 

# *Options to provide energy price relief* Impact Analysis – Addendum in relation to policy design changes for a mandatory code of conduct for the east coast wholesale gas market

## Outline

On 9 December 2022 the Government published the *Options to provide energy price relief* Impact Analysis (IA) in support of the Energy Price Relief Plan. Under the Plan, the Government announced the introduction of a mandatory code of conduct (Code) to address systemic issues within the wholesale gas market and guide behaviour in the negotiation of wholesale gas contracts. Impacts of the Code were detailed in the December IA. An initial round of consultation on the Code was undertaken between 9 December 2022 and 7 February 2023, and a second round of consultation focussed on an exposure draft of the *Competition and Consumer (Gas Market Code) Regulations 2023* was undertaken from 26 April 2023 to 12 May 2023.

In response to stakeholder feedback, some key policy design features of the Code have been changed to better achieve the objective of ensuring adequate supply of reasonably priced gas to the east coast market. This IA addendum provides an update on the impact of the policy changes compared to the original policy proposal (detailed in the December 2022 IA) and estimates a saving of $4.32 million over ten years compared to the original policy proposal.

## Some key design features of the Code have been improved following the initial round of consultation

The original Code policy assessed by the December 2022 IA included three main elements:

* a reasonable pricing provision which would reflect the efficient long run marginal cost of domestic supply and serve as a basis for producers and buyers to negotiate wholesale domestic supply contracts.
* arbitration of pre-contractual disputes, that could allow independent determinations on price and other terms and conditions of wholesale gas supply contracts.
* conduct provisions which would set minimum standards on interactions between producers and buyers when negotiating wholesale gas supply agreements.

Stakeholder feedback on this design included material concerns that the reasonable pricing provision and pre-contract arbitration mechanism would create significant business uncertainty for gas producers. Feedback highlighted that this uncertainty would make it difficult for gas producers to finance new supply projects, in turn exacerbating forecast supply shortages, domestic competition issues and price volatility. Several producers announced they had suspended major investment decisions in response to the Code’s original proposed design.

Since December 2022, new market analysis from the ACCC and Australian Energy Market Operator (AEMO) has forecast market shortfalls and supply gaps in the absence of further investment in supply. These analyses, including AEMO’s 2023 *Gas Statement of Opportunities*, highlighted the critical role that gas will need to play to support the energy transition to net zero. As Australia moves away from coal-powered electricity generation, shortages of gas for on-demand electricity generation could put upward pressure on energy prices and threaten electricity grid reliability and energy security. Gas shortages would also impact industrial productivity and investment, where there are not readily available alternatives for processes which require high temperatures or gas as a feedstock.

Following consideration of these issues, Government proposes an improved Code with several policy changes designed to better support continued investment in gas production required to offset declining production from existing resources, support Australia’s energy transition to net zero and support industrial productivity. The improved Code design replaces the previously proposed reasonable pricing provision and arbitration mechanism with a simpler framework which includes:

* a price cap, initially set at $12 per gigajoule, for gas supplied under wholesale supply contracts longer than 12 months, with civil penalties for contravening the cap, and;
* an exemptions framework which would enable gas producers to be relieved from complying with this pricing requirement where they supply solely to the domestic market, or for larger producers and those supplying LNG exporters, enter into enforceable commitments to support the supply of gas to the domestic market at reasonable prices.
* Additionally, the Code will retain the conduct provisions originally proposed, to support the fair and balanced negotiation of new wholesale supply contract negotiations between gas producers and buyers.

The impact of these design changes, as compared to the impact of the original Code design, is detailed below.

## Overall, the policy changes are estimated to reduce costs and improve investment outcomes compared to the original Code design

### Lower regulatory burden costs

Compared to the original Code design, the improved Code design reduces regulatory burden costs, with estimated savings of $4.32 million over 10 years. This saving results from the removal of the arbitration policy element included in the original Code design.

Aside from the regulatory burden savings resulting from the removal of arbitration, the improved Code design would otherwise impose the same regulatory burden costs estimated for the original Code design. These costs were costs associated with adjusting internal business processes and costs associated with obtaining legal compliance advice.

### Stronger incentives for investment

The December 2022 IA indicated the original Code design was unlikely to impact on investment incentives, while impacts on investment incentives as a result of implementing the emergency price cap would be mitigated by the short-term nature of the cap. Through the consultation process, stakeholders indicated arbitration would result in greater business uncertainty, and would be likely to have a material impact on investment incentives. The removal of arbitration in the improved Code design responds directly to this issue, for better investment outcomes.

While the improved Code design proposes a pricing framework which establishes a price cap on gas sold through wholesale supply contracts, it also includes features designed to mitigate the effect of the price cap on investment incentives, and positively impact investment in gas production for domestic supply.

First, the improved Code establishes a framework for exemptions from the price cap which would (1) apply automatically to smaller producers (the majority of gas producers) who exclusively supply the domestic market, and (2) may apply to any other producer on the condition that they negotiate an enforceable domestic supply commitment, with suitability jointly determined by the Minister for Climate Change and Energy and the Minister for Resources.

Second, the price cap will be subject to periodic review and determination by the ACCC, with the objective that a change in the price cap must promote sufficiency or adequacy of investment in, and production of, natural gas to meet domestic demand (along with other matters). This will allow the cap to be varied, where necessary, to ensure it does not negatively impact investment while supporting the adequate supply of reasonably priced gas to the east coast gas market.

The proposal also includes a scheduled review of the operation and effectiveness of the Code, which would be required to commence within two years of the Code coming into effect. The review mechanism provides a basis to refine, strengthen or disable aspects of the Code if they are no longer relevant or not achieving the Government’s objectives.