



## ABS INFORMATION PAPER: DEVELOPMENTS IN PRODUCER PRICE INDEXES FOR NATURAL GAS QGC RESPONSE

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### 1. INTRODUCTION AND SUMMARY

QGC welcomes the opportunity to comment on the Australian Bureau of Statistics (ABS) Information Paper: Developments in Producer Price Indexes for Natural Gas (**the Paper**).

We support the development of a liquid and transparent East Coast Gas Market and recognise the importance of developing an effective reference price to underpin this transition. Overall, we appreciate how a quarterly gas price index (the index) could be beneficial in understanding gas price movements over the long term (i.e. fundamental shifts in the market). However, we are unclear whether such an index addresses and responds to the underlying issues observed in the market.

To ensure the index is the appropriate measure and meets the evolving needs of the market, more fundamental consideration and clarification is necessary before a final decision is made to introduce the index: In particular,

- **The purpose and objectives of the index need to be defined.** It is unclear whether the purpose of the index is to capture long-term structural shifts in the market or short-term dynamics.
  - In the context of short-term movements, the proposed index is unlikely to produce particularly meaningful outcomes. Long term legacy Gas Sales Agreements (GSA) may not be reflective of current or future market conditions due to the major shift in the market observed through the introduction of LNG exports.
  - Priority should be on developing building market liquidity (e.g. at Wallumbilla Gas Supply Hub (GSH)) in order to establish a “credible” reference price for gas. Once established it should capture short-term movements and reflect long-term trends negating the need for other measures.
- **Detailed aspects of the methodology are also unclear and are likely to be more complex to resolve than initially considered.** For example:
  - Determining the most appropriate data collection point and which producers are intended to be captured.
  - Which contracts will be incorporated and the data collation process.
  - Whether issues such as the treatment of pipeline transport may have a material impact on the accuracy of the index.
  - Should be consistent with the International Organisation of Security Commissions (IOSCO) Principles.

These issues are discussed in the following sections.

## **2. THE OVERALL PURPOSE IS UNCLEAR**

QGC does not consider that this is the most meaningful mechanism in which to inform the market (and other stakeholders) of dynamic changes in domestic gas price movements.

While the purpose of the index and the proposed methodology are not entirely clear, based on our understanding, the ABS will select a “basket” of gas contracts (based on specific attributes) and report quarterly movements in contracted prices. This will be either through the averaging of contract price escalation factors and / or the price of new contracts or measuring the change in invoiced price. As contracts expire, they will be replaced with new contracts of a similar nature.

The East Coast Gas Market is changing (possibly more rapidly than anticipated) and an index of this nature is unlikely to capture these movements (which we consider are of interest to participants). While the concept may have appeared reasonable in the early stages of the AEMC Review, in our view, it might be less relevant and its usefulness is likely to reduce over time

### **Relevant short-term activity is not captured**

Over recent times, there is a noticeable shift to shorter-term gas trading activity.

The quarterly index, as suggested, is unlikely to capture these short-term gas trades and associated price movements. Rather, it is likely to reflect quarterly CPI changes as typical of longer-dated Gas Supply Agreement (GSA) price escalation factors.

While more frequent reporting may assist, it would need to be on at least a monthly basis and this could become too burdensome and costly for producers and most likely for the ABS.

### **Level of contract variation will reduce the effectiveness of the index as a benchmark**

The terms under individual GSAs are likely to vary considerably across agreements and counterparties. As a result, each contract cluster is likely to have insufficient depth in which to generate an appropriate sample size.

This would reduce the coverage/breadth of the index and participants overall confidence in using the index as a benchmark for price movements and / or as a reference price for future contracts.

### **Information is currently available and will improve in the near-term**

We consider there is a sufficient level of price information available and the quality will improve along with market liquidity. Liquidity is expected to improve as the broader AEMC/Australian Energy Market Operator (AEMO) reforms are implemented.

This information includes price data on the Wallumbilla GSH, Short-term Trading Markets (STTM), and information published by Price Reporting agencies such as Argus. Central to these improvements is the development of the Wallumbilla GSH. It will play an important role to promoting liquidity in the East Coast Gas Market and the development of a “credible reference price” for gas. As liquidity grows we expect price to reflect short to long positions around this trading point.

We expect the GSH to develop with reasonable pace now that the AEMC Stage 2 Draft Recommendations (and the AEMO work programme) are focused on addressing key factors limiting liquidity (including access to capacity, hub services and information). Further, during 2016 AEMO will implement reforms designed to create a single pricing point at the Wallumbilla GSH. This should materially assist in concentrating trade and building greater market confidence in the prices generated.

In our view, these developments could negate the need for other measures such as the index. In fact this process could distract from progression of other reforms, which are essential to ensuring that a “credible reference price” for the east coast gas market develops within a reasonable timeframe.

### **3. METHODOLOGY CONCERNS**

Notwithstanding the points raised above, if the ABS proceeds with the introduction of the index, the methodology requires significant clarification and the following points should be taken into consideration.

#### **Further work is necessary to determine the most appropriate data collection point**

Under the original AEMC proposal, the index was to be constructed based on information received from “customers” (electricity generators, retailers, industrial customers and LNG producers). Under the current ABS proposal this obligation seems to be placed on gas producers.

In our view, this issue remains unresolved and requires further consultation. In particular, some of the issues include:

- *The reason for the change is unclear*- while there was some early stakeholder discussion, on the most appropriate data source, there was no industry consensus and the Paper does not provide any detailed reasoning for the shift.
  - The Paper does suggest that the ABS recently commenced a monthly data collection from large producers, however, has not been published for a number of reasons (e.g. small sample size). It would seem a simplistic approach if this was the basis for adopting a producer price based survey for this purpose.
  - It is also unclear which producers have been surveyed, what information is being collected and if this aligns with the nature of the proposed (i.e. shifts in domestic contract prices).
- It would also seem appropriate that those benefiting (i.e. customers) from the publication of the index are directly contributing to the data collation process.
- *Relevant transactions could be excluded* - Placing the obligation on one segment of the supply chain could unintentionally exclude relevant transactions. As mentioned, while particular segments are considered “natural” sellers and buyers, businesses (producers and customers) trade gas to manage short and long-term positions.
  - For example, if the onus is placed on producers, the index could exclude “buy” transactions undertaken to manage a physical outage. Further as the market becomes more dynamic, the physical and financial players are likely to take- on various positions for strategic and risk management purposes.

- Many traditional buyers have become sellers through changes in their portfolio and strategy.
- Resolving this is not necessarily straight forward, however, it might be more appropriate to sample across the supply chain.

## Other Issues

- *Transport* – We consider that the exclusion of transport arrangements from the index calculations should be investigated further. Transport has a significant influence on the price of gas at particular locations relative to others either directly or indirectly. Transport pricing may reduce the price buyers are willing to purchase gas at and, conversely, expected pipeline constraints (either physical or contractual) could increase prices.

It is unclear whether this would have an impact on the “meaningfulness” of the index with respect to existing contracts (i.e. whether contracts at different locations can be compared). If, however, new contracts are incorporated into the basket, reported price changes could be more reflective of transport costs than underlying changes in the price of physical gas.

*CPI indexed “legacy” contracts should be excluded* – In-line with the points raised above, there is no material value in incorporating CPI indexed legacy contracts as part of the index sample set. Rather it places an unnecessary reporting/obligation on businesses, particularly at a time when gas businesses are experiencing a significant increase in their information reporting obligations (i.e. new AEMC reporting obligations for LNG producers).

*IOSCO Principles for Financial Benchmarks* – To ensure the integrity of the index, QGC considers the ABS should confirm that its arrangements meet the IOSCO Principles. The Paper does not provide any insight as to whether the proposal meets these international standards. We would appreciate further advice on this issue.