7 February 2023

Submission: Options to ensure the domestic wholesale gas market delivers for Australians

Priority Feedback

- The potential for unintended outcomes as a result of the truncated Code of Conduct reform process must be recognised, understood, and mitigated.
- Gas industry stakeholders agree that affordable, secure long-term sources of new gas supply are required to reduce customer prices in the medium- to long-term.
- Applying economic regulatory principles used for infrastructure regulation to gas commodity pricing is very likely to have immediate and enduring negative impacts on the Australian gas commodity market.
- Governments should support renewable gas production as a genuine source of new, zero emission gas supply and new competition to incumbent producers. Renewable gases must be exempted from the Code of Conduct.

The Australian Pipelines and Gas Association (APGA) represents the owners, operators, designers, constructors and service providers of Australia's pipeline infrastructure, connecting natural and renewable gas production to demand centres in cities and other locations across Australia. Offering a wide range of services to gas users, retailers and producers, APGA members ensure the safe and reliable delivery of 28 per cent of the end-use energy consumed in Australia and are at the forefront of Australia's renewable gas industry, helping achieve net-zero as quickly and affordably as possible.

APGA welcomes the opportunity to respond to the *Options to ensure the domestic wholesale gas market delivers for Australians* consultation paper. APGA is fully supportive of action to deliver affordable gas supply to Australia.

Gas is an essential component of Australia's energy system and economy. During such a compressed policy process, it is essential that outcomes and unintended consequences are fully considered to minimise the risk of significant unintended consequences arising in the medium to long term in response to the truncated reform proposal that is aimed at addressing short term.

APGA supports a net zero emission future for Australia by 2050[1]. Renewable gases represent a real, technically viable approach to lowest-cost energy decarbonisation in

[1] APGA, *Climate Statement*, available at: https://www.apga.org.au/apga-climate-statement

Australia. As set out in Gas Vision 2050[2], APGA sees renewable gases such as hydrogen and biomethane playing a critical role in decarbonising gas use for both wholesale and retail customers. APGA is the largest industry contributor to the Future Fuels CRC[3], which has over 80 research projects dedicated to leveraging the value of Australia's gas infrastructure to deliver decarbonised energy to homes, businesses, and industry throughout Australia.

APGA acknowledges the long and protracted discourse and issues of gas supply and price that have culminated in the Government's actions in 2022 and the continuation of this process to establish a mandatory code of conduct for gas producers in 2023. It is understandable that such actions have been taken in difficult circumstances. It is critical that the potential for unintended outcomes from these actions is recognised, understood, and mitigated.

The impact of price intervention on future supply must be recognised

Gas market reform and intervention has been an enduring feature of the East Coast gas market for the majority of the last 10 years. The one priority that is agreed on by stakeholders across the gas industry is the need to secure long-term sources of affordable new gas supply. It is critical that Governments focus on measures that will ensure that sufficient supply is available over the short, medium and long-term. APGA is concerned that the current process and proposals are overly focussed on the short-term.

A key consideration for investors in new gas supply is the price that will be achieved for the commodity. The proposals set out in the consultation paper go directly to increased regulatory intervention in gas prices, particularly the reasonable pricing provisions (page 10).

The prospect of inappropriate intervention in gas price will be a new material risk that all investors must consider. It is highly likely that some investment will not proceed, or be materially delayed, as a result of introducing the reasonable pricing provisions. This could easily exacerbate the current supply and price issues and extend them longer than would otherwise be the case.

Australia's competition policy has been heavily influenced over the last 30 years by the 1993 "Hilmer Report" [4]. The potential for these negative consequences is well understood:

> *Firms without a legislated or natural monopoly rarely enjoy the capacity to charge excessive prices over a sustained period. Intervening to restrict prices can deter new investment, constrain productivity growth and dull the signal to new firms to enter the market.*
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> […]

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[2] APGA, 2020, *Gas Vision 2050*, https://www.apga.org.au/sites/default/files/uploaded-content/website-content/gasinnovation_04.pdf

[3] Future Fuels CRC: https://www.futurefuelscrc.com/

[4] Hilmer, F, Raynor, M and Taperell, G, 1993, *National Competition Policy,* Report of the Independent Committee of Inquiry, p. 271, available at http://ncp.ncc.gov.au/docs/National%20Competition%20Policy%20Review%20report,%20The%20Hilmer%20Report,%20August%201993.pdf

> *In either monopoly or poorly contestable markets, the nature of the intervention will be important. Regulated solutions can never be as dynamic as market competition, and poorly designed or overly intrusive approaches can reduce incentives for investment and efforts to improve productivity. There are costs involved in administering and complying with pricing policies.*
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> *Finally, from a government's perspective, resort to price control might be seen as an easy and popular way of dealing with what is in reality a more fundamental problem of lack of competition in an area.* ***Since price control never solves the underlying problem it should be seen as a "last resort".*** *For all these reasons, regulatory responses to monopoly pricing concerns must be approached with caution.*

APGA considers it unlikely that the introduction of a reasonable pricing provision for the commodity of natural gas will solve the underlying problem of supply.

Monopoly utility regulation principles should not feature in commodity price estimates

When designing the reasonable pricing provision, ensuring the correct incentives remain in place for investors is essential.

APGA is concerned that the consultation paper is drawing heavily on existing energy infrastructure regulatory principles as the basis for establishing a theoretical reasonable price for east coast gas supply. In our view, this is highly inappropriate and likely to ignore the fundamental supply and demand balancing equations that actually set prices in competitive commodity markets.

The application of the reasonable pricing provision, like any form of economic regulation, places a cap on the maximum returns an investment can achieve but does not similarly limit the amount an investment can lose.

Gas exploration is an uncertain business and gas production presents its own unique challenges to investors.

The geology of a field, the success rate of a company's exploration program, and the unpredictable long-term flow rate of an individual gas well are all examples of risks faced by investors that negatively impact returns and are poorly accounted for in regulatory settings. The vagaries of the supply and demand balance of the commodity itself presents upside and downside risk. Any intervention that limits upside returns without limiting downside losses is likely to have a chilling effect on investment.

Application of economic regulatory principles used for infrastructure regulation to commodity pricing, which is then expected to be used in binding commercial arbitration, is very likely to have immediate and enduring negative impacts on the commodity market by reducing investors' appetite to invest in gas supply to the East Coast.

New measures to deliver supply are essential

The most sustainable and least interventionist solution to high gas prices is increased supply. To counteract any negative pressure on gas supply created by reasonable pricing provisions, it is essential that paramount importance is assigned to ensure future supply is delivered in a timely and efficient manner. Government should immediately allocate resources to develop policy that will deliver new supply, including renewable gas supply.

Recalling the view of the Hilmer Report, the East Coast gas market is yet to see any real focus on improving competition in gas supply despite more than a decade of reform to reduce gas prices.

Developing supply of gas new to the Australian market, renewables gases such as hydrogen and biogas, should be one approach. The rapid development of domestic renewable gas markets would present genuine new competition to incumbent producers. It has the additional value of accelerating Australia's decarbonisation. The pathway to decarbonise through a renewable gas market works in tandem with renewable electricity to provide a zero-carbon insurance policy for households, businesses, and industry.

Renewable gases such as hydrogen and biomethane can decarbonise gas supply, just as solar and wind have decarbonised electricity supply. However, renewable gases are at the start of their commercialisation journey and require Federal Government support to grow. The Federal Government helped create the Australian renewable electricity industry through the Renewable Energy Target, and it has the opportunity to support a local Australian renewable gas industry through the creation of a Renewable Gas Target.

Biomethane production costs can be as low as $12.20 per gigajoule today and $9.80 in 2030[5], at which point hydrogen is also anticipated to cost as low as $13.31 per gigajoule[6]. The Renewable Energy Target was put in place when the levelised cost of electricity from solar PV was more than $500 per megawatt hour. Upfront investment in supporting the domestic market today through federal renewable gas incentives will play an important role in delivering a lower-cost and simpler pathway to net zero tomorrow.

The opportunity to reuse or repurpose today's natural gas infrastructure for renewable gases is being realised globally[7]. Similar opportunities exist in Australia, where more energy is delivered via existing gas transmission and network infrastructure than is delivered via electricity infrastructure[8]. However, the short-term impacts of lowering gas commodity prices today may have flow-on effects to the gas infrastructure that will transport the renewable gases of tomorrow.

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[5] ARENA, 2021, *Australia's Bioenergy Roadmap*, available at: https://arena.gov.au/assets/2021/11/australia-bioenergy-roadmap-report.pdf

[6] A$1.89 per kg, CSIRO, 2021, *Green hydrogen production costs in Australia: implications of renewable energy and electrolyser costs*, available at: http://iceds.anu.edu.au/files/2020%2009%2001%20-%20ZCEAP%20-%20CCEP%20Working%20Paper%20-%20Green%20hydrogen%20production%20costs.pdf

[7] European Hydrogen Backbone, 2022, available at: https://ehb.eu/

[8] DECCEEW, 2022, *Australian Energy Statistics 2022 Energy Update Report*, available at https://www.energy.gov.au/publications/australian-energy-update-2022

Measures should be explicitly limited to natural gas

Consideration should be given to the role renewable gases can play in expanding Australia's gas supply over the longer term. However, given the renewable gas industry remains very early in its development and that it exhibits significant structural differences to the upstream market for natural gas, the Code should focus only on natural gas, and its application should therefore be limited only to 'natural gas'. This would be consistent with the approach taken by the Price Cap Instrument.

To discuss any of the above feedback further, please contact APGA National Policy Manager, Jordan McCollum, on +61 422 057 856 or jmccollum@apga.org.au.

Yours Sincerely,

STEVE DAVIES
Chief Executive Officer
Australian Pipelines and Gas Association