOGHUE: Well I think there is - I mean part of it is you know amongst the producers or the groups looking to produce you know included organisations that have a strong history of supplying domestically, so they're not simply the companies that sort of came with a view to building an export business who may or may not have an interest in you know augmenting that with domestic supply. So I mean we're talking about you know organisations that have historically been domestic suppliers, have ongoing customers, have a reason to supply.

I'm talking about supplies that are you know relatively close to a load centre in New South Wales, particularly with reference to Sydney and Newcastle and therefore you know the transportation costs of getting it to that market are materially lower than getting it to Gladstone. Perhaps I - perhaps I slightly overstated given that we're talking about hypotheticals but the logic of the market would seem to strongly suggest that some at least of those resources would be - would ultimately flow to the domestic market.

CHAIRPERSON SIMS: I guess looking back and getting to that logic by a historical look obviously those suppliers were supplying domestic market pre LNG so it's hard to rely on that evidence I guess. Do you have any perspective on some of the points that have been put to us and no doubt will in future continue to get put to us in terms of companies - domestic users of gas not being able to get any offers or only one offer or inflexible offers? Do you have any commentary on that? As I say probably not something necessarily affected by the moratoria that we're talking right now.

MR DONOGHUE: Sure.

CHAIRPERSON SIMS: Those projects affected by that wouldn't be in play now, would be producing now.

MR DONOGHUE: I mean it's not for me to gainsay users on what they consider their experiences to have been. It's - I will observe that I believe Arrow have publicly declared that before their takeover by Shell and PetroChina they had sought to effectively monetise the resources they had through seeking partnerships with large domestic users and have not been able to do so.

If I note that that seems to be - to be one route and I can understand why users might feel it's a particular - it's a more complex and risky route than they've been used to in the past for some of them to access gas would be to underpin domestic - domestic gas development, particularly with some of the prospective onshore - you know again I note that there may be a period of a year or two years where that doesn't you know - before that came on stream and therefore it wouldn't necessarily solve all their problems right now.

But I'd observe that - you know that is clearly an option that is open. I acknowledge that it would be - it's a different kind of option from simply going out and getting a supply contract, but it's you know sort of exploring further upstream in that - you know in that respect in terms of sorting seeking access to gas would be a logical - logical approach for large domestic gas users and their opportunities to do so are being constrained by the constraints on onshore gas development.

CHAIRPERSON SIMS: I guess just one - I wasn't aware of Arrow, of that statement you made about Arrow so I might through this just ask the team to chase that up and if you've got that information--

MR DONOGHUE: I'll see if I can find it. I'm pretty confident it was a comment made to the press.[[1]](#footnote-1)

CHAIRPERSON SIMS: --that would be very helpful. I think we'll no doubt be talking to them at some stage but I wasn't aware that they had tried to do that. I'll ask the team to make a note of that one as well. Look I guess there's always the complexity I suppose when talking about markets and government intervention again it's a difficult issue I suppose for governments when people are saying they can't get supply offers. That doesn't suggest a very forming market but I take it your view is that's just a transitory problem?

MR DONOGHUE: Well as I say it's very hard to diagnose particularly seeing as we you know - from our perspective some of those comments are hearsay and I don't mean to say that to be critical of those making them. But unlike us you had had access you know to particular contracts and had you know comments given to you under oath of what people's experiences of the markets are.

Certainly I agree that if that is people's experiences then that is understandably a source for concern. Due to the oversupply in the electricity sector we're not - you know we're not as an industry running out trying to prove up lots of gas contracts for brand new coal or gas fired power stations right now but if you know the supply and demand balance changes and we are doing then you know our members with those interests would certainly be keen to see a competitive dynamic of offers from potential suppliers.

CHAIRPERSON SIMS: I think it's fair to say the concerns aren't coming from anybody wanting to use gas for electricity. I think they've quickly worked out there's other ways of doing that. It's more for the manufacturing sector who are making the comment.

MR DONOGHUE: But we as an industry potentially have a role to play and I think within the ability of the existing arrangements have been playing that role in as much as gas - gas fired electricity has been lower for a range of reasons and you know there is an opportunity I guess for some of that gas to find its way back to domestic users who wish to use gas (indistinct)

CHAIRPERSON SIMS: And has of course.

MR DONOGHUE: Yeah, exactly.

CHAIRPERSON SIMS: Very important large gas fired plants been closed down and that gas being made available which is a sensible market. Any other questions?

MR LLEWELLYN: I just wanted to ask a question around information availability. So I suppose through this inquiry we're trying to obtain specific examples of issues with information within the market. We hear a lot of comments that information - there are issues with information in the market. Things aren't transparent and I guess trying to get more specific information. Look I don't know if you can give us those specific examples but I just wondered if in general you had any views on - I'm sure you have users who say more information is required and other users who say we shouldn't have to provide that information potentially. I guess I've got two questions. The first question is do you have any broad comments on the information that's out there?

MR DONOGHUE: This is a market with relatively few buyers and sellers and so I think that some participants in particular are confident in their ability within that context to effectively extract enough information from a range of sources to be able to sort of make reasonably well informed decisions. But I don't think all participants - you know perhaps particularly some of the newer participants in the market are quite so confident. I guess I'd observew2 that you know electricity is probably the outlier rather than gas in that respect. You know because we have a gross pool and various other regulations we have an immense amount of information transparently available in the electricity market.

Most other commodity markets - we as far as I know don't. I mean there obviously is information available through indices that have often emerged by industry initiative and I'm sure - I'm sure you've sort of gone through that thought exercise yourselves as to you know what should we expect gas to be like? Should we expect it to be like electricity or should we expect it to be like you know iron ore or crude oil or other - or wheat or other major commodity markets.

CHAIRPERSON SIMS: It's a liquid and have spot markets?

MR DONOGHUE: Sorry?

CHAIRPERSON SIMS: Liquid and have forward markets, I just mention those two.

MR DONOGHUE: Yeah, absolutely and those are clearly very useful tools of participants in those markets. I guess that comes back to the question as to whether that is precisely what is needed in this market or not.

MR LLEWELLYN: Just the second question that's just picking up on something you've said to us or the AEMC to our issues paper was that it wouldn't be reasonable to impose requirements on CSG and LNG proponents and not on the upstream sector more broadly. Just wondering what exact requirements are you referring to there?

MR DONOGHUE: I'm trying to recall the context of that remark. Can you?

MR COLE: Yeah, well I think that - that was an issue that I think - I don't know if it was raised in the ACCC paper or in the AEMC, their paper. But our point I think was essentially that you need to be clear about what information you're asking them for and to what end. So I guess what are you trying to achieve from imposing additional requirements on the LNG proponents that you're also not imposing on the upstream sector more broadly.

MR LLEWELLYN: All right, sure.

CHAIRPERSON SIMS: All right, so is there anything else you wanted to cover?

MR DONOGHUE: No, I think we're fine. Thank you very much for your time.

CHAIRPERSON SIMS: Well thank you Kieran and Shaun. Thank you very much for making the time available and giving us those views, very much appreciated.

<THE WITNESS WITHDREW

LUNCHEON ADJOURNMENT

CHAIRPERSON SIMS: So we've got the Australian Industry Group, welcome. I want to just make a few preliminary comments, ask a few questions before we get underway, thank you. These are quite formal processes. This hearing is conducted under subsection 95R of the Competition and Consumer Act and, as part of our East Coast Gas inquiry, I'm Rod Sims, Chairman of the ACCC. Jill Walker is a Commissioner, Roger Featherston as well. We are, between the three of us, conducting this inquiry. I'll just ask the staff members to introduce themselves.

MR LLEWELLYN: Jeremy Llewellyn.

MR PHILP: Brenton Philp.

MR JOSE: Jeremy Jose.

MR RENTSCH: Dale Rentsch.

CHAIRPERSON SIMS: So, as I said earlier, and I think to the extent the audience is staying the same, is getting sick of hearing the same thing, but anyway the hearing today is open to members of the public, but today it's all about hearing from those who will be giving sworn evidence. So, as I have said, we're very delighted to have observers here, the more the merrier, but as I've said before I'd ask them to refrain from intervening into the process.

This hearing is going to be recorded. A transcript will be made available to you. I just need to confirm that you've been given a copy of the Notes for Witnesses.

MR REED: Yes.

CHAIRPERSON SIMS: Thank you. As I've said this is a public hearing, but if at any stage you've got anything you want to say confidentially then, subject to us assessing that, we can reconvene in a different format, but otherwise this is all on the record. Has - I think it has actually, but has your organisation provided any documents to the inquiry?

MR REED: We have not provided a written submission at this time.

CHAIRPERSON SIMS: Yes, I think I've seen a couple of your documents that have been made generally available.

MR REED: That's right.

CHAIRPERSON SIMS: Which is what confused me. And so you don't have anything additional to provide now, I assume?

MR REED: No, that's correct.

CHAIRPERSON SIMS: No, okay. So, look, I need to just remind you that it's a criminal offence to give evidence that you know to be false or misleading. Do you understand that?

MR REED: I do.

<TENNANT REED, AFFIRMED(1.22PM)

CHAIRPERSON SIMS: Thank you. Now if I could just get you to state your name, address and occupation and then we'll be underway.

MR REED: Tennant Reed of 1107 Hoddle Street, East Melbourne, Policy Adviser.

CHAIRPERSON SIMS: Thank you. We're very keen to hear from you. Over to you, thank you.

MR REED: So the Australian Industry Group represents a very wide array of businesses but many of the businesses that we represent are energy users. Well all of them are users, many of them are significant gas users.

CHAIRPERSON SIMS: Yes.

MR REED: And so we have been interested in developments in the east coast gas market primarily for many years. Over the past five years or so there has been a special interest and concern in an expected substantial uplift in price in the market and also serious questions about supply in the market arising in connection to, but not exclusively attributable to, the commencement of gas exports from Queensland. There have been other factors at work as well, but that has been the single largest driver of change in the market and one that has attracted a great deal of focus on understanding what's going on and what might happen next on the factors that may be exacerbating the situation and on the potential solutions.

Some of the work that we have done we have done in collaboration with other industry bodies, including the Energy Users Association, who I note you heard from earlier today, and so what I will say today is adding to, or on top of, the statements that you will have had from them. Broadly what we have seen is a fairly consistent concern from members over the last few years that the terms on which gas was available were very difficult to deal with, that prices were rising very rapidly, that if they were looking for long term secure supply arrangements those were very hard to come by.

Now there was a lot of anecdotal evidence of that several years back. We conducted a survey to try to put some more numerical foundations in the debate, and the results of that survey were published in a report which you may have seen already.

CHAIRPERSON SIMS: Yes, we have.

MR REED: It's publicly available on our site. So without going into a full recapitulation of--

CHAIRPERSON SIMS: No, no, but still bringing out the main points, yes.

MR REED: Certainly. The report and the underlying survey dealt with the needs that gas users were trying to fill, including the lengths of contract for which they were looking, their ability to secure offers in the marketplace, the kinds of price that were being offered, and there was some additional analysis there on policy and on other factors.

So the key findings out of that report were that there genuinely was a widespread experience of difficulty in acquiring contracts - offers of contracts in the gas market. Now I should say the survey was conducted a couple of years ago now and we have had a lot of ups and downs in energy policy and energy markets in that time and that's a subject to which I'll return in a moment. But the findings at that time were that of the businesses that we surveyed there was wide diversity in the kinds of contract for which they were looking.

Some were just after relatively short duration contracts, one year, two year. Many were after substantially longer contracts. And that will tend to reflect the size of the gas use involved and its centrality to the operations of the businesses concerned. Certainly for the largest gas users they are interested - they really require very long term contracts to underpin their long term business plans. They can make do with shorter temporary transitional contracts but there's a fair amount of risk to them in making decisions on the basis of short term contracts.

The finding around the ability to secure offers was that nearly a third of businesses were able to get an offer from more than one supplier. And that's the ability to secure an offer from more than one supplier is, from a consumer's point of view, a hallmark of a competitive market. Around a quarter were able to get an offer, but from only one supplier. Nearly a third were reporting that suppliers were not making serious offers which in the framing of the question could have gone to many matters including not just price, but also the duration of the contract, very likely terms around take or pay arrangements, which are frequently a sore spot for consumers, and the quantity of gas available to the contractor for the period of time that was required.

And then nearly 10% reported that they were unable to get an offer of any sort, even an unreasonable one. So, in terms of the prices that were being reported by those who were able to secure offers, generally there was agreement that historic prices were in a - the wholesale price component were in a $3 to $4 a gigajoule range. The averages for short term contracts which were to commence in 2013 and were two years or less was a little under $5.50 a gigajoule. So a significant uplift from the past, but not yet reaching the levels that had been projected and anticipated to result from the linkage of the east coast market to international markets.

But for longer term contracts, contracts that were to either last for more than two years or were to commence after 2013 the average was more than $9 a gigajoule that was being offered at that time,[[2]](#footnote-2) which then was at the upper end of the projections for prices. Projections, as I think we've all seen plenty of evidence of in the last few years need to be treated with caution, but certainly we were seeing at that time whenever a price projections exercise was run the projections would come out higher each time and a more rapid rise was anticipated.

When we and a number of partners commissioned modelling of the impacts of these price rises, now nearly 18 months ago that process began, the assessment that we made with advice from Deloitte and also advice from the Department of Industry was that price projections over the next couple of years of wholesale prices reaching $9, $10, $12 a gigajoule were a reasonable scenario to consider.

What I think I should turn to now though is the significant uncertainty that is confronting I think all players in the gas market, producer and user, at present. Whereas a year ago the future looked relatively clear, if from a user's point of view distinctly bleak, what we see now is as a result of the steep decline in global oil prices a set of circumstances where we don't have as much confidence in predictions around what domestic gas prices are going to be over the short and medium term.

The markets to which Australia's eastern gas market is becoming linked, and other markets have already been linked, is to East Asian gas markets where gas is traditionally priced against oil. And while there had been some moves in other markets to move away from oil linked pricing it has been fairly durable in East Asia. So the assumption was that high oil prices meant we would see inevitably high gas prices being brought back into Australia through the expectations of producers that they would get a comparable return whoever they were selling to.

Now as far as we're able to judge, and we're not experts in global oil markets but there are at a very simplified perspective on the oil/gas linkage, the netback price for gas exports might actually be below production costs at current oil prices were they to be sustained. That's an enormous turnaround. That would be an unsustainable situation. How that plays out we don't understand yet. Nobody really knows how long gas prices - sorry, oil prices can remain at the depressed levels that they are at now.

They, according to most analysts, are below the costs of new production from many major sources, whether that be much of the much talked about US shale oil resource, or oil sands in Canada, so it appears to be the case that when substantial new production is required prices will have to rise to justify that. But, as we have seen and as we are seeing right now in the eastern Australian electricity market long term unsustainable prices can nonetheless be sustained for quite a while if demand is weak enough and if additional supply is brought in by means other than the strict operation of the central market mechanism.

So with oil demand a lot weaker than many would have expected some years back with major economies taking a different development path and with circumstances like the apparent re-entry of Iran to a significant role in global oil markets it could be that weak oil prices last for some time. Certainly we will have no idea until - until it happens, and we will probably argue about why it happened even after it does.

So the significance for the eastern Australian gas market is which of the many possible avenues of impact of that on price and supply predominate because on the one hand a lower export price would suggest that domestic consumers would face a lower price to compete with that source of demand. However the incentive to produce more gas, to explore for more gas and bring it to market is not very high when prices are so low internationally and analysts are saying certain companies would be worth nothing if prices were sustained at that level.

When you combine that with the political and regulatory and social barriers to new unconventional gas production in much of the country it may be that the supply situation is very unhealthy regardless of the ups and downs of oil price linkage and so looking at this from the point of view of our members, and we've been consulting with them about what they are seeing in the market, they are in a state of confusion.

The supply adequacy issue which our survey, other than highlighting the difficulty of getting contract offers, dealt with that exclusively from the perspective of users and not trying to make some kind of bottom up assessment of the sources of supply in the market and so on but there have been serious worries about the amount of gas available. Official projections of inadequate supply have been revised down or eliminated for different regions of the market over the past six months or so. However our understanding is that that incorporates a substantial projected reduction in demand significantly attributable to a price response.

Now we're not sure about where prices are going. We're not sure about where demand is going if we're not sure about prices. So the result is we are not sanguine about the supply picture. The only thing we know is that we don't know what is going to happen in that respect. But if supply - physical inadequacy was avoided largely through, as appeared to be the case in the projections from the market operator some months back, largely through a shrinkage of industrial demand consistent with the modelling done by Deloitte Access Economics for us and other associations last year, a loss of industrial production and a switch by electricity generators from gas to coal, that would avoid a physical inadequacy. It would not be the ideal way to avoid a physical inadequacy of gas supply, we wouldn't be comforted by that.

So that's a flavour of where we have seen the market at and where we see it at now. Some individual members have reported to us recently that if seeking short term gas contracts - we've heard of individual businesses that have been able to secure those and at prices that while they are above the levels being reported even two years ago are not in the $8 to $10 range that projections were suggesting. Issues around take or pay and over the commercial workability of contracts remain significant.

We have also heard from large users, much larger users looking for longer term contracts, that conditions remain extremely difficult. And while we don't obviously speak for the upstream industry we would certainly think that if the market looks as confusing and uncertain to energy users as it does, it probably doesn't look much better to producers in terms of their willingness to take a risk by locking in a contract.

Some users have signed oil linked contracts, explicitly oil linked contracts, in recent years, typically for shorter periods or for smaller quantities of gas, and they did that with a heavy heart. They may have had, not being privy to the details of their contracts, they may have had a pleasant surprise in the last few months. But the future is pretty foggy as to whether those will wind up being a good deal for any of the parties concerned. I might leave the opening statement there and make myself available.

CHAIRPERSON SIMS: I've got a couple of questions just to kick the ball into play, a narrow set then a broader set. The narrow set really does go to the price I guess, and there's two parts to it. I'm particularly interested in how much your members expected the price to go up once we had the international link and really how much the statements around not being able to get offers or not being able to get offers you can accept, how much that's just price based if they were on $3.50 a gigajoule gas and someone came along and said it's 6.50 or 7.50, making up numbers.

MR REED: Yes.

CHAIRPERSON SIMS: Because that's I guess a different story to the fact that no one is really willing to supply, that would show willingness to supply just at a price you don't like. So how much do you think the difficulty that is in your numbers, which of course you're not privy to each company's detail, but can you get a sense from interacting with your members that those who say they only got one sensible offer and those who say they got no sensible offers--

MR REED: Yep.

CHAIRPERSON SIMS: --how much that was due - I mean I'd put aside the ones that didn't get an offer at all, but the others in the other two categories, which I think is about 60% of your response base, how much of that do you think was just price and in which case you had a willing seller, possibly keen seller, but your buyer just didn't like the price versus how much was it just so restrictive other terms that it was really not possible of being accepted?

MR REED: So, as you say, the survey data themselves can't resolve that question.

CHAIRPERSON SIMS: Yes.

MR REED: My sense from members with whom I've spoken is that there's certainly a widespread lack of sympathy for the view that the prices that they're paying should be reflective of anything other than what can be negotiated between the parties and a reasonable return for all. And, you know, some of them will say, "Well my supplier's costs haven't gone up, they are still getting gas from the Bass Strait or the Cooper, or wherever, at more or less the same cost they were getting it before. If they raise the price too much I'll - I can't do business here. Why won't they - why aren't they willing to just make an offer at a price that enables them to still have a customer here?" There's some of that.

In terms of however the statements that they are unable to get an offer, that's a different matter. I don't have a sense from the members with whom I've spoken over the last several years that when they say "can't get an offer" that they mean just, "Well, I was being offered netback--

CHAIRPERSON SIMS: "I can't get a reasonable offer."

MR REED: Well, yes, yes. When they say "I can't get a reasonable offer", they don't just mean "I could get an offer but it was at netback pricing." They mean insofar as they refer to price it is - there have been offers that seem to have been deliberately pitched to be rejected, prices well above - again for what they are worth - projections of where the market was going. But mostly the feedback that I've had is that the difficulties go to the volume or the time period for the contract, or to matters such as take or pay, that whether they reflect the - I should be careful about speculating about the motivations for these terms and offers, it might be that they represent - and we certainly have thought it very likely that they represent - uncertainty on the part of producers as to whether they would be able to meet additional domestic demand.

And there has been serious concern about that notwithstanding recent projections of supply adequacy. There has been a widespread view that the LNG projects in Queensland have to some degree been short of the gas that they required to meet their export commitments and that that was why they were going in and purchasing gas from fields in South Australia and so forth that otherwise would have been expected to be produced for the domestic market. So that is a factor that - probably the single biggest factor that users have ascribed to the difficulty.

CHAIRPERSON SIMS: So I guess, well, one comment and then another question on the price, clearly if you're trying to buy apples or car engines or whatever you realise you're going to have to pay the international price because if you aren't doing that why would someone not just - I mean if your members were in that position presumably they would prefer to take - they'd take the highest price, so I can't imagine your members have any great problem with people who have a resource getting the price that's available.

MR REED: They understand the commercial interests at stake.

CHAIRPERSON SIMS: Yes.

MR REED: There is a difference however between the - it's very easy to fit what's happening in the east coast market into a neat and idealised framework of how markets ought to work and to say we've got a market here that is linking to a global market and there will be a global price. But the global - there is no global gas market. There are a set of quite different markets with different drivers, many of them heavily shaped by government policy. The drivers of price in the East Asian markets are very different to those in the North American market and different again to the European market.

And so another important issue though is that the capacity of the east coast export sector, enormous though it will shortly be, is limited; there is only so much gas that can be exported per year through the three major projects. And it is entirely imaginable, though there are barriers in the way of it, that a gas producer or an investor considering whether to put their money into gas production could say, "Well I can't necessarily get more gas out through Gladstone, I may not be able to get a Korean landed price or a Chinese landed price or a Japanese landed price, but I can get a domestic customer who is willing to pay a fair bit above my production costs, that's worthwhile."

Now we have never sought, and I'm not aware of any group representing energy users who has sought a whole series of detailed mandates to ensure that that situation came about. The view that we have had is that if gas production is regulated in a way that the community can have confidence in, that allows producers to produce if they meet standards that are expected of engineering, of treatment of land owners and so forth; if that is the case and more gas is able to flow into the market, and if you have a gas market and gas distribution system that is as competitive as it can be, that is the best hope that energy users have.

One scenario would be that gas producers are extremely happy to pile in and produce more gas and exceed the amount that can be exported. The assumption that the export channel will eventually expand to fit available supply is very likely not to be the case in practice because of the costs of constructing additional LNG capacity in Australia versus other potential destinations, uncertainties about demand and, right now, very unpleasant certainties about price in some of those destinations and the great exposure that investors who - existing investors already have to Australian conditions.

CHAIRPERSON SIMS: Okay. Could I just ask you to perhaps just explain what you think the main reforms to the market you'd like to see, if any, versus letting the situation work itself out? Is there anything you think that governments should do in relation to the situation?

MR REED: So I would stand by the platform that we and a number of associations, including the EUAA, advanced last year which went to reforms on the network side, on the price transparency side and on regulation of matters like joint marketing. So to expand briefly on those, the network situation is one in which probably like most of this area there is a contest of views and versions about what is going on, but our feedback from members is that there is a real difficulty. Some members have been working with producers, second tier producers and would-be new entrants to bring gas to market.

And one of the concerns that they have - they have plenty of concerns, many of them to do with the production side, but one of the concerns they have is difficulty of getting that gas to market.

CHAIRPERSON SIMS: Yes.

MR REED: Now the appropriate solution to that, there have been some calls for the principle of "use it or lose it" to be applied to contracts for pipeline capacity. There have also been concerns that that would be a very intrusive step and could be construed to involve an acquisition of property and raise a range of issues. There appear to be other approaches available, including the “oversell and buy back” approach that is in use in the UK, and that I understand is part of the reforms that the AEMC had raised with it and may be considering.

Our view on the network side is that of course we should be very cautious before intervening in contracts and up-ending commercial arrangements that appear to have suited the parties making those arrangements, but that there is enough importance to a pipeline system that not only is physically adequate, but is in practice able to be accessed that reforms to encourage more trading of pipeline capacity need to be part of the solution. And that if those don't deliver then down the track we will need to look again at - if there is a significant physical underutilisation of the network then more intrusive steps might need to be looked at.

CHAIRPERSON SIMS: Right. And when you say force oversupply and buy back, that's a way of getting liquidity in the short term market?

MR REED: That's right. So with respect to the issue of joint marketing arrangements that's something that a number of members have raised over many years as something they think has had its day.

CHAIRPERSON SIMS: Do they think it matters a lot? Do they have any experience that suggests single marketing would matter?

MR REED: The feedback that I've had from members who are active in Victoria and elsewhere is that, yes, they do think it matters. Now there is--

CHAIRPERSON SIMS: That's because there's less sources of supply?

MR REED: That's right. And one thing I would say is that with respect to the survey that we conducted two years ago and then the modelling work that we commissioned last year - or that was completed last year, I should say - we saw no significant difference in the kinds of prices that were being offered to those who were getting offers in Victoria compared to New South Wales, Queensland, South Australia. There was a common degree of uplift.

CHAIRPERSON SIMS: Doesn't that suggest the pipelines are working well and the gas is flowing in the sense that the price equalises?

MR REED: Well there is no physical interconnection with current directions of flow between the Victorian - a Victorian producer cannot get their gas to Gladstone. So one of the questions that users have asked out of that is, is that a perfectly competitive market? The work that was done by two consultancies for the federal government's domestic gas market study that was released about 18 months ago now involved - although they considered many scenarios - but one set of work by the consultant IES produced what they described as a least cost model of prices that would be expected across the market in response to the changes that are going on around export.

And a relatively simple idealised conception of the market produced radically different prices between Victoria and the other states. The work that then SKM - now Jacobs, I think - produced took a different approach, modelled prices under a few scenarios including assumptions that - a set of scenarios where there was assumed to be market power and also a bring forward of the price rises that would be expected for new contracts that reflecting a scenario where retailers acted to new customers as if they needed to acquire a new gas contract upstream, rather than making use of their existing contracts. So under those assumptions SKM modelled a much more uniform rise with--

CHAIRPERSON SIMS: Reflecting market power, are you saying?

MR REED: That's how they arrived at that.

CHAIRPERSON SIMS: All right.

MR REED: And that set of results much more closely accorded with the experience to that point of members in different parts of the country.

CHAIRPERSON SIMS: It's still not obvious how market power in each place still leads to the same price, but anyway. I might just see whether there's other questions amongst the commissioners, or others.

MR PHILP: Sure. Can I just ask one? Tennant, you mentioned export price and its equation to lower domestic prices and the incentive to not produce becoming higher as a result. Can you consider a scenario where domestic prices might become higher than export prices?

MR REED: That is imaginable because I referred to the possibility that netback is above current production costs. Production costs have risen and are expected to keep rising for many reasons, but I think the biggest is probably that the scale of production has needed to triple to meet export plans and commitments and that as a result of that the resources that are being tapped are progressively moving up the cost curve to the point where even if there were no export price linkage the minimum floor for imaginable prices has increased substantially.

So a couple of years ago the necessarily over-simplified estimate of production costs from the federal government, I think, had risen to $5 a gigajoule. Now there will be plenty of individual fields that are producing at less or more than that, but that implies that now or in the next few years you could have a scenario where producers need to ask from domestic customers a high price. If they have an incentive to meet export commitments that is - I'm not aware of the content of their contracts - but is a sufficiently strong incentive they would probably rather meet that even if the oil linked formula is implying a lower price than they had hoped for and domestic prices set by supply and demand and with a higher floor under them for production cost could be higher. I think that could be an internally coherent scenario, which is about the most definite thing you can say about it.

MR PHILP: Okay, thanks.

CHAIRPERSON SIMS: Any other questions?

MR LLEWELLYN: Maybe just on pipeline capacity and "use it or lose it". APA has had its model of, if you like, the pipeline capacity listing for a year, there's been some industry led reform, if you like, in that area. Any views on whether that's had sufficient time to develop or whether something stronger is needed? Or when would you make that call?

MR REED: So I guess there's a general problem here of many efforts successively to try and address the problems, even as the problems themselves are evolving. It's never the right time to make a final judgment on any of these things, it's always too soon, but judgments have got to be made. I think that we can develop alternatives and further evolutions at the same time as we continue to assess how existing reforms are progressing.

MR LLEWELLYN: Those other things you're suggesting are just around how that information is being made transparent, or what are you--

MR REED: No, so in terms of pipelines I was referring to looking to the design reforms inspired by the UK market. Other reforms around joint marketing or increased transparency, contract indexes, that sort of thing can certainly proceed on their merits irrespective of the progress of the pipeline trading.

CHAIRPERSON SIMS: Any other questions down here? No. I just have one last very quick one, because I'm conscious of time. Is there any reason why your members would have a conceptual problem with oil linked gas prices? I mean if we are now in a world of linkage to overseas gas prices, and I don't really know, and you may not either, but whether those international gas prices are indeed linked in some way to oil prices. I mean would that be such a bad thing if you had a market that was linked to oil prices then presumably at least you could hedge it because you'd go and hedge the oil price. I'm not sure I've fully thought that through, but - so is there any conceptual problem with oil linked prices?

MR REED: Well there's two issues here. One is the idea of linkage to an international price, and then there's a question of how that price itself is set. So there are widespread objections in East Asian markets to the continuation of oil linked pricing. And there was a strong move, probably less so with oil prices having fallen, but there was a strong move to reconsider that basis of pricing which is a feature as much of history and of convenience and standard practice rather than the underlying rationale for it having continued application, because gas is not used simply as a substitute for oil, heating oil, in most markets. It has a much more important and larger application.

CHAIRPERSON SIMS: Sure.

MR REED: So there's that question. The question of an international linkage, well many prices that we pay are internationally linked. That comes with benefits and drawbacks. And when we're exposed to shocks from overseas, sometimes they are pleasant ones, sometimes they are not. So industry will work with the environment that it encounters and there will be positives and negatives to international pricing. The way that we have tried to work towards is that the opportunity is there for prices to be as low as the market can sustain. And strong local supply, a competitive market and careful attention to failures that might - of planning - that might emerge are the best path that we've got towards that.

CHAIRPERSON SIMS: Okay. Well if there's nothing else? Is there anything else you wanted to say?

MR REED: Just that on the production side of things the weak price conditions internationally and cutbacks in exploration and development budgets and activity by oil and gas companies worldwide make it particularly important to - because, you know, of the uncertain implications of that for both price and supply locally - make it particularly important that we get the regulation of production right because additional barriers to production, in an environment where it's already difficult to produce, are even less tolerable. And the importance of a competitive market to facilitating additional supply is higher than ever amidst that low oil price backdrop. Thank you.

CHAIRPERSON SIMS: Thank you very much, Tennant, for your attendance and we really appreciate you making the time available and we'll conclude this part of the hearing for now.

<THE WITNESS WITHDREW

SHORT ADJOURNMENT

CHAIRPERSON SIMS: Thanks for joining us, Richard. I've got a few formalities to go through. This is a public hearing pursuant to subsection 95R of the Competition and Consumer Act as part of our East Coast Gas Inquiry. I'm Rod Sims, chairman of the ACCC, and we've got Jill Walker and Roger Featherston, Commissioners of the ACCC, and between us we're running this inquiry. I'll just get the staff to mention their names again.

MR LLEWELLYN: Jeremy Llewellyn.

MR PHILP: Brenton Philp.

MR JOSE: Jeremy Jose.

MR RENTSCH: Dale Rentsch.

CHAIRPERSON SIMS: Thank you. As I've already said and I think everybody has heard too many times, but this is a, we very much welcome the observers but this is a hearing to, in this particular case, hear evidence from Mr Lewis. The hearing is being recorded. A transcript of the hearing will be made available to you. I just want to confirm that you've received a copy of the notes for witnesses.

MR LEWIS: I have.

CHAIRPERSON SIMS: Thank you. Obviously this is a public hearing but if you've got anything you'd like to say in confidence now or at any other time let us know and we can, subject to how we assess that, request that it convene in another forum. Have you provided any documents to the--

MR LEWIS: No, I haven't.

CHAIRPERSON SIMS: Okay. Before commencing the hearing, I need to remind you that it's a criminal offence to give evidence that you know to be false or misleading, do you understand that?

MR LEWIS: Yes.

CHAIRPERSON SIMS: And now I need to get you to give your evidence on oath or affirmation.

<RICHARD LEWIS, AFFIRMED(2.34PM)

CHAIRPERSON SIMS: Thank you. If you could give your name, occupation and address formally for the record, thank you.

MR LEWIS: Richard Lewis, consultant, 20 Gordon Street, Balwyn.

CHAIRPERSON SIMS: Thank you. And now, Richard, we'd be delighted to hear from you and then we can engage in a good discussion. Thank you.

MR LEWIS: Okay, thank you. Good afternoon and thank you for inviting me to make a presentation. I'll briefly note that Lewis Grey Advisory is my pre-retirement project after 32 years in the Australian gas industry, 18 of which have been in consulting. My consulting career has spanned more than 200 projects, one of which is the SKM project that Mr Reed mentioned in his address to you earlier this afternoon.

My specific expertise is principally an upstream gas markets and downstream gas and electricity. And prior to that I held various positions in the Victorian gas industry and was responsible for the industry's involvement in gas reform and resolution of the tax dispute with the gas producers in the mid-1990s.

CHAIRPERSON SIMS: And who were you working for then?

MR LEWIS: Gas Corp, Gas Corporation.

CHAIRPERSON SIMS: Gas and Fuel, yes.

MR LEWIS: I'd like to talk about what I regard are some very important aspects of the market that have received fairly limited attention in previous investigations, and my focus is particularly on issues regarding market liquidity which are covered in the issues paper for the inquiry in paras 61 to 69 questions 30 to 37.

Basically what I'd like to do is challenge the idea that the market is really capable of becoming any more liquid and then consider what that means for the inquiry. Turning back the pages, Australian gas reform has pursued the development of a more transparent and liquid market since 1997, and it's timely to ask how well is that project progressing? And from my perspective, the need for the current inquiry suggests that not well enough is the answer.

Going back, based on the transformations of the UK and US gas markets, it's been widely assumed that the Australian market, and particularly the eastern Australian market, in WA they seem to have avoided this thinking, that the what are regarded as economically inefficient, illiquid and opaque long term contracts would quite rapidly disappear and be replaced by more efficient short term markets. And the transformation has been assisted by the creation of the declared wholesale gas market in Victoria, the STTMs in Adelaide, Brisbane and Sydney, and more recently the gas supply hub in Wallumbilla. But here we are in 2015 and new gas supply is entering the market almost entirely through long term contracts, and even the limited liquidity of long term contracts appears to have dried up because of LNG export demand.

So an important question is why has the transition to spot markets failed? And my view put simply is that the eastern Australian gas market, or markets in plural both up and downstream, can't really support the number of participants it takes to sustain the sort of developments that have been seen in the US and the UK. And why is that? Again this is my view, the market itself doesn't have the scale to support the large numbers of participants. If you assume that domestic gas producers, need to produce about 100 petajoules a year to get the right economies of scale, the eastern Australia's 700 petajoule domestic market would support seven producers. And this would compare to 30 in the UK based on their market size, and more than 250 in the US, and I do know that the number of producers in the US is somewhere around the 400 mark.

Now seven producers doesn't add up to liquidity, and I have to emphasise as well that adding LNG to the eastern Australian market although it's increased the size hasn't increased the number of producers, because to participate in LNG the producers have to be a lot bigger still. Each of the producers involved in LNG is looking to produce 6 to 800 petajoules a year for their export projects. So given that situation the question is is this going to change, and based on the current evidence I don't think that it will.

It's also evident that from this perspective the current market outcomes, that is the gas supply difficulties being experienced by buyers, should actually be expected because rapid demand growth for LNG and the uncertainty as to whether supply will match it have generated some opportunities for market power. And if one looks at a Herfindahl–Hirschman Index calculation which I'm sure the Commission is familiar with--

CHAIRPERSON SIMS: A passing familiarity.

MR LEWIS: --the HHI gas production based on figure 1 from the issues paper is about 12 and increasing to about 20 if the 2018 production estimates are put in. Now as those familiar with HHI know, any figure over 10 suggests that the market has some propensity to market power. For reference the US market HHI is below 1.5, in other words very intensely competitive, and looking forward I don't see that this will change terribly much. I should also add that US market observers are from time to time concerned even about liquidity in that market, particularly when Enron disappeared from the market in the early 2000s, but being a very deep market it survived.

Now I wouldn't claim that this is the ultimate analysis, and I'm aware that numerous submissions to the inquiry still have the faith that pursuing more hubs and more refined marketing structures will somehow create liquidity. But what I would do is challenge those parties to actually demonstrate that that will happen. I think the markets had sufficient time in response to the existing spot market developments to have done that and it hasn't so far.

In particular, and again I believe the Commission is very fond of looking at counterfactuals, the counterfactual for this would be to ask whether more hubs that people want would actually have brought about a different outcome today, and again I have to say that I cannot see that it would have. But I would really encourage the Commission to reach its own conclusions in this regard. And the point of that is really that having done that the design of gas market institutions and the regulation of the market would probably look - the requirements of it might look different. The regulation of a market susceptible to outbreaks of market power may need to be more robust. And there needs to be a much stronger focus on improving the contract market operation rather than the spot market operation. After all, it's the contract market that isn't working and is failing to provide the gas that people want to put into the market. And broadly improving the contract market operation is all about the regulatory factors behind the way the upstream operates.

Now I'm aware that this view makes me probably sounds like I'm anti-spot markets and a bit of a dinosaur in that respect, however I would say that I have done a lot of work over the last 15 years on spot markets. I actually authored the study that demonstrated the economics of the STTM and I've had a fair bit to do with the price caps in the Victorian gas market. So I have nothing against them, it's just that I don't think they are the solution to the current problems.

So what would I be recommending? I'm sure you're going to ask me this question.

CHAIRPERSON SIMS: Thank you.

MR LEWIS: It's really back to the stuff about what information the parties need to negotiate gas contracts. And first of all, they need to be able to figure out what the gas reserves positions are, so gas reserves and resources information that's available and relevant. So that is the 2P and 2C figures updated at least annually by all title holders. And I have to say that somewhat surprisingly, the figures that one can get for the coal seam gas that's going to be exported are generally quite good. And the big problem in this area right now is all the conventional gas, particularly the conventional, the biggest resource in Gippsland hasn't been officially updated for some time.

Equally important though is not just what those reserves figures are but some idea as to what the uncontracted reserves are, because clearly what's available on the market is only going to be what hasn't already been sold. Now how this information gets collected I don't have a view. Whether it's an industry initiative which I would hope it might be, or whether it's a government initiative I couldn't advise, but these two things are fairly important.

I would also think it might be useful to get a matching requirement for gas retailers and traders to reveal their net contract positions, i.e. the gas they've got under contract that hasn't been sold to large end users or is not expected to be sold into mass markets. And the reason for this is that although consultants, myself and others, have been able to put together these figures, there has now been sale of gas from these formerly domestic portfolios to the LNG projects because some of the LNG projects are short of gas. And so what gas that was previously assumed to be held by the retailers and would be available is no longer available.

I'd also recommend implementing some form of contract price publication. This has been discussed and I know the AEMC is focusing on such an index. I think it would be more useful though if it dealt more with new contracts so that this wide divergence that others have talked about today could be addressed. It would also be important to review retention lease policy upstream. Now it's a very old favourite of mine, I've been recommending this for years, and I think something, some elements of it have been investigated. But the key problem now is that the CSG projects have apparently obtained very long term effective retention over the assets, which is fine if they're actually going ahead because they need those assets, they need those resources. But for the project that isn't going ahead there is a major question about whether it needs to retain those leases or should be able to retain those leases. There should of course be the reviews of joint marketing.

CHAIRPERSON SIMS: Sorry, just before you move on, I'm sorry I just didn't hear that and I might ask a more detailed question later, but just repeat that last point before you go onto joint marketing if you could.

MR LEWIS: Retention leases?

CHAIRPERSON SIMS: Yes. Retention leases.

MR LEWIS: I mean retention leases traditionally have been given for gas fields prior to development. Once development is planned, the lease turns into a production lease, and then production has to start within two years or some figure like that. What I understand has happened in Queensland is because of the nature of CSG where you do need a lot of fields that are not initially developed but are necessary to commit to a project that an effective retention of fields that are not developed immediately has been granted. Now what I'm saying is that that's fine once a project has reached construction in its final investment decision, but if that doesn't happen for a period of five years then that lease needs to be reconsidered.

Joint marketing, I think that's an obvious one, and I know that many joint venture participants recently have in fact opted for separate sales anyway. But I think that does tend to answer the question of whether it's technically feasible. Of course we're not privy to any of the details of that, but certainly the Cooper Basin they have now sold separately, and I don't see any in principal reason why that would be impossible elsewhere.

Much more broadly than this I think it's important to look at the application of competition policy and to resist mergers in markets where there's already some market concentration of power. I don't believe that the Act actually directs the Commission to act in that way at present, I think it's more to - it's relatively not contingent on what the current situation is.

And more broadly, and this is something that happened I know in the UK, to give competition authorities a more definitive procompetitive mandate rather than just restricting anticompetitive conduct which is pretty much the same as what I said before.

CHAIRPERSON SIMS: Sorry, pretty much?

MR LEWIS: Sorry, I said this is more a general repeat of the previous issue.

CHAIRPERSON SIMS: The merger issue?

MR LEWIS: Yes.

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CHAIRPERSON SIMS: Yes.

MR LEWIS: I think that's probably enough on that part.

CHAIRPERSON SIMS: Okay. Thank you very much. I've got a couple of questions just to, while other people are catching their thoughts. I just wouldn't mind a bit of an elaboration on the, well perhaps one thing is a quick point, you say some of the LNG players are short gas, what do you base that on, just public statements or, I mean how to do you form that view?

MR LEWIS: I think they've been fairly open about it. GLNG has purchased gas from a number of third parties including Santos which is part of the joint venture itself. They have a fairly large contract for gas from the Cooper Basin.

CHAIRPERSON SIMS: Have they fixed it though or are they still short of gas? I know the transactions they've done.

MR LEWIS: No, I believe they are still short of gas.

CHAIRPERSON SIMS: And why do you say that?

MR LEWIS: Well not exactly short of gas, but their planned, the planned ramp up of the LNG production is fairly quickly to ramp up to one and a half train's worth, and then take another three years to get the other half a train filled with gas, and that's because they are having to develop more of their own resources than they had planned several years ago, on my understanding.

CHAIRPERSON SIMS: Because other developments just didn't proceed to help them out?

MR LEWIS: I can't give any precision. I mean they--

CHAIRPERSON SIMS: That's fine.

MR LEWIS: --Santos is still trying to develop gas in the Gunnedah Basin which may have been intended, some of it to contribute to export.

COMMISSIONER FEATHERSTON: And why do you say that there seems to be better information about the CSG reserves and production compared with the conventional gas?

MR LEWIS: The companies themselves have been very forthcoming on producing gas reserves and resource estimates. Part of that I believe is because they've been very keen to justify to financial markets that the gas is there. So when the projects first reached financial closure they did not have enough 2P to meet the 20 years of gas supply, and that was part of what they did initially was they proved those up. And so they gave fairly full details of what those figures were, including the contingent resources which they were trying to convert to prove resources, proven for them.

In addition, Queensland Government publishes quite detailed CSG and conventional gas 2P reserves figures. I think it would be very useful if the other states followed that example. I'm not sure under what legislation they'd get the data for that.

CHAIRPERSON SIMS: If we had the information on resource reserve availability and what was uncontracted what would that do, I mean why would that change behaviour?

MR LEWIS: Well it would show roughly how much is available. I mean if the total was a large sum, you would imagine that there'd be a fair number of potential suppliers. I guess it would form part of the answer to the question why are buyers of gas not getting as many offers as they used to. If it was found that this number was quite small, that the reserves were not really available for sale, then that would probably answer to that.

CHAIRPERSON SIMS: Sure. And if the answer was the reverse, how does that help you?

MR LEWIS: You'd have to then say well why are these, you know, is it simply the price, but it would push the answer more in that direction.

CHAIRPERSON SIMS: But if one felt that they were, they had the resources so they'd proven them up but they weren't selling them because they felt that whatever reason but presumably the prices would be higher in the future, how would that help us? How would we better off knowing that? A few buyers might be a bit angrier, but how else does it help us?

MR LEWIS: I think we've had a number of assessments that have said that, yes, there are sufficient reserves resources, but we don't know why they're not being sold.

CHAIRPERSON SIMS: So this would put moral pressure or?

MR LEWIS: Well it may. It may. I think, I recently read the QGC submission to the inquiry which as I understand it and may have misunderstood it, but it basically said that from the time they committed to the project they were not in a position to sell further gas because of the levels of uncertainty, that whilst on the basis of the 2P reserves there is sufficient gas for the project, the uncertainty in how much will be produced from each field which is quite uncertain with coal seam gas, lead them to decide that they couldn't commit to sell any further reserves until the LNG project was up and running. The implication being that they may, now that the project is up and running, they may in some near future time be able to sell more gas. And the reserves picture may not have changed in that whole period, it's simply that they needed a period of several years to develop up the reserves and to get them into production and really prove that what they said was 2P really is 2P.

CHAIRPERSON SIMS: So that would suggest putting the figures out there but also with a bit of an explanation or again just the moral pressure to require them to put out an explanation.

MR LEWIS: Yes, yes. I think it's been clear to all of us who do much analysis of the gas market, the gas supply and demand, that that has been the case, because the reserves have been there and there has been spare gas that one might have expected would be sold to the domestic market at a suitable price, but it wasn't. And you can only put that down to there being either they don't have the resources to develop things sufficiently quickly to meet both export and domestic demand, or there's a lot of uncertainty. Now it appears that what they're saying is that there's a lot of uncertainty. And I have heard it said by a number of CSG producers that CSG is very difficult to predict exactly what you'll get out of each well.

CHAIRPERSON SIMS: Sure.

MR LEWIS: Unlike conventional gas where you can pretty much guarantee what you'll get, it's very varied.

CHAIRPERSON SIMS: I guess that just reinforces a slight concern we might not, we might have the information but it doesn't help us much.

MR LEWIS: Yes.

CHAIRPERSON SIMS: Just one last question and then I'll pass to others. I realise gas is a very different business, in the market we're in having seven players is pretty damn good. We don't have that in too many markets and the idea you might have 400 that would be nirvana I think. I mean this point that seven producers isn't enough liquidity, I mean partially there's a pipeline issue I guess, they're not all able to get gas at the same time because they're spread over this vast continent, but also I guess it's lumpy, so you get, you sell it, so if you've got seven players maybe only one or two have got gas at any time, is that really why it's--

MR LEWIS: Yep, that's mainly the reason, yes.

CHAIRPERSON SIMS: Okay. Questions.

COMMISSIONER FEATHERSTON: Just in relation to information and transparency, I take it that the same sort of principles would apply to pipeline capacity and usage? Or I mean we do have figures that are published in relation to both the capacity and how much gas is flowing, but would there be further information that would assist in terms of creating a secondary market for pipeline transportation?

MR LEWIS: I'm sure that publication of some form of capacity utilisation would lead to more trading. I think it's reasonable that capacity should be made available when it is available, when the capacity holders are not using it. Exactly what terms are reasonable I haven't really thought about.

MR RENTSCH: Just to say, again going back to the idea of the seven major producers or whatever number there is, and especially in a contract market, is it that in addition to those larger producers perhaps it was these smaller almost niche producers who are producing 10, 20 petajoules potentially a year as new gas coming in, that they're the ones who are becoming increasingly important in this market which is very tight and it's this very, it's these quite small parcels of gas which makes quite a difference potentially in a tight contract outcome?

MR LEWIS: Well certainly the newer and the smaller producers are very important. Mainly because they are the more, more keen to take on the risk of developing new projects, and we saw that coal seam gas ten years ago. It was largely developed by smaller players. Santos was the exception to that. But they then got swallowed up and they became bigger players. QGC was taken over by BG. Arrow was taken over by Shell, and a Chinese company. And, yeah, I don't know whether one can say that the same fate would await any other smaller ones. But it does seem that some small explorers their business model is to develop up a resource and then sell that rather than actually get into production.

CHAIRPERSON SIMS: That's been the same in the mining industry forever.

MR LEWIS: Yep. There's nothing wrong with that model.

MR JOSE: On the issue of information transparency there is a lot of information that's compiled by secondary sources, consultants and sort of generally available in the industry, to what extent do those sources meet the requirements of industry participants to have some knowledge about the market, or are they so far off the mark that they're not as sufficiently useful for those commercial decisions?

MR LEWIS: I think in terms of gas reserves in particular they're probably these sets of numbers that are available in general to anyone without inside information. But I think it would be better if they were provided officially. They are compiled from a number of different sources that may be inconsistent, and people make mistakes. I know I've miscounted gas reserves more than once, because they are difficult to put the numbers together.

MR LLEWELLYN: Richard is, so it would be better compiled officially, is it the oversight of them or is it a consistent set of rules as to how they're worked out, what's the concern there?

MR LEWIS: I think consistency is very important, and doing it all under one set of rules. I know it's not a discrepancy between different consultancies whether you pay great attention to what's being reported and whether it's being reported on an operating basis or an equity basis. So the operating basis is that it's been reported under whichever company operates the resource, and equity is based on their actual share of the resource. And some of the differences appear to stem from people not paying full attention to which is which. And some of the reports don't actually state all that clearly which basis is being used, so you are left there without full knowledge.

MR LLEWELLYN: Just on a different topic, I'm not particularly fond of counterfactuals, but you said--

MR LEWIS: Sorry, I missed that?

MR LLEWELLYN: --I'm not particularly fond of counterfactuals but, I'm not from the mergers division, but you said would more hubs have brought about a different outcome today, that could be the counterfactual. I was just interested in your thoughts would less hubs have brought about a different outcome today? Do you think the existing hubs--

MR LEWIS: No, I think in terms of gas supply being available for contract, I'm not sure they make a great deal of difference. Certainly, the market in Victoria has made it easier for retailers, new small start-up retailers to enter the gas market. They have been able to do so by buying gas on a spot basis, but typically when they reach a reasonable size in numbers of customers or gas sales, they start looking for gas contracts because of the risks of buying spot. The STTM likewise, I think it was Adelaide Brighton in its submission emphasised that the STTMs were useful for them to manage and they could buy some gas spot, but they have been buying their own gas upstream as well, so.

CHAIRPERSON SIMS: So I guess the other way to put the question if you don't mind, I mean it's one thing to ask if Jeremy has, would have been better off without them, I guess the other question, and you've answered that, is if they do, if they had been helpful, would more gas going through those markets would anything that could be done to make those markets do more would that be helpful? And we had a discussion earlier with people from the Grattan Institute who were suggesting that the government could try and mandate some more gas flowing through those markets and there's various ways to do that. Would that be helpful or it really wouldn't make much of a contribution?

MR LEWIS: I don't think I see it making much of a contribution to be honest. I think one thing one has to remember is that almost all the gas if not all the gas that goes through those markets is gas that is originally sold under long term contract, and by long term I don't really necessarily mean ten years anymore, no. I think it's quite evident that shorter terms have become more prevalent. But it's still gas sold under what are really bespoke contracts negotiated in confidence and with all the usual elements of that. So it's that aspect that makes it very difficult to, I mean for the government to mandate a NEM like structure would be, unless it actually changed and forced the gas producers into that structure, it would simply leave the need for contracts unchanged. And the producers historically have not shown a great deal of interest in moving into participate, they still like to sell contracts.

CHAIRPERSON SIMS: I just had one further question as well. You mentioned that with the transparency that you're open to it being done by government or industry that, further industry I think, do you think there's a free rider problem where it would be hard for industry to get together to do that, because you probably need all them to do it?

MR LEWIS: No, I think, I don't necessarily mean the actual players would do it. I think it's more companies like ARGUS and other market makers would do it.

CHAIRPERSON SIMS: But would they do it on their own?

MR LEWIS: Well they are trying to do things on their own. They have set up a Wallumbilla index.

CHAIRPERSON SIMS: But I guess is that, I mean is the problem getting solved or not?

MR LEWIS: Well I think, you know, if you could get, if the Wallumbilla hub did trade significantly more, then a price index based on that would be very useful, and even having, it might even form the basis for futures. But up to now that hasn't gone terribly well. The ASX did have a futures contract, I mean it still does I think, based on the Victorian spot price, but to the best of my knowledge there hasn't been any material trading in that index, and so it basically didn't get the right sort of pricing.

CHAIRPERSON SIMS: I guess I'm trying to work out, I mean the government has done a certain amount of mandating not perhaps a lot. I mean just because the market then hasn't developed it could well be that there needs to be more the government does to help create those markets rather than, well without much use because they didn't develop it themselves, is that the question or?

MR LEWIS: I agree, that's always a hope, but I just look at it and say, well that's been the hope for some time and I don't think the current market structures are particularly bad. I think that Wallumbilla is a particularly good location being at the intersection of three domestic pipelines and now three export pipelines, that if any depth of trading is going to get established it should be there. But up to now, I mean there has been trading. Some people say it's more than expected. I'm not sure what they actually expected. They must have expected nothing.

CHAIRPERSON SIMS: I guess it took a fair while to get an electricity future's contract up on the ASX.

MR LEWIS: Yep, that's right.

CHAIRPERSON SIMS: The market was there, that people kept on their over the counter trades and I suspect that market's been in operation for much longer than the gas market's been up and running, and of course it was, you've got a complete market there so liquidity was there which is within the OTC market and then the ASX could set up a very different market I guess.

MR LEWIS: I think, I mean the main difference between the NEM and gas markets is as I said, it's the NEM, it's compulsory for the generators to participate in there. They can only generate through there.

CHAIRPERSON SIMS: That's right.

MR LEWIS: And therefore the financial markets and the hedges had to evolve, whereas that hasn't been the case in gas.

CHAIRPERSON SIMS: I'm sorry, I keep flogging the same dead horse, I mean the government actually created all that.

MR LEWIS: It did.

CHAIRPERSON SIMS: Is there a parallel in gas?

MR LEWIS: Not that I'm aware of.

CHAIRPERSON SIMS: You don't think the government put--

MR LEWIS: Well I think, my knowledge of the gas market in the UK is a bit limited, but my understanding is that the equivalent to the spot markets in Australia is the, and I've forgotten the name of it, but it's the sort of peak balancing market, and it's available to anyone to put gas in and set a price for it for balancing the gas transmission network. And my understanding several years ago was that that had about 1% of all the gas that went through the UK pipes going through that market. But that set a price at which on days when there high levels of demand that it would set the balancing price for the whole system. And since everyone was free to participate in it they accepted that that was the price and it was okay. But it was only 1%, so they only effectively mandated 1% of the market to go through there.

CHAIRPERSON SIMS: And you say that was enough or not enough?

MR LEWIS: I believe it's worked satisfactorily for more than ten years. Another difference with that is I believe the pipeline operator itself can actually initiate transactions regarding that market whereas our operators are strictly hands off.

CHAIRPERSON SIMS: But I guess is that something that you'd like to change or you think should change?

MR LEWIS: No, I haven't investigated whether that would be more appropriate for Australia or not.

CHAIRPERSON SIMS: Okay. Any other questions?

MR PHILP: I was going to ask just your view of the proposal to have a Moomba hub as well.

MR LEWIS: I'm not sure that it's, I don't think it's as relevant as Wallumbilla. I'd say I would think it was a good idea subject to two things happening at Moomba, one being the gas gathering system becoming more like a third party gas gathering system, which has been suggested. I think even Santos recently put out a presentation in which that appeared to be what they were suggesting. Third party gas gathering was an option they were looking at. And the second would be for there to be some form of stage at Moomba, publically third party storage. At the moment there is storage, but again to the best of my knowledge it's not third party - available to third parties.

COMMISSIONER FEATHERSTON: Is gas gathering the same as aggregation, or there's--

MR LEWIS: Yeah, I'm sorry, it's taking the gas from the wells to the processing centre. And to some extent it implies that the processing centre is also available to third parties unless you build other processing centres right in Moomba location.

MR PHILP: You just mentioned storage as well, do you see a role for additional storage in the market?

MR LEWIS: Yeah, I think so. I think that it is, given the relative scarcity of supply that would encourage gas producers to want to run the their plants more on a 24/7 basis, and so to meet any variation of demand from that flat profile will require some form of storage. Now that's an exaggeration, there will be some flexibility in gas production, but my view is that it will probably decline, and therefore the role for peaking suppliers will increase. There are a number of storage and AGL has recently built an LNG storage in Newcastle, I think largely because there are no underground wells suitable to do that, although they may have chosen LNG anyway. There's two new storages associated with the LNG projects in Queensland to help them smooth over demand supply balance issues. There's Moomba and then there's the Iona facility in western Victoria.

COMMISSIONER WALKER: Go back to another topic of the joint marketing, what, I mean you were talking about having perceived they didn't have any technical difficulties to that, but what do you see as the advantages of separate marketing given that they're joint producing anyway?

MR LEWIS: Well I guess if you were a buyer and you talked to two separate sellers you might get some competitive tension between them even though they were sharing the same output. I'm not aware exactly how that works in practice, whether there would be any tension or not, but that's the theory. But I agree that it's on some inconsistency in the fact that the producers under their venture agreement are presumably not allowed to vary their output share, so they have to sell the same share, or in proportion to their actual share in fact. But it has happened recently.

MR RENTSCH: Just going back to the, I guess if you take your point that recognising it's largely a contractual market, liquidity is not that strong in the trading markets, but we've heard consistently and I think increasingly from a number of gas users and some of the public submissions as well, that they do want some ability to trade on top of their contracts to give them that flexibility, especially with contractual terms and conditions tightening up. Is there something better than the STTMs given that there's a high cost of users who don't use the STTMs everyone has to put their gas through, is there something better that could be done to facilitate that sort of marginal trading if you like on top of contractual obligations?

MR LEWIS: I have to say I can't really answer that question. I'm aware of people saying that the STTMs have these high costs, but I haven't really thought of whether any alternative would come in in lower cost.

CHAIRPERSON SIMS: Okay. Well thank you very, very much for coming along today, Richard. We appreciate the time and the effort put into compiling the presentation and discussion, and that now concludes the hearings.

<THE WITNESS WITHDREW

ADJOURNED

1. See the correction to this statement made by way of a letter from the witness which has been published on the ACCC website: <https://www.accc.gov.au/regulated-infrastructure/energy/east-coast-gas-inquiry-2015/melbourne-public-hearing> [↑](#footnote-ref-1)
2. See the correction to this statement made by way of a letter from the witness which has been published on the ACCC website: <https://www.accc.gov.au/regulated-infrastructure/energy/east-coast-gas-inquiry-2015/melbourne-public-hearing> [↑](#footnote-ref-2)