Australian Government
The Treasury
Department of Climate Change, Energy, the Environment and Water

Options to ensure the domestic wholesale gas market delivers for Australians

Consultation paper

December 2022

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Consultation Process

Request for feedback and comments

Interested parties are invited to comment on this consultation paper.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

Submissions will be shared with other Commonwealth agencies where necessary for the purposes of this consultation. All information (including name and address details) contained in submissions will be made available to the public on the Treasury and Department of Climate Change, Energy, the Environment and Water websites unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions:

Consultation on the price cap (including the draft price cap instrument at Appendix B) closes on **15 December 2022**. Consultation on the remainder of the paper closes on **7 February 2023**.

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Options to ensure the domestic wholesale gas market delivers for Australians

Introduction

The need for intervention

Russia's war in Ukraine has disrupted global energy markets and contributed to sharp increases in gas and electricity prices. This has compounded a decade of energy policy failures that have left Australians more vulnerable to global energy shocks. The result has been significant increases in domestic gas and electricity prices for households and businesses which are expected to continue. There are also broader issues in the wholesale gas market which mean that offers for supply contracts are not always being made on reasonable terms.

Without intervention, retail gas prices are expected to increase by 20 per cent in 2023-24 and retail electricity prices are expected to increase by 36 per cent in 2023-24. High wholesale gas prices impact on industrial customers' viability where production is reliant on gas, and result in households and commercial users ultimately paying more for electricity, gas, and goods.

This consultation paper seeks input on the design of the east coast gas market elements of the Government's plan to address high energy prices.

The Government is taking responsible and meaningful action to ensure that our gas markets enable domestic users to access deliver adequate supply at reasonable prices and on reasonable terms. This will consist of two complementary measures:

- a mandatory code of conduct to address systemic issues within the market and guide behaviour, which includes a reasonable price provision; and
- an emergency, temporary cap on wholesale gas prices for 12 months.

The mandatory code will be an ongoing addition to Australia's east coast gas market regulation, with key elements subject to review on the basis of changes to the market's structure and conduct. It will be subject to consultation until February 2023, and is expected to come into effect shortly thereafter.

Current low levels of competition between producers, high prices and risks of supply shortages warrant the inclusion of a reasonable pricing provision within the code. A reasonable pricing provision would provide a basis for producers and buyers to negotiate domestic wholesale gas contracts at 'reasonable prices', which reflect the cost of domestic gas production, allowing for a reasonable return on capital. This provision is expected to remain as long required, and until the ACCC advises the Government that domestic gas prices are reflective of the underlying costs of production and that there is sufficient supply at these prices. The operation of this provision will be considered as part of a review of the broader code, once it has been in place for a year.

For a 12-month period, a temporary, emergency price cap will also be put in place to ensure domestic industry remains viable, and to limit energy price rises for households and businesses. The temporary price cap is intended to commence in December 2022 – following a focused consultation period, and to be subject to review in mid-2023 – to assess whether it is having the intended impact on contracting behaviour.

These interventions will be enforced by the ACCC, with a range of tools including significant civil penalties under the Competition and Consumer Act 2010 (CCA). The Government is also considering the role of existing regulatory levers and other complementary actions to support the operation of these interventions.

Criteria for intervention

The final design of these interventions will be informed by responses to this consultation paper and assessed against the following criteria. Interventions should:

- Be effective at limiting increases in domestic wholesale gas prices.
- Be targeted and fit-for purpose, to minimise any distortionary impacts in energy markets and related markets.
- Allow producers to make a reasonable return on investments, to ensure sufficient domestic supply and diversity of suppliers.
- Retain incentives for future investments to develop and bring gas to market.
- Be capable of being implemented in a clear, workable way which does not create excessive uncertainty or undermine the functioning of the gas market.
- Allow producers to continue to meet their existing contractual obligations, including long-term foundational contracts with international partners.
- Support Australia’s emissions reduction target and the transition of our domestic energy markets.

Consultation questions

An emergency, temporary price cap on wholesale gas prices

Objectives

The key design objectives of the emergency price cap are that it should:

- Be in place no longer than necessary, and be no broader than necessary, to ensure domestic industry remains viable, and to ensure households and businesses have access to affordable energy.
- Ensure domestic prices are reasonable and reflect the costs of supply to the domestic market during the period, allowing for a reasonable return on capital.
- Minimise and mitigate any distortions to wholesale gas markets and related markets, including electricity generation, and retail gas and electricity markets.
- Preserve incentives and certainty for investors.

Proposal

The Government intends to put in place a temporary, emergency price cap on east coast wholesale gas sales, where:

- the seller is a gas producer (including sales made on behalf of gas producers by a related entity);
- the gas is sold via contracts that are directly negotiated between the parties, or agreed through the Gas Supply Hub;
- the price is agreed, and the gas is to be supplied, while the price cap is in effect (that is, the price cap will not impact prices set through existing contracts, or gas to be delivered after the cap ends); and
- the gas to be supplied is sourced for supply from developed gas fields (noting gas to be supplied from currently undeveloped fields will instead be subject to the reasonable pricing provision).

The cap will be set at a level that reflects reasonable costs of production at currently developed gas fields including a reasonable return on capital, on the basis of advice from the ACCC and any additional considerations raised in response to this consultation paper.

The ACCC advised that a $12 per gigajoule price cap would be an appropriate level to set a temporary, emergency price cap on the wholesale gas contracts described above. This recommendation is supported by analysis of offers made in 2021 for supply in 2023, prior to international prices increases, and of the estimated costs of gas production of the east coast's proven reserves. Of the 289 domestic offers made over this period, 96 per cent were below $12 per gigajoule, and the average offer was $9.20 per gigajoule. Based on this, the ACCC considers a price cap of $12 per gigajoule is a reasonable price allowing for the key costs of domestic supply, including a reasonable return on capital for gas sourced from currently operational fields.

The intended coverage of the temporary, emergency price cap is detailed below, and a draft price cap instrument is at Appendix B to this paper, to enable feedback on whether the draft instrument reflects the policy intent.

New sources of supply would be exempt from the cap, and instead be covered by the reasonable pricing provision, as the pricing observed prior to the increases in prices this year may not provide a reliable indication of the price necessary to recover the costs of new entrants.

The price cap would not apply to prices set through contracts in place at the commencement of the relevant legislation. It would apply to new contracts signed while the price cap is in operation, for supply during the period when the cap is in operation. In the case of a multi-year contract, the price cap will apply to gas to be supplied while the cap is in effect, and the reasonable pricing provision will apply to supply delivered during the remainder of the contract.

The price cap applies to producers in order to capture the first sale of gas, so would not apply to gas sold at the wholesale level by other market participants like retailers, which have different cost structures. The ACCC and AER will be closely monitoring the behaviour of all participants in the wholesale contract market and, if other wholesale gas sellers' prices are identified as being excessive relative to their costs, the scope of the price cap could be expanded.

The price cap is also not proposed to apply to the Victorian Declared Wholesale Gas Market (DWGM), or to Short Term Trading Markets (STTM) (Sydney, Adelaide and Brisbane), as these spot markets operate under different pricing and supply structures. Dampening price-based signals in these balancing markets could limit the responsiveness of supply during periods of unexpectedly high demand. The Gas Supply Hub (Wallumbilla and Moomba) will be within the scope of the price cap, as trades completed through the hub are bilateral transactions and can be used to source supply for durations of weeks or months.

Finally, the price cap is not proposed to apply in markets which are *functionally separate* from the eastern gas region. This reflects that the eastern gas region is the primary gas market in Australia, and other markets are physically or functionally separate, subject to different regulatory frameworks, and are not experiencing the same supply and pricing issues. In practice, this means the price cap and mandatory code would not apply to Western Australia, or to Northern Territory for the period that the Northern Gas Pipeline is not operational.

The price cap will be enforced by the ACCC, supported by the broader market monitoring activities of the AER. While the price cap is in place, prices above the cap for relevant contracts will contravene the legislation and may be subject to ACCC enforcement action, including potential significant civil penalties under the Competition and Consumer Act 2010.

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?
- 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?
- How might the impacts of this policy differ across key segments of the gas market?
- Does the proposed model appropriately mitigate the risks associated with market intervention?

A mandatory code of conduct to guide behaviour in the market

Objectives

The key design objectives of the mandatory code are that it should:

- Address bargaining power imbalances between producers and buyers in the domestic wholesale gas market.
- Set minimum standards for dealings between producers and buyers, ensuring a clear and certain commercial negotiation framework.
- Support producers and buyers to arrive at agreements on reasonable terms.
- Provide a reasonable pricing provision to ensure that domestic prices are set at reasonable levels given the underlying costs.

Proposal

The government intends to introduce a mandatory code under the Competition and Consumer Act 2010. All domestic gas producers will be subject to the requirements of the code in their negotiation of wholesale gas supply contracts, except for those in markets which are *functionally separate* from the eastern gas region. Broader application of the code to wholesale contracts sold by other market participants will be considered, informed by the ACCC's advice and responses to this consultation paper.

The mandatory code will build on the existing voluntary code (see summary at Appendix C), and will place obligations on both producers and buyers of gas in the domestic wholesale market.

At a high level, the mandatory code will contain:

- obligations on both producers and purchasers to act in good faith;
- requirements for gas producers to publish or otherwise make offers broadly available to the domestic market;
- requirements for gas producers to disclose certain information when issuing expressions of interest (EOIs) or making offers to enter into a gas contract, such as the factors considered in determining the price;
- obligations around the timing for issuing EOIs and making offers (for example, specifying minimum periods for EOIs and offers to remain open);
- minimum standards for some terms and conditions of gas supply contracts;
- a reasonable pricing provision.

The mandatory code will also include a formal process for the resolution of pre-contractual disputes, ranging from mediation to binding arbitration. Arbitration will generally be available on all terms of gas supply contract negotiations. However, while the price cap is in effect, any price below the cap will be deemed compliant and 'reasonable' for contracts within the scope of the cap. Binding arbitration will therefore be limited to the non-price terms of gas supply contract negotiations for these contracts.

Once gas supply contracts are agreed, any disputes will be governed by the dispute resolution provisions within the relevant contract. The code will be administered and enforced by the ACCC, and the significant penalties within the Competition and Consumer Act will be available for non-compliance.

Reasonable pricing provision

The Government intends to include a 'reasonable pricing' provision in the mandatory Code of Conduct, which would have the objectives to:

- Ensure domestic prices reflect costs of production, allowing for a reasonable return on capital.
- Be flexible to accommodate changes to the costs drivers of production.
- Allow for competition on price and price variation reflecting differences in suppliers' costs.
- Maintain incentives for investment in new sources of supply.

The reasonable pricing provision will provide a basis for producers and buyers to negotiate domestic wholesale gas contracts at 'reasonable prices', defined as efficient long run marginal costs of domestic supply, allowing for a commercial return on capital reflective of the industry's risk profile. This would be assessed with reference to the cost of the most likely new domestic gas production to meet forecast domestic demand, including:

- operating expenditure reflecting efficient new development(s);
- depreciation based on the economic life of the new development(s);
- return on capital (set as a benchmark return reflecting the financing costs of an efficient business facing similar risks); and
- an allowance for taxation and royalties.

The depreciation and return on capital would reflect the capital costs of identifying and bringing new developments to market, including capitalised exploration and development costs. This will maintain incentives for exploration and supply of gas to the domestic market. The ACCC will provide guidance in relation to each of these factors.

Like the temporary price cap, the reasonable pricing provision applies to producers in order to capture the first sale of gas, so would not apply to gas sold at the wholesale level by other market participants like retailers, which have different cost structures.

For currently undeveloped fields, gas will be subject to the reasonable pricing framework as soon as it is introduced as part of the code in early 2023, and would not be subject to the temporary price cap. For developed gas fields, the reasonable pricing provision would apply at the conclusion of the price cap period for relevant contracts that are within the scope of the reasonable pricing provision.

As with the price cap, the pricing behaviour of other wholesale gas market sellers will be closely monitored by the ACCC, with the possibility of extending the code and reasonable pricing provision to other market participants in future if warranted by the structure and conduct of the market.

The reasonable pricing provision will be administered by the ACCC as part of the code. The ACCC will consult with industry to develop guidelines setting out how it intends to approach compliance and enforcement.

Questions

- Are the obligations outlined in the voluntary code (summarised at Appendix C), if made mandatory, adequate to address bargaining power imbalances between gas suppliers and purchasers in the negotiation of gas supply contracts?
- Should the Code of Conduct be limited to wholesale contracts where the supplier is a gas producer, or be expanded to include contracts offered by other market participants, such as retailers? This need not broaden the application of the reasonable pricing provision.
- How could the binding arbitration process be designed to ensure resolution in an efficient and cost-effective manner, particularly with regard to reasonable pricing?
- On what grounds should a party to a gas supply agreement negotiation be permitted to refer a dispute to a binding arbitration process? Should mediation be a pre-condition to accessing arbitration?
- On what basis should an arbitrator be able to make a determination on price?
  - What factors should be considered for the reasonable pricing provision?
  - What type of guidance on reasonable pricing should be provided to support negotiations, and if necessary, arbitration?
- What design features will ensure the reasonable pricing provision provides a sufficiently clear basis for producers and buyers to negotiate a price?
- What model of arbitration should be used to resolve disputes about reasonable pricing?
- Does the proposed model appropriately mitigate the risks associated with market intervention?

Legislative process and instruments

As part of this consultation process, feedback is sought on the Competition and Consumer Amendment (Gas Market) Bill 2022 and explanatory memorandum. If passed, the Bill will establish a new Part IVBB within the *Competition and Consumer Act 2010*, creating a tailored enabling framework for the making of gas market regulation instruments.

Once the enabling framework is in place, the price cap would be implemented by the making of a gas market emergency price order under Part IVBB of the CCA. A draft of this order is available for comment at Appendix B to the consultation paper.

The mandatory code would also be made via regulations under Part IVBB of the CCA. The feedback provided through this consultation process will inform the drafting of the regulations.

Appendix A: Price cap and reasonable pricing framework

	Price cap	Reasonable pricing provision
Market coverage	Applicable to east coast market wholesale contracts with producers, directly negotiated between the parties, or reached following a trade through the Gas Supply Hub. Not applicable to Victorian Declared Wholesale Gas Market or the Short Term Trading Markets in Brisbane, Sydney and Adelaide. Not applicable to gas supplied from undeveloped fields.	Applicable to east coast market wholesale contracts with producers, directly negotiated between the parties, or reached following a trade through the Gas Supply Hub. Not applicable to Victorian Declared Wholesale Gas Market or the Short Term Trading Markets in Brisbane, Sydney and Adelaide.
Which pricing mechanism applies for the first 12 months from the introduction of the price cap?	Producers' contract prices will be regulated by the price cap if the gas is to be supplied from developed fields, and meets the market coverage criteria. Not applicable to sales by non-producers.	Once the Code of Conduct is enacted, producers' contract prices will be regulated by the reasonable pricing framework if it meets the market coverage criteria and is: • gas to be supplied from currently undeveloped gas fields; and • gas to be supplied beyond the period of the price cap. Not applicable to sales by non-producers.
Which pricing mechanism applies after the expiry of the temporary price cap?	Not applicable, will expire after 12 months.	Producers' contract prices will be subject to this framework.
Pricing requirement	Prices are required to be below the price cap.	Prices are negotiated or, determined via arbitration in the event of a dispute, with reference to the reasonable pricing provision and relevant ACCC guidance.
Compliance and enforcement	Prices above the cap are non-compliant and would be subject to ACCC enforcement action.	Where producers and buyers are unable to agree a 'reasonable price', they may seek a binding arbitration determination.

Appendix B: Draft price cap instrument

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Competition and Consumer (Gas Market Emergency Price) Order 2022

I, Dr Jim Chalmers, Treasurer, make the following Order.

Dated   2022

Dr Jim Chalmers **DRAFT ONLY—NOT FOR SIGNATURE**
Treasurer

Contents

Part 1—Preliminary

1 Name

This instrument is the *Competition and Consumer (Gas Market Emergency Price) Order 2022*.

2 Commencement

(1) Each provision of this instrument specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms.

Commencement information		
Column 1	**Column 2**	**Column 3**
Provisions	**Commencement**	**Date/Details**
1. The whole of this instrument	The day after this instrument is registered.	

Note: This table relates only to the provisions of this instrument as originally made. It will not be amended to deal with any later amendments of this instrument.

(2) Any information in column 3 of the table is not part of this instrument. Information may be inserted in this column, or information in it may be edited, in any published version of this instrument.

3 Authority

This instrument is made under section 53M of the *Competition and Consumer Act 2010*.

4 Definitions

Note: A number of expressions used in this instrument are defined in the Act, including the following:

(a) agreement;

(b) Australia (see subsection 53E(2) of the Act);

(c) gas exchange.

In this instrument:

Act means the *Competition and Consumer Act 2010*.

AEMO has the same meaning as in the *Renewable Energy (Electricity) Act 2000*.

National Gas Law means the National Gas Law set out in the Schedule to the *National Gas (South Australia) Act 2008* of South Australia as in force from time to time.

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National Gas Rules means Rules as in force from time to time, made or having effect under the National Gas Law.

price cap means $12 per gigajoule.

price cap period means the period:

(a) starting on the day on which this instrument commences; and

(b) ending 12 months after that day.

regulated gas means a substance that:

(a) is in a gaseous state at standard temperature and pressure; and

(b) consists of naturally occurring hydrocarbons, or a naturally occurring mixture of hydrocarbons and non-hydrocarbons, the principal constituent of which is methane; and

(c) is suitable for consumption; and

(d) does not include liquefied natural gas (within the meaning of the *National Greenhouse and Energy Reporting Regulations 2008*).

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Part 2—Application

5 Geographical application

(1) For the purposes of subsection 53N(2) of the Act, Part 3 applies in relation to all parts of Australia other than each part of Australia in relation to which the requirements specified in subsection (2) are met.

(2) For the purposes of subsection (1), the requirements are as follows:

(a) the part of Australia represents a market for regulated gas;

(b) that market is functionally separate from the primary market for regulated gas in Australia.

6 Application to gas

This instrument only applies in relation to gas that:

(a) is regulated gas; and

(b) is sourced from a field (within the meaning of Part 18 of the National Gas Rules immediately before the commencement of this instrument) that commenced operation before the day on which this instrument commenced.

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Part 3—Price cap and exceptions

Division 1—Price cap

7 Price cap

(1) A person covered by section 8 contravenes this subsection if:
   (a) the person enters into an agreement for the supply of regulated gas; and
   (b) the day on which the agreement is entered into is in the price cap period; and
   (c) under the agreement, the person is to supply regulated gas; and
   (d) the price payable under the agreement, for regulated gas to be supplied by the person in the price cap period, could exceed the price cap.

(2) A person covered by section 8 contravenes this subsection if:
   (a) the person entered into an agreement for the supply of regulated gas; and
   (b) the day on which the agreement was entered into was in the price cap period; and
   (c) the person supplies regulated gas under the agreement in the price cap period; and
   (d) the price payable under the agreement, for that gas, exceeds the price cap.

(3) Subsections (1) and (2) are civil penalty provisions (within the meaning of the Regulatory Powers Act).

(4) Subsection (1) applies only if entering into the agreement mentioned in paragraph (1)(a) is gas market conduct described in subsection 53ZZA(1) of the Act.

(5) Subsection (2) applies only if the supply mentioned in paragraph (2)(c) is gas market conduct described in subsection 53ZZA(1) of the Act.

8 Persons subject to price cap

(1) For the purposes of section 7, a person is covered by this section if any of the following conditions are met:
   (a) the person carries on a business of producing regulated gas;
   (b) the person:
      (i) is covered by subsection (2) in relation to a person (the ***producer***) that carries on a business of producing regulated gas; and
      (ii) has entered into an agreement for the supply of gas by the producer to the person.

(2) A person (the ***affiliate***) is covered under this subsection in relation to the producer if any of the following conditions are satisfied:
   (a) the affiliate and the producer are related to each other;
   (b) the affiliate and the producer are related entities (within the meaning of the *Corporations Act 2001*);

(c) there is a joint venture in which the affiliate and producer are participants;
(d) there is:
 (i) a joint venture in which the affiliate and a third person are participants; and
 (ii) another joint venture in which the producer and the third person are participants;
(e) there is:
 (i) a joint venture in which the affiliate and a third person are participants; and
 (ii) another joint venture in which the producer and an associate of the third person are participants;
(f) there is:
 (i) a joint venture in which the producer and a third person are participants; and
 (ii) another joint venture in which the affiliate and an associate of the third person are participants.

9 Price cap—variations to agreements

(1) This section applies if:
 (a) the person enters into an agreement for the supply of regulated gas; and
 (b) the day on which the agreement is entered into is before the start of the price cap period; and
 (c) in the price cap period, the person enters into a variation of the agreement.

(2) For the purposes of applying subsections 7(1) and (2) in relation to the variation, treat the agreement, to the extent that it is varied under the variation, as being an agreement entered into at the time the variation is entered into.

Division 2—Exceptions to price cap

10 Exceptions to price cap

Subsections 7(1) and (2) do not apply if any of the following conditions are met:
 (a) at the time the agreement is entered into, the person to whom the regulated gas is to be supplied under the agreement intends to export from Australia the regulated gas in a liquified state;
 (b) all of the following apply:
  (i) the agreement is a subordinate contract under a master gas supply agreement;
  (ii) the master gas supply agreement was entered into before the start of the price cap period;
  (iii) the subordinate contract does not include a provision determining the price of the gas to be supplied under it;
 (c) the agreement is a contract for the storage of regulated gas;

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(d) the agreement results from a transaction on a gas exchange (other than a gas trading exchange established by AEMO under subsection 91BRK(1) of the National Gas Law).

Appendix C: Summary of voluntary code

The existing *Voluntary Code of Conduct for the Negotiation and Development of Gas Supply Agreements between Gas Suppliers and Gas Customers in Australia* (voluntary code) is contained at Annex C to the *Heads of Agreement: The Australian East Cost Domestic Gas Supply Commitment* between the Australian Government and East Coast Liquefied Natural Gas Exporters.

Broadly, the voluntary code is split into three key parts.

The **operative provisions** outline the obligations on gas suppliers, such as the obligation to act in good faith in negotiations with gas customers, disclose particular information to gas customers when issuing expressions of interest or offers to enter into a gas supply agreement (GSA), and apply minimum standards to all GSAs agreed under the code.

Pricing principles set out the factors that a gas supplier must consider when determining the price of gas in an offer, including obligations requiring gas suppliers to disclose what factors were considered in determining the price of an offer.

Dispute resolution provisions outline the appointment process and function of a Code Arbiter to manage disputes relating to the Code, including the investigation, determination and reporting of complaints made by gas customers.

The code also contains administrative provisions dealing with matters such as signing up to (or withdrawing from) the code, processes for review and amendment to the code, and transitional arrangements.

The full text of the voluntary code is available at: https://www.industry.gov.au/mining-oil-and-gas/oil-and-gas/securing-australian-domestic-gas-supply