AUSTRALIAN ALUMINIUM COUNCIL LTD

Australian National Audit Office
Design of the Energy Price Relief Plan
https://www.anao.gov.au/work/performance-audit/design-the-energy-price-relief-plan

17 June 2024

Dear Audit Office

Re: Audit of the Design of the Energy Price Relief Plan

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 $16B[i] a year to the economy in export value. More than $14B 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 19,000 people, including 6,600 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. The Grid Reliability Scenario (Figure 6) in the Interim National Gas Infrastructure Plan 2021 showed the modelled gas supply vs demand outcomes are very sensitive to the changes in the electricity sector, due to the use of gas firming to maintain system reliability. Recent outages of major generators and the extreme energy market volatility of May/June 2022 have confirmed this. In the medium term, as Australia's energy system transitions to firmed renewables, ensuring adequate gas supply and competitive prices for gas will help to maintain electricity reliability at least cost to consumers.

The Council welcomes the audit of the Design of the Energy Price Relief Plan (the Plan) which is focused on:

- Was the development of the Plan informed by sound policy advice?
- Are arrangements to support the implementation of the Plan effective?
- Are the arrangements to assess the achievement of outcomes of the Plan effective?

<u>Feedback on the Plan and its effectiveness</u>

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, sellers can bring on additional supply 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. The Council welcomed the actions of the Government in December 2022 to meaningfully address gas prices in the short and medium term and as a stepping stone to a long term solution.

The Council believes that the price cap was the only policy option available to bring prices down from the late 2022 level, at which industry is unviable, in the short term. While the $12 / GJ price cap, was recommended by the Australian Competition and Consumer Commission (ACCC), it is substantially above the level which the Council believes is sustainable for industry in the long term. 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 removal of physical congestion, to deliver internationally competitive outcomes for consumers. Achieving a market with adequate gas supply is the ultimate goal but will take some time. The Council has previously supported a redesign of the ADGSM to include commercial incentives for LNG producers to supply the domestic market. To restore a fully functioning gas market in the long term with sustainable pricing, the Council supports continued State and Federal collaboration to remove barriers to the increases in diversity of supply and notes the intent of the Future Gas Strategy in this regard.

While noting that the price cap only applied 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 away from, 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. In the long term, gas should be priced in a reasonable manner considering the cost of production and not to default commercial arrangements at $12/GJ.

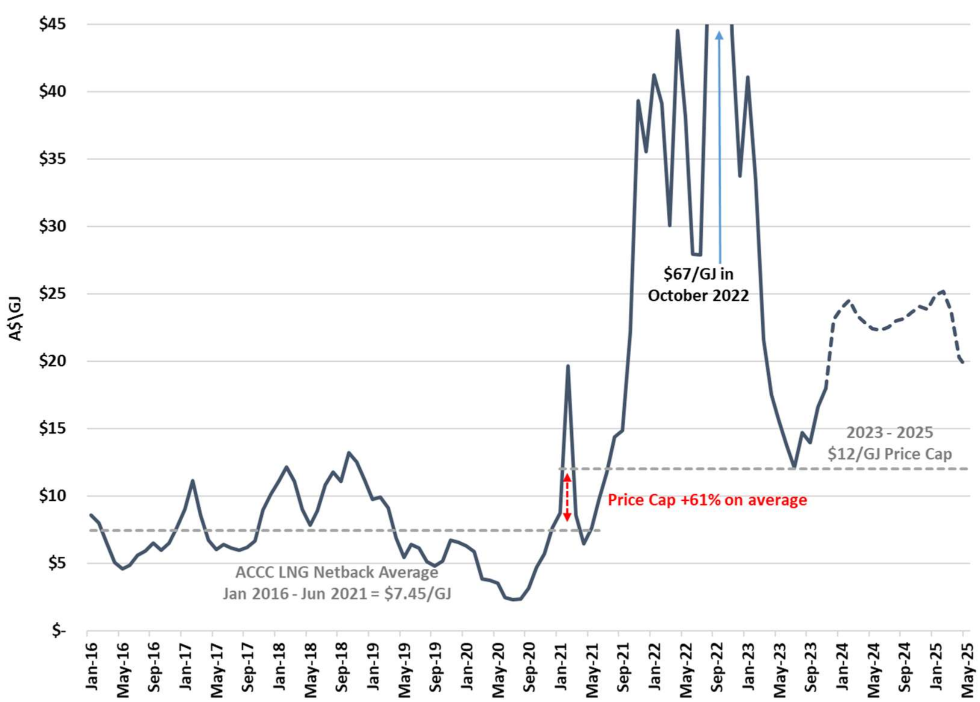

Figure 1. ACCC LNG Netback January 2016 to May 2025

In conducting the audit, the Council recommend that ANAO considers the data required to demonstrate:

1. Sufficient pricing information is being received from both gas sellers and gas buyers to measure the current price and the price for future offers for supply;
2. Sufficient data is being obtained to determine gas reserves and resources and the cost of developing those resources to supply the domestic market;
3. Verification of the claims made by gas producers about the forecast costs of developing those gas reserves is conducted when the reserves commence supply to the market; and
4. Auditing of the claims made by LNG exporters about the amount of gas they acquire from the domestic gas market for export and the gas reserves they have developed specifically to supply exports.

It is also worth considering the context of scale of this data, in that just one LNG export cargo carries around 4PJ of gas, enough to supply the whole east coast gas market for about 8 days.

The Mandatory Code of Conduct, in conjunction with a reasonable pricing mechanism and other policy changes is needed to deliver the meaningful reform required for sellers to offer reasonable gas prices with the length of contract to justify ongoing operation of and investment in Australian industry. The current lack of competition, high prices and risks of supply shortages support the need for the reasonable pricing provision to be introduced. The Council believes that this provision should remain in place until the ACCC is satisfied, and can advise Government, that Australia's gas prices are reflective of the underlying costs of production and that there is sufficient supply at these prices. The introduction of the Mandatory Code of Conduct, while less than 12 months old, has seen some limited improvement in producer behaviour, but this has not been consistent and does not meet the needs of Australian industrial users. .

While some of the Council's members operate within the wholesale gas market, much of the downstream manufacturing industry relies on retail contracts. The Council notes the existing powers of the ACCC and Australian Energy Regulator (AER) to closely monitoring the behaviour of all participants in the wholesale contract market to ensure that prices in this market reflect the price cap and implementation of a reasonable price under the Mandatory Code of Conduct. Despite reservations about its effectiveness, the Council would support expansion of the Code to include retailers.

<u>Conclusion</u>

Overall, the Council believes the Plan was informed by sound policy advice, noting the urgency with which action was required. The arrangements to support its implementation are effective, but there are opportunities for ongoing improvement and continued assessment of gas prices are needed to ensure the intent of the Plan is met.

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. An ongoing set of actions is needed to help ensure that there is sufficient supply of reasonably priced gas to meet the forecast needs of industry and households within Australia, including supply to the electricity market. 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.

Kind regards,

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[i] https://www.industry.gov.au/sites/default/files/2023-12/resources-and-energy-quarterly-december-2023.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.