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Department of Climate Change, Energy, the Environment and Water (DCCEEW)
Via - https://consult.dcceew.gov.au/gas-mandatory-code-of-conduct
11 May 2023

Dear Minister

Re: Mandatory Code of Conduct for the East Coast Gas Market – Consultation Paper

The Australian Aluminium Council (the Council) represents Australia's bauxite mining, alumina refining, aluminium smelting and downstream processing industries. The aluminium industry has been operating in Australia since 1955, and over the decades has been a significant contributor to the nation's economy. Today's aluminium industry contributes around $16.9B[i] a year to the economy in export value. More than $15 B of this comes from the alumina and aluminium industries, as value adding mineral processing sectors.

The industry includes six large bauxite mines plus several smaller mines which collectively produce over 100 Mt per annum making Australia the world's largest producer of bauxite. Australia is the world's largest exporter of alumina with six alumina refineries producing around 21 Mt per annum of alumina. Australia is the seventh largest producer of aluminium, with four aluminium smelters and additional downstream processing industries including more than 20 extrusion presses. Aluminium[ii] is one of the commodities most widely used in the global transition to a clean energy future. It is also recognised for its importance to both economic development and low emissions transition. Aluminium is Australia's top manufacturing export. The industry directly employs more than 17,000 people, including 4,000 full time equivalent contractors. It also indirectly supports around 60,000 families predominantly in regional Australia.

The Australian alumina, aluminium and downstream manufacturing industries are highly dependent on gas for their operations and viability; directly using more than 166[iii] PJ of gas per annum as well as indirect consumption via the electricity market.

Securing Australia's Domestic Gas Supply

Industry has been calling for gas market reforms for more than a decade. The Council and its members have been seeking an efficient, effective and deep Australian domestic gas market – a market which is comprised of many buyers and sellers who are able to negotiate contracts where both sides can obtain a fair return and where, for example, shortages in supply lead to higher prices, additional supply is brought on to satisfy this demand. The inherent systemic failures in the existing east coast gas market currently do not ensure delivery of adequate supply at reasonable prices.

Gas policy needs to balance Australia's contribution to the world's energy security and the trust trading partners and international investors have shown in Australia's resources and energy sectors, with the needs of domestic consumers. In 2022, the Council's Members which sought to recontract for gas saw prices increases up to 300% compared to prices in 201. This is not sustainable when energy typically accounts for

30-40% of the industries' cost base and therefore is a key determinant of their competitiveness. Without price relief, unsustainable will become unviable.

In December 2022, the Prime Minister announced a suite of measures to aimed at mitigating the impacts of predicted energy price spikes caused by Russia's illegal invasion of Ukraine and the consequent pressure on global energy markets. The Council publicly welcomed these actions on gas prices and made submissions in December 2022 and February 2023 on the implementation of these measures.

The industry has experience operating under the Western Australian Domestic Gas Reservation Policy for almost 15 years. This policy has helped provide domestic market security to the alumina industry[1], including a recent agreement with a smaller energy company which was sufficient to underpin the development of a new onshore gas field[2]. But it also demonstrates the mutual value which can be created between the mineral processing industry and its energy suppliers, with supportive policy settings. Australia should adopt a strategic national approach to gas and its manufacturing sector, as many of its competitors have. A prospective gas reservation policy should be one part of the Governments strategy.

Response to the Consultation Paper

The Council welcomes the release of the Mandatory Code of Conduct for the East Coast Gas Market (Code of Conduct) – Consultation Paper (the Paper). As each operation has unique energy arrangements, the Council will limit its comments on the Paper to a high level. The Council also supports the submission of the Energy Users Association of Australia, particularly on the Exposure Draft Competition and Consumer (Gas Market Code) Regulations 2023.

The proposed code is intended to:

- ensure domestic prices are reasonable by establishing a price anchor through a price cap, initially set at $12/GJ and conditional exemptions from the price cap for producers on the basis of satisfactory voluntary enforceable supply commitments or being a small producer who exclusively supplies the domestic market;
- negotiations between users and producers take place in good faith, on a level playing field by introducing conduct requirements which will apply to all gas producers and address bargaining power imbalances between producers and gas users and establish minimum conduct and process standards for commercial negotiations;
- provide a strong penalty regime that will be enforced by the ACCC to ensure compliance with the Code, including compliance with the full conditions of any supply commitments entered into by producers; and
- require gas producers to publish details on the uncontracted gas they have available and when this would be brought to the domestic market over the forward 12 months to provide greater market transparency.

To date, a voluntary code has been ineffective, and the Council welcomes the intention to establish a clear domestic price anchor, incentivise producers to commit more gas to the domestic market and support good faith negotiations so gas users, including industry, can secure gas supply contracts at reasonable prices through this mandatory code.

The Council notes the $12/ GJ price cap is consistent with advice from the Australian Competition and Consumer Commission (ACCC) reflecting the cost of provision for Australian gas from Australian producers

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[1]https://www.alcoa.com/australia/en/news/releases?id=2015/04/alcoa-secures-new-gas-supply-agreement-to-power-its-alumina-refineries-in-western-australia&year=y2015 and https://files.woodside/docs/default-source/media-releases/woodside-to-supply-domestic-gas-to-worsley-alumina.pdf?sfvrsn=6706356_2.

[2]https://www.alcoa.com/australia/en/news/releases?id=2020/09/alcoa-secures-continued-gas-supply-with-three-new-agreements&year=y2020 and https://www.afr.com/companies/energy/large-alcoa-gas-deal-to-kick-start-onshore-wa-field-20200928-p55zv2.

to Australian users, rather than reflecting the international price and the production cost estimates developed for Australian Energy Market Operator (AEMO) Gas Statement of Opportunities (GSOO) for new supply. This should incentivise new investment to ensure the Australian gas market remains well-supplied and supports affordable market prices in the medium to long term.

Since the intervention of December 2022, members of the Council have continued to be challenged in accessing gas contracts due to perceived uncertainty in the market and around the terms of this mandatory code. The Council hopes that this situation will now be rectified as gas producers have more confidence and clarity in the likely 'rules of engagement'.

The Council supports the differentiated approach to be applied to small producer who exclusively supplies the domestic market. The Council recognises that the construction of the three LNG export facilities in Gladstone as well as moratoria on gas exploration in some states, has fundamentally changed the gas market with the east coast increasingly reliant on Queensland gas. Increased supply of gas will require an increased diversity of sellers, new sources of gas that meet/exceed current domestic requirements and current LNG export capacity, and the removal of physical congestion, in order to deliver internationally competitive outcomes for consumers. A market with inadequate gas supply will continue to track volatile international LNG pricing (less netback) and is unlikely to achieve the Government's policy aims. State and Federal collaboration is needed to remove barriers to the increases in diversity of supply. The proposed differentiated approach should help bring increased competition and diversity to the domestic market.

<u>Responses to specific questions</u>

- *Do you have any comment on the proposed approach to 'good faith' in the exposure draft Code?*

Parties acting in Good Faith is fundamental to the success of any mutually beneficial commercial transaction. The addition of factors drawn from the Voluntary Code of Conduct should help to further negotiations on a level playing field, setting aside behaviours that may have been associated with the gas industry in the past. This creates a clear set of expectations from the regulator and will be fundamental to how negotiations for the domestic supply of gas will operate moving forward.

- *Are the factors listed in the exposure draft Code appropriate to the gas industry?*

While noting that the Code does not apply to retailers or short term trading markets, the Council encourages an ongoing role for both the ACCC and Australian Energy Regulator (AER) in monitoring the behaviour of all market participants to ensure the benefits of the Code flow through to all consumers.

- *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?*

The Code provides a clear framework for timelines that relate to offers and responses. Increased flexibility while directing reasonable periods in which responses can be provided should avoid unreasonable timeframes to respond to offers in the future while setting a clear expectation for all parties.

- *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?*

The Code does not appear to account for the size of a transaction as it relates to a reasonable expectation of the time in which an offer can be accepted to proceed and any stage. Larger transactions will result in increased periods of time in which a buyer needs to perform its own due diligence on a transaction and obtain the necessary internal approvals to proceed. Recognising there is the ability to agree an extended offer periods by mutual agreement, allowing flexibility based on the size of the transaction should be a starting point rather than an exception.

- *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?*

The Code obligates a set of behaviours by the parties but does not mandate making volumes available such as found in Western Australia's Domestic Gas Reservation Policy. The Code seeks to address price imbalances and requires producers to report on uncontracted volumes but does not obligate producers to make these volumes available to the domestic market.

This approach goes some way to address the current concerns with wholesale gas supply and price but still does not embed the necessary market reform the industry needs to support long term requirements for domestic customers on the east coast. A cap on pricing for large producers is expected to encourage volumes to be sold via long term, offshore contracts, reducing the volume of gas made available for sale on domestic markets.

Equally, the Code (and also the Price Order) does not apply to declared wholesale gas markets or short term trading markets, anonymous trades or pre-matched trades on gas exchanges of three days or less and as such there is an in-built limitation on the applicability of the Code and Price Order. This limitation, by fundamentally separating the markets could lead to divergent pricing where one market is subject to a Price Cap and the others are free to price gas at any level.

Introduction of conditional and automatic exemptions for producers who negotiate a satisfactory enforceable domestic supply commitment is likely to result in two divergent markets in which one market is regulated at a $12 price cap with minimal volumes available in the market for sale, and the other market operates at a price far exceeding the $12/GJ price cap due to a further tightening of supply.

- *Do you think the price cap set at $12/GJ is appropriate to achieve this objective?*

While noting that the price cap only applies to contracts in the wholesale market, a cap of $12/GJ is a welcome ceiling given the volatility in the market since mid-2021. However, for high volume users such as the aluminium industry, $12/GJ is not a long term sustainable price. These users require a price closer to the cost of production to promote long term sustainable operation. Using the ACCC LNG netback as a reference to an export parity price, $12/GJ is materially higher than the average price prior to recent volatility (Figure 1).

The price of gas becomes more important to industry in the future as it moves aware from high emissions, coal based processes to reduce carbon emissions. $12/GJ may be suitable to halt high prices in the short to medium terms but is challenging for long term decision making. The Code should encourage producers to price gas in a reasonable manner considering the cost of production and not to default commercial arrangements at $12/GJ.

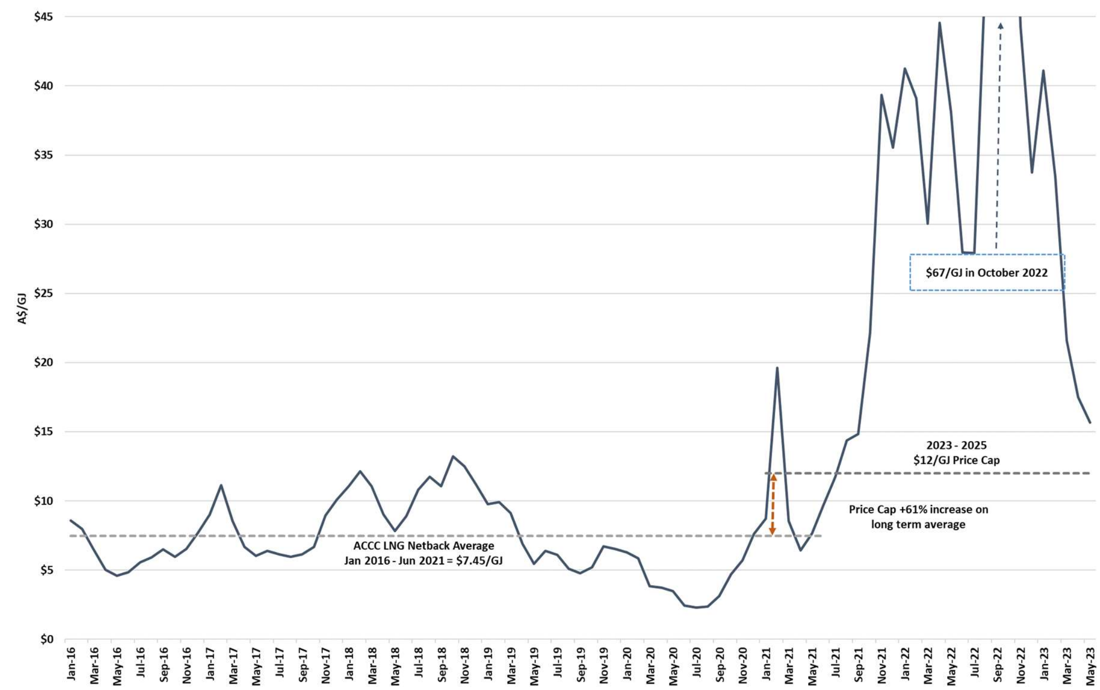

Figure 1. ACCC LNG Netback January 2016 to May 2023

Conclusion

At a time when manufacturers are facing serious challenges, energy is one of the few advantages Australia has to offer and which Government can help to deliver. The Council seeks a national climate and energy policy framework which is transparent, stable and predictable, while maintaining the economic health of the nation including vital import and export competing industries. Given the importance of a functioning gas market to the industry, the Council is happy to provide further information on any of the issues raised in this submission and looks forward to continuing to work with the Government on the development of gas policy. The Council also supports the submission of the Energy Users Association of Australia.

Kind regards,

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[i] https://www.industry.gov.au/sites/default/files/minisite/static/ba3c15bd-3747-4346-a328-6b5a43672abf/resources-and-energy-quarterly-september-2022/documents/Resources-and-Energy-Quarterly-September-2022-Aluminium.pdf

[ii] https://www.worldbank.org/en/topic/extractiveindustries/brief/climate-smart-mining-minerals-for-climate-action

[iii] The industries' gas usage can be summarised as follows:

- Gas usage by alumina refineries (WA Gas Market) ~125 PJ, which is 32 % of WA's domestic gas market;
- Gas usage by alumina refineries and aluminium smelters (East Coast Gas Market) ~40 PJ, which is 7% of the East Coast domestic gas market; and
- Indirect consumption via the National Electricity Market (NEM) the industry has four aluminium smelters, two alumina refineries and a number of extruders; and uses more than 10% of the electricity consumed in the NEM.
- This gas consumption includes gas used in cogeneration for export electricity, as this activity is directly linked to the alumina refineries; and produces low emissions electricity for the National Electricity Market and South West Interconnected System (SWIS). Data provided is for 2021 calendar year.