Australian Chamber of Commerce and Industry

Mandatory code of conduct for the east coast gas market

ACCI Submission

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Introduction

ACCI welcomes the opportunity to contribute to the second round of consultation on the Mandatory Code of Conduct for the East Coast Gas Market (Competition and Consumer Order [Gas Market Code] Regulations 2023) and to provide recommendations that will assist in designing a code that supports gas-reliant businesses and improves efficiency and effectiveness of the domestic gas market.

ACCI believes that there is a case for government measures to provide temporary relief for domestic gas-reliant businesses facing spiralling gas prices linked to international markets. A well-designed code of conduct can be a useful mechanism for transparency and efficiency. However, a heavy-handed regulatory approach, with a government-mandated price cap, has the potential to impair the market and deter crucial investment in the industry. ACCI is concerned that the measures that have been proposed through the mandatory code of conduct for the east coast gas market may create larger problems down the track.

The current gas crisis is driven mainly by international events, specifically the Russian invasion of Ukraine that has destabilised global energy markets and constrained gas supply. However, this should not take away from the fact that the Australian domestic gas market has been dysfunctional for almost a decade, due to poor government planning and coordination following the opening of the east coast to international gas markets with the development of the three gas export terminals at Gladstone in Queensland. The new gas field development has been insufficient to meet the export contracts, requiring gas supply to be diverted from the existing domestic network. Coupled with dwindling supply from gas fields in the Otway and Gippsland basins, previously relied on for much of the supply to the southern states, the result is shortfalls in supply and escalating prices for domestic gas-reliant businesses.

The mandatory code of conduct and mandated price cap will provide some temporary relief for gas users from high gas prices and constraints on supply. However, it does little to address the longer-term issues, which are structural. A comprehensive national gas strategy is needed to provide long-term stability to the gas market and boost investor confidence. This holistic strategy should focus on increasing competition, creating a more interconnected network and improving the efficiency and effectiveness of the gas market. The strategy must strike right balance between providing secure, affordable and reliable supply to commercial and industrial gas users and residential customers, while maintaining our gas export market and the benefit it brings to Australia's trade balance and gross domestic product (GDP).

The following addresses questions raised in the discussion paper.

Good Faith

ACCI agrees that all transactions between producers and buyers of gas should occur in good faith. This is essential in providing both parties confidence the other party is acting fairly and honestly. The proposed good faith framework, with penalties for non-compliance, will deter parties from acting dishonestly or failing to work in the legitimate interests of the other party.

ACCI agrees the list of factors, drawn from the voluntary code, is appropriate for determining whether a producer or buyer has acted in good faith. These factors provide a useful guide to ascertain the extent to which parties have acted in good faith.

Expressions of Interest

ACCI has long advocated for greater transparency in the domestic gas market to improve the efficiency and competitiveness of the market. Requiring producers to publish information on the amount of uncontracted gas available over the next 12 months on their websites, and how much they expect to offer to the domestic market, will go some way to improving transparency and reduce the information asymmetry between producers and buyers.

The prescribed requirements included in the expressions of interest (EOI) for publication are reasonable, as the data to be published is readily available to the producer, thus does not represent a substantial administrative burden or include confidential information. The EOI period of 20 days and the response period of 25 days are also reasonable.

ACCI also agrees flexibility is important. The consultation paper notes that the code does not mandate an EOI process, however it does not offer an alternative approach. Instead, it requires all producers to prepare the information (the prescribed requirements) and publish it on their website in the form of an EOI process.

Commercial and industrial (C&I) gas users require certainty of long-term gas supply. They have made a large capital investment, which typically have an operational life of decades. C&I gas users require long-term security of supply to justify and support these investments. ACCI would like to see options for alternative approaches, outside the EOI process, to provide greater surety of gas supply for C&I gas users reliant on a long-term consistent supply of gas. Opportunity should be provided for existing customers to have first right of refusal for new gas supply when their current contract expires. C&I users need a level of certainty that when they reach the end of their contract, a new contract will be offered to them on reasonable terms.

The code of conduct only makes provisions for 12-month supply periods. However, it is essential that C&I buyers have access to contracts of five years or more. The inability of C&I gas users to secure long-term contracts has ramifications for investment and ongoing operations of many businesses. Thus, it is imperative the code of conduct includes provisions for supply periods for more than 12 months. This may include requirements that a certain proportion of total supply is allocated to long-term contracts of five years or more.

Pricing framework

The price cap of $12 gigajoule, when it was initially established, was only introduced as a stop-gap measure in response to the spiralling international gas prices due to the conflict in Ukraine. It was intended to shield households and businesses from unsustainably high prices in the short term. However, the proposed regulations extend this price cap to July 1, 2025, at which time it will be reviewed and potentially extended for a longer period. This has the potential to make the price cap permanent.

The consultation paper indicates the ACCC be charged with undertaking the review, which appears sensible given the ACCC is already undertakes the Gas Market Inquiry. The Gas Inquiry interim reports assesses the east coast gas supply-demand balance, which will form part of the assessment for the review of the pricing framework. Given the Gas Inquiry interim reports are now provided quarterly, it should be feasible to review the pricing framework quarterly, or at least annually. This will provide more timely assessment on the effectiveness of the mandatory code of conduct and enable the price caps to be lifted sooner, when are no longer necessary.

It needs to be recognised that the price caps are a significant market intervention that may influence behavioural and other external factors of both produces and buyers. There is a risk that in extending the price cap, it becomes permanently entrenched in investor's expectations, with producers delaying or cancelling investments. In introducing the mandatory code of conduct and extending the price caps to 2025 (potentially longer pending the review), the government must make sure that investment in new gas supply is not adversely impacted.

Forecasts in AEMO's Gas Statement of Opportunities rely heavily on undeveloped 2P (proven and probable gas reserves that are yet to be developed) and 2C (contingent reserves that are less certain and less commercially viable) gas reserves to meet future demand. If investment in these undeveloped 2P and 2C reserves do not go ahead due to uncertainty created by the heavy-handed regulation the mandatory code of conduct represents, then future gas supply shortfalls will come on sooner and be larger than is currently projected.

Exemptions from the price cap

The rules around applying for an exemption from the price cap are straightforward, with only small (less than 100 PJ) producers supplying solely to the domestic market able to gain automatic exemption, while small producers exporting part of their production, and large producers, must apply for a conditional exemption.

However, criteria the responsible ministers must apply in making their decision for conditional exemptions is a veritable black box. The decision is solely at the discretion of the responsible ministers, with the rules open and vague. Decisions can be made based on the expected effect of other related decisions, government policies and impact on trade and exports, and any other matter the ministers consider relevant.

The government needs to ensure exemption provisions are robust, with clear rules that can be consistency applied. To enhance transparency, the minister should be required to publish the reason for granting an exemption on the department's website. Greater transparency and a consistent approach to how the exemptions are applied is needed. An unpredictable inconsistent approach, with different rules for different producers, could lead to further dysfunction in the gas market.

The mandatory code of conduct applies only to producers, with retailers and aggregators effectively exempt. Yet, the role of retailers and aggregators is crucial as they exercise significant market power in supplying to smaller users. Smaller buyers in the 1-3PJ market are generally reluctant to take part in the negotiations with producers, so are dependent upon the retailers and aggregators for supply. The retailers and aggregators typically align their pricing with the LNG export pricing, with gas prices well above the

$12 pricing level for these buyers. Without specifically ensuring this portion of the market is under the influence of the code, the government's policy objectives are unlikely to be fully met.

Penalties and Court enforceable undertakings

ACCI agrees with the penalties and court enforceable undertakings, as long as they are consistent with the Competition and Consumer Act 2010. The tiered approach is sensible.

Concluding comment

The proposed code of conduct in the consultation paper is an advance on the initial approach advanced in the December 2022 consultation. However, the proposed regulations, with exemptions granted at the discretion of the responsible ministers, adds significant complexity and uncertainty to the gas market, which may have ramifications for long-term investment in new gas supply.

As ACCI has highlighted in previous submissions, the core issue faced by the gas market, which is contributing to the high domestic gas prices, is the lack of supply. The proposed code of conduct and price caps are the short-term fixes for Australia's dysfunctional gas market that does little to address the core issue. The code is a form of heavy-handed regulation and should only be viewed as a temporary, stop-gap, measure.

ACCI has, and continues to, advocate for more comprehensive reforms to address gas supply, security and affordability for east coast gas users in the long term, through the development of a national gas strategy. The strategy would aim to achieve a functioning gas market, by removing supply constraints, freeing up the market to competition and bringing down domestic gas prices, rather than adding further regulation.

A national gas strategy should aim to achieve a functioning competitive gas market, with a focus on improving its efficiency and effectiveness, increasing competition and removing supply constraints. A key component of this strategy must be increasing supply, through increased exploration and the development of gas resources on the east coast.

To be consistent with the National Gas Objective, the strategy would be consumer-focused, catering for the needs of C&I gas users and residential customers. At the same time, it needs to support the LNG export sector, which is a major contributor to Australia's trade balance and GDP.

The national gas strategy should aim to ensure domestic gas consumers have access to a functioning gas market. Short-term policy priorities should aim to increase competition, create a more interconnected network and improve the efficiency and effectiveness of the gas market. Long-term policy priorities should aim to remove constraints on exploration and gas-field development to increase domestic supply and drive down prices.

The strategy should focus on freeing-up the market to competition, rather than the addition of further regulation on what is an already heavily regulated and highly distorted market.

In developing the national gas strategy, we recommend the government work with its state and territory counterparts through the Energy National Cabinet Reform Committee and Energy Ministers' Meetings to ensure consistency of policy and regulation in the highly integrated.

About ACCI

The Australian Chamber of Commerce and Industry represents hundreds of thousands of businesses in every state and territory and across all industries. Ranging from small and medium enterprises to the largest companies, our network employs millions of people.

ACCI strives to make Australia the best place in the world to do business – so that Australians have the jobs, living standards and opportunities to which they aspire.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

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