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N M Heath  
Gas & Power Marketing Director

**ExxonMobil**  
*Gas & Power  
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14 April 2005

Options for the development of  
the Australian wholesale gas  
market

Manager - Energy Market Reform Team  
National Energy Market Branch  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra  
ACT 2601

Dear Sir / Madam,

I refer to the draft report on options for the development of the Australian wholesale gas market that was released in March 2005. Please find attached the submission of ExxonMobil that addresses some of the key issues raised in the paper.

In summary, ExxonMobil believes that the wholesale gas market will develop most effectively by promotion of greater participation in a free and even market without unnecessary regulatory intervention. To this end, we support the organic development of the current market (option 1) and a bulletin board facility in the current market (option 2) providing that such bulletin board is voluntary. For the benefit of the wider economy, we urge governments to take steps to enhance free market participation by new players in both the supply and the demand for natural gas.

Yours faithfully,



N M Heath  
Gas & Power Marketing Director

An ExxonMobil Subsidiary

## **Options for the development of the Australian wholesale gas market.**

### **Ministerial Council on Energy**

#### **Submission by ExxonMobil**

**14 April, 2005**

#### **Introduction**

ExxonMobil is the largest integrated oil and gas company in Australia with a total investment of about A\$13 billion. Over A\$2.5 billion in technology and facilities has been invested in Australia over the last five years.

ExxonMobil is a producer of gas from the Gippsland basin in Victoria through its subsidiary Esso Australia Resources Pty Ltd. This gas is supplied to customers in Victoria, New South Wales, the ACT, Tasmania and South Australia. In addition, ExxonMobil is seeking to become a major gas producer in Papua New Guinea and in the Carnarvon Basin of Western Australia. Our PNG marketing group is actively marketing gas into the north and east of Australia. Our marketing activity for Carnarvon Basin gas targets both export LNG sales and domestic gas sales in Western Australia.

ExxonMobil is also the world's largest non-government marketer of natural gas with significant presence in almost every major global gas market including North America, The United Kingdom, continental Europe, Australia, Asia Pacific and the Southern Cone of South America.

As a major Australian and global marketer of gas, ExxonMobil welcomes the opportunity to draw upon its domestic and global experiences and expertise to provide comment to the Ministerial Council on Energy on options for the development of the Australian wholesale gas market.

#### **Preferred Options**

ExxonMobil supports the options presented in the draft paper that minimise regulatory intervention in the development of the wholesale gas market. To this end, we support the organic development of the current market (option 1) and a bulletin board facility in the current market (option 2) providing that such bulletin board is a voluntary mechanism for sellers and buyers to exchange excess or deficient gas and pipeline capacity.

#### **Excessive regulation hinders free market solutions**

The efficient development of the wholesale gas market is best served by both minimising unnecessary new regulations and removing current regulations that hinder efficient solutions. Based on its global experiences, ExxonMobil believes that governments can best facilitate the development of a competitive gas market by promoting laws and enabling legislation that are designed to embrace the most efficient mechanisms based on commercial principles while protecting against abusive behaviour of dominant positions. To this end, we believe that the Trade Practices Act (TPA) efficiently regulates the misuse of market power and other anti-competitive behaviour.

ExxonMobil has also found that excessive government regulation, such as some of the state restrictions on cross-ownership and restrictions on producers to market gas, hinders optimal solutions and creates costs and inefficiencies that are ultimately borne by the consumer. Examples of improvements to the regulatory environment, that in our view would improve the gas market include:

- Removal of barriers to gas exploration, development and supply. Recent intervention by the State Governments of Victoria and South Australia on spurious environmental grounds have unnecessarily restricted access to potentially prospective offshore acreage. Onshore, protracted negotiations over access to land subject to Native Title claims has slowed or stopped industry developments.
- Removal of barriers to market access for all participants, including producers and new retailers. Costs of participation in the Victorian gas market, for example, include the costs of licensing and mandatory participation under the Victorian Market and System Operations Rules, which govern the regulated market.
- Repeal of the restrictions on producers to market gas imposed by the significant producer provisions of the Victorian Gas Industry Act 2001. In Victoria it is illegal for significant producers to sell gas directly to consumers unless those consumers take at least 500 TJ per year. This means a large part of the market is denied the actual or prospective competition provided by significant gas producers.
- Cessation of retail price capping and facilitation of full contestability. Even where formal price caps are not being applied, the existence of such enabling legislation means that retailers are obliged to reach "voluntary agreements" with the governments.
- Liberalisation of pipeline regulation, and specifically allowing pipelines to operate uncovered with market determined tariffs, to stimulate pipeline investment by implementing reforms of the kind recommended by the Productivity Commission.

Further more, we would note that gas is competing with other forms of energy, such as electricity, coal, natural gas liquids, renewables and refined products. The total energy market will be most efficient and competitive when current regulatory imposed biases towards particular sectors of the energy market are removed and all forms of energy can compete freely on a level playing field. We believe, therefore, that regulation and taxation should be applied fairly and evenly across all types of energy and not unequally between the different sectors of the total energy market as is currently the case. Examples of improvements to the regulatory environment that, in our view, would improve the efficiency and competitiveness of the total energy market include:

- Remove secondary tax disadvantages that are applied to gas and not other fuels.
- Remove the regulatory incentives and concessions for renewables.

#### **Illiquid nature of the Australian gas market**

While the Southeastern Australian Gas Market has been transformed from a number of state based gas markets to a single market that now spans all southern and eastern states, the market is still largely illiquid due to the small number of large participants that constitute the wholesale gas market. These participants include:

1. Five major retailers, with most states being dominated by either two or three retailers.
2. Two transmission lines connecting capital city demand centres.
3. Two storage service providers.
4. Ten gas producer groups, with two gas producer groups providing a large fraction of the available capacity for the southeastern states.

Liquidity of the wholesale gas market will develop through greater participation. While the options presented in the draft report focus on transparency, none of the options, in our view, develop mechanisms that enable this increased participation to take place..

Greater participation in the wholesale market may be achieved by:

- Encouraging more suppliers, thereby increasing buyer choice. This can be achieved by enhancing exploration and development economics and removing barriers to gas exploration, development and supply as set out earlier in this submission.
- Encouraging more retailers, thereby increasing consumer choice. This can be achieved by allowing producers to market gas to end users without limitation.
- Encouraging growth and diversification of the gas market. Gas is a reliable and clean fuel that is cost competitive with other fuels when taxation is applied consistently. With more equitable taxation, the penetration of gas into base load power generation will be significantly accelerated.

#### **Nature of contracts in this illiquid market are incompatible with spot trading**

For as long as there are only a few discovered and producing gas fields and only a handful of customers large enough and with sufficient credit capacity to underwrite long term offtake agreements from the suppliers, the market will remain without any significant depth or liquidity. This is irrespective of the degree of price transparency. Indeed, there will be little, if any, public benefit from improved transparency without liquidity. Efforts to regulate transparency may only add costs for consumers, as has been the experience in the Victorian spot market to date. Analysis shows that while a transparent spot price has been published in Victoria for some time, it rarely changes and can sit at the same level from day to day or weeks at a time.

Gas sales are typically conducted under long-term bilateral agreements that are not compatible with daily spot trading. Due to the lack of depth in the wholesale market and the small number of participants in the wholesale gas market, appropriate gas sales and transportation arrangements have been established to manage the need for long term bilateral relationships with strong inter-dependencies. Gas sales are conducted under a few large sale and purchase agreements between producers and retailers that cover ~95% of market demand. Such sales are characterised by:

- Long term commitments - to recognize the long periods required to obtain a return on investment and to cover development risk.
- Periodic price reviews - to ensure competitive pricing.
- Take or pay provisions - to manage volume risks.
- Daily swing and capacity reservation - to accommodate demand variability.

Similarly, transportation and distribution contracts are also typically long term and highly committed arrangements.

The high levels of commitments undertaken by both producers and retailers in gas sales and transportation means that only a small amount of supply and demand is uncommitted on any day and available for spot trading. This is evident in Victoria, where despite a spot price being determined, trading is still predominantly static as most of the demand is met by committed supply.

## Options for the development of the Australian wholesale gas market: Submission by ExxonMobil

A voluntary bulletin board to clear daily uncommitted supply and demand would probably provide an improvement to the states other than Victoria where such a mechanism already exists.

### **Conclusion**

ExxonMobil believes that the wholesale gas market will develop most effectively by promotion of greater participation in a free and even market without unnecessary regulatory intervention. To this end, we support the organic development of the current market (option 1) and a bulletin board facility in the current market (option 2) providing that such bulletin board is voluntary. For the benefit of the wider economy, we urge governments to take steps to enhance free market participation by new players in both the supply and the demand for natural gas.