AUSTRALIAN ENERGY COUNCIL

Senator Jess Walsh
Senator for Victoria
Chair of Economics Legislation Committee

Via email economics.sen@aph.gov.au

28 September 2023

Dear Senator,

Competition and Consumer (Gas Market Code) Regulations 2023

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Economics and Legislation Committee for inquiry on the Competition and Consumer (Gas Market Code) Regulations 2023 ('the Code').

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.

Background

The AEC understands that the government's intent with the 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) gas production, with the anticipated consequential softening of domestic wholesale gas prices to cascade through the supply chain and ultimately 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, and with caution, precision, and regular review to minimise risks of unintended consequences.

The AEC has submitted in December 2022, February 2023 and in May 2023 to the government's Gas Mandatory Code of Conduct consultation process. The response below emphasises points raised previously by the AEC and presents our views on further matters of concern.

Concerns regarding potential misinterpretation of what a wholesale gas $12/GJ price cap will deliver customers

The AEC is concerned that in the case of medium to large customers, the media and industry lobby groups are holding expectations that new 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 objective of having 'reasonable' domestic wholesale gas prices to feed into the competitive retail gas market. Under the Code, a price cap of $12/GJ is set to anchor wholesale negotiations between suppliers and buyers. 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.

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The major challenge over the last 18 months has been gas procurement due to the tight supply conditions prevailing since mid-2022. The domestic price linkage by way of 'export parity netback price' comparatives is clear and has been documented by numerous bodies, including the ACCC in its Gas Inquiry 2017-2030. 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.

Australia does not necessarily reflect international structure. In contrast to large Australian gas producers, domestic wholesale buyers are restricted to transact with domestic counterparties – a shallower pool of options and are thus natural 'price-takers'. Noting of course 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" (p.60).

The best way to understand it is that the Australian gas producers are the price makers, as the pool of firms they sell to is not limited to the domestic market and they have the option of an international price. Whereas the domestic retailers are price takers because the pool of firms that supply them is limited to the domestic market. AGL's LNG terminal project at Crib Point (disallowed by the Victorian Government) had a key purpose of increasing the supply (and security) of domestic gas, and that this would potentially put downward pressure on gas prices. This was not just signalling, as AGL put over $100 million into the project before it was disallowed. The Crib Point project would have increased buyer power by giving AGL the option of an international price and thus reduced AGLs vulnerability as a price taker. Given the investment they made, AGL clearly see it as a real and not just theoretical problem.

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.

In their position 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, along with market operational and prudential requirements. Retailers also provide customers with support services and adapted products while undertaking customer billing (billing for full supply-chain costs) and managing the resultant customer debtor's book. Certain retailers also take on retailer of last resort (ROLR) responsibilities - an increasingly risky proposition in the current market.

Actual market realities that affect the price of retail gas

Market realities that affect the price of gas include that:

- Retailers may have GSA's that were struck prior to the enactment of the gas price cap order at prices higher than $12/GJ.
- Haulage costs add to the price.

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- Retail contracts with customers connected to distribution networks will include distribution tariffs.
- Retail operating costs (cost to serve) along with customer acquisition and retention costs are reflected in the final price.
- A margin to provide an adequate return commensurate with the retailer's risk exposure and cost of capital is required.
- The degree of risk the retailer is exposed to depending on the contract type e.g., shaped, take or pay, seasonality or load following.[1]

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 as retailers will also have historical gas contracts in their portfolio that were not subject to the $12/GJ. As seen by the AGL Crib Point example, high gas prices were a problem before the cap was introduced.

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, 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.

An informative background document was prepared for large customers by the AEC in January 2023. It can be found here: https://www.energycouncil.com.au/news/background-briefing-retailers-and-gas-supply-for-c-i-customers/.

Information campaign for C&I customers
Due to the unforeseen level of international and domestic pressures, the gas market has evolved to be a new and very different market – this has placed increased pressures on both C&I users and retailers. Both parties are trying to navigate what has become an increasingly complex market. There are two main factors which continue to drive outcomes experienced in the market – uncertainty and unrealistic expectations.

While the market has to an extent stabilised, the uncertainty is being driven now by the unknown impact of the Gas Producer Code. There is no clear line of sight for retailers about how the exemption framework will work in practice and there is uncertainty due to the two-month transitional period.

[1] Explanations of some of the contract types are below:
Shaped: Shape is basically the Time of Use. Gas is a physical product that must be supplied and shipped to locations and so there can be adjustments for daily variance. Variance may be seasonal, quarterly, weekly, daily etc. It can be intertwined with other contract types. The $12/GJ number is not the "price of gas".
Take or pay: Take or pay provisions guarantees the seller a minimum portion of the payment, transferring risk to the buyer if it does not actually take the full amount it has contracted. These exist because fixed and overhead costs are high, but managed well they can provide benefit to the buyer as well if they can allocate gas across a portfolio more readily. But the risk may be too much for a smaller retailer.
Load following: The load following contract decreases risk by fixing a proportion of a retailer's gas costs and provides cover to the retailer in the event of load and load shape variations. They are used in various proportions as part of a portfolio approach, and often are favoured at up to 100% by new entrants to manage their wholesale risk, though the gas is more expensive.

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C&I customers may be more engaged than small customers, but many still lack information or resources to critically navigate what is an increasingly complex market. Retailers are keen to learn from their customers experiences over the last 18 months, and what C&I customers are not getting which they want. Retailers are also able to engage with C&I customers to explain why some of their needs cannot be met, where that is the case.

Retailers support information provision to C&I customers to enable them to have better understanding of their contracts. The AEC proposes a government led information campaign for C&I customers, to help them to navigate the new and different gas market.

The AEC strongly opposes further regulatory intervention at this point, as there has been so much change for both customers and retailers to navigate and now is the time to allow these changes to unfold so that participants can learn how best to navigate the new normal.

Any questions about this submission should be addressed to Jo De Silva, General Manager Retail Policy by email to [redacted] or by telephone on [redacted].

Yours faithfully,

[redacted]

Jo De Silva
General Manager Retail Policy