

ACCC foreshadows a regulatory shake-up of the wholesale gas industry on the east coast of Australia

On 22 April 2016, the Australian Competition and Consumer Commission ("**ACCC**") released its report ("**Report**") to the Federal Government following its 12 month inquiry into the competitiveness of the wholesale gas industry on the east coast of Australia. The Report recommends a regulatory shake-up of the industry (particularly in the pipeline sector) which is likely to have implications for industry participants including investors, producers, sellers, pipeline operators, shippers and buyers.

Unprecedented Change in the East Coast Gas Market

Australia's equivalent to the 'shale gale' in North America has been the liquefied natural gas ("**LNG**") rush in Queensland in late 2010 with the development of three large LNG projects. East coast gas demand is expected to soar from around 700 PJ per annum in 2014 to around 1750 – 2200 PJ per annum in 2017-18 due to exports from the LNG projects.

These developments have resulted in a fundamental change to the structure of the east coast gas market with the domestic industrial gas users raising concerns as to the inability to secure long terms gas supplies. On the other hand gas suppliers argued that the gas market was functioning well.

In these circumstances, it will take some time for a new equilibrium to emerge as participants seek to capitalise on their investments.

Key Issues

- The ACCC released its Report on 22 April 2016.
- The Report contains the ACCC's key findings and recommendations.
- The ACCC's recommendations include:
 - **Gas supply:** Regulate onshore gas development on a case by case basis rather than by using blanket moratoria;
 - **Gas transportation:** Tighten the regulation of gas pipelines; and
 - **Market operation and transparency:** Streamline the reporting requirements for, and increasing information flows between, industry participants.
- Whilst the government considers its response to the ACCC's recommendations (together with the recommendations coming out of last year's competition policy review or "Harper Review"), companies and directors should start to consider the possible implications of increased regulation in the wholesale gas industry on the east coast of Australia (particularly in the pipeline sector).

Regulation vs Policy Innovation

The key question is whether equilibrium is best achieved through increased regulation or policy innovation at a government level.

The most logical (but perhaps most challenging from a political perspective) place to start is arguably to lift the current restrictions on onshore gas development on the east coast. However, this requires a commitment from government to put policy innovation ahead of politics given the strong concerns voiced by local communities and environmental groups to onshore exploration and development.

Increased regulation may reduce the appetite of stakeholders to invest, which may in turn exacerbate the uncertainties around future gas supply and connectivity in an already challenging macro-economic environment.

ACCC Inquiry and Report

The ACCC was requested to undertake an inquiry into the competitiveness of the wholesale gas prices and the structure of the upstream, processing, transportation, storage and marketing segments of the east coast gas industry under Part VIIA of the Competition and Consumer Act 2010 (Cth) ("**Act**") on 13 April 2015.

The ACCC released its Report on 22 April 2016. The Report focuses on three key areas:

- Gas supply;
- Gas transportation; and
- Market operation and market transparency.

Gas Supply

ACCC's Views

The Report contains a number of key findings and recommendations by the ACCC around gas supply:

Gas Supply	
ACCC's Key Findings	ACCC's Recommendations
Queensland domestic purchasers experienced difficulties in obtaining gas as a result of the LNG rush, particularly from 2010 to 2014 for gas to be supplied in 2016 and beyond.	Governments should consider adopting regulatory regimes to manage the risks of individual gas supply projects on a case by case basis.
The future of gas supply remains uncertain (particularly post-2025) because of the demand from the LNG projects in Queensland, the low oil price environment and moratoria and restrictions on ongoing gas exploration and development.	Blanket moratoria should not be used. Policies which require producers to reserve gas for domestic use (i.e. gas reservation) should not be used.
More sources of gas supply are required, particularly in southern states (e.g. New South Wales and Victoria) who are dependent on gas produced offshore by the Gippsland Basin Joint Venture (" GBJV ").	As part of its future work the ACCC should investigate the competitive effect of the joint marketing arrangements of the GBJV under section 45 of the Act.

Potential Implications

A regulatory regime that manages the risks of gas supply projects on a case by case basis (as recommended by the ACCC) may create uncertainty for industry participants.

We expect that governments will come under increasing pressure to reduce the barriers to investment in gas exploration and development and encourage new entrants into the market. This may include by making exploration data publicly available and lifting moratoria and restrictions on onshore development.

As part of this process we expect that industry participants will play a more active role in communicating the benefits of their industry (and how they play a role in shaping it) with both government and the community.

Gas Transportation

ACCC's Views

The Report contains a number of key findings and recommendations around gas transportation:

Gas Transportation	
ACCC's Key Findings	ACCC's Recommendations
A large number of pipeline operators have been engaging in monopoly pricing which results in higher gas prices for consumers and the existing test for regulation is ineffective.	The existing test for regulating gas pipelines (i.e. the coverage criteria) under the National Gas Law should be replaced with a new test (refer below).
Less than 20% of the transmission pipelines on the east coast are subject to regulation which is much lower than comparable jurisdictions including the United States, the European Union and New Zealand.	<p>The new test would give the relevant Minister discretion to consider if:</p> <ul style="list-style-type: none"> ■ a pipeline has substantial market power; ■ a pipeline is likely to continue to have substantial market power in the medium term; and ■ coverage will or is likely to contribute to the achievement of the National Gas Objective*.
<p><i>* The National Gas Objective is to promote efficient investment in, and efficient operation and use of, natural gas services for the long-term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.</i></p>	
Shippers have limited ability to identify the exercise of market power and negotiate effectively with pipeline operators because of a lack of transparency and information asymmetry.	<p>Pipeline operators should publish financial information so that shippers can negotiate more effectively</p> <p>The dispute resolution mechanisms under the National Gas Law and National Gas Rules should be amended to make it more accessible to shippers.</p>

Potential Implications

The Report finds that greater investment in pipeline infrastructure is required to better connect gas reserves on the east coast to the market (including by alleviating the dependency of users in southern states on jointly marketed GBJV gas).

However, this part of the Report is perhaps the most controversial as the strength of the ACCC's

recommendations may surprise many as being an unexpected outcome of its inquiry, particularly having regard to the broader context of access regulation in Australia being wound back where the facilities are not "essential" and can be duplicated by other investors.

From an industry perspective, concerns have already been raised that increased regulation or threat of regulation of gas pipelines will have the opposite effect to that desired by the ACCC and deter investment and therefore exacerbate issues around the certainty of future gas supply.

To address some of these concerns with investment the ACCC notes that existing safeguards in the national gas law relating to 15 year no coverage determinations should continue for Greenfield pipeline projects, protections for long term commercially negotiated contracts between pipeline operators and shippers as well as merits review provisions from decisions to regulate a pipeline.

Industry participants who are looking to build new gas pipelines or sell existing gas pipelines in the short to medium term may choose to wait until there is greater certainty around the proposed new regulatory regime.

The results of the market study in the Report raise questions about the appropriateness of the ACCC as the competition regulator undertaking these studies and recommending these competition reforms where it will regulate and enforce them. A question arises whether these reports should be done by the Productivity Commission and considered by an independent national competition council for consistency with national competition policy. The ACCC appears alive to this issue and goes to some lengths to explain why regulation of gas pipelines should diverge from the access regime in Part 111A of the Act.

We expect that pipeline operators will undertake a review of their existing gas transportation arrangements and operating policies and procedures in light of the proposed new regulatory regime to ensure that they are ready for the changes once enacted. In doing so, this may help to reduce the risks of increased disputes with shippers in the short to medium term (particularly in light of the proposed changes to the dispute resolution mechanisms under the National Gas Law and National Gas Rules).

Market Operation and Transparency

ACCC's Views

The Report contains a number of key findings and recommendations around market operation and market transparency:

Market Operation and Transparency	
ACCC's Key Findings	ACCC's Recommendations
Gas specifications may affect market liquidity (i.e. coal seam gas is typically interchangeable with conventional gas but some LNG projects have been designed for a dry gas such as coal seam gas).	The need for non-standard gas specifications should be monitored by the Council of Australian Governments (" COAG ") Energy Council, and the associated costs should be borne by market participants who require the alternative specifications (e.g. LNG projects).
The gas market is opaque and is not signalling expected supply problems effectively.	All explorers and producers (including non-ASX listed entities) should report consistent reserve and resource information across the east coast gas market based on common price assumptions. This information should be displayed on the Gas Market Bulletin Board Geological and reserve / resource information collected by governments should be consistent, non-duplicative and shared.
Improved price information would promote collective bargaining – currently information about gas prices is partial, provisional and mostly private.	A monthly LNG netback price to Wallumbilla (i.e. gas trading hub in Queensland) with a clear explanatory framework and inputs should be developed and published by the Australian Energy Market Operator (" AEMO "). The Australian Energy Market Commission (" AEMC ") should consult with gas users about the benefits of publishing price information.
Risk management mechanisms are becoming more important to buyers	The AEMC should consider how to monitor changes in the level of trading flexibility

Market Operation and Transparency	
ACCC's Key Findings	ACCC's Recommendations
(particularly industrial users) including gas storage and the short term trading market (" STTM ") and should be supported.	available to gas buyers over time and how the trading and other risks of having to purchase gas and transportation services on a day-ahead basis can be best managed.
There is no evidence of withholding of capacity by shippers on major east coast pipelines. However, there is evidence that capacity is being withheld by incumbents on some regional pipelines.	The AEMC should consider requiring the introduction of a centralised capacity trading platform to facilitate secondary capacity trading and day-ahead auctioning of unutilised capacity.
Competition for gas hub services should be promoted (i.e. auctioning of unutilised capacity).	The AEMC should consider the benefits of a short-term auction process for hub services if it decides to implement the day-ahead auction process for pipeline services (above).
There is no evidence that access to storage capacity on reasonable terms is a significant barrier but this may change over time if the volume of gas available for supply increases.	Whilst not listed as a recommendation, the ACCC has acknowledged the increasing importance of storage and the need to monitor potential barriers to accessing such storage particularly in southern markets.

Potential Implications

Investors and producers may need to reassess their internal policies and procedures to ensure compliance with the proposed new reporting requirements for reserve and resource information.

The increased importance of risk management mechanisms such as gas storage and the STTM may also create opportunities for industry participants (including for portfolio players looking to invest further downstream to take advantage of these opportunities).

ACCC's Potential Future Inquiries

Scope of Potential Future Inquiries

The Report indicates that the ACCC is planning to carry out additional inquiries in relation to the following:

- the competitive effect of joint marketing arrangements of the GBJV in light of current market dynamics for the purposes of section 45 of the Act (i.e. anti-competitive agreements); and
- whether the availability or pricing of capacity on regional pipelines raises any concerns as a breach of the misuse of market power provisions or the exclusive dealing provisions of the Act.

Competition Issues under the Act

These additional inquiries will require a consideration of the following issues by the ACCC:

- anti-competitive agreements, which are contracts, arrangements or understandings that are likely to substantially lessen competition in a market;
- misuse of market power, which occurs when a business with a substantial degree of power in a market uses this power for the purposes of eliminating or substantially damaging a competitor or to prevent a business from entering into a market; and
- exclusive dealings, which occur when one person trading with another imposes some restrictions on the other's freedom to choose with whom, in what, or where they deal and such conduct has the purpose or effect or likely effect, of substantially lessening competition in a market.

Suggested Next Steps

It is important to understand the potential future effect of these proposed regulatory changes on your business activities as they may establish a framework for future investments and regulation affecting those investments.

Whilst the immediate impact of this Report may be the government's consideration of changes to the Act in relation to pipeline regulation, it is likely that there will be a broader impact if the government accepts the Report's recommendations on market operation and transparency relating to public reporting of reserves and resources, as well as proposals in relation to gas transportation services and hub capacity.

Our Team

Our team (overleaf) has extensive experience advising corporations, financial institutions and governments on a broad range of oil, gas and energy related matters in Australia (including in relation to onshore gas development and transportation on the east coast).

Please do not hesitate to contact us if you have any questions in relation to this briefing note or would like any further information about the Report and its potential implications for your business.

Contacts

Australia

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

Tracey Renshaw
Partner
T: +61 8 9262 5505
E: tracey.renshaw@cliffordchance.com

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

Asia Pacific

Geraint Hughes
Partner
T: +65 6410 2212
E: geraint.hughes @cliffordchance.com

Kathy Honeywood
Partner
T: +65 6661 2083
E: kathy.honeywood @cliffordchance.com

Sze-Shing Tan
Counsel
T: +65 6661 2027
E: sze-shing.tan @cliffordchance.com

Useful External Websites

- ACCC Report: <https://www.accc.gov.au/regulated-infrastructure/energy/east-coast-gas-inquiry-2015>
- Australian Energy Market Operator ("AEMO"): <http://www.aemo.com.au/>
- Australian Energy Market Commission ("AEMC"): <http://www.aemc.gov.au/>
- National Gas Rules: <http://www.aemc.gov.au/energy-rules/national-gas-rules/current-rules>

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