



12 May 2023

Submission: Mandatory Gas 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 provide comments on the proposed Mandatory Gas Code of Conduct (the **Code**). The amended Code proposed in this consultation improves upon the original proposal by stepping back from a regulated rate of return. However, it still increases revenue risk for gas producers, in turn increasing supply risk for gas customers.

APGA highlights the following in its submission:

- The Code exposes customers to increased gas supply risk and risk of higher gas prices in the long-term; and
- Retrospective analysis shows the basis of the Code may not align with the cause of the 2020 gas price crisis, indicating a need to reconsider design in light of new data.

To address these concerns, APGA recommends:

- Introduction of an automatic greenfield exemption;
- Introduction of a materiality threshold for reporting requirements; and
- Increase certainty around how the Code will change in the future; and
- Pause Code development until a study into the 2022 gas price crisis can be pursued; and
- A Regulatory Impact Statement should be pursued prior to implementation of the Code.

To discuss any of the above feedback further, please contact me on +61 422 057 856 or jmccollum@apga.org.au.

Yours Sincerely,

A handwritten signature in dark ink, appearing to read "JM", is positioned above the typed name.

JORDAN MCCOLLUM
National Policy Manager
Australian Pipelines and Gas Association

Gas customers require affordable gas *and* availability of supply

APGA is pleased to see that the Government recognises the importance of ensuring affordable gas is available to customers over the long term. This recognition is demonstrated in the introduction of an automatic exemption for small producers supplying domestic market, which acknowledges that price capping can negatively impact revenue certainty, and in turn investment in new supply. Negatively impacting new gas supply puts domestic gas customers at greater risk of the supply shortfalls projected by the ACCC and AEMO.

This risk is not without solution, however. Lessons learned in addressing revenue risk for new gas infrastructure under the National Gas Law (NGL) being applicable to economic regulation of the gas as a commodity. Both the revenue risk created by the Code, and the potential to learn lessons from the NGL, are explored in the remainder of this section.

The proposed Code will impede access to gas supply

The most recent Gas Statement of Opportunities has acknowledged that gas-powered generation will continue to play an important role in reducing emissions and bolstering electricity reliability as the power system transitions from coal to intermittent renewable generation. Domestic gas consumption is forecast to increase over the short term, requiring additional gas supply so that customers may avoid gas shortages.

Across the medium-term horizon, this new supply will come from a combination of small producers on fringes of current production acreage, and larger producers with new greenfield acreage (such as in the Beetaloo Basin).

While the proposed Code largely avoids direct negative impacts on small producers, particularly those which are operating in existing basins, it would still risk impeding producers seeking to develop greenfield basins. These supply developments are likely to involve complex, multi-stage developments and investment decisions, and as such are likely to be large scale developments, well over the 100PJ/year threshold for conditional exemptions to the price cap.

How does the Code impact investment?

There are several aspects to the proposed Code that will act independently to either increase revenue risk and regulatory burden or increase gas prices accessible by customers.

Asymmetric truncation of returns

Gas producers contract gas at different points in time over the life of a field, rarely all in one big deal. Long-term price caps effectively carve off the top of the price cycle while leaving investors exposed to the bottom of the price cycle. This means that new gas production investment will need to secure higher average prices in the long term to achieve the same rate of return.

This will either lead to higher average gas price to achieve investment hurdle rates in the long term, or the inability to achieve the required rate of return to secure final investment decision (FID), preventing investment in new supply.

Revenue uncertainty

The Code contemplates price caps will continue with no certainty beyond 1 July 2025. This provides certainty that there will be price caps, not what the value of the cap will be. This reduces revenue certainty over the life of an investment, in turn increasing hurdle rates required to achieve FID. Price uncertainty leads again to higher gas prices in the medium term or impeded revenue certainty.

Exemption uncertainty

The proposed Code introduces broad a broad Ministerial exemption process. While this is appropriate given the nature of the industry and complexity of investments, it does introduce uncertainty whereby there are no specific criteria for exemptions other than satisfying the administering Minister, the Industry Minister and the ACCC that the exemption is warranted. This also introduces a 'many Ministers' problem, where this agreement relies on the disposition of those Ministers and indeed on the disposition of the government of the day.

This takes the gas market away from being a competitive market and towards being a market in which the producers with the best ability to lobby ministers win the right to produce gas. Without decision making frameworks, leaving exemptions at the discretion of Ministers leaves little regulatory certainty, and is counter to the Code's stated focus on increasing liquidity in the gas market.

Cost burden of reporting obligations

Reporting obligations can be a considerable the cost burden for small producers. APGA has previously highlighted in our comments on the Gas Wholesale Market Monitoring and Reporting reform¹ and the Pipeline Information Disclosure reform² that the additional cost and compliance burdens risk impeding the development of new gas supply. This is also counter to the Code's stated focus on increasing liquidity in the gas market.

APGA Recommendations

APGA raises three Recommendations to mitigate the above concerns based upon lessons learned from decades of economic regulatory impacts on the gas infrastructure industry:

- An automatic greenfield exemption;
- A materiality threshold for reporting requirements; and
- Increase certainty around how the Code will change in the future.

Recommendation 1 – Automatic greenfield exemption

The negative impacts of asymmetric truncation or returns and revenue uncertainty have been recognised and addressed within the NGL as it applies to gas pipelines. The Code introduces equivalent negative impacts upon gas producers. Taking the lesson learned through implementation of the Greenfield Incentive and Price Protection Mechanism for

¹ APGA, 2023, *Submission: Gas Wholesale Market Monitoring and Reporting reform*, https://www.apga.org.au/sites/default/files/uploaded-content/field_f_content_file/230504_apga_submission_-_aer_gas_wholesale_mmr.pdf

² APGA, 2023, *Submission: Pipeline Information Disclosure reforms*, https://www.apga.org.au/sites/default/files/uploaded-content/field_f_content_file/230509_apga_submission_-_aer_pipeline_disclosure.pdf

greenfield gas pipelines, APGA recommends the Code include greenfield gas production investments under its automatic exemption regime.

Under the Greenfield Incentive pipeline projects receive protection from the harsher forms of economic regulation for up to 15 years of the life of the asset. Further, the price protection mechanism protects foundation prices for pipelines developed via a workably competitive process. These legislated protections demonstrate that the negative impact on investment of asymmetric truncation of returns and revenue uncertainty are real and require mitigation.

Recommendation 2 - Materiality threshold for reporting requirement

The National Gas Rules (NGR) consistently applies a materiality threshold for a range of reporting obligations of 10TJ/day capacity for gas facilities, including production facilities. This approach is reflected in National Electricity Law and Rules and the AEMC's recommendations for extending the existing regulatory frameworks to hydrogen and other renewable gases.³

APGA recommends introducing a consistent reporting materiality threshold of no less than 10TJ/day should apply to all recordkeeping and reporting obligations in Part 6 of the Code. This would address many of the concerns about the burden of reporting compliance and potential duplication raised within APGA's submission.

Recommendation 3 – Provide certainty about key aspects of the Code

In order to minimise revenue and exemption uncertainty the Code must provide greater clarity around how the Code will change in the future. In particular, certainty around an end date and basis for ministerial approval of exemptions require specific attention.

APGA observes in comparison that the price cap on coal, implemented in December 2022 for 12 months, does not appear to be likely to be extended. It is unclear what difference there is between gas and coal prices, or the price of any commodity, that warrants different approaches to price capping considering current cost of living concerns.

Justification for the Code – benefit of hindsight

The Consultation Paper notes that the creation of the Code was intended to avert “the worst impacts of predicted energy price spikes caused by Russia’s illegal invasion of Ukraine and the consequent pressure on global energy markets”. The central objective is to facilitate “a well-functioning domestic east coast gas market with adequate supply at reasonable prices and on reasonable terms for both producers and consumers.”

This justification was derived during the 2022 gas price crisis at a time where not all facts were on the table. With the benefit of hindsight, APGA notes that the problem statement used to justify the code does not reflect what can be observed as having caused the 2022 gas price crisis. On this basis, APGA proposes that Energy Ministers reconsider whether the current design of the Code still reflects what gas customers need to avoid high gas prices and unavailability of gas supply in the medium term.

³ AEMC, 2022, *Review into extending the regulatory frameworks to hydrogen and renewable gases*, <https://www.aemc.gov.au/sites/default/files/2022-11/Hydrogen%20and%20Renewable%20Gas%20Review%20-%20Final%20Rules%20Report.pdf>

Correlation between gas, electricity, and LNG prices

Justification for the Code was founded upon the notion of local gas price spikes being the result of international gas prices. This is central to the design and introduction of the interim \$12/GJ price cap and the Code. However, reviewing the data in hindsight demonstrates that this may not be entirely accurate.

Questions about this foundation are raised through analysis of time series data for the Japan Korea Market LNG Price Assessment (JKM) netback to the Wallumbilla Gas Supply Hub (WGSB), the WGSB volume weighted average (VWA) price, Sydney and Brisbane short-term trading market (STTM) gas prices, and NSW and QLD National Electricity Market average prices (Figure 1).

Analysis of this data found that domestic gas prices demonstrate significantly greater correlation with NEM prices than with JKM netback (Figure 1). The domestic gas price spike which triggered government intervention directly correlates with a spike in NEM prices and a drop in JKM netback price. Further, increased JKM netback price does not align with the start of the war in Ukraine, and domestic gas price reductions correlate with reductions in NEM price rather than introduction of the price cap.

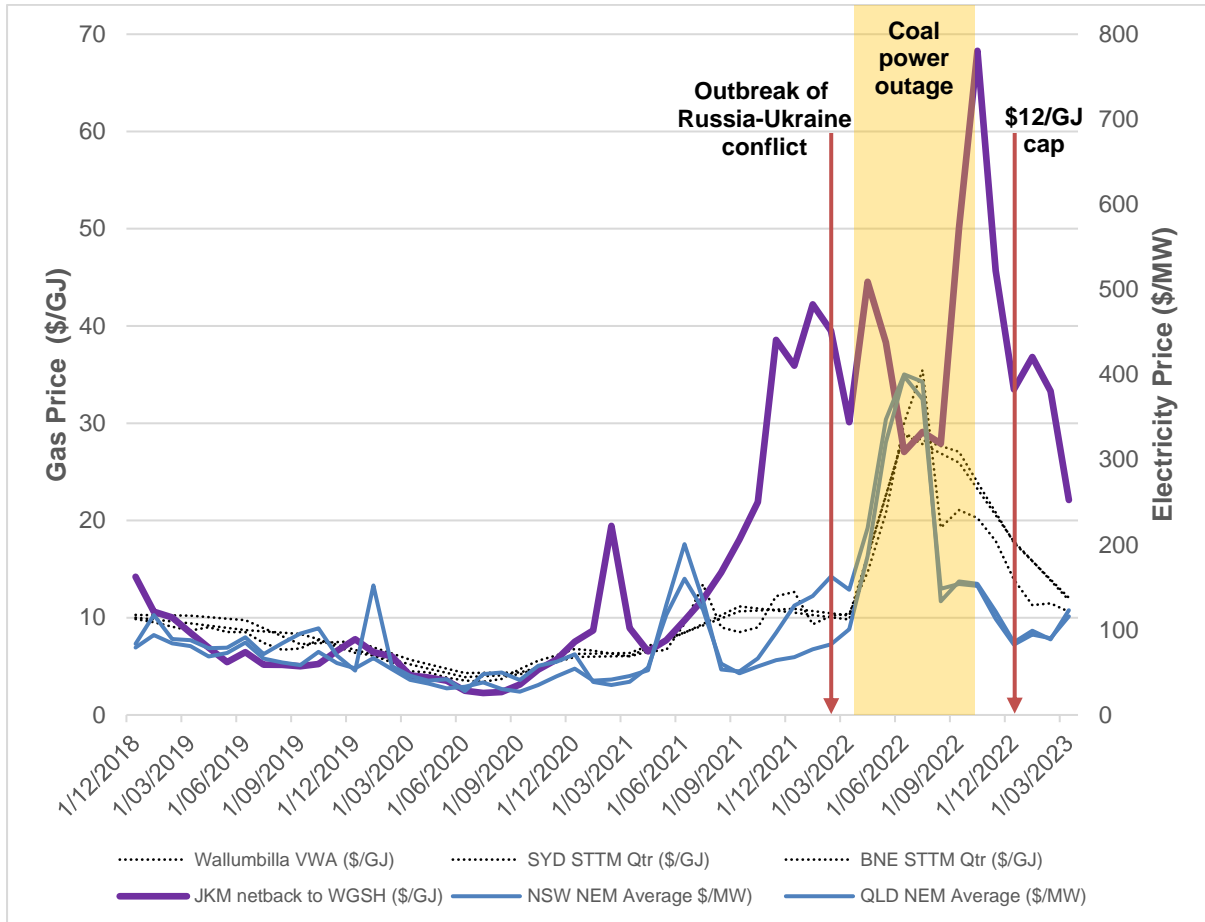
Analysis by EnergyQuest⁴ has identified a strong statistical correlation between domestic gas prices and their respective NEM average prices – R=0.93 in NSW and R=0.94 in Queensland – compared to a weaker R=0.53 correlation between the JKM and WGSB.

Also shown in Figure 1 is a window of substantial unplanned coal-fired generation outages where nearly 25 per cent of coal generation was offline in the NEM. Price increases in the NEM correlate strongly with this period in which four of the NEM's five largest coal fired power generators were unable to operate at capacity as seen in Figure 2.⁵ During this period, gas power generation was leveraged to keep the lights on, explaining the correlation between high gas prices and this window of coal-fired generation outages.

⁴ EnergyQuest, 2023, *Projecting the long and short-term domestic price outlook: presentation to the 2023 Australian Domestic Gas Outlook Conference*, <https://www.energyquest.com.au/energyquest-presentation-to-2023-adgo/>

⁵ Packham et al, 2022, 'Nearly 25pc of coal capacity remains offline despite energy crunch', *Australian Financial Review*, available at <https://www.afr.com/companies/energy/nearly-25pc-of-coal-capacity-remains-offline-despite-energy-crunch-20220606-p5argd>

Figure 1: International LNG, domestic spot gas and electricity prices, December 2018-March 2023



Sources: ACCC LNG netback price series; AEMO STTM quarterly prices (smoothed); AER WGSB VWA prices; AEMO NEM averages; APGA analysis

Figure 2: Coal fired power outages analysis by the Australian Financial Review

Coal-fired plants facing difficulties

| Owner | Site | Capacity (MW) |
|-----------------------------|--------------------|---------------|
| Origin Energy ¹ | Eraring, NSW | 2880 |
| AGL ² | Bayswater, NSW | 2665 |
| AGL ³ | Loy Yang A, Vic | 2240 |
| AGL ⁴ | Liddell, NSW | 2000 |
| Gladstone Power Station | Gladstone, Qld | 1680 |
| Stanwell Corporation | Stanwell, Qld | 1460 |
| EnergyAustralia | Yallourn, Vic | 1450 |
| Stanwell Corporation | Tarong, Qld | 1400 |
| EnergyAustralia | Mt Piper, NSW | 1390 |
| Delta Electricity | Vales Point B, NSW | 1320 |
| Gippsland Power | Loy Yang B, Vic | 1160 |
| Millmerran Power Partners | Millmerran, Qld | 852 |
| Callide Energy ⁵ | Callide C, Qld | 840 |
| CS Energy | Kogan Creek, Qld | 744 |
| CS Energy | Callide B, Qld | 700 |
| Stanwell Corporation | Tarong North, Qld | 450 |

1. Reduced capacity due to coal supply, coal spot price
2. Unit 3 offline until beginning of July for planned maintenance
3. Unit 2 offline until August 1 due to technical issues
4. One of four units offline until July 30 due to unplanned maintenance
5. Unit 4 offline until April 7, 2023 due to fire

SOURCE: FINANCIAL REVIEW, AEMO, COMPANY FILINGS FROM AGL, ORIGIN, CS ENERGY

Conclusion and recommendations

APGA proposes the Code be paused until a study and a Regulatory Impact Statement be undertaken to ensure that the Code will adequately address the causes of the 2022 gas price crisis and deliver a positive impact to Australia.

Recommendation 4 – Study

Considering this analysis, the justification for the Code may not be aligned with the cause of the 2022 gas price crisis. This warrants investigation prior to implementing the Code noting the additional risk of gas supply shortfall which the Code introduces for gas customers.

APGA recommends Energy Ministers commission a study into the events surrounding the 2022 gas crisis prior to implementing the Code. Code implementation should be paused to allow for analysis to ensure that Code delivers the best possible outcome for customers reflecting the causes of the 2022 crisis.

Consideration of lessons learned in this context may also be of benefit for the coming decade as coal-power generation withdraws from the NEM.

Recommendation 5 – Regulatory Impact Statement

APGA also notes that there has not been a Regulatory Impact Statement performed for the Code. The Federal Government has not prepared a Regulatory Impact Statement for other recent gas market reforms as well, including the Gas Wholesale Market Monitoring and Reporting framework and the East Coast Gas System reforms. This is a concerning pattern.

We urge that Regulatory Impact Statements or Policy Impact Analyses be undertaken for any future reforms.



Consultation questions

| Question | APGA response |
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| Scope and conduct provisions | |
| <p>Good faith</p> <ul style="list-style-type: none"> • Do you have any comment on the proposed approach to 'good faith' in the exposure draft Code? • Are the factors listed in the exposure draft Code appropriate to the gas industry? • Do you have any alternative or additional suggestions? | <p>APGA has no comments on this aspect.</p> |
| <p>EOIs</p> <ul style="list-style-type: none"> • Does the proposed approach strike the right balance between prescription and flexibility, and accommodate typical commercial processes? • Are the proposed EOI timeframes and information requirements suitable? • Are the circumstances specified in the Code that form the basis on which a producer may withdraw from an EOI process appropriate? • Is the exclusion of specific timelines and process steps for contracts under 12 months appropriate? Noting good faith provisions apply to contracts under 12 months, are any other protections required? • Should the Code also prescribe a process and apply civil penalties to buyer-initiated EOIs? • Do you have any additional comments on what is proposed? | <p>APGA has no comments on this aspect.</p> |
| <p>Initial offer</p> <ul style="list-style-type: none"> • Are the proposed timeframes and information requirements for EOIs and initial offers suitable? • Are there any situations not already reflected in the Code in which a producer would, at the completion of an EOI process (i.e. upon notification of successful EOI applicants), not be in a position to make an initial offer to successful applicants? | <p>APGA has no comments on this aspect.</p> |

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| <ul style="list-style-type: none"> • Do the flexibility provisions (i.e. to restart the initial offer clock or allow for extension of timeframes by mutual agreement) support typical commercial negotiations between parties at this stage? • What circumstances not already reflected in the Code would result in a producer having to withdraw an initial offer? • Do you have any additional comments on what is proposed? | |
| <p>Final offer</p> <ul style="list-style-type: none"> • Is the definition of a final offer and when this stage commences clear? • Are the proposed timeframes and information requirements for a final offer suitable? • Do the flexibility provisions (i.e. to restart the clock or allow for extension of timeframes by mutual agreement) support typical commercial negotiations between the parties at this stage? • Are timing or other operational provisions necessary for the process following acceptance of a final offer and finalisation of a supply agreement? • Do you have any additional comments on what is proposed? | <p>APGA has no comments on this aspect.</p> |
| <p>Pricing framework</p> | |
| <p>Application of price cap</p> <ul style="list-style-type: none"> • Do you think the proposed approach will support the adequate supply of gas to the domestic market, at reasonable prices and on reasonable terms over the short and longer term, and how does this compare to the approach outlined in the December 2022 consultation paper? • Do you think the price cap set at \$12/GJ is appropriate to achieve this objective? • Do you have any comments on how price reviews are conducted? • Do you have any other comments? | <p>APGA appreciates that the advice of industry has been heeded regarding the originally proposed benchmarked rate of return mechanism.</p> <p>We do have concerns over the long-term impact of a price cap on new supply investment, considered in more detail in our submission.</p> <p>In terms of the price review, is little detail provided on how price reviews would be conducted, including what criteria would lead to a change in the price cap measure or its disablement. The Regulations also do not specify that the review of the instrument would necessarily include a review of the price cap, including whether it should be altered or extended.</p> |
| <p>Exemptions from price cap</p> <ul style="list-style-type: none"> • Are the criteria and process for qualifying for exemptions clearly defined? • Are the factors Ministers may consider in granting an exemption appropriate? | <p>APGA agrees the automatic exemption criteria are well defined and appropriate in this context, particularly where it ensures smaller producers who are entirely supplying the domestic market are unaffected.</p> |

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| <ul style="list-style-type: none"> • Do you have any comments on what information should be published by the ACCC in relation to producers who are granted exemptions? • Do you have any other comments? | <p>In terms of Ministerial exemptions, APGA has provided comments in the main submission above. APGA suggests including a greenfields automatic exemption.</p> <p>Automatic exemptions from the Part 6 record keeping, information and publication obligations should be provided to small producers, as outlined in the main submission above.</p> |
| <p>Implementation and enforcement</p> | |
| <p>Timing and transitional arrangements</p> <ul style="list-style-type: none"> • Do you see any issues with the proposal to apply the new pricing rules after the current price cap arrangements contained in the Competition and Consumer (Gas Market Emergency Price) Order 2022 (Price Order) expire in December 2023? • Should additional transitional arrangements be considered to ensure contract negotiations for new supply are not impacted? • Do you have any other comments? | <p>APGA has no comments on this aspect.</p> |
| <p>Reporting and recordkeeping</p> <ul style="list-style-type: none"> • Do you have any comments on the proposed reporting and record keeping requirements. | <p>APGA has concerns over the level of reporting required through the Code, which is in addition to and largely duplicates reporting requirements for entities under existing and proposed mechanisms (such as the gas wholesale market monitoring and reporting framework). It is not clear that there is any benefit to providing this information, the collection of which has real costs.</p> <p>APGA recommends considering introducing a materiality threshold of at least 10TJ/day for this aspect.</p> |
| <p>Penalties</p> <ul style="list-style-type: none"> • Do you agree with the maximum penalties in the Code, including the allocation of provisions among the three penalty tiers? • Do you have any other comments on enforcement regimes? | <p>APGA has no comments on this aspect.</p> |
| <p>Review mechanism</p> <ul style="list-style-type: none"> • Do you agree a review mechanism is required and the proposed frequency is appropriate? • What conditions would warrant a review being triggered? • Do you have any other comments? | <p>APGA agrees that a review mechanism is necessary.</p> <p>As noted above, there are no specifics on the nature of the review mechanism in the Regulations, including whether it would review the quantum and ongoing necessity of the price cap provision.</p> |