

12 May 2023

Department of Climate Change, Energy, the Environment and Water

Submitted online



Dear Sir/ Madam,

### **Gas Market Code Exposure Draft**

The Australian Financial Markets Association (AFMA) is responding to the Department of Climate Change, Energy, the Environment and Water's (DCCEEW) consultation on the exposure draft of the Gas Market Code (the Code).

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our role is to provide a forum for industry leadership and to advance the interests of the markets and their respective participants. Our membership is comprised of over 125 of Australia's leading financial market participants, including many of the energy firms who participate in the Australian gas market.

---

#### **Key Points**

- **Investment is required to ensure secure gas supply for the east coast**
  - **Certainty is critical to facilitate investment**
  - **The Code does not currently provide the required certainty**
- 

#### **1. Context**

The Government's original decision to intervene in the east coast gas market was motivated by extraordinary geo-political events that caused significant disruption to global and local energy spot markets. In AFMA's December 2022 submission to the consultation on the draft *Competition and Consumer Amendment (Gas Market) Bill*, we felt the Government's desire to intervene temporarily in the gas market to cushion the Australian economy from the unprecedented volatility was understandable. But even in December last year, there were signs the market was correcting and we questioned the need for ongoing intervention.

Asian and local spot gas prices have continued to decline this year and are now at levels similar to those seen in 2021. We therefore question the policy rationale for an ongoing intervention in the east coast gas market given the global market has performed as expected with additional supply coming into the market in response to very elevated prices, resulting in prices reverting to more normal levels. As noted in our December submission AFMA is concerned intervention in the east coast gas market will undermine the confidence required for new investment and could ultimately threaten the security

**Australian Financial Markets Association**

ABN 69 793 968 987

Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001

Tel: +612 9776 7993 Email: [secretariat@afma.com.au](mailto:secretariat@afma.com.au)

of supply. AFMA considers that any intervention should be temporary with clear criteria for when it should end.

In our previous submission, AFMA was particularly concerned by the approach to reasonable pricing proposed in the material accompanying the Bill. We appreciate the Government has recognised the importance of providing certainty to enable investment in new production to ensure supply security; and welcome the move away from infrastructure like price regulation. But we think that the proposed approach based on exemptions granted by ministers on very discretionary grounds, potentially for short periods of time and with the ongoing ability for them to be revoked, does not provide a sound basis for investment decisions or ongoing participation in the market. Our submission deals with our reservations about the impact of ongoing intervention in the gas market and raises a number of technical issues that we see with the proposed Code.

## 2. A global market

---

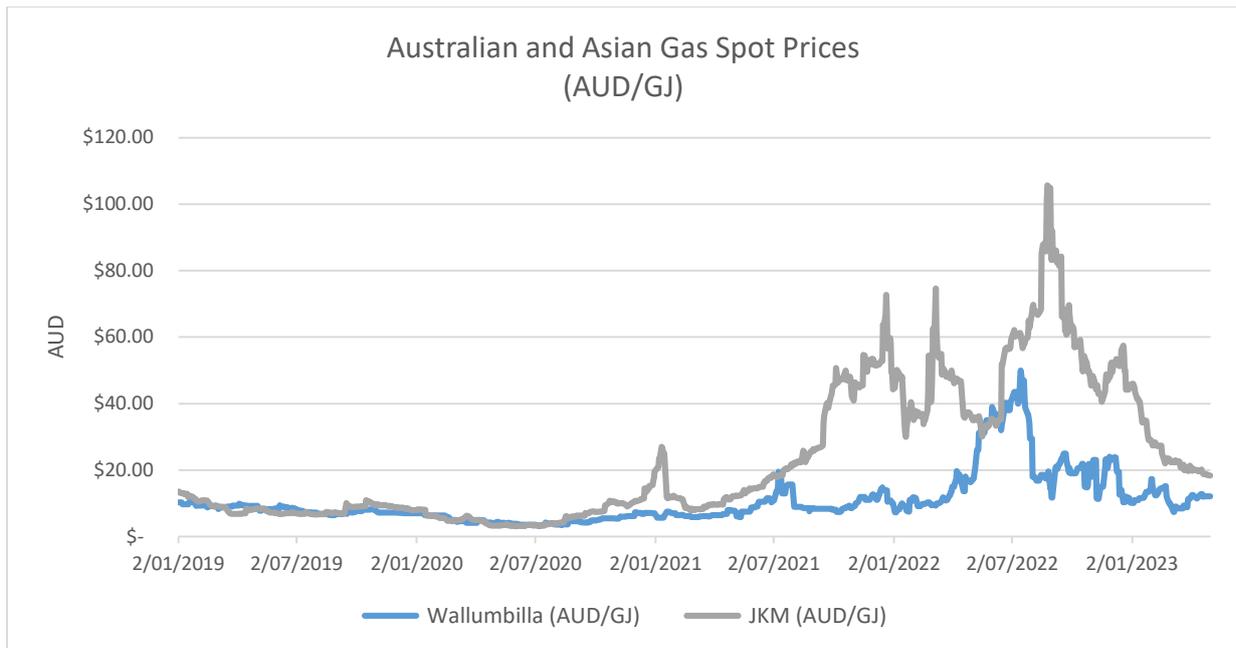
### Key Points

- **Accessing global gas prices is critical for facilitating investment**
  - **East coast spot prices are generally well below the levels seen in Asia**
- 

Part of the policy rationale for the Government’s proposed intervention in the gas market is “to ensure that domestic prices reflect reasonable levels governed by Australian market fundamentals.” The unstated assumption underlying this approach is that the fundamentals of the east coast gas market are inherently separate from the fundamentals of global gas markets and therefore an appropriate policy intervention can allow east coast customers to access gas on terms and conditions closer to those that prevailed before the development of the east coast LNG industry. AFMA’s view is that this approach is mistaken and that in the long run, the fundamentals of the east coast gas market are similar to those of the global market and therefore, attempts to regulate prices are likely to deter investment and ultimately increase the risk of inadequate supply.

Markets have underpinned the development of the east coast gas market. With the decline of the traditional conventional gas basins, foreign buyers and investment has been critical for the development of the coal seam gas industry, which is now essential to ensure adequate supply for the east coast. The production costs of these new assets are typically higher than for legacy conventional fields and the investments were based on the ability to access prices that reflected global gas prices.

Since the commissioning of the Queensland LNG projects, east coast gas prices have been linked to Asian LNG prices (such as JKM); but while they are linked, as shown in the chart below, east coast spot prices have generally remained below Asian LNG spot prices and for the last 12 months, east coast spot prices have been substantially below the netback price that would be implied by the Asian spot prices. It is worth noting that peak east coast gas pricing was more closely aligned with high NEM demand for gas generation in the middle of 2022 rather than movements in JKM.



Data: AEMO and Platts (as quoted on investing.com)

It is also worth emphasising that in all markets, spot prices are a poor indicator of the prices faced by users and that spot prices are typically more volatile than longer term physical supply contracts or financial forwards; and that prudent users should hedge their exposure to spot prices.

In your consultation paper, you indicate that one of the reasons for regulating prices is so that east coast prices do not “reflect the international price which, based on ACCC’s netback price analysis, will average around \$20/GJ until 2025.” When publishing this data, the ACCC makes clear that it “do[es] not represent the ACCC ... forecasting international or domestic gas prices”<sup>1</sup> and AFMA thinks it is worth pointing out that east coast spot prices are currently well below \$20/GJ, the ACCC’s most recent LNG netback price for May 2023 is \$15.65/GJ and the ACCC’s forward medium-term LNG netback prices currently indicate forward prices declining from \$14.58/GJ in FY23/4 to \$12.83/GJ in FY27/8.<sup>2</sup>

AFMA considers that there is ample evidence that both the international and east coast gas markets have responded effectively to last year’s dislocations and that prices returned to more normal levels. As a result, we do not see that there is a good basis for ongoing intervention in the market.

#### **AFMA Recommendations**

- i. The Government should reconsider the need for ongoing intervention in the east coast gas market given developments in the global and domestic markets.
- ii. If Government considers that intervention is required there should be clear criteria for when the intervention should end and regular reviews to determine if these criteria have been met.

<sup>1</sup> <https://www.accc.gov.au/inquiries-and-consultations/gas-inquiry-2017-30/lng-netback-price-series>

<sup>2</sup> [ACCC forward medium-term LNG netback prices](#) Quote dated 28 April 2023

### 3. Investment certainty

---

#### Key Points

- **The Code's exemption framework does not support investment in new assets**
  - **Failure to invest could lead to supply shortages**
- 

As DCCEEW has acknowledged investment certainty is critical to allow new investment to occur to ensure security of supply on the east coast. Government has had an opportunity to observe the impact of the lack of certainty created by the introduction of the \$12 price cap as a number of projects have been delayed as suppliers are unsure of the price they will be able to get for their output. While the Code is an improvement on the approach flagged in the earlier consultation, AFMA remains concerned that a policy approach based on the regular ministerial decisions made on unclear criteria, provides insufficient certainty to support long term investments, particularly the investment necessary to ensure supply in the southern states.

#### 3.1. Concerns with ministerial decision making

The Code proposes a framework that is built around Ministers making decisions to issue exemptions to gas suppliers who sell gas for export, on the condition that they enter into enforceable undertakings to supply the domestic market on terms that are acceptable to Ministers. Given the scale of these suppliers, Minister exemption decisions are likely to be the key inputs for the east coast gas market and AFMA is concerned that the broad discretion given to Ministers about the nature and duration of an exemption will not give the market adequate certainty to make long term investments.

In AFMA's view, to give the market adequate certainty to support investment, the Code should set out objective criteria about when intervention should be justified, and equally, when it should not. We think intervention should only be considered if there is an expected shortfall of supply on the east coast. Additionally, any consideration of price should compare the cost borne by a prudently contracted user to similar users in international markets; rather than being based on spot market volatility or comparison to historic prices that do not reflect current cost structures.

As the Code is currently drafted, ministerial exemption decisions will be a key input to all decision making in the east coast gas market. While AFMA does not think this is desirable, we consider that if a decision is made, it should apply for an appropriately long period to support investment by the market. We consider that the current requirement, that decision be for no less than 12 months, is far too short and that Ministerial decisions should have to apply for at least 5 years. Additionally, we consider the grounds for revoking a decision, which only requires ministers to be "satisfied that it is appropriate," is far too broad and will undermine certainty. We suggest that decisions should only be able to be revoked or varied:

- a) With agreement from the supplier;
- b) In response to a material change to the conditions on which the decision was made (noting that AFMA considers that the criteria for granting an exemption should be much more objective); or

- c) Following ongoing serious breaches of the conditions of the exemption which cannot be remedied.

### **3.2. Criteria for intervention**

As stated above, AFMA does not agree that there is currently a rationale for ongoing intervention in the east coast gas market. We are concerned that the Government does not have clear policy objectives about what it is trying to achieve in the east coast gas market and that this has resulted in a lack of clarity about when and how it should intervene. In AFMA's view, this has resulted in a confused model incorporating a price cap combined with a highly unusual discretionary exemption process that involves four cabinet ministers and the ACCC that is very unlikely to provide certainty to the market.

AFMA's impression is that the Government's policy is attempting to balance; the interests of users and suppliers, the needs of the energy market, macroeconomic considerations related to inflation, and diplomatic relations with Australia's key trading partners. The mechanism chosen appears to indicate that Government has not been able to resolve these issues to date and intends to attempt to deal with them on a case-by-case basis in negotiations between senior ministers and the largest suppliers. AFMA does not consider that this represents good policy making and whatever other merits this arrangement may appear to have to the Government, it will not provide adequate certainty to allow investors to develop the supply needed to meet east coast demand.

### **3.3. Impact on small suppliers and southern state investment**

The Government has correctly identified that promoting the development of additional supply is critical to ensure east coast gas security and that locational constraints mean it is important to develop resources directed to supplying the southern states as northern supply cannot always meet southern demand. To achieve this, the Code proposes to exempt small suppliers who only supply the domestic market. While AFMA supports the proposal to exempt small suppliers, we are concerned that, by itself, this will not be adequate to incentivise investment in smaller assets, particularly those located in the southern states.

The incentives for investing in small assets are similar to those for investing in larger assets, at its most basic, the investor is looking to make a commercial return on their investment. In the east coast gas market, for both small and large suppliers, this means the opportunity to capture high market prices. The opportunity to capture market prices is particularly important for small suppliers who are likely to be price-takers as they are not large enough to influence the overall market price. AFMA's view is that because of their size, the undertakings by the large suppliers to supply the domestic market are likely to have an outsized impact on the market price. As price-takers smaller suppliers will struggle to achieve a significant premium over the price the large suppliers are required to sell at. As a result, we do not think the exemptions for smaller suppliers will effectively incentivise investment. We are particularly concerned that this will have an impact on the incentives for suppliers to develop resources to supply the southern states.

The other potential source of supply to the southern states that has been touted by the market is LNG imports. AFMA wants to point out that LNG for an import facility will have to be bought at global prices. It is difficult to see how these facilities will operate profitably in an environment where the east coast gas price is suppressed below global prices. We therefore think it will be challenging for these investments to proceed under the Code, which means southern state demand will have to be met by domestic supply.

### 3.4. Interaction with the ADGSM

The interaction of the Code with the Australian Domestic Gas Security Mechanism (ADGSM) is another area where AFMA considers there is a lack of clarity in the Government's policy. The Commonwealth Minister for Resources entered into a new Heads of Agreement (HoA) with LNG exporters in September 2022, this agreement runs until 1 January 2026. The ADGSM and the Code are both aimed at ensuring adequate supply of gas to the east coast and, while not as far reaching as the undertakings proposed under the Code, the HoA covers much of the same subject matter. It is not clear to AFMA how these two mechanisms are intended to work together, and it is unclear what the role remains for the ADGSM once the code is implemented. Failure to clarify how the instruments are expected to interact increases uncertainty in the east coast gas market. We recommend that the Government should clarify how the two policies interact and particularly how suppliers are expected to manage potentially contradictory obligations under the HoA and the Code.

#### AFMA Recommendations

- iii. Decisions to make, revoke and vary exemptions should be based on objective criteria.
- iv. Exemptions should apply for at least 5 years.
- v. While AFMA supports exemptions for smaller suppliers we do not believe they will be an adequate investment incentive if they are not able to capture prices linked to the global market.
- vi. AFMA considers that investment in LNG import facilities will be challenging under the Code.
- vii. The Government should reconsider the ongoing need for the ADGSM once the Code is implemented and clarify how the two instruments are expected to interact.

## 4. Market signals

---

### Key Points

- **The Code Does not support long term market signals**
  - **This undermines incentives for participants to contract to manage their risk**
  - **A lack of contracting threatens incentives to invest which could lead to supply shortages**
- 

In addition to the impact the Code will have on signals for investment AFMA is concerned about the impact it will have on incentives to transact in the east coast market. AFMA's members have observed the negative impact the price cap has had on transacting in the east coast gas market. Uncertainty

about the application of the cap, the terms and conditions imposed by it, restrictions on pricing flexibility imposed by the ACCC Interim Compliance and Enforcement Guidelines and the prospect of retrospective application of future unknown code provisions has undermined participants ability and confidence to contract. As a result, AFMA's members have seen very limited contracting for supply in 2024 and beyond, which is very concerning for buyers, including industrial users, who have been unable to access gas for 2024. We are concerned that the framework for granting exemptions under the Code will perpetuate this ongoing uncertainty.

As discussed in section 3 above, AFMA considers that ministerial exemption decisions and the undertakings provided by large suppliers will be the key factors determining price in the east coast market. We consider that in addition to being detrimental to investment decisions this process will undermine long term signals in the market and disincentivise contracting. AFMA anticipates that the Code will result in regular behind closed doors negotiations between exporters and ministers and that participants in the market will be unwilling to contract while these negotiations are ongoing as their outcome is likely to have a decisive impact on the market price. AFMA's view is that a stable regulatory environment should support efficient contracting by participants to manage their risk over the longer term. We are concerned that the Code will undermine the long-term pricing signals that are required to support this contracting and will result in participants being more exposed to spot price volatility.

#### **AFMA Recommendations**

- viii. If the exemption framework is retained decisions should have to be made:
  - a. At least 2 years before they are to apply; and
  - b. Apply for a minimum of 5 years.

## **5. Operational issues**

In addition to their significant concerns about the proposed Code AFMA's members have raised a number of technical issues about its operation that we have set out here.

### **5.1. EOI process**

AFMA's members are broadly comfortable with the proposed process requirement around Expressions of Interest (EOI) but have identified concerns regarding:

- The requirement to reserve gas during the offer period
- The potential for protracted contract negotiations after an offer is accepted

The Code introduces a number of timing and other requirements around the issue of offers, including a requirement that offers gas may not be cancelled during the offer period. AFMA's understanding is that this is intended to ensure buyers have a reasonable period of time to consider the offer. Our members have raised concerns that this may not work as intended in practice. Currently gas buyers will typically seek offers from a number of suppliers, but ultimately will not contract with all of them. Suppliers are therefore approached to supply more gas than they are able to as buyers seek offers from multiple suppliers that in total exceed their anticipated usage. Currently suppliers can make offers to all buyers confident that they can cancel outstanding offers once they have sold their total available volume. We note that this is a typical feature of how markets operate. Under the Code suppliers will not be able to do this, AFMA anticipates they will respond by making a smaller set of

offers to an initial set of potential buyers and hold these offers open for the full offer period. They will do this despite the fact that they know it is unlikely that this initial set of buyers will purchase all their capacity. This will mean that another set of potential buyers will not receive any offers until the expiry of the offer period for the first set and this could continue through multiple rounds. AFMA considers that this is not a desirable result for any of the parties involved and recommends that suppliers should be able to cancel or reduce an offer if the volume required to meet the offer has been sold through the EOI.

Additionally, the Code provides that final offers cannot be withdrawn after they are accepted. This presents an issue if parties are unable to agree contractual terms for supply after the buyer has accepted an offer. Currently, the supplier can withdraw an offer when it becomes clear that they will not be able to enter into a contract, but it is unclear that they will be able to do this under the Code. AFMA considers that it would be a poor outcome for gas to be kept from the market as a result of overly protracted contractual discussion. We recommend that there be a timing requirement on both buyers and sellers to enter into a binding agreement and that either party may withdraw if agreement is not reached within the timeframe. Given the extensive pre-contractual disclosures of terms and conditions required by the Code AFMA suggest that the time limit should be 20 business days from acceptance of the offer.

## **5.2. Regulated gas markets**

The Code is proposing to retain the exemptions for regulated gas markets that apply under the current price cap. These markets are necessary for balancing short term physical supply and perform an important role as the underlying for gas financial products. AFMA supports the exemptions for the Declared Wholesale Gas Market and Short Term Trading Market but considers the current exemption for the Gas Supply Hub (GSH) should be expanded.

The Code currently permits unregulated trading of GSH products up to D+3. AFMA considers the restrictions on trading longer term products are unnecessarily hampering short term physical trading and undermining the development of financial products based on the GSH. Since the price cap was introduced, our members have observed a significant decline in liquidity of weekly and monthly products, as well as daily products for periods beyond D+3. Daily and weekly products are an important tool to allow participants to manage their short term demand, particularly for users with variable demand such as gas generators. AFMA does not consider that these short-term products are an alternative to, or in competition with, longer term supply contracts and we therefore think they should be exempt.

Additionally, we think the Monthly product should be exempted as the ASX is currently working with AEMO and industry to list a physically settled Wallumbilla futures product that will allow participants to take physical delivery of gas as a GSH monthly product. AFMA's members consider this product could be an important instrument to improve transparency in the gas market by allowing the development of a credible east coast forward curve. AFMA is concerned that this product will not succeed without an exemption as many of the suppliers who would be interested in trading it will not if there is a risk that making physical delivery under the futures contract could be seen as breaching the reasonable pricing provisions. AFMA therefore recommends that all trading on the GSH should be exempt from the requirements of the Code.

### 5.3. Non-exempt supply

AFMA's members have raised a number of issues with the ACCC's Interim Compliance and Enforcement Guidelines, particularly that they do not offer buyers or sellers sufficient flexibility to agree terms and conditions to accommodate their usage patterns. The Code does not provide any greater clarity about how the reasonable pricing obligation will be applied to suppliers who do not have an exemption. In AFMA's view the Code should make it clear that the \$12 reasonable price applies only to the sale of the gas and that buyers and sellers are able to negotiate different prices for transport and storage services and increased delivery flexibility. The ACCC's guidelines should also be revised to reflect this.

### 5.4. Small supplier exemption

The Code grants an exemption to suppliers who produce less than 100PJ/pa and do not sell for export. Suppliers who wish to claim this exemption must provide evidence that at the time they entered into the agreement to sell gas the buyer did not have an intention to export the gas and are subject to civil penalties if this is not the case. Proving the intention of the buyer is obviously difficult and we therefore think there should be greater clarity about what a supplier's obligations are at the point of sale. In AFMA's view the supplier's obligation should be to ensure a provision requiring domestic supply of the gas is included in the sale contract. Additionally, we think the Code should be clear that sales to the regulated gas markets are considered to be domestic sales for the purpose of the small supplier exemption.

### 5.5. Retailer exemption

AFMA's members welcome the Government's desire to provide greater clarity about the application of the Code to gas retailers but have provided feedback that the current provisions may not work as intended to exempt retailers and other gas market intermediaries. AFMA's view is that to facilitate users being able to obtain the greatest number of offers the Code should exempt the widest range of retailers and intermediaries possible. It is important to note that, unlike in electricity, a retailing authorisation or licence is not required to sell gas unless you wish to sell it within a distribution system. This means that a number of large users, include ones located within distribution systems who are registered with AEMO as self-contracting users, are able to buy gas from wholesale intermediaries who are not retailers. AFMA therefore recommend the exemption should be extended to include these intermediaries.

AFMA is also concerned that the definition of affiliate may unintentionally capture retailers and intermediaries who are related companies of suppliers but operate structurally separate businesses that do not benefit from the supplier's gas production. We therefore suggest that the definition of affiliate be revised to only capture retailers and intermediaries who do not have current commercial agreements to sell their related supplier's gas.

#### **AFMA Recommendations**

- ix. Suppliers should be able to cancel or reduce an offer if the volume required to meet the offer has been sold through the EOI.
- x. There should be a mandatory 20 business day timeframe for parties to enter into a binding agreement after the acceptance of a final offer under an EOI.

- xi. The exemption for GSH trades should be extended to all GSH products.
- xii. The Code should clarify that the \$12 reasonable price only applies to the sale of gas not to ancillary services for transport, storage or delivery flexibility.
- xiii. The ACCC's Interim Compliance and Enforcement Guidelines should be revised to provide participants with greater flexibility to negotiate terms and conditions for supply.
- xiv. The obligation for small suppliers to provide evidence of the buyers' intent should be replaced by an obligation to include a provision in any sale contract requiring that the gas be used for domestic use.
- xv. The Code should clarify that sales by small suppliers to regulated markets are considered to be domestic supply.
- xvi. The retailer exemption and definition of affiliate should be clarified to ensure that it applies to the broadest category of retailers and intermediaries.

AFMA would welcome the opportunity to discuss the Gas Market Code. Please contact me on 02 9776 7994 or by email at [lgamble@afma.com.au](mailto:lgamble@afma.com.au).

Yours sincerely



**Lindsay Gamble**  
**Policy Director**