

# Australian Food and Grocery Council SUBMISSION

12 FEBRUARY 2014

**TO:**  
GENERAL MANAGER, ONSHORE GAS - ENERGY DIVISION,  
DEPARTMENT OF INDUSTRY

**IN RESPONSE TO:**  
EASTERN AUSTRALIAN DOMESTIC GAS MARKET STUDY



## PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, drink and grocery manufacturing industry.

The membership of AFGC comprises more than 150 companies, subsidiaries and associates which constitutes in the order of 80 per cent of the gross dollar value of the processed food, beverage and grocery products sectors.

With an annual turnover in the 2011-12 financial year of \$111 billion, Australia's food and grocery manufacturing industry makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

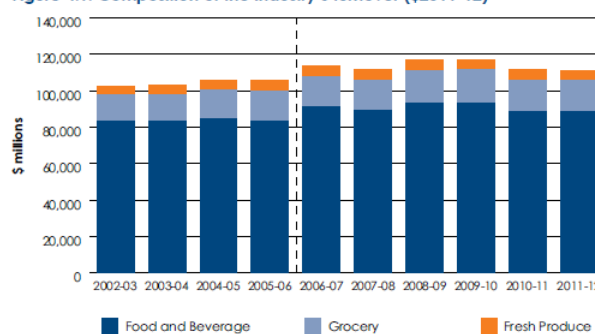
Manufacturing of food, beverages and groceries in the fast moving consumer goods sector<sup>1</sup> is Australia's largest manufacturing industry. Representing 27.5 per cent of total manufacturing turnover, the sector accounts for over one quarter of the total manufacturing industry in Australia.

The diverse and sustainable industry is made up of over 22,600 businesses and accounts for over \$50 billion of the nation's international trade. These businesses range from some of the largest globally significant multinational companies to small and medium enterprises. Industry spends \$535.8 million a year on research and development.

The food and grocery manufacturing sector employs more than 298,825 Australians, representing about 32.3 per cent of all manufacturing industry jobs.

Many food manufacturing plants are located outside the metropolitan regions. The industry makes a large contribution to rural and regional Australia economies, with almost half of the total persons employed being in rural and regional Australia<sup>2</sup>. It is essential for the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies. Australians and our political leaders overwhelmingly want a local, value-adding food and grocery manufacturing sector.

Figure 4.1: Composition of the industry's turnover (\$2011-12)<sup>4</sup>



Source: Based on ABS, catalogue number 8221.0, 8159.0 and 8155.0

1 Fast moving consumer goods includes all products bought almost daily by Australians through retail outlets including food, beverages, toiletries, cosmetics, household cleaning items etc.

2 About Australia: [www.dfat.gov.au](http://www.dfat.gov.au)

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## 1. INTRODUCTION

The AFGC welcomes the opportunity to provide comments on the Australian Government's Eastern Australian Domestic Gas Market Study. This submission is made on behalf of food, beverage and grocery manufacturers, including members of the AFGC's Agribusiness Forum who are involved in the early stage processing of agricultural commodities.

The food, beverage and grocery manufacturing industry is significantly concerned about a forecast doubling in the wholesale price of gas, which will hamper the industry's competitiveness at a time when it is facing several other challenges. These challenges include limited ability to pass through higher costs; retail price deflation; a major shift of profit from suppliers to retailers<sup>3</sup>, loss of flexibility in labour markets and high regulatory costs<sup>4</sup>.

As a trade exposed sector, the forecast increase in gas prices will negatively impact Australian food, beverage and grocery manufacturers' ability to secure and build market share in international markets where they face strong competition from other countries, such as the United States, that have lower cost access to energy. It will also make Australian products less competitive compared to imports.

The food, beverage and grocery manufacturing industry comprises a wide variety of businesses with different energy use profiles and different challenges – from small businesses who face an information asymmetry and lack of negotiating strength through to large agribusiness processors and sanitary paper product manufacturers who use significant amounts of gas and are trade exposed. Regardless of the scale of operations, rising gas prices will have a significant impact on all food, beverage and grocery manufacturers.

In this submission, the AFGC estimates the direct impact of forecast higher gas prices on food and beverage manufacturers using data from the Australian Bureau of Statistics (ABS) at \$170 million per annum in the short term. ABS energy data are not available for the combined food, beverage and grocery industry. Due to a lack of granular data available at sub-sector levels for relevant grocery categories such as the manufacture of sanitary paper products, cleaning compounds, cosmetics and toiletries the AFGC's analysis is limited to food and beverage manufacturing<sup>5</sup>. The analysis also does not capture the indirect impacts of higher gas prices on input costs such as packaging and transportation. It should therefore be noted that the actual impact of higher gas prices on the food, beverage and grocery manufacturing industry will be greater than \$170 million per annum short term and \$110 million per annum long term.

AFGC is participating in more detailed analysis of gas user impacts, including economic modelling and case study impacts, which is being undertaken on behalf of several industry associations representing industrial users. A copy of the report will be provided for the Government's consideration when finalised.

The AFGC recognises that gas exploration and extraction are inherently risky and expensive activities and that policy certainty and long term contracts are important in encouraging investment in the sector.

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3 AFGC and KPMG, *Competitiveness and Sustainable Growth*, June 2013

4 AFGC and Deloitte Access Economics, *Reforming regulation of the Australian food and Grocery Sector*, 28 October 2013

5 Although AFGC does not include tobacco manufacturing in its definition of food, beverage and grocery manufacturing, it cannot be separated from the ABS energy data for the beverage category.

However, the AFGC is concerned that the gas market is not operating efficiently for several reasons including:

- lack of transparency/ information upstream and in the contract market,
- lack of policy clarity and certainty to encourage new sources of gas supply,
- ability for developers to stockpile rather than develop reserves,
- lack of secondary trading mechanisms for businesses that are not large industrials, and
- asymmetry of information and negotiating strength, particularly for SMEs, which can result in poor contract negotiations/ outcomes.

Addressing these issues requires urgent agreement through the Council of Australian Governments to develop and advance a gas reform agenda that includes progressively harmonising and then integrating the eastern gas markets and developing a policy environment that encourages new sources of gas supply. It will also require a commitment to develop trading mechanisms and more flexible contractual arrangements that help to overcome the information asymmetry and weaker negotiating position that gas users face.

## 2. GAS USE IN THE FOOD, BEVERAGE AND GROCERY MANUFACTURING INDUSTRY

The food, beverage and grocery manufacturing industry uses natural gas in several applications including as a direct fuel source in ovens, and in co-generation plants that create on site electricity and heat that can be used in boilers or refrigeration.

In 2011-12, the food product manufacturing industry used approximately 26 petajoules (PJ) of natural gas at a cost of approximately \$284 million while the beverage manufacturing sector used 3 PJ of natural gas spending \$25 million during the same period.<sup>6</sup> Gas use data are not available for grocery manufacturing.

According to data collected as part of the AFGC's *Sustainability Commitment*, the food, beverage and grocery manufacturing industry used 1.08 gigajoules (GJ) of natural gas per tonne of production in 2011-12, with significant variations in gas intensity depending on the nature and scale of the business.<sup>7</sup> For example, the sector comprises a large number of SMEs with low levels of gas use, though to agribusiness processors with significant gas use.

ABS data show that agribusiness processors are significant gas users, particularly meat and meat product manufacturing, dairy product manufacturing and sugar manufacturing.<sup>8</sup> Other food and grocery categories that are high gas users include confectionary and paper product manufacturing.<sup>9</sup> These results are consistent with the energy data collected in AFGC's Sustainability Commitment.

Data from the AFGC's Sustainability Commitment 2011-12 show that the reported sample of food, beverage and grocery manufacturers rely more heavily on gas as a fuel source, with 54 per cent of their

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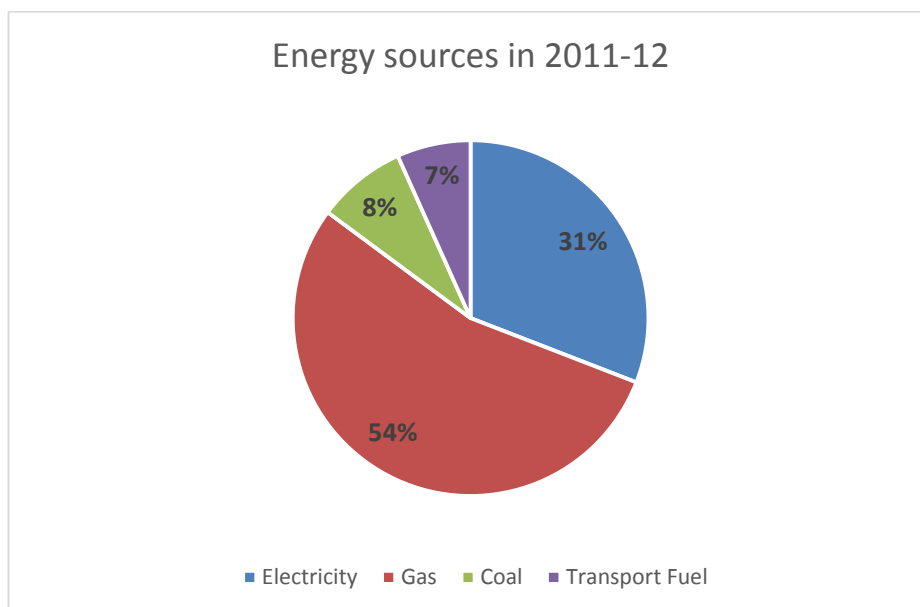
<sup>6</sup> ABS Catalogue 4660 Electricity Use, Electricity Generation and Environmental Management, Australia 2011-12

<sup>7</sup> AFGC Sustainability Commitment Update 2011-12

<sup>8</sup> ABS Catalogue 5209.0.55.001: Australian National Accounts: Input-Output Tables 2009-10

<sup>9</sup> Ibid

energy requirements coming from natural gas, 31 per cent from electricity and the remaining from coal and transport fuel.<sup>10</sup>



From 2010-11 to 2011-12, the common sample of members surveyed reduced their use of electricity, coal and transport fuel use per tonne of production, instead increasing their use of gas as an energy source by 13 per cent in 2011-12 compared to the previous year.<sup>11</sup>

This heavy and increasing reliance on gas as a fuel source means that the forecast increases in gas prices will have a significant impact on the food, beverage and grocery manufacturing sector, particularly given manufacturers' limited ability to pass cost increases through to retailers.

### 3. IMPACT OF HIGHER GAS PRICES

The forecast increase in gas prices will have a significant impact on the operating costs and competitiveness of the Australian food, beverage and grocery manufacturing industry. Anecdotal evidence from AFGC members is consistent with the findings of an Australian Industry Group survey released last year, which revealed that businesses are already struggling to find competitive offers.<sup>12</sup> Several AFGC members have already reported price increases and difficulties securing contracts beyond one to two years.

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<sup>10</sup> AFGC, Sustainability Commitment Update 2011-12

<sup>11</sup> AFGC, Towards Sustainability 2007-08; AFGC, Sustainability Commitment Update 2011-12.

<sup>12</sup> AiGroup (2013) Energy shock: the gas crunch is here.

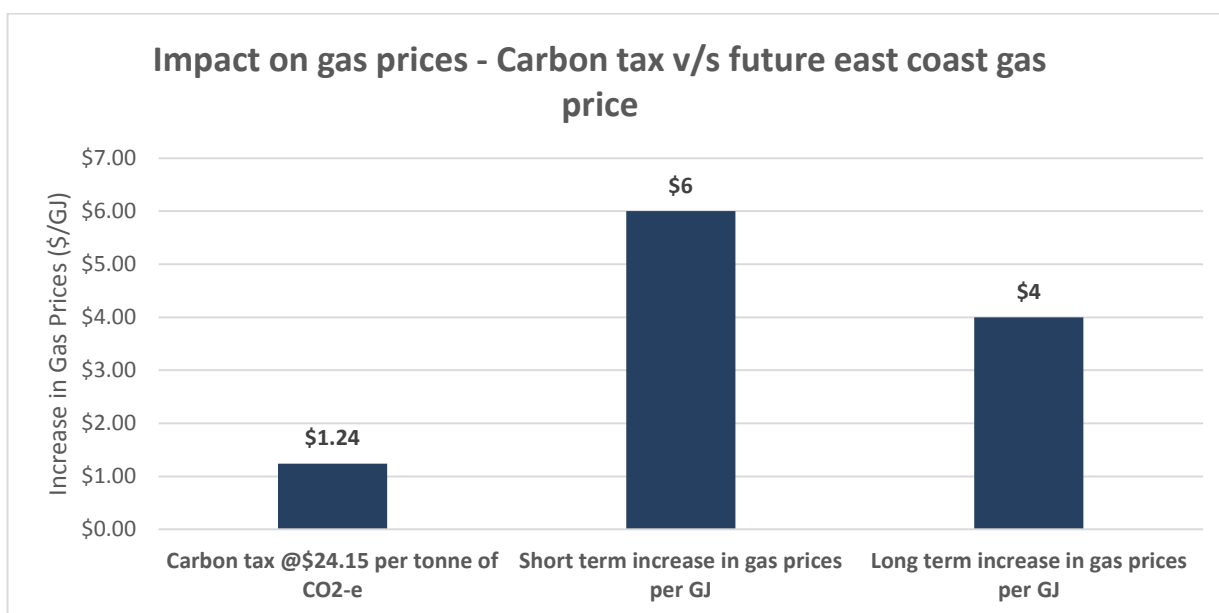
[http://www.aigroup.com.au/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/LIVE\\_CONTENT/Publications/Reports/2013/13219\\_energy\\_shock\\_gas\\_crunch\\_is\\_here\\_web.pdf](http://www.aigroup.com.au/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/LIVE_CONTENT/Publications/Reports/2013/13219_energy_shock_gas_crunch_is_here_web.pdf)

Analysts generally agree that the Eastern Australian gas market is likely to see a doubling of gas prices in the next few years. Given there are several scenarios for gas supply and demand and hence pricing it is difficult to determine a definitive gas price path and hence impact on the food, beverage and grocery industry.

The Australian Government’s Eastern Australian Domestic Gas Market Study estimates that gas prices could more than double over the next few years as LNG exports link domestic gas prices to the more expensive Asian market, domestic supply potentially tightens and producers potentially exercise market power. This transition is unfortunately occurring at a time when existing contracts are due for renewal. Beyond this transitional period, some analysts estimate that wholesale prices will come down slightly, but will still be just under double existing rates.

For indicative purposes, the AFGC has conducted analysis assuming that wholesale gas prices increase from their current level of approximately \$5/GJ to \$11/GJ in the next two to four years, with prices then stabilising at \$9/GJ in the longer term.

The graph below shows that a \$6 increase in gas prices is nearly four times greater than the increase in gas prices due to the introduction of carbon price (on a per gigajoule basis).<sup>13</sup>



Based on this analysis, **the AFGC estimates that the direct impact of rising wholesale gas prices on the food and beverage manufacturing sector alone would be approximately \$170 million per annum for the next two to four years (equivalent to 2.3 per cent of operating profit before tax) and over \$110 million per annum in the longer term (equivalent to 1.5 per cent of operating profit before tax).**<sup>14</sup>

<sup>13</sup> Based on emissions intensity for natural gas as provided in Table 2, National Greenhouse Account Factors July 2013

<sup>14</sup> AFGC analysis using BREE (2013), *Australian energy statistics*, Table F; ABS catalogue number 8155 *Australian Industry 2011-12* and based on an existing wholesale gas price of \$5/GJ. Due to limitations in data, the AFGC has only been able

The direct impact on profitability of food manufacturing alone (i.e. excluding beverages and grocery) will be significantly higher at 4.33 per cent of operating profit before tax in the short term and 2.88 per cent in the longer term.<sup>15</sup>

**The overall impact of rising gas prices would be considerably greater after taking into account the impact on the grocery manufacturing sector and the indirect impacts of a gas price rise on inputs such as packaging and transportation.**

Once indirect impacts are also considered, it is expected that the near doubling of gas prices will have an impact on the food, beverage and grocery manufacturing sector that is at least equal to the carbon tax, which was estimated to be equivalent to 4.4 percent of operating profit before tax, after taking into account direct and indirect impacts.<sup>16</sup>

**It should be noted that the impact on profitability is an average across the food and beverage manufacturing sector and that certain sub-sectors will face a greater impact on their profitability. This includes gas-intensive agribusinesses such as meat, dairy and sugar and the manufacturing of confectionary and sanitary paper products.**

AFGC has conducted analysis of data collected as part of the AFGC's *Sustainability Commitment 2011-12* to show the impact of the above gas price rise on various sized food, beverage and grocery manufacturers.<sup>17</sup> The results show:

- Businesses with an annual turnover of around \$127 million and using less than 0.1 PJ of gas per year are expected to experience average additional costs of \$140,000 per year in the short term and slightly less than \$ 95,000 per year in the longer term.
- Businesses with an annual turnover of around \$1.4 billion and using between 0.1 PJ and 1 PJ of gas per year are expected to experience average additional costs of \$2.6 million per year in the short term and \$1.7 million per year in the longer term.
- Businesses with an annual turnover of around \$2 billion and using more than 1 PJ of gas per year are expected to experience average additional costs of \$9.9 million per year in the short term and \$6.6 million per year in the longer term.

As a trade exposed sector, the forecast increase in gas prices will negatively impact Australian food, beverage and grocery manufacturers' ability to secure and build market share in international markets

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to estimate the direct impact of a gas price increase on the food and beverage manufacturing sector (that is, excluding the impact on the grocery sector and excluding indirect impact on input costs such as packaging). Further, while tobacco is not relevant to the analysis, disaggregated data are not available to remove this product category. It is anticipated that excluding tobacco would have the effect of increasing the impact in terms of proportion of operating profit (because gas use in the tobacco industry is likely to be low given product is predominantly imported, yet the profit for the sector is captured).

<sup>15</sup> Ibid

<sup>16</sup> AFGC and AT Kearney, Impact of Carbon Pricing 2011: Potential impacts across the supply chain.

<sup>17</sup> AFGC analysis based on data collected through AFGC Sustainability Commitment Survey 2011-12, using an existing wholesale gas price of \$5/GJ, estimated price of \$11/GJ in the next two to four years and \$9/GJ beyond it.



where they face strong competition from other countries, such as the United States, that have lower cost access to energy. It will also make Australian products less competitive compared to imports.

Increasing gas prices will add further challenges to the industry due to its limited ability to pass on cost increases through the supply chain. As witnessed with the introduction of carbon tax, around two-thirds of the businesses were unable to pass through the costs with a key factor being non-acceptance of price increases from retailers/customers.<sup>18</sup>

A further impact of rising gas prices is the undermining of investments in gas-fired technologies. With the industry's commitment to reduce its carbon footprint and Government incentives from the Clean Technology Food and Foundries Investment Program, food manufacturers have invested \$339 million in energy efficiency projects, with nearly \$220 million of this contributed by industry. This includes investment in low emission technologies such as gas-fired boilers, co-generation and tri-generation plants. With gas prices forecast to double, these new installations are likely to become less economically viable, potentially leaving businesses with stranded assets.

Perversely, high gas prices are likely to drive an increase in emissions, as manufacturers switch to lower cost, but more emissions intensive, fuel sources. This risks undermining the effectiveness of the Emissions Reduction Fund and the achievement of a 5 per cent reduction in emissions by 2020. For example, several food, beverage and grocery manufacturers (including those that have installed gas fired co-generation facilities) have indicated that if gas prices increase to forecast levels, they will need to switch to alternative, cheaper fuel sources – for example directly firing coal or using coal fired electricity, depending on the application. This is akin to the recent decision by Stanwell power station to switch from a gas to coal fuel source.<sup>19</sup>

Higher gas prices also risk a contraction in manufacturing industry activity and competitiveness, contrary to the aims of the Government's manufacturing policy, which is to boost manufacturing competitiveness by keeping costs down. Some industry sectors particularly high gas users such as the paper and tissue manufacturing have indicated that it may not be possible to switch fuel source due to technical limitations and the need for significant upfront capital. As a result, some manufacturers may reduce or cease domestic production, resulting in job and income loss. This issue is particularly pertinent to the food, beverage and grocery industry due to limitations in manufacturers' ability to pass cost increases on to their major customers – supermarket retailers.

In addition to the direct impact of high gas prices on the competitiveness of the food, beverage and grocery industry, businesses that switch to a higher emissions fuel source risk being penalised under the government's proposed Direct Action Plan (DAP), which will further impact their profitability.

These potential adverse consequences of high gas prices are contrary to the situation in the United States of America where access to low cost gas has led to a resurgence in manufacturing while at the same time achieving reductions in emissions.

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<sup>18</sup> AFGC Impact of Carbon Tax Survey, July 2013

<sup>19</sup> <http://www.brisbanetimes.com.au/queensland/swanbank-power-station-to-close-for-three-years-20140205-321m6.html>

## 4. POLICY RECOMMENDATIONS

In calling for the following forms of policy intervention, the AFGC is not seeking to force non-commercial outcomes but rather is seeking to improve the efficiency of the Eastern Australian gas market.

### 4.1 POLICY RESPONSE NEEDS TO REFLECT SHORT TERM TRANSITION

The *Eastern Australian Domestic Gas Market Study* recognises that there are imperfections in the operation of the Eastern Australian gas market and recommends several policy options primarily aimed at improving the transparency and efficiency of the market and encouraging new sources of supply. While the AFGC supports the proposed policy options, we are concerned that they are likely to only have effect in the medium to longer term.

The Government's study and several other sources conclude that gas prices will increase to export parity, which is at least a doubling of historical gas prices. However, the Government also notes that there is the risk that domestic prices may overshoot export parity in the short to medium term due to the fact that LNG producers may not be able to meet their export contracts due to a longer than expected timeframe for CSG coming on-line. As a result, there is the possibility that gas suppliers may take gas from the domestic market in order to meet their export contractual obligations.

While the Government's study acknowledges the risk of a shorter term transitional price spike that exceeds export parity, there are no policy options offered to address this possible market failure, which the Government suggests may arise due to the exercise of market power in a period of tight supply.

The following quotes illustrate the problem:

*"A shortage of reserves available for the domestic market in the near-term, especially the period around 2014, is apparent. Most of the reserves available up to 2015-16 are in the Gippsland Basin potentially causing high transmission costs if supplied to distant markets."*<sup>20</sup>

*"It is possible that in a period of tightness prices will overshoot export parity until there is sufficient supply or information to either overcome transient market power or readjust risk expectation."*<sup>21</sup>

*"Long-run contracting, the potential for the exercise of market power and a lack of transparency may conspire to make this transition longer than it might otherwise be."*<sup>22</sup>

If short-term policy mechanisms are not implemented, and there is a significant short term price spike, then there is a real risk that businesses that may have been viable in the longer term once the price resettles at export parity may not be able to sustain the short term price spike.

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<sup>20</sup> SKM, *Gas Market Modelling*, page 26

<http://www.innovation.gov.au/Energy/EnergyMarkets/Documents/SKMGasMarketModelling.pdf>

<sup>21</sup> Department of Industry, *Eastern Australian Domestic Gas Market Study*, page 115.

<sup>22</sup> Ibid, p.3

The AFGC recommends that the Government give consideration to the timing of implementing various areas of policy reform so as to minimise the risk of a short term overshoot of export prices. This could include for example expediting reforms to improve transparency and secondary trading.

Given one possible cause of a short-term price spike is the exercise of market power and that this is a structural issue that will take time to resolve, the Government should give urgent consideration to allowing group buying schemes for food, beverage and grocery manufacturers to counter gas suppliers stronger negotiating position that is derived from their market power.

Some very large users have been recently reported in the media as entering into direct contracts with gas producers to underwrite exploration and secure long-term gas contracts. For example, it has been reported that Amcor's packaging business Orora has recently entered into a gas supply arrangement directly with Strike Energy.<sup>23</sup> Such arrangements are able to strike at the heart of the market power problem, by going around gas retailers to enter into direct arrangements that benefit the market by bringing new sources of supply and benefit the user through access to lower priced gas. However these arrangements are currently only viable for very large users (e.g. over 1 PJ of annual demand).

The AFGC considers that a group buying scheme could help address market power by allowing a greater number of users who otherwise lack sufficient scale to bypass gas retailers and enter into a direct arrangement with new gas producers. The AFGC recognises that such arrangements would require ACCC authorisation before proceeding.

## 4.2 REDUCE INFORMATION ASYMMETRIES

The gas market is undergoing significant change, with many and varied views about the level of supply, demand and the future price path. In addition, the food and grocery manufacturing industry has been facing a challenging time (due to a high Australian dollar, high input costs, retail price deflation etc.), with several businesses closing sites but having to continue to pay for gas given the take or pay nature of their contracts and limited ability to on-sell their unused gas quantities.

It is vital that food and grocery manufacturers are informed about the gas market changes and outlook and the contract options that are open to them before entering into contract negotiations. While contract negotiations are a matter for individual parties, there is an information asymmetry, particularly for SMEs, which can impact their ability to strike an effective deal.

Businesses need to understand the changes the market is undergoing, the future price scenarios and the options that they should consider in their contracts. However SMEs generally lack the time and resources to dedicate someone to these issues and hence may not be aware of their options with the result that they enter into sub-optimal or inflexible contracts. For example, businesses may enter into a 100 per cent take or pay contract at a time when their business outlook is uncertain and they may have been better to negotiate an 80 per cent take or pay arrangement at a higher price, but may not be aware of the options available to them.

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23 <http://finance.ninemsn.com.au/newsbusiness/aap/8784172/strike-enters-into-option-deal-with-orora>

The AFGC recommends that the Government give consideration to the following options to overcome this information asymmetry:

- Allocating funding to peak bodies to assist the provision of information about the changes the gas market is undergoing and factors to consider on contract negotiation. A workable model for this type of program is the Energy Efficiency Information Grants program.
- Standard minimum terms in contract offers, (e.g. giving users the options of various levels of take or pay/ price structures); allowing for on-selling of gas without requiring retailer approval

### **4.3 ENCOURAGE NEW SOURCES OF SUPPLY**

The AFGC supports policies that encourage new sources of supply into the market, particularly projects that are not linked to the LNG export market such as local unconventional gas sources. Given the importance of land and water resources to the food, beverage and grocery manufacturing industry, the AFGC is mindful of the potential impacts of these developments but, as has happened in parts of Australia and other parts of the world, these can and should be managed effectively to reduce the risk to the environment.

At the moment there are very different approaches to unconventional gas supplies in each State. The AFGC recommends that the Government use the COAG process to encourage States to develop a nationally consistent approach to unconventional gas supplies, which builds on best practice approaches.

Group buying schemes could also potentially assist in bringing new sources of supply to market by allowing manufacturers who normally lack sufficient scale to jointly negotiate with gas producers. Such an arrangement could potentially deliver significant benefits by giving both parties long term contractual arrangements which could underwrite new gas development investments and provide food, beverage and grocery manufacturers with lower priced gas and longer term certainty.

### **4.3 REQUIRE DEVELOPERS TO ‘USE IT OR LOSE IT’**

Gas reserves are public resources that should be put to their highest value use. Companies that hold licences over gas reserves should not be able to hold them indefinitely as this provides the potential for stockpiling gas and gaming the market with artificially high prices. Gas reserves should either be developed or, if there are not valid plans to develop reserves, they should be returned to market and re-auctioned to the highest bidder, while compensating the affected party losing rights over the reserve.

The AFGC commends the Australian Government for adopting this approach to off-shore gas reserves, however is concerned that there does not appear to be a similar approach to the allocation of licences over on-shore gas reserves. To the extent that use it or lose it provisions exist in State-based licences, they need to be enforced. Where use it or lose it provisions do not form part of a State’s licencing regime for on-shore gas, then the AFGC recommends that the Australian Government use the COAG processes to encourage State governments to adopt use it or lose it provisions for on-shore gas reserves.

## 4.4 ENABLE CONTRACTUAL FLEXIBILITY AND SECONDARY TRADING

Given the significant changes the Eastern Australian gas market is undergoing, it is more important than ever that there be mechanisms that allow businesses to hedge their price and volume risk at a low transaction cost.

The AFGC welcomes the Government's recognition of the need to improve gas and pipeline capacity trading markets. The AFGC is however concerned that the pace of change is very slow in this regard, with the lack of a deep and transparent secondary market despite many reviews recommending the need to improve the trading arrangements. While the AFGC acknowledges the establishment of the Wallumbilla Hub will provide a trading platform, it is unclear whether this will be of use for smaller transactions.

The Government's study notes that "...some large industrials may have the opportunity to on-sell their contracted gas supply."<sup>24</sup> However this level of flexibility is not provided to all gas users. The AFGC is aware of anecdotes of food, beverage and grocery manufacturers on take or pay contracts that have closed one of their manufacturing sites due to a decline in the businesses profitability yet they have been unable to transfer their liability to one of their sites in another state; and unable to resell their contracted gas quantities due to restrictions imposed by their gas retailer.

In one situation this led a user to flare their contracted gas as it was considered a better alternative to not taking the gas, paying a penalty and then the retailer benefitting by on-selling the gas. This is clearly a perverse outcome in a market that is experiencing a tightness of supply and also a perverse outcome that a business that is experiencing a decline in production cannot on-sell one of its unused inputs. This example demonstrates the challenges and inequity posed by a reliance on a long-term contract market with inflexible take or pay conditions.

Another example of the lack of flexibility in contractual arrangements is the requirement that users do not exceed their annual contracted quantity of gas. Without paying a premium this limit is not tradeable between sites even if they are located on the same branch of the network.

The AFGC recommends that as a matter of principle gas users should be able to transfer gas liabilities to other sites and trade unused volumes of gas to other users without the approval of their gas retailer. This may require changes to standard contract terms to allow greater flexibility; and the development of a trading mechanism that enables smaller volumes to be aggregated and traded at a low transaction cost.

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<sup>24</sup> Department of Industry, *Eastern Australian Domestic Gas Market Study*, p.41

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