Australian Dairy Products Federation

Committee Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
economics.sen@aph.gov.au

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Re: Senate Standing Committee on Economics Competition and Consumer (Gas Market Code) Regulations 2023.

The Federal Government's Mandatory Gas Code of Conduct came into effect on 11th July 2023. On the 8th of August 2023, the Senate referred the *Competition and Consumer (Gas Market Code) Regulations 2023* to the Senate Standing Committee on Economics for inquiry and report by 6 October 2023.

The Gas Market Code applies to wholesale gas users and aims to ensure that east coast gas users can contract gas at a reasonable process and on reasonable terms, to level the playing field between users and producers and deliver a better functioning market. This includes a gas price cap of $12/GJ, and subject to a review commencing by 1 July 2025.

The Australian Dairy Products Federation (ADPF) appreciates the opportunity to provide comment to the Economics inquiry into the Gas Market Code. We have consulted with our members in developing this response and builds on our submission to the Department of Climate Change, Energy, the Environment and Water's *Mandatory code of conduct for the east coast gas market – Consultation Paper, May 2023*.

We reiterate the need for:

- Urgent action to deliver energy policies to lower energy costs for upstream industrial users (i.e., dairy manufacturers), and secure sustainable gas supply and safeguard dairy manufacturing in Australia.
- Transparency on contract offers upstream (as applies for electricity), with adequate time to respond to those offers (e.g., a minimum of 5-10 business days).
- Comprehensive analysis and commercial policy framework to support dairy processing businesses transition to alternate energy sources.
- Investment in dairy processing as a core pillar of Australia's manufacturing future under the National Reconstruction Fund, including assistance for dairy processors to transition to the new energy future – regardless of size and origin of ownership.

The ADPF is the national peak policy and advocacy body representing the post farm-gate members of the Australian dairy supply chain, including manufacturers, ADPF Australian Dairy Products Federation

traders and marketers of Australian dairy products. Our members process more than 90% of Australia's total milk pool and work across rural and regional Australia to bring dairy foods from the farm to the consumer, delivering healthy, nutritious products to Australians and for international markets.

Current operating challenges.

Whilst we are fortunate that dairy remains an important dietary staple amongst consumers, despite inflationary pressures, the ongoing decline in raw milk production volumes, challenging local and global market conditions, and high input and overhead costs present significant ongoing challenges to the dairy manufacturing sector.

There is now a 30% differential in Australia's farmgate milk price (FMP) compared to New Zealand, as reflected by cheaper NZ dairy cheese and butter on our supermarket shelves, whereby consumers, who are facing cost-of-living pressures, are increasingly buying cheaper products regardless of origin through necessity not choice. Import volumes are up 17% in 2022/23, with imports from New Zealand specifically up 28% year to date (May 2023)[1].

Adding to this pressure, is the ACCC's Dairy Code of Conduct under which buyers of raw milk are obligated to make publicly available Milk Supply Agreements (MSAs) by June 1 – which includes locking in a minimum farmgate milk price for the duration of the contract. No other commodity market in the world requires manufacturers to announce farmgate milk prices 13 months out from the seasons end for an annual contract, leaving dairy manufacturers totally exposed to market volatility and price uncertainty, in a market where the costs of Australian dairy products are not competitive with imports.

These factors are making Australia an increasingly uncompetitive place to manufacture dairy products. If we do not address the triple threat of low raw milk production volumes, the inequities of the Dairy Code and high input costs – particularly those pertaining to energy – there will be major implications on domestic supply and Australian exports.

Significant transformation and reduction in long term capacity can be expected to lead to job losses, reduced investment in regional communities, and impacting farmers who currently benefit from having manufacturing assets in their region.

Gas Market Code Regulations – July 2023.

Dairy manufacturing is unique: it is inherently energy intensive and transforms raw milk – a highly perishable, low value commodity – into safe, nutritious and premium dairy products for domestic and global markets, every day of the year.

Raw milk needs to be collected and processed within 24-48 hours of milking, seven days a week – there is simply no option to 'switch this off'.

[1] Data c/o Dairy Australia

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As the agricultural commodity most exposed to energy costs, substantial increases in gas and electricity costs have already stripped significant value from the supply chain further adding margin pressure to dairy manufacturers and putting upward pressure on prices for consumers. This dynamic ultimately risks making food inflation a bigger problem than it already is.

At the same time, dairy manufacturers recognise and are responding to the requirements of a new energy future and are implementing ways to lower production costs and improved efficiencies, capability, and capacity, such as through wind, solar and biogas.

However, commercially viable and reliable alternate energy sources are also not currently available that can replace the need for gas in the interim. For example, at present only gas can provide the heat required to generate steam for large boilers used in dairy manufacturing. Heat pump technology is only a viable energy source for small boilers (to generate both steam and hot water), and not the large boilers that dairy manufacturers require to generate steam for process usage (pasteurisation, homogenisation) and sterility.

Whilst we acknowledge the real impact of the Gas Market Code is still to play out, early indications signal not much has changed, with continued evidence of high gas prices hurting dairy manufacturers bottom line.

The Gas Market Code applies to wholesale gas users and has no regard upstream for purchasing by industrial users such as dairy manufacturers (regardless of their size) – and therefore they remain totally exposed to retail pricing. The assumption that the benefits of the gas price cap flowing upstream has not transpired, or to the level presumed.

We had previously noted in our May submission, that several of our members had signified an end to fixed price and fixed term gas contracts as of 2022 and been unable to secure new fixed term and fixed price contracts from gas suppliers for 2023 (and 2024) due to the current uncertainty in the gas market ('additional capacity') and the uncertainty of the 'price cap'. They were forced to accept high default rates up to six times higher than previous gas rates or enter into variable spot pricing agreements at an estimated to cost up to $20-$30 million annually, to ensure production continues and consumers continue to receive the dairy products they adore.

Upstream, there remains a lack of transparency on the contract negotiation process and price for industrial users, with ongoing limited retailer choice, limited gas supply, high prices and a lack of action by regulatory authorities. Members continue to report challenges in obtaining gas offers and that when they receive offers the prices remain high.

Whilst there has been some stabilisation in spot market prices, contract pricing on offer remains around $20/ GJ – an *$8.00 differential* to the $12/GJ gas price cap – and still significantly above the gas prices of 2022.

Considering the Gas Market Emergency Price Order came into effect on 23 December 2022 – and applied a temporary price cap of $12/GJ to new domestic wholesale gas contracts by east coast producers for gas supplied over the next 12 months – but the Gas Market Code didn't come into effect until 11th of July 2023, there is a 6-month window (at least) whereby contracts with much higher gas prices were taken up, for some.

What consequences will be acknowledged, and compensation considered?

As per the *Mandatory code of conduct for the east coast gas market – Consultation Paper* noted: "a new code covering retail sales will follow if evidence arises that retailers are not offering gas at efficient or competitive prices to users".

Clearly, the principles of a 'retail code' needs to be explored as a priority to avoid further unintended consequences as a result of dairy manufacturers being unable to secure sustainable and fairly priced gas supply.

Transparency on contract offers upstream is needed (as applies for electricity), with adequate time to respond to those offers (e.g., a minimum of 5-10 business days).

In addition, dairy manufacturers need comprehensive analysis and commercial policy framework to support businesses transition to alternate energy sources.

We seek investment in dairy processing as a core pillar of Australia's manufacturing future under the National Reconstruction Fund, including assistance for dairy manufacturers to transition to the new energy future – regardless of size and origin of ownership.

Conclusion

Input costs for manufacturers have risen dramatically over the past ten years, in particular energy along the east of Australia – as well as labour, transport, packaging and compliance costs – with costs projected to significantly increase further in 2023.

These higher energy costs are biting manufacturers, impacting their ability to remain cost-competitive and invest in innovation and technology. This risks the security of the Australian dairy industry.

Dairy manufacturers urgently need government to deliver energy policies for upstream industrial users that limit the risks presented by fast rising gas and electricity costs.

Government investment in – and clear policy options – are needed to continue to help facilitate this process and drive down production costs and optimise efficiencies.

Dairy manufacturers want to see our whole industry come together to help elected representatives land the policies required to secure dairy's future. Australian consumers want a thriving, sustainable dairy sector offering great local products. The Australian government wants more manufacturing jobs in regional areas, export growth and lower levels of food inflation. We can find universal alignment, but we must adjust key settings to enable Australian dairy's success and these settings include addressing Australia's energy prices.

Australian Dairy Products Federation

The ADPF welcomes the opportunity to work collaboratively with the Committee to address and resolve the challenges dairy manufacturers are facing, and would appreciate the opportunity to host a visit to a dairy manufacturing site to offer first-hand experience into the challenges and opportunities facing the dairy manufacturing sector.

Regards,

[redacted]

John Williams
President
Australian Dairy Products Federation
E: [redacted]
M: [redacted]

[redacted]

Janine Waller
Executive Director
Australian Dairy Products Federation
E: [redacted]
M: [redacted]