POLICY PAPER

NATIONAL GAS POLICY OPTIONS - UPDATE
JUNE 2022

EUAA
Energy Users Association of Australia

INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

Our members are highly exposed to movements in both gas and electricity prices and have been under increasing financial stress due to escalating energy costs. These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items. For some manufacturers, gas prices that persist above $15Gj is unsustainable and will ultimately lead to their demise.

The EUAA and its member companies are concerned that despite repeated warnings over the last decade that gas prices were at unsustainably high levels and despite the key findings of the 2016 ACCC East Coast Gas Report and 12 subsequent 6 monthly gas market reports that continues to validate energy users concerns, the gas market reform agenda had stagnated.

The current perilous state of the Australian energy market, while driven by significant global factors, could have been mitigated if gas customers had been the focus of policy. We firmly believe that a more balanced set of market reforms would have encouraged significant LNG export while ensuring Australian domestic manufacturing and households would have been protected from the worst outcomes of a highly volatile international market.

A SNAPSHOT OF WHATS AT RISK

As we consult with large industrial gas users it is clear that what constitutes an acceptable gas price will differ from sector to sector. Some industries can, reluctantly, accept a long-term gas price in the $10GJ to $12GJ range. While they can "survive" at this gas price, the prospects of significant investment in expanding their business are low with additional investment likely to occur in lower cost jurisdictions.

For other sectors a gas price in the range of $8GJ to $10GJ would lead to plant closure and job losses, especially if they have limited ability to pass these increased input costs through to end consumers. Regardless of the price point, all large industrial gas users continue to report that future investment decisions are being deferred due to uncertainty over domestic gas prices.

What is clear from <u>all</u> of these gas users is that if domestic gas prices persist at levels materially above $15Gj they will find will be virtually impossible to expand their business while some will have little alternative but to close their domestic operations. There have already been cases where this has occurred such as the decision by Incitec Pivot to construct a new multibillion-dollar facility in Louisiana instead of New South Wales, with gas costs a major influence on this decision. Others in the pulp and paper industries are also reporting they are progressively moving capacity to other jurisdictions such as New Zealand. While other issues such as water costs and availability of sufficient raw materials are factors, energy costs are identified as the key driver.

One of the industry sectors at risk is food processing and associated upstream fruit and vegetable suppliers. A majority of the companies involved in this sector such as EUAA members Simplot and Kagome are gas intensive with few alternatives for fuel switching given the high capital costs involved. Many of these manufacturers are very concerned about current and future gas prices, the long term impact on their operations and ability to produce price competitive products, especially where there is a material threat from imports.

It is not just the direct food processing implications but the potential knock-on effects to the farming sector and regional and rural Australia where a majority of these industries are located. Other suppliers in the food and beverage value chain such EUAA members Incitec (fertiliser), Orora (paper and cardboard), Visy (glass and paper) and Qenos (plastics), could also experience a significant downturn if we rely more on imported food products over time.

Many building products manufacturers such as bricks, steel and cement are also gas intensive with increasing costs largely being absorbed by these business, impacting their bottom line, reducing their ability to re-invest and putting jobs at risk.

We are also concerned about the impact of unsustainably high gas prices on wholesale electricity prices and the smooth transition to a low emissions energy system. While renewable energy, batteries and pumped hydro will play a growing role, highly flexible gas turbines will also play a crucial role in stabilising the electricity grid and smoothing out variable generation from wind and solar.

What is also clear is that the impact of higher energy prices are beginning to be reflected in the price's households are paying for many everyday items. Everything from pasta sauce and toilet paper through to building products and beer are all being impacted. At a time of growing inflation and cost of living pressures, the energy crisis will only make things worse.

POLICY AND REGULATORY OPTIONS

The EUAA is a technology neutral organisation. Our primary concern is achieving the best outcome for consumers measured by:

1. Achieving a long-term sustainable gas price that allows existing business to flourish and for new investments in manufacturing to occur.
2. Ensuring a competitive and highly liquid domestic gas market where market power is minimised or can't be exercised.
3. Achieving fair and reasonable contractual terms and conditions.
4. Improving transparency and decreasing information asymmetry.

The EUAA does not provide explicit support for individual projects or suppliers rather it supports approaches, actions and investment that clearly demonstrate that they contribute to meeting the above principles including appropriate action by Government.

There has been some excellent work in recent years by the ACCC to improve transparency and reduce information asymmetry, by the GMRG to establish pipeline capacity trading and implement an arbitration framework to help level the playing field between shippers and pipeline operators and by the Federal Government via the ADGSM/Heads of Agreement that has had some positive impact on domestic supply, although recognising this has not had a material impact on domestic prices.

We also note the Victorian Government has recently lifted the moratorium associated with conventional on-shore gas while the Queensland Governments approach to prospective gas reservation has seen some improved outcomes for domestic consumers.

During the course of 2020, the EUAA and member companies were invited to engage directly with the Federal Department of Industry, Science, Energy and Resources on a range of policy and regulatory approaches that would help improve outcomes for large commercial and industrial gas users. In addition to this, the EUAA, member companies and other representative bodies have been working with Axiom Economics and NERA Economic Consulting with similar goals as above. A summary of policy and regulatory options developed as part of this work is provided as *Attachment A*.

Despite the critical need for gas market reform, progress to date has been frustratingly slow. Domestic gas markets are still immature, opaque, lack liquidity and exhibit limited competition.

Clearly, much more needs to be done on gas market reform if we are to achieve a domestic gas market that sustains both the gas industry and customers. The EUAA continue to advocate for an “end-to-end” national gas strategy that targets an affordable price and fair and reasonable terms and conditions for consumers rather than just more supply in the hope that this alone will resolve a fundamental lack of competition.

While the objectives of gas market reform are universally agreed by EUAA members, there are a range of views expressed as to the best way to move forward. The following options represent a range of policy and regulatory reforms that have been discussed and debated amongst EUAA members and as part of broader discussion. Where possible, we have tried to identify the level of support that exists for each policy and regulatory option.

It is fair to say that with recent events, some more interventionist policy that was once greeted with a low level of enthusiasm is now being seriously considered as a way forward. As we have stated many times, the decisions only get harder to make the longer you delay in making them. This current gas crisis, while extreme has happened before (prices of +$20Gj have occurred in the past) and will happen again unless we can de-couple the domestic gas market from international markets, as is the case in Western Australia.

Federal Government

<u>There is strong support for extending and strengthening the Commonwealth Heads of Agreement and ADGSM</u>:

EUAA members support the extension of the existing Commonwealth Government’s Heads of Agreement with LNG producers because it has been clearly demonstrated that LNG producers have the capacity to supply additional gas into the domestic market when needed (or when it is required of them).

It has been suggested that strengthening the agreements price commitments could be achieved by reference to LNG price expectations for uncontracted gas in overseas markets over the relevant period. EUAA members are concerned this will drift toward the higher cost Asian spot price (i.e. JKM), does not represent fair and reasonable contract pricing and will not place sufficient downward pressure on domestic gas prices.

The ADGSM could also be strengthened so as to allow it to be triggered where both a supply issue arose or if unsustainable prices were to occur. For example, the AEMO have been forced to cap prices at $40Gj (which we still view as excessively high) in Queensland, NSW and Victorian gas markets. While this is an emergency measure it provides little longer term protection for consumers. We understand these are complex issues so would welcome a discussion in the near future on how the price of gas is a central component of the ADGSM trigger.

<u>There is strong support for strengthening gas industry code of conduct</u>:

The EUAA was one of a number of consumer representatives that participated in the development of the voluntary gas industry code of conduct during the course of 2021.

We, and the then Federal Government, were assured that a voluntary code, with no price commitment (not even a fair and reasonable commitment) and no compulsion for any participant to act would be sufficient. As we are now observing, the voluntary code of conduct has had little if any impact on the behaviour of the gas industry who continue to misuse their market power.

As numerous ACCC interim reports have revealed, the periods of moderate gas prices we have observed over the last 12-18 months has been more a result of the threat of government intervention (i.e. domestic gas reservation, price caps and export controls) than any improvements in the imbalance of market power between suppliers and customers.

If it becomes abundantly clear that the voluntary code of conduct is little more than a paper tiger then we would fully endorse government moving quickly to strengthening it, including making it a mandatory code via regulation. It is through this form of code of conduct that strengthening domestic market protections could be achieved.

<u>There is strong support for the establishment of a multi sector gas task force:</u>

All too often gas users have felt their voices have not been heard. While the EUAA and its members have been engaging at both a departmental and political level for some time it is difficult to understand what impact this is having on policy.

Therefore, we recommend the Federal Government convene a permanent, multi sector gas task force that covers all aspects of the gas supply chain followed through with additional policy and regulation that brings about a mature, transparent and highly liquid domestic gas market capable of delivering economically sustainable outcomes for all stakeholders.

Supply

<u>There is strong support for the establishment of an Australian Gas Hub:</u>

The Henry Gas Hub, located at Erath Louisiana, is the the key pricing point for natural gas futures contracts and OTC swaps in the USA and, due in part to its interconnection with nine interstate and four intrastate pipelines, also makes it one of the most liquid gas trading hubs in the world. Aiming to replicate this by establishing a central

Australian Gas Hub at Wallumbilla is laudable and if achieved would deepen liquidity and improve transparency, particularly for northern gas buyers.

While very supportive of this, southern gas buyers are concerned with both dwindling southern gas supply and worsening north-south pipeline congestion that would restrict access to this proposed hub and the prospect of lower prices (not to mention north-south pipeline charges).

Therefore, for it to have a truly national benefit significant north-south pipeline infrastructure should also be encouraged to increase southern supply and improve pipeline competition. In lieu of this, establishing a more liquid and transparent southern hub (including increasing southern based supply options) would also be supported by EUAA members.

Further to this, the introduction of market maker provisions (discussed below) should be linked to this to help build liquidity in the near term and ensure that actual contract volumes are offered to domestic customers.

<u>There is strong support for removing gas moratoria</u>:

Replacing the blunt instruments of moratoria with transparent technical assessment, robust planning/monitoring and a just compensation framework for landowners should be a priority.

<u>There is growing support for alternative fuels:</u>

We continue to keep a watching brief of alternative fuels such as renewable gas and hydrogen. Volume and cost competitiveness need to improve, in some cases dramatically, for alternative fuels to be a viable option for energy users.

We are supportive of government R&D and early stage deployment support for alternative fuels via agencies such as ARENA and the CFC.

<u>There is strong support for prospective gas reservation</u>:

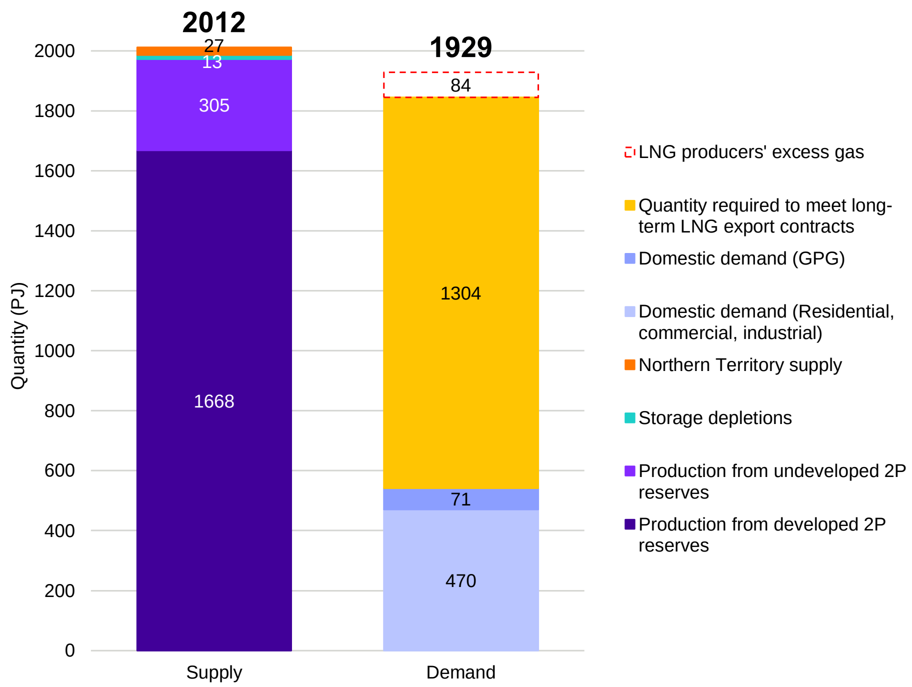
We encourage state governments to continue to identify and release new acreage, with an allocation for the domestic market. Queensland has already set a precedent and it has been well received by market participants. We would not be opposed to linking additional state and commonwealth support (i.e. underwriting, book build) to new acreage set aside for domestic gas users.

<u>There is renewed consideration and support for some form of retrospective gas reservation:</u>

Domestic gas reservation is a feature of virtually every jurisdiction that has established an LNG export industry, recognizing that its citizens are the ultimate owners of the resources and therefore should enjoy the full benefits of it. They have also sought to protect their domestic economy from global price fluctuations and in doing so maintain their international competitiveness. It is a source of great frustration that Australia did not adopt a similar approach.

According to the ACCC Gas Inquiry Interim Report[1] domestic demand (including GPG) represents approximately 25% of the East Coast Gas Market, with the balance going to LNG export facilities. If the total volume of domestic gas associated with a retrospective gas reservation policy was prioritised to "high value" tasks such as manufacturing and peaking generation the total volume covered by the reservation policy would be relatively small and could be sourced from a combination of existing 2P reserves and excess gas.

Chart 1: Forecast supply-demand balance in the East Coast Gas Market (including supply from the Northern Territory) for 2021



In the past, the EUAA have not called for retrospective gas reservation due to the negative impacts it could have on existing and future investments. The gas industry is correct to say that this would damage the reputation of Australia as a safe destination for international investors.

However, while we agree with this sentiment it is frustrating that the gas industry does not recognize this is precisely the issue many manufactures are faced with given they warned of gas price shocks would come and suggestions of even a mild national interest test were rejected by the gas industry. Billions invested in good faith in manufacturing capacity is now at risk as a result.

To be clear. In considering if some form of gas reservation policy should be put in place, we <u>do not</u> endorse Australian LNG exporters defaulting on existing contracts. They must be able to honor their existing contract commitments.

However, given the circumstances we now find ourselves in we must reconsider some form of domestic gas reservation or national interest test that has the effect of de-coupling domestic markets from the volatility of the global environment. This could be related to spot gas cargoes, possibly as part of a strengthening of the ADGSM,

[1] ACCC Gas Interim Report, July 2020. Page 10.

Heads of Agreement or mandatory code of conduct. Working with state governments to ensure that future license conditions also include a domestic gas commitment would also be a positive step.

<u>There is strong support for asset underwriting and book build programs:</u>

Working in tandem with prospective domestic gas reservation, establish an asset underwriting program designed to not only bring new forms of supply to the domestic market but to assist in diversity of suppliers.

Similar to Recommendation 4 in the July 2018 ACCC Retail Electricity Price Inquiry[2] the Federal Government would act as a commercial safety net to assist proponents secure longer-term GSA's and obtain required funding.

EUAA members are also supportive of developing a book build program that further assists with developing long-term pipeline assets and new acreage development.

In both of these examples, the Federal Government is not directly competing with private investment (a criticism of some of its actions in electricity markets) but is acting to reduce risk for market participants by leveraging its strong balance sheet.

<u>There is broad support for the introduction of use it or lose it provisions:</u>

As recommended by the ACCC in their August 2020 Gas Market Update[3], Government should look to "active tenement management" to ensure gas acreage is not being withheld to the detriment of domestic gas users.

<u>There is some support for LNG cargo underwriting (Virtual Pipeline):</u>

Should LNG import terminals be established by non-government participants on the east coast, governments could underwrite LNG cargoes from North West Shelf. This would have an immediate impact on supply, price and competition in both wholesale gas markets and transportation.

Market Development

<u>There is strong support for the introduction of market maker provisions</u>:

Accelerate the maturity of the wholesale domestic gas market with a medium-term goal of achieving similar outcomes to the wholesale domestic electricity market.[4] Within this context, government should consider the introduction of "market maker" requirements on major wholesale participants in regions where there is low liquidity and little price discovery.

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[2] REPI recommendation 4 proposed that the Australian Government should operate a program to encourage new entry, promote competition and enable C&I users to access low-cost new generation. The recommendation was aimed at supporting the development of a competitive market by introducing additional independent firm supply and reducing concentration.

[3] https://www.accc.gov.au/publications/serial-publications/gas-inquiry-2017-2025/gas-inquiry-july-2020-interim-report

[4] Electricity is traded through a "gross pool" market where all energy is traded in an open, transparent fashion that facilitates high levels of liquidity and price discovery

Market marker requirements are already being considered for the South Australian wholesale electricity market for these same reasons.

There is strong support for actions to reduce the likelihood of market power:

Working in tandem with incentives to increase both new supply and diversity of suppliers, ensure the ACCC has all that it needs to monitor market structure and market power and to take appropriate action where necessary.

There is strong support for market development initiatives:

Over a period of 18 months, the EUAA had regular discussion with the Commonwealth Department of Energy regarding potential policy and regulatory reforms. We were also been part of consultation with Axiom Economics who have been engaging with gas users on behalf of the Commonwealth. Appendix A provides an outline of a number of policy and regulatory reforms that would be helpful.

There is some support for the introduction of big stick legislation:

This is a vexed issue. The previous Federal Government enacted it's so called "big stick" legislation to ensure electricity market participants do not exercise market power, despite significant competition already occurring in that market. The EUAA were opposed to the introduction of this measure believing it unnecessary in the circumstances.

However, we note that many aspects of the domestic gas market are far less competitive yet we see little evidence of strong government actions to address what many gas users feel have been instances of an abuse of market power. It would be useful to understand the diversity of approach taken by government to market reform in electricity markets as opposed to the approach in gas markets.

Transportation

There is strong support for asset underwriting:

Working in tandem with prospective domestic gas reservation, establish an asset underwriting program designed to support more gas pipeline development to help bring both new forms of supply to the domestic market assist in supporting a diversity of suppliers (i.e. Expansion in gas transport capacity from Queensland to southern States).

Similar to Recommendation 4 in the July 2018 ACCC Retail Electricity Price Inquiry[5] the Federal Government would act as a commercial safety net to assist proponents secure longer-term GSA's and obtain required funding.

[5] REPI recommendation 4 proposed that the Australian Government should operate a program to encourage new entry, promote competition and enable C&I users to access low-cost new generation. The recommendation was aimed at supporting the development of a competitive market by introducing additional independent firm supply and reducing concentration.

There is strong support for streamlined planning:

Working in tandem with asset underwriting, governments could consider accelerated planning approvals and favorable regulatory treatment in exchange for price guarantees for shippers. A precedent exists with the new rules to make the AEMO ISP actionable where a streamlined approvals process seeks to balance regulatory oversight, transparency with a quicker regulatory approval.

There is limited support for import terminals:

In recent Gas Market Reports, the ACCC have recommended investment in import terminals as a means of improving market conditions for consumers. The impacts, both positive and negative of LNG import is a point of debate amongst member companies. Some feel it will lock the domestic market into an international price while other feel that could be an important source of new supply and driver of increased competition.

The EUAA do not comment on individual projects other than to state that if market participants are prepared to make these investments and these investments lead to increasing competition and lower prices for consumers (although it is not clear how that would come about) then the EUAA would be supportive.

END USE EFFICIENCY

There has been considerable focus on energy efficiency in the context of reducing electricity bills over many decades. Federal and State Government education programs, grants for energy efficiency audits and funding programs for a range of practical improvements including replacing lighting systems, improving efficiency of compressed air systems and upgrading to high efficiency HVAC systems.

We have not seen evidence of a similar effort to improve end use efficiency. While it is suggested that simply "switching fuel" to gas alternatives or electricity is a viable option, this ignores both the significant capital investments already made by energy users, that would need to be written off, and the additional capital investment required to switch fuels. Some energy users may be in a position to fuel switch (i.e. they are about to embark on a capital upgrade program) but for a majority, the short to medium-term opportunities are limited.

Therefore, for a vast majority of industrial gas users lowering the cost of gas and increasing end use efficiency are the primary means of managing near term issues associated with high gas costs.

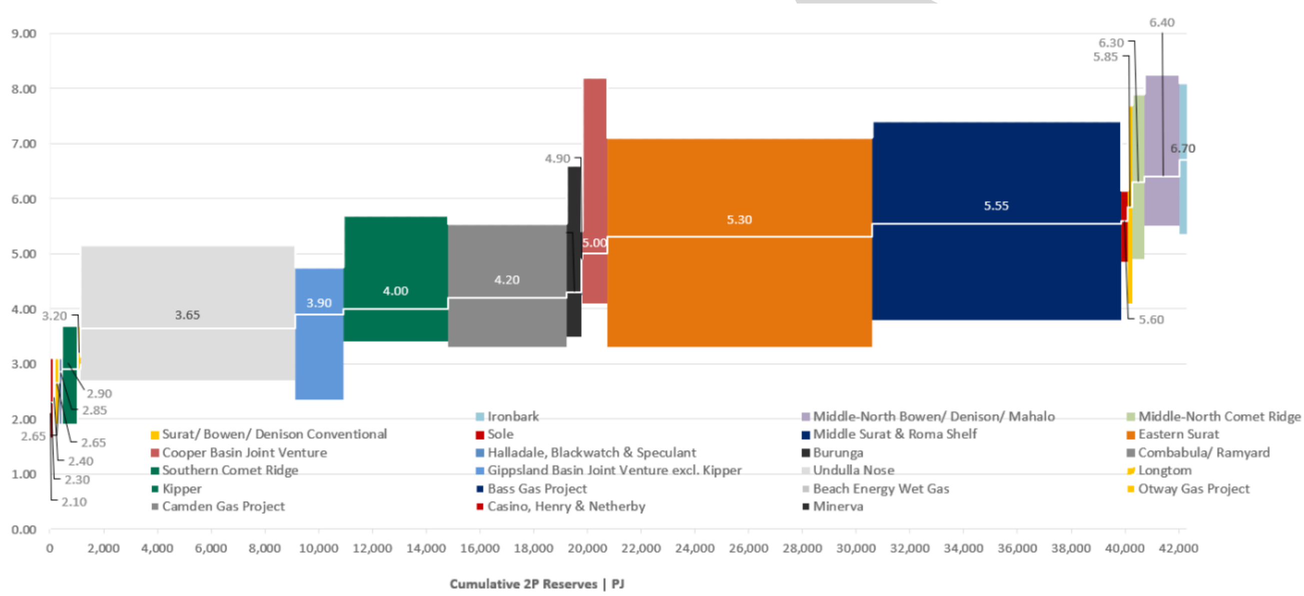
We would suggest that governments consider replicating energy (electricity) efficiency programs already in place that:

- Educate and raise awareness of gas efficiency opportunities
- Identify clear actions that can be taken while quantifying benefits
- Assist with deployment of technologies to improve gas efficiency

PRICE CAPS

The introduction of price caps would be another significant step by government. In consideration of what price cap or price range would be possible, a report published by Core Energy and Resources for the ACCC[6] as part of their initial gas inquiry provided the following cost summary of 2P reserves by supply region. This would indicate that if price caps or price range were introduced then a price range of between $5.00 GJ and $7.50 GJ would be possible.

Go forward cost summary- High low and reference cost range : 1 Jan 2018 $/ GJ y axis and X axis PJ of 2P reserves per supply region



[6] https://www.accc.gov.au/system/files/Core%20Energy%20report%20for%20ACCC%20-%20November%202018.pdf

ATTACHMENT A

Table 5.2: Summary of options

	Measure	Straight forward for Commonwealth Gvt to implement or champion?	Timing of impact once implemented*	C&I user group
Measures to increase domestic supply (treat problem)				
1a	Management and enforcement of producers' compliance with permits	▪ Yes for Cth offshore tenements/grants ▪ No for onshore tenements/grants because requires state/territory gvt action	Medium to longer term	All
1b	Issuance of more tenements and/or grants (see also 2b)		Medium to longer term	All
1c	Gvt co-ordination and potential underwriting of pipeline investment	▪ Yes for funding but planning process requires state/territory gvt action	Medium to longer term	All
Measures to increase producer competition (treat problem)				
2a	ACCC review of joint marketing	▪ No – ACCC investigation required	Short to medium term	All
2b	Award tenements and grants to junior producers, or new entrants to the East Coast market	▪ Yes for Cth offshore tenements/grants ▪ No for onshore tenements/grants because requires state/territory action	Medium to longer term	All
Measures to facilitate more retail competition for C&I users (treat problem)				
3a	Expand scope of the AER's Energy Made Easy website, or develop another website for C&I users	▪ No if implemented through AER site ▪ Yes if implemented through a new site	Short-term	Small – medium
3b	Mandatory market making	▪ No – requires change to legislation/rules	Short to medium-term	All
3c	Gas release programme	▪ No – likely requires ACCC investigation and then change to legislation/rules	Short to medium-term	Small – medium
Measures to improve producer-retailer selling practices and reduce imbalance in bargaining power (treat symptoms)				
4a	Introduce producer and retailer negotiation framework	▪ Yes if industry code developed ▪ No if regulatory option taken	Short-term	All
4b	Require retailers to provide cost breakdown for offers and invoices		Short-term	Small – medium
4c	Require retailers to explain risks if selling facilitated market products		Short-term	Small – medium
4d	Reform EOI processes		Short-term	Medium – large
4e	Develop standardised producer and retail agreements that act as a baseline for negotiations		Short to medium-term	All
4f	Buyers' groups	▪ Yes – already possible under CCA	Short-term	Small
4g	Collective switching	▪ Yes if voluntary switching programme ▪ No if forced switching or imposition of obligations on retail bills	Short to medium term	Small
Measures to improve access to infrastructure (treat the problem and symptoms)				
5a	Pipeline access education programme	▪ Yes – AER is already able to run	Short-term	Medium – large
5b	Improve access to regional pipelines	▪ No – requires change to legislation/rules	Short to medium-term	All
5c	Third party access to storage	▪ No – requires change to legislation/rules	Short to medium-term	Medium – large
Measures to improve the conduct of third party intermediaries (treat problem)				
6a	Introduce mandatory code of conduct or accreditation scheme for third party procurement advisors	▪ Possibly if ACCC directed to develop code or scheme for gas and electricity	Short to medium-term	Small
Measures to reduce complexities, costs and risks of self-contracting and markets (improve other aspects of market)				
7a	Business energy coaching	▪ Yes if funded by Cth	Short-term	All
7b	Improve facilitated market registration process and reduce other barriers to these markets	▪ Yes – AEMO already able to do	Short-term	Medium – large
7c	Review level of market price caps	▪ Yes – Already scheduled to occur	Short-term	Medium – large
7d	Facilitated markets education programme	▪ Yes– AEMO already able to do	Short-term	Medium – large
7e	Market making obligations for financial derivatives	▪ No – relies on action by ASX or legislative/rule changes.	Short to medium-term	Medium – large
7f	Develop more cost-effective risk management products for STTM	▪ No – relies on action by ASX	Short to medium-term	Medium – large
7g	Ring fencing and other arrangements for facilitated mkts	▪ No – requires review by AEMC and legislative/rule changes.	Short to medium-term	Medium – large

Source: NERA and Axiom Analysis.
* Short-term = < 1 year, medium-term = 1-3 years and long-term = >3 years