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Senate Standing Committees on Economics
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INQUIRY INTO THE COMPETITION AND CONSUMER (GAS MARKET CODE) REGULATIONS 2023

The Australian Industry Group (Ai Group) welcomes the chance to make a late submission to the Inquiry. Our members are businesses of all sizes and many sectors across Australia, and include many who use natural gas for process heat or as feedstock. The health of the gas market and the future of natural gas supply and demand are critical issues and Ai Group has been closely involved in debates about the Mandatory Gas Code of Conduct, its predecessor Voluntary Code, and broader gas policy issues for a long time.

The Mandatory Code includes two broad elements:

- Behavioural provisions relating to good faith, conduct and transparency. These are important for strengthening confidence in the wholesale gas market, which has been marred by dissatisfaction with the conditions under which deals are sometimes done.
- Reasonable price provisions relating to the $12 per gigajoule price anchor and, likely more importantly, provisions for being exempt from the anchor. This potentially represents a major and positive change in the underlying structure of the Eastern Australian Domestic Gas Market.

The key exemptions from the price provisions include:

- a range of short term balancing transactions; this is important to ensure that balancing markets can respond to match supply and demand, for instance during the days of highest winter heating demand;
- "small" sub-100 petajoule producers without export channels; and
- Larger or exporting producers who are granted a conditional exemption, which we understand will be done on the basis of legally enforceable commitments to supply particular volumes of gas to the domestic market.

It appears likely that most or all gas actually sold in Eastern Australia will eventually be subject to one of these exemptions. If so, it is plausible that the architecture of the Eastern Australian market will be positively changed. That is because since the commencement of East Coast exports of Liquefied Natural Gas, without any safeguard in place, the opportunity cost of not exporting has become a very important factor in shaping the wholesale price of gas to domestic customers. The result has been very heavy exposure by Eastern Australian gas users to the vagaries of international LNG markets. By contrast if gas suppliers are either non-exporters or firmly committed to supply particular volumes of gas locally, domestic gas supply will not have an alternative path to export and international opportunity cost will not be relevant to domestic price-setting.

The result would be that local gas prices would be influenced by local supply, demand and production cost, rather than by swings in the spot price of LNG delivered to Japan or of crude oil in Northern Europe. It is too early to tell if this approach is going to work. It crucially depends on the outcomes of the discussions underway between the Federal Government and individual large producers on the basis for the exemptions they are seeking. To the extent that exemptions are not sought or granted, the $12/GJ price anchor will apply and have an influence. In our view the price element of the Mandatory Code is worth trying, and having reached a range of compromises with gas users and gas producers the Government's regulations should go into effect and have a chance to operate and be judged on their performance.

It does not look likely that 'good' prices by historical standards will be achieved by any policy now in prospect. The reason is that older cheaper resources are depleting, and many of the cheapest remaining resources are committed to export. The combined production and transport costs of the marginal new sources of supply are significantly higher than historic prices and comparable to the $12/GJ price anchor. However as we saw last year, prices can always get worse and the improvement offered by the Code is worth pursuing.

While reducing the influence of international volatility on local gas prices is sensible, we also need to avoid a local supply-demand mismatch that would spike prices and reduce reliability. That requires:

- A basis for supply investment. The arrangements for exemption from the Code help simplify the challenge for new investors, but a functional and timely environmental approvals process will also be important to achieve.
- Attention to demand reduction. Higher prices, depleting resources and the imperative of emissions reduction necessitate accelerating the transition for gas users to alternative sources of the energy services provided by natural gas today. The relevant alternatives differ from one use case to another, but include forms of electrification, biogas and/or hydrogen. Different users will have different practical timeframes for change, but the overall level of demand transition needed this decade is substantial. Much more attention is needed to how to achieve this transition and manage its consequences. The Gas Code itself is unlikely to be the place for that demand-side transition work.
- Emergency backstops to ensure supply and demand align. The recently reformed Australian Domestic Gas Security Mechanism is one such backstop, though the use of the ADGSM could have unwelcome consequences for Australia's trading partners, and should be a last resort if other means of balancing the market fail. One or more LNG import terminals on the East Coast could provide flexible backstop supply with relatively little capital investment, but their interactions with domestic pricing need careful consideration.

Ai Group urges the Senate to allow the Code to come into force, while contributing to the development of a broader strategy to keep meeting energy users' needs.

The realisation of benefits for retail gas customers is very important. We are hopeful that wholesale improvements will flow through to retail gas buyers once the market settles down. If this does not occur, a Retail Code could be worth considering, though the use of the existing 'big stick' powers could be an alternative. We advise against holding back the operation of the Code in the meantime; it is important to strengthen contracting in the gas market, which is emerging from a freeze and should not be thrown back into uncertainty.

For any questions in relation to this submission, please contact our Director – Climate Change and Energy, Tennant Reed, on [redacted] or at [redacted].

Sincerely yours,

Louise McGrath
Head – Industry Development & Policy