



EnergyAustralia

LIGHT THE WAY

7 February 2023

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Exposure Draft – Competition and Consumer Amendment (Gas Market) Bill 2022

EnergyAustralia is one of Australia’s largest energy companies with around 2.4 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. EnergyAustralia owns, contracts, and operates a diversified energy generation portfolio that includes coal, gas, battery storage, demand response, solar, and wind assets. Combined, these assets comprise more than 4,500MW of generation capacity.

We welcome the opportunity to provide a submission on the Gas Market Code canvassed in the Draft Bill. We understand that the DRAFT Gas Market Code will be consulted on at a later stage prior to when it takes effect, expected in March. The Draft Bill and consultation paper helps us understand the potential broad scope of the Gas Market Code and the Government’s proposed intention. However, Government consultation on the DRAFT Code is critical as it will provide us a chance to understand how the obligations are codified. With that in mind, our submission highlights our concerns with the Code and the Reasonable Pricing Provision and the risks if the Government does not proceed with caution on this significant industry reform. We then respond to the specific consultation questions in turn.

Alleviating high price concerns for customers and gas users requires addressing supply

We understand that the Government is trying to find ways to meaningfully reduce energy prices for customers. We recognise cost of living pressures are a significant concern for customers, whether they are households or businesses; we speak to around 10,000 customers a day and understand the real day-to-day challenges families and business owners are facing. In considering how to alleviate the impact of high prices for customers, it is critical to understand what drives high energy prices.

In 2022, a perfect storm of issues meant it cost EnergyAustralia more both to generate and purchase wholesale electricity for our customers. These issues included the sustained impact of the war in Ukraine on energy prices, extreme weather conditions, coal supply issues including many domestic coal generators being offline and unavailable to meet demand. These factors, amongst others, impacted energy prices. In response to the high electricity prices, gas generation quickly increased, far beyond forecast expectations. Nearly all gas available for generation was used to meet demand in the domestic market over the winter. As additional supply of gas as a resource became scarce, the domestic gas price rose to meet international parity prices.

While we appreciate the Governments best intentions to reduce energy prices, the Governments solution to price must directly entail addressing future energy supply levels, as the two factors (supply/price) are interlinked. Specifically with regards to the Governments proposed reform, a fundamental question that we believe requires attention and consideration is whether the Reasonable Pricing Provision via the Gas Market Code will improve supply? Additionally, is the Government confident through its analysis that this longer-term price regulation will address the root cause of higher prices, and will effectively resolve the underlying supply problems? These are important matters that need consideration.

As mentioned, addressing supply is needed to alleviate the root cause of high prices for domestic gas users. A negotiation framework and formal dispute process to support gas users' access to reasonably priced gas will not be effective if producers have a limited amount of gas to offer. Buyers and gas users will compete for gas contracts as the resource in the market becomes scarce. Even with more gas from Queensland being made available to the domestic market at a Reasonable Price there is the critical issue of transport to the southern states. Pipeline transport is not covered in the Code so will not address this issue, as noted in our previous submissions.

EnergyAustralia considers the Australian Domestic Gas Security Mechanism (ADGSM) will play a significant role in maintaining adequate gas supply for southern states in the future. We suggest the ACCC and Government develop a combined long-term solution incorporating a combination of the ADGSM, Gas Market Code and consideration of pipeline contracting and capacity to ensure there is enough gas supply to the south when it is needed and at a reasonable price.

Clear industry guidance requires the ACCC to answer very difficult questions

In providing clear guidance to industry on the Gas Market Code, the ACCC will need to grapple with complex yet critical questions on the Reasonable Price Provision. The Consultation leaves a lot of detail to be dealt with in the Code, however, at a high level we consider that the ACCC or appointed arbitrator will find it difficult to set the Reasonable Price of the 'most likely new gas production' as it will need to answer difficult questions on the role of gas in the market. Further, how the Reasonable Price will work remains highly unclear. Critical questions that need clarity include:

- How will the 'economic life' of a new gas asset in a transitioning sector be assessed?
- Will the 'economic life' of the new gas asset take into account government emissions reduction target?
- Does the Reasonable Price apply to each individual producer, or will one Reasonable Price apply across the market?
- How will a Reasonable Price be set when gas contracts have a variable component and are linked to the international oil market?
- Will Reasonable Price apply to gas imports to the domestic market and how will this work?
- Will the ACCC make the Reasonable Pricing decisions, or will it appoint an arbitrator?
- How will other factors not related to whether a new gas project is likely or not, be assessed against the factors listed in the consultation paper?

Reasonable Pricing appears to be a price cap applied in perpetuity, and there needs to be a lot of consideration on how this will impact the market. A Reasonable Price set too low would discourage new investment.

The ACCC will need to accurately balance the transition risks in the gas sector, otherwise gas as a resource could leave the energy sector before there are competitively priced low-carbon alternatives. The critical questions above require clear guidance. We question how the ACCC can provide sufficient guidance to industry with the Code expected to be in effect March 2023. A lack of clarity on the complex issues above can see the threat of stranded assets discourage any new investment.

Retail regulation via the Code is untested and imposes complexity and duplication

Wholesale gas producers have different cost structures to retailers so we agree with the consultation paper that the Code should not extend to retailers.

The Reasonable Pricing Provision is seeking to address the potential for producers to exercise market power by not offering gas supply on reasonable terms and prices. Retail participation in the wholesale market is not the cause of high wholesale gas prices. There is strong retail competition in the energy market, as we drive to provide the best outcomes we can for customers, or risk losing our market share. It is also important to note that most retailers are net buyers and 'price takers' for gas in the wholesale market. Understanding this is important. The retail market is already heavily regulated and monitored by bodies such as the Australian Energy Regulator, the Essential Services Commission and the ACCC. There are existing frameworks for retail prices where prices are published, and customers can compare offers and switch retailers. Creating additional regulatory hurdles via the Code will impose unnecessary complexity and duplication. This could have unintended consequences, for example on retailer viability and potential retail competition, which already incentivises retailers to pass through reasonable costs to customers.

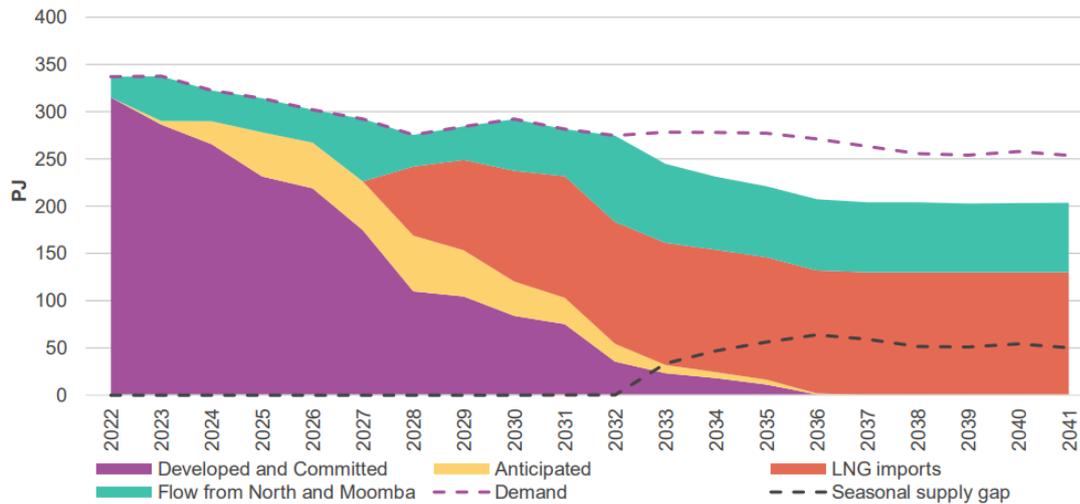
Existing risks and unintended consequences warrant a slow and careful policy approach

As the Gas Market Code is a significant piece of reform that will not have a sunset clause, it is best to approach policy slowly, and with care, as there may be significant unintended consequences of this price intervention, in a sector that is not considered a natural monopoly (outside the ACCC normal price regulation mandate).

Gas supply in the east coast gas market is already expected to decline from 2023 as projected by AEMO in its Gas Statement of Opportunities and the chart below. The Gas Market Code and Reasonable Pricing is not aimed at reducing barriers to entry for gas production or encouraging more players into the market. This means this reform will not address or prevent the gas supply decline shown by the chart. Further, the chart below relies on significant LNG imports supplied to the domestic market. It is unclear what impact the Code reform will have on this forecast level of LNG imports, and as noted above, there is a question of whether the Reasonable Price will apply to gas imports and how this will work.

Moreover, the unpredictability created by the reform can unintentionally harm competition and future supply as potential or existing market participants may be discouraged from investing. The impact of this on the chart could see 'anticipated' gas volumes reduced or even eliminated. Recent media coverage on the halting of future gas investment in the east coast gas market in response to this reform gives credence to this risk. Senex Energy's Atlas gas expansion has been put on hold, which would provide long-term gas from mid-2024 out to 2035. A Reasonable Price that is set too low will not encourage new investment.

Figure 39 Projected annual adequacy in south-eastern regions, Step Change scenario, with existing, committed, and anticipated developments, 2022-41 (PJ)



In addition, the Reasonable Price can have the unintended consequence of limiting retail competition. Assuming an appropriate Reasonable Price is set for wholesale gas, buyers will compete to access this reasonably priced gas. It is unclear how buyers will be selected for the contract of this gas, given the resource is scarce and consideration must be given to how this can work effectively. If one retailer gains exclusive access to this reasonably priced gas and this gas field is the cheapest on the east coast, this will place other retailers at a significant disadvantage as they will be unable to compete. This could entrench the market dominance of the retailer with the reasonably priced gas and erode future competition, all of which would harm households and businesses.

We will engage with the details of the Reasonable Pricing Provision and the Gas Market Code further in consultation to a Draft Code. The rest of the submission will respond to the specific questions asked.

Consultation questions

- 1. Are the obligations outlined in the voluntary code (summarised at Appendix C), if made mandatory, adequate to address bargaining power imbalances between gas suppliers and purchasers in the negotiation of gas supply contracts?**

At a high level, the aspects of the Gas Market Code that standardise the expression of interest process for all buyers and provide transparency of offers offered by producers seem encouraging. This appears to positively reinforce the standardised practices and requirements established from the Heads of Agreement between Queensland LNG Producers with broader applicability to all gas producers.

- 2. Should the Code of Conduct be limited to wholesale contracts where the supplier is a gas producer, or be expanded to include contracts offered by other market participants, such as retailers? This need not broaden the application of the reasonable pricing provision.**

Our views on this question are reflected above.

- 3. How could the binding arbitration process be designed to ensure resolution in an efficient and cost-effective manner, particularly with regard to reasonable pricing?**

The benefits of binding arbitration in contracting for wholesale gas should outweigh the costs - otherwise buyers will be left worse off. Assuming there is a strong case to introduce binding arbitration in the wholesale gas market, both gas buyers and producers must trust the process is timely, cost-effective and not resource intensive.

For larger buyers binding arbitration may be a rational avenue when an agreement with a producer cannot be reached as larger buyers are able to spread the cost of arbitration against a larger volume of gas that they're willing to purchase. Smaller buyers such as commercial and industrial customers will also need to assess the cost of arbitration against the potential benefit. It may be harder to justify the potential high cost of arbitration against a smaller volume of gas.

Arbitration should be sufficiently transparent. Transparency will provide buyers an understanding of how the arbitrator has set the Reasonable Price and can support buyers assess the benefit of arbitration against the potential cost. Without this clarity, some buyers may not be incentivised to refer disputes to arbitration, which will undermine the protection intended by the intervention. That said, producers will likely have strong concerns over publishing confidential and commercial information about their costs. The level of transparency to balance these competing interests would need to be considered.

An independent expert should assess the Reasonable Price put forward by producers, and this can be critiqued by an arbitrator. The onus should not be on buyers to disprove the Reasonable Price. This would be highly burdensome, lengthy, and costly as buyers must gather information, which may be commercial and hard-to-attain, to challenge the producers' cost assumptions.

The issue of gas producers justifying their price is reasonable is that there may be an incentive to lift costs to capture a higher price, which can then be used as a baseline for future negotiation. For example, 'with reference to the cost of the most likely new domestic gas production' producers could inflate operating expenditure or at least not spend efficiently to capture a higher price. This would not promote efficiency and mitigating this risk would need to be considered.

Overall, arbitration will not be effective at regulating access to reasonably priced gas if producers do not have gas to offer all buyers. Buyers will likely look at the 12-month wholesale gas price cap of \$12/GJ as the baseline for what is a Reasonable Price going forward. However, some producers have said that this price cap is too low and would force them to reconsider spending on new gas developments. As gas becomes scarce, buyers will compete for gas as producers will not have enough to supply all buyers, as noted above.

4. On what grounds should a party to a gas supply agreement negotiation be permitted to refer a dispute to a binding arbitration process? Should mediation be a pre-condition to accessing arbitration?

Generally, gas producers and buyers want to come to an agreement. That said, uncertainty from the gas price intervention has impeded on the ability for gas producers to contract for future supply as they consider how their pricing will comply with new requirements.

At a high level, creating regulatory hurdles for producers or buyers before a gas contract can be entered into (for example by making mediation a pre-condition or requiring Reasonable Pricing to be an upfront obligation) can cause delay and uncertainty in negotiating agreements. This is particularly true if hurdles are resource-intensive, costly, or lengthy.

Parties should be free to negotiate commercial agreements. Where parties cannot come to an agreement freely on price or other matters, binding arbitration and Reasonable Pricing could act as

a “backstop”. Consideration could be given to limiting disputes to price, rather than all terms and having a minimum volume threshold that can be referred to dispute.

5. On what basis should an arbitrator be able to make a determination on price?

- i. What factors should be considered for the reasonable pricing provision?**
- ii. What type of guidance on reasonable pricing should be provided to support negotiations, and if necessary, arbitration?**

As above, arbitration and Reasonable Pricing could be a “backstop” when parties are unable to negotiate an agreement freely. This would minimise the distortionary impact of this price intervention. That said, the underlying lack of supply means that Reasonable Pricing via arbitration may not be available to all buyers if producers do not have enough gas to offer and must select who to contract with.

The factors listed in the consultation paper used to assess the Reasonable Price appear sensible. Where it would be difficult and costly to determine the operating expenditure of an efficient new gas development, actual costs may be used if this data is readily available and gas producers are incentivised to pursue efficiencies. Information on operating costs of comparable new gas fields could support buyers form a better view of a Reasonable Price. While there is existing public information on the cost of supply at the point in production, buyers are unaware of producers' costs from operating a gas field.

Clear guidance on Reasonable Pricing requires the ACCC to answer the critical questions we noted above.

6. What design features will ensure the reasonable pricing provision provides a sufficiently clear basis for producers and buyers to negotiate a price?

Our view on Reasonable Pricing is reflected in the responses above.

7. What model of arbitration should be used to resolve disputes about reasonable pricing?

The following process would allow commercial negotiation to remain the primary method for determining agreements between gas producers and buyers:

- Buyers and producers are free to negotiate commercial agreements for gas.
- Where parties cannot come to an agreement freely on price or other terms, the producer or buyer may notify a dispute to the ACCC.
- Where a dispute is raised, the ACCC is empowered to appoint an independent and qualified arbitrator, which the producer and buyer agree on, to resolve the dispute.
- An independent expert should assess the Reasonable Price put forward by the producer, and this can be critiqued by the appointed arbitrator.
- The ACCC is not otherwise empowered to determine the terms or price of gas agreements.

Arbitration to resolve disputes about reasonable pricing will only be effective if the benefits of arbitration outweigh the costs, and this will vary depending on the buyer, their willingness to pay and the volume of gas they're buying. Dispute resolution will not be effective at regulating reasonably priced gas for all buyers where gas producers do not have gas to offer all buyers.

8. Does the proposed model appropriately mitigate the risks associated with market intervention?

No. We do not consider price regulation will limit increases in domestic wholesale gas prices as it does not stimulate supply or address pipeline transportation. The risk that uncertainty from price regulation will stifle future investment is also apparent and the complex issues that the ACCC must answer creates a lot of uncertainty on whether Reasonable Pricing can be implemented in a clear workable way.

If you have any questions in relation to this submission, please contact Maria Ducusin (Maria.Ducusin@energyaustralia.com.au or 03 9060 0934).

Yours sincerely,

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