SUBMISSION

GAS PRICE CAP INSTRUMENT | 15 DEC 2022

EUAA
Energy Users Association of Australia

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.

The EUAA has consistently highlighted, and the ACCC has consistently concluded, the existence of market failure in the east coast gas market. This has been caused by a combination of factors highlighted by the ACCC in its regular gas market reports. We agree that while a price cap is a relatively blunt instrument, more preferable approaches eg increasing supply in southern states, are simply not possible or could not be implemented quickly to prevent potentially severe impact on large gas users, their employees and more broadly in the community.

The old saying 'the solution to higher prices is higher prices' only works in a properly functioning competitive gas market. It does not apply in the east coast gas market where LNG exporters control >80% of reserves and restrictions in NSW and Victoria prevent new supply being developed. The Queensland Government's Australian Market Supply Condition[1] provides acreage to supply domestic manufacturing industry, but the absence of any 'reasonable price' type clause means the prices offered by producers can take advantage of what their competitors (LNG exporters) are offering.

The EUAA supports the proposed emergency, temporary, $12/GJ price cap as a measured response to balance the needs of consumers and producers. As the Consultation Paper notes, producers were happy with selling 2023 gas in 2021 at prices below $12/GJ. The cap simply takes the price back to what producers regarded as acceptable before the war in Ukraine.

Gas producers should not have been surprised by the Government's move. Their exercise of market power has enabled the substantial rise in domestic gas prices since the war in Ukraine that has nothing to do with higher costs. The Government's policy still allows the LNG producers to earn international prices for the vast majority of their production. The EUAA believes that a core part of LNG companies' ability to export at international prices is to supply domestic consumers at reasonable prices not driven by the impact of a war.

While gas producers might rail against the temporary price cap, we expect that it will have very little impact on their profitability and this view has been supported by independent commentators. This is because it will only apply to contracts for 2023 supply that are signed from next Monday. We understand that most, if not all, of our members have already put in place their 2023 supply arrangements because they could not risk contracting for 2023 with less than two weeks to finalise arrangements.

This is why we consider the development of a mandatory code that includes 'reasonable price' provisions to be the key positive policy development for our members and the wider economy. We participated in long negotiations on the current Voluntary Code over most of 2021 before we eventually withdrew because it failed to produce anything of substance that could assist gas users. It was a gas sellers code that only benefitted gas sellers.

[1] See https://www.resources.qld.gov.au/?a=109113:policy_registry/operational-policy-australian-market-supply-condition.pdf&ver=2.01

We would very much appreciate the opportunity for further consultation with the Commonwealth - Treasury, Department of Climate Change, Energy, Environment and Water and the ACCC - as we prepare our 7th February submission on the Code.

Responses to specific questions

- Is $12 per gigajoule the appropriate level for a cap on wholesale contracts offered by producers, for supply from existing fields?
  – Does this need to be expressed as an average to ensure producers are able to offer flexibility over the course of the contract?

Response

Given the data provided by the ACCC – that 96% of the 289 domestic offers for 2023 gas in 2021 were below $12/GJ with the average at $9.20/GJ - we consider that $12/GJ is an appropriate gas price cap. Obviously a price of $12/GJ in 2021 covered not only the full costs of production and an acceptable return on capital from existing fields, but also provided sufficient incentive to explore and develop new gas fields. We find it difficult to understand the apparent argument of gas producers that circumstances have changed so significantly since then that a $12/GJ price does not now cover the same components as in 2021.

In August 2020 Santos' presentation to the NSW Independent Planning Process of its case for approval of the Narrabri project, they presented a report by ACIL Allen[2] on the impact of the Narrabri project on the east coast gas market. That modelling had a real production cost of $6.40/GJ for Narrabri with ACIL Allen concluding (p.23):

> "However, New South Wales has also been increasingly reliant on supply from Queensland CSG over the past few years. The marginal cost for undeveloped 2P CSG reserves in Queensland is now estimated to be around $5.70/GJ. With transportation costs of around $2.50/GJ added on according to the latest tariffs posted by APA, the delivered cost will be north of $8/GJ. It is expected that the Narrabri project will be competitive with these prices considering the ability of Santos to reduce costs of production to $6.40/GJ. This development means the impact from Narrabri on the market is that it will increase competition in the eastern Australian gas market by providing gas consumers with another competitive source of supply. This is a key point in placing downward pressure on gas prices."

For LNG producers the incentive to develop new fields comes from the need to supply LNG contractual requirements. The price cap only applies to excess gas produced that would otherwise be sold on the spot market. We expect that LNG producers' primary return – and debt servicing coverage under their project financing facilities - comes from LNG contract sales which are not affected by the Government's proposed changes.

Trying to position it as an average price ie allowing producers to charge prices above and below $12/GJ would introduce an unnecessary level of complexity to the cap compliance.

[2] See https://www.ipcn.nsw.gov.au/resources/pac/media/files/pac/projects/2020/03/narrabri-gas-project/correspondence/santos-submission/200810-ngp-economics-report_acil-allen.pdf

- In relation to the scope of the price cap:
  - What gas sales need to be covered to make the price cap effective?
  - Does the draft instrument (at Appendix B) clearly and appropriately define the wholesale contracts which are subject to the price cap?
  - Is the draft 'application to gas' provision the most appropriate way to exclude undeveloped fields, which may have higher costs of production, from the scope of the price cap?

Response

We agree with the proposed coverage. We agree with the inclusion of the Gas Supply Hub at Wallumbilla but are puzzled at the reasons for the exclusion of the Victorian DWGM and STTMs in Sydney, Adelaide and Brisbane. The Consultation Paper seems to be concerned that applying the price cap in these markets might limit the supply of gas that gas generation can draw on at times of high gas generation. Yet AEMO has recently been given extensive powers to prevent that supply shortfall occurring[3].

If these markets are excluded, we look to the ACCC to closely monitor market behaviour in these markets to see if there is any exercise of market power.

We understand that there are legal reasons for the exclusion of gas retailers from the price cap but that consumers should be protected given the range of ACCC compliance and enforcement powers.

We have a number of members which source their gas from retailers and some members who have sought to source from producers but have been told to go to retailers. We will be advising members to engage with the ACCC where they believe that a retailer is not being reasonable in their negotiations.

We will also be advising members to contact the ACCC were they to see producers seeking very restrictive non-price terms as part of a $12/GJ contract.

- How might the impacts of this policy differ across key segments of the gas market?

Response

No comment.

Does the proposed model appropriately mitigate the risks associated with market intervention?

[3] See https://www.energy.gov.au/government-priorities/energy-ministers/priorities/gas/proposed-regulatory-amendments-extend-aemos-functions-and-powers-manage-east-coast-gas-supply-adequacy#:~:text=On%2028%20October%202022%2C%20Energy,over%20winter%202023%20and%20beyond.

Response

Yes. The residual risks are very small given the criteria for intervention and the design features of the proposal. As we noted above, the potential application of the price cap is likely to be very small given it only applies to contract for 2023 supply contracts entered into from next Monday from existing fields. We expect that most, if not all, of our members, and C&I gas users in general, would have already locked in their 2023 supply. Indeed we have seen announcements from Cooper Energy[4] Cooper Energy saying that the impact will be minor.

> "Regarding the Government's proposed 2023 gas price cap, and consistent with the industry in aggregate, approximately 85% of Cooper Energy's gas sales for 2023 are under medium- and long-term gas sale agreements, with the remainder sold as spot volumes. These existing gas sale agreements are excluded from the cap, as is gas sold into the Victoria and Sydney spot gas markets.
> …
> The impact on Cooper Energy from the proposed gas price cap is therefore anticipated to be limited to the extent spot prices during 2023 are influenced by the one-year wholesale gas price cap."

Macquarie's broker report on Origin referring to the gas and coal price caps concluded that:

> "Price caps do not have a material impact on …earnings."

Morgan Stanley says:

> "The proposed temporary gas price cap is consistent with our expectations and, we believe, should be manageable for the gas producers in our coverage

Thank you for the opportunity to make a submission. Do not hesitate to be in contact should you have any questions.

Kind Regards,

Andrew Richards
Chief Executive Officer

[4] See https://www.cooperenergy.com.au/Upload/Documents/AnnouncementsItem/Wholesale-gas-market---Government-announcements.pdf