

Gas Market Consultation
Labour Market, Environment, Industry and Infrastructure Division
The Treasury
Lanton Crescent
PARKES ACT 2600

Submitted via email: gasmandatorycode@dcceew.gov.au

12 May 2023

RE: Mandatory code of conduct for the east coast gas market

The Australian Energy Council (AEC) welcomes the opportunity to make a submission in relation to the proposed *Competition and Consumer (Gas Market Code) Regulations 2023* ('the Proposed Code') as discussed in the Government's April 2023 *Consultation paper 'Mandatory code of conduct for the east coast gas market'* ('Consultation Paper').

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

The AEC understands government's intent with the Proposed Code is to introduce measures to decouple Australia's domestic gas prices from international markets and thus allow wholesale gas contracting to better reflect long-term cost of (domestic east coast) production, with softening domestic wholesale prices to cascade through the supply chain and be reflected end user costs.

In the AEC's view, given the dynamic and complex nature of energy systems, any mandatory rules (be they via industry codes of conduct or otherwise) should be implemented temporarily with caution, precision, and regular review to minimise risks of unintended consequences.

The AEC has submitted in [December 2022](#) and [February 2023](#) to the government's earlier consultation process. The below response emphasises points raised previously and presents the AEC's view on further matters of concern.

Specifically, the AEC provides comment on:

- (i) Concerns regarding potential misinterpretation of what a *wholesale gas \$12/GJ price cap will deliver customers.***
- (ii) Areas for drafting refinement in the Proposed Code.** The AEC and its members have noted several issues with the Proposed Code provisions and present a number of areas which require attention and refinement.
- (iii) The need for transparency, clarity of process and review to mitigate impacts of uncertainty brought about by these interventions.**
- (iv) Concern that the government is considering extending the scope of interventions to include retailers.** Such measures would be regulatory over-reach, inconsistent with Commonwealth industry code policy and would diminish incentives for innovation and efficiency through-out the supply chain.

(i) Concerns regarding potential misinterpretation of what a *wholesale* gas \$12/GJ price cap will deliver customers

The AEC is concerned that there are medium to large customers, the media and industry lobby groups holding expectations that retail contracts will be offered at, (or only marginally above), \$12/GJ. An expectation like this is ill informed as it ignores the other factors that will influence the prices retailers can offer.

The AEC understands the Policy's objective of having 'reasonable' domestic wholesale gas prices to feed into the competitive retail gas market. Under the Proposed Code gas retailers and large customers who directly contract with covered suppliers are able to purchase gas for no more than \$12/GJ under a gas supply agreement ('GSA') no shorter than 12 months duration (Proposed Code section 42). However, depending on contract structure (e.g. take-or-pay, shaped or load following), the time of year and the location of the end user (among other factors) the cost of gas is not constant. The ACCC clearly demonstrates this in its Interim Guidelines.¹

One of the examples set out by the ACCC, is the case of a purchaser entering into an 80 per cent take or pay GSA at \$12/GJ. They only use 60 per cent of the contracted gas but have to pay for 80 per cent of the contracted gas. This results in an effective gas price of \$16/GJ. The ACCC concludes this does not contravene the regulation as it only considers the contracted price requires to comply with the \$12/GJ cap. Other examples presented include arrangements where haulage costs form part of the \$12/GJ cap and others where haulage costs are excluded. With respect to shaped contracts with differing seasonal pricing whether or not the contract contravenes the regulation is subject to the ACCC's discretion. In light of these inconsistencies, the AEC believes the Proposed Code needs to be more explicit as to how the \$12/GJ cap is to apply with respect to the actual price paid by retailers (and other buyers in the wholesale market).

With respect to actual market realities that affect the price of retail gas:

- Retailers may have GSA's that were struck prior to the enactment of the gas price cap order at prices higher than \$12/GJ. The Proposed Code (Section 7) states that GSAs struck on or before its commencement are excluded.
- Haulage costs add to the price. The Proposed Code states that if a party was previously selling gas inclusive of haulage then GSAs under the new regulations will be \$12/GJ inclusive of haulage. In contrast, others will be able to sell at \$12/GJ plus haulage. In the AEC's view this fails to understand the price terms which applied to contracts inclusive of, or exclusive of haulage, where the price of the haulage inclusive contract was higher to allow for haulage costs.
- The degree of risk the retailer is exposed to depending on the contract type e.g. shaped, take or pay, seasonality or load following. As stated previously, under take-or-pay arrangements, depending on actual consumption, the average price paid for the gas by the retailer can be well in excess of \$12/GJ.
- Retail contracts with customers connected to distribution networks will include distribution tariffs.

¹ ACCC, 'Interim Compliance and Enforcement Guidelines on Part IVBB and Competition and Consumer (Gas Market Emergency Price) Order 2022', March 2023.

https://www.accc.gov.au/system/files/Part%20IVBB%20Enforcement%20Guidance%20-%20March%202023_0.pdf

- Retail operating costs (cost to serve) along with customer acquisition and retention costs.
- A margin to provide an adequate return commensurate with the retailer's risk exposure and cost of capital.

In addition to the points set out above the other issue is how many exemptions for producers will be granted. Depending on how many producers are exempt will determine how much \$12/gas is offered to retailers and if it is widespread retailers are likely to have to pay more than this for gas.

The AEC is not aware of any government messaging to inform customers of the facts outlined above. Furthermore, the Consultation Paper fails to address this as well and one could be forgiven for thinking that the policy sets delivered gas prices at \$12/GJ. In the interests of better informing customers and other stakeholders, it would be helpful if future government media releases and documents clearly explained the difference between wholesale gas prices and retail gas prices.

(ii) Areas for drafting refinement in the Proposed Code.

The AEC acknowledges the challenges in drafting the Proposed Code to deliver on the policy objectives and the need to appropriately exempt particular entities and transaction types while considering anti-avoidance measures. In the interests of maximising the consistency and effectiveness of the code, the AEC supports anti-avoidance principles. The AEC however also notes numerous technical definitional points for refinement to provide participants clear practical application of these regulations. These pertain to the retailer exemption mechanisms, transaction/contract types along with specific application of the \$12/GJ cap provisions.

Retailer exemption

- **Entities who sell gas to large end users:** It is clear that the policy intention is to exclude gas retail entities. The AEC notes that the Proposed Code seeks to achieve retailer exemption by way of Section 47 where to be exempt, an entity must hold one or more retailer licences (as listed). The AEC has learned from its members that there are instances where a legal entity might sell gas to large end users and, under the National Energy Retail Law² and/or the Victorian legislation³ the legal entity is not required to hold such a licence. In the AEC's view the Proposed Code should be refined to enact exemption provisions which cover all retail entity types. The AEC suggests that this might be achieved by adding a functional description of a retailer to Section 47(a), **and** including a section (sequenced early in the regulation) which excludes sale of gas to customers based on annual consumption volume (customer size) – such as those who use 0.5PJ (or less) per annum.

Transaction/contract types

- **Physical gas swaps:** These arrangements involve one party selling gas to a counterparty and buying that gas back from the counterparty at a different time and/or location. These transactions are volume neutral for the market, and are beneficial as they allow gas to be available when and where it is needed most. As currently drafted, a swap agreement with an LNG exporter would mean the party is not eligible for the small producer exemption under the Proposed Code. The AEC suggests that parties should be able to enter physical swap agreements and still qualify for the small producer exemption.

² As referred to in sub-section 47(a)(i) of the Proposed Code.

³ Being the *Electricity Industry Act 2000* (Vic) and the *Gas Industry Act 2001* (Vic) referred to in subsections 47(a)(i) and 47(a)(ii) respectively.

- **Financial gas swaps:** A derivative (and not physical supply), these instruments are an important tool for the functioning of the market and managing risk. It is not clear in the Proposed Code if swaps offered by a ‘covered supplier’ would they be subject to the \$12/GJ price cap. The AEC recommends that the Proposed Code be amended to clarify the treatment of swaps.
- **Pre-negotiated contracts:** The AEC notes the ‘good faith’ provisions in Sections 30 and 31. The AEC supports good faith provisions for pre-contractual negotiations as this is where price and terms are established prior to an enforceable contract between the parties being established. Once a contract has been agreed upon the AEC does not see the need for good faith provisions to continue after this. Because generally in commerce, once an enforceable contract is established there are existing laws that provide an avenue of recourse to an aggrieved party.
- **Constraint of export through downstream supply chain:** The AEC notes the requirement in Section 28 (b), for ‘exempt small suppliers’ to not enter into a GSA with a counterparty who intends to export that gas. This provision is problematic and needs refinement. The AEC is concerned that an (otherwise) exempt small supplier would be challenged to reliably know the intention of a counterparty nor could the supplier trace the precise gas sold through the purchaser’s portfolio of on-sale arrangements.

Clarity and consistency of \$12 price cap application

- **Haulage and take-or-pay contracts:** We refer to matters raised in section (i) above.

(iii) The need for transparency, clarity of process and review to mitigate impacts of uncertainty brought about by these interventions

The AEC is concerned about the level of regulatory intervention and how this will impact the risk assessment for developers and ultimately gas supply in the longer-term. Nevertheless, on the understanding that the government is committed to implementing the Proposed Code we offer the following points for improvement to reduce uncertainty and perceived regulatory risk.

Ministerial exemptions (Sections 48 – 52)

The regulation provides for several conditional ministerial exemptions. In the AEC’s view, ministerial exemptions should be subject to clear requirements regarding standardised timeframes, criteria for approval, public disclosure of points of discretion and be subject to independent review. This could possibly take the form of a general ministerial exemption which would differ from what is proposed in that it would not require numerous bespoke arrangements between suppliers and the government. Leaving what is proposed as a process of last resort.

The AEC also notes that according to the Consultation report (p.17), under these arrangements suppliers are required to enter into enforceable domestic supply commitments. However, the AEC cannot locate any reference to this in the legislation. In the AEC’s view any such requirements should be clearly set out in the regulatory provisions.

Review

The AEC welcomes the requirement for a review to be commenced before 1 July 2025. However, the *nature* of this review is not specified. The AEC believes the Proposed Code should be improved by including further guidance as to the nature of the review, a more specific timeline and further suggests that the review should be comprehensive (including leaving open the option to reduce or repeal interventions).

Furthermore, the AEC believes that in interests of providing some degree of certainty for affected parties a superior approach would involve the inclusion of a sunset clause (applying on 1 July 2025) in the Proposed Code. This would then shift the onus on the government to justify a case to continue its intervention in the wholesale gas market.⁴

(iv) Concern that the government is considering extending the scope of interventions to include retailers

The AEC is concerned that misconceptions regarding the \$12/GJ cap explained in section (i) above are leading to an incorrect view that the Proposed Code ought to be extended to include retailers. The AEC strongly reiterates its view that retailer contracts (be they wholesale or retail) are not the driving force behind high gas prices, therefore including retailers would be beyond the Proposed Code's issue-solving objectives and contrary to Commonwealth policy.

The AEC notes the *Industry Codes of Conduct Policy Framework 2017*⁵ ('The Policy Framework') where the Commonwealth acknowledges that operating under codes of conduct come at a cost and "are only prescribed by the Government in very limited circumstances where there is a compelling case for intervention, supported by robust evidence."⁶

The AEC also notes The Policy Framework's prescriptive terms regarding threshold criteria for code creation and design⁷, including the importance of a narrowly and precisely scoped code focussed on solving clearly articulated issues⁸.

The AEC's [February submission](#) sets out why the underpinning issue is the cost of **wholesale gas supply** and that retailer contracts are not driving high prices and therefore extending the Proposed Code to retailers would be regulatory over-reach. Beyond this our prior submission outlined why the Proposed Code provisions are wholly inappropriate for the retail market. For emphasis we summarise these points again below.

The domestic wholesale gas supply price is driven by the international price

The domestic price linkage by way of 'export parity netback price' comparatives is clear and has been documented by numerous bodies including the RBA⁹ and the ACCC.¹⁰ Heightened international prices brought about by multiple global factors and punctuated by supply constraints connected to the war in Ukraine, have been the driver of higher east coast wholesale gas supply costs.

⁴ This approach is also consistent with the principles set out in the Commonwealth's policy framework for designing and implementing industry codes of conduct. The Australian Government – The Treasury, *'The Industry Codes of Conduct Policy Framework 2017'*

⁵ The Australian Government – The Treasury, *'The Industry Codes of Conduct Policy Framework 2017'*, <https://treasury.gov.au/sites/default/files/2019-03/p2017-t184652-5.pdf>

⁶ The Australian Government – The Treasury, (n6), p1

⁷ The Australian Government – The Treasury, (n6), p11

⁸ Ibid

⁹ de Atholia & Walker, *'Understanding the East Coast Gas Market'*, The Reserve Bank of Australia, Mar 2021. <https://www.rba.gov.au/publications/bulletin/2021/mar/understanding-the-east-coast-gas-market.html>

¹⁰ ACCC, *'Gas inquiry 2017-2030 – Interim report, January 2023'* (hereafter referred to as ACCC Report), p14. <https://www.accc.gov.au/publications/serial-publications/gas-inquiry-2017-2030/gas-inquiry-january-2023-interim-report>

As buyers of wholesale gas, retailers are natural 'price-takers'

In contrast to large gas producers, wholesale buyers are restricted to transact with domestic counterparties – a shallower pool of options and thus are natural 'price-takers'. Noting that some retailers have relatively small gas producer affiliates to assist them in managing their risks. In their January 2023 report *Gas inquiry 2017-2030 – Interim report*, ('the ACCC Report'), the ACCC highlighted that retailers are amongst the constrained buyers impacted by producers, where they mention that, according to some users “retailers were unable to supply gas due to their inability to obtain gas from producers.”¹¹

When retailers offer wholesale gas contracts they are 'price-followers'

While overall retail market participants are wholesale gas buyers, they do at times, offer wholesale contracts to either close out a long position or pass on supply arrangements to large commercial and industrial consumers. In such transactions retailers do not hold bargaining power commensurate to their large gas producer counterparts as retailer alternative price options are limited to:

- (a) comparable domestic wholesale deals - in which case retailers may be 'price-followers', (with producers setting market price), and
- (b) retail market sales - where, being competitive and geographically constrained retailers are incentivised to offer customers acceptable prices.

Such wholesale contract offer pricing from retailers is evidenced in the ACCC Report, where, during last year's peak price period, retailer offers are shown to have been predominantly below producer offers.¹²

The Proposed Code does not consider the retailer context, natural incentives or bargaining power - given their role in the supply-chain

Downstream from gas production and converging with wholesale trading, retailers' role in the supply chain is to manage wholesale market risks and requirements for their customers. This is a net buy-side exposure involving price volatility and regulatory risks, and market operational and prudential requirements. Retailers also provide customers with support services and adapted products while undertaking customer billing (for full supply-chain costs) and managing the resultant customer debtor's book.¹³

Given this supply-chain function, the context for retail supply contracts is far removed from the Proposed Code's design and it is wholly inappropriate to regulate retail contracts. Furthermore, the NECF mechanisms provide sufficient regulatory oversight of retailer interactions with small customers and in the AEC's view, the competitive landscape for large retail gas customer business means that no further intervention is warranted.

¹¹ ACCC Report, p60.

¹² ACCC Report, p14, Chart O.3.

¹³ Certain retailers also take on retailer of last resort (ROLR) responsibilities - which is an increasingly risky proposition in the current market.

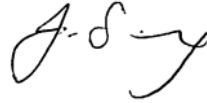
Any questions about this submission should be addressed to Peter Brook, Wholesale Policy Manager by email to peter.brook@energycouncil.com.au or by telephone on (03) 9205 3103.

Yours sincerely,



Peter Brook
Wholesale Policy Manager

Yours sincerely,



Jane Sing
Interim Retail Policy Lead