SUBMISSION

AUSTRALIAN DOMESTIC GAS SECURITY MECHANISM REVIEW
6 SEPTEMBER 2019

Energy Users Association of Australia

Department of Industry, Innovation and Science
Onshore Gas Team
Via: https://consult.industry.gov.au/resources/australian-domestic-gas-security-mechanism-review/

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INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing and materials processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and are desperate to see all parts of the energy supply chain making their contribution to the National Gas Objective.

Our members are highly exposed to movements in both gas and electricity prices and have been under increasing stress due to escalating energy costs. These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items.

EUAA members who have a key interest in gas market reform include (but not limited to) Incitec Pivot, Orica, OI, Orora, Qenos, Brickworks, Bluescope Steel, Australian Paper, BOC Gas, Simplot, Kagome, Air Liquide, Alsco, CQMS Razer and the Australian Aluminium Council.

While there is some work underway to improve outcomes for domestic gas users, clearly more needs to be done if we are to see domestic gas prices move to a more economically sustainable level. In the media release that accompanied the seventh interim gas market report, the ACCC had this to say:

However, it appears that prices offered in the southern states, particularly by retailers, have not decreased with expected netback prices. In the first quarter of 2019, these mostly remained in the $10-12/GJ range. "It is clear that these current gas prices remain high and challenging for many C&I gas users, and while some have found ways to absorb the higher costs, this is often not possible," Mr Sims said. "This underscores the need for timely action, both by governments, by gas producers and by retailers."[1]

We think this review of the Australian Domestic Gas security Mechanism (ADGSM) is timely and thank you for the opportunity to make comment along with the opportunity to provide EUAA views on broader gas market reform.

In their seventh and most recent interim gas market report the ACCC made the following statement that we are in full agreement.

"Addressing the longer-term concerns in the East Coast Gas Market requires attention at all points in the supply chain. The ACCC has long advocated the need for an increase in supply and diversity of suppliers, particularly in the Southern States, and has made a range of recommendations to improve the transparency and operation of the East Coast Gas Market. Further efforts are also required in respect of gas transportation and storage, and in retail markets[2]*."*

[1] https://www.accc.gov.au/media-release/east-coast-gas-market-still-tight
[2] https://www.accc.gov.au/publications/serial-publications/gas-inquiry-2017-2020/gas-inquiry-july-2019-interim-report

In April 2019, the EUAA released a Gas Strategy Options Paper that was divided into two parts. Part one provided a brief overview of the impact of LNG export on domestic supply and price and the consequences on domestic gas users and the economy as a whole. Part two outlined a range of possible policy and regulatory options that could be adopted by governments, regulators and the gas industry itself.

These options ranged from largely doing nothing through to significant government intervention including the establishment of a Commonwealth Gas Company, retrospective gas reservation and arbitrary price caps.

As the ADGSM is just one part of a larger set of market reforms that are being contemplated, this submission will address the terms of reference of this review and will also put forward a range of additional policy and regulatory options that we believe deserve serious consideration. These have been drawn from our previous Gas Strategy Options Paper and from conversations with a range of stakeholders that have occurred since its release.

2019 ADGSM Review Terms of Reference

1. The effectiveness of the ADGSM in ensuring a sufficient supply of natural gas for Australian consumers with minimum disruption to Australia's liquified natural gas export industry.

As stated in section 6 of the Customs (Prohibited Exports) (Operation of the Australian Domestic Gas Security Mechanism) Guidelines 2017 legislation:

"The objective of the ADGSM is to ensure that there is a sufficient supply of natural gas to meet the forecast needs of Australian gas consumers by requiring, if necessary, LNG Projects which are drawing gas from the domestic market to limit exports or find offsetting sources of new gas.[3]"

We take the view that a definition of "the forecast needs of Australian gas consumers" requires an assumption on both sufficient supply and reasonable price. At $12/GJ we believe the needs of consumers is not being met and that at this price level the forecast supply needs will be significantly lower than at $7/Gj due to the likelihood of demand destruction and reduced use as feedstock for gas fired power generation.

It could be said that the ADGSM has met the forecast needs of Australian consumers given that it seeks to balance the market based on forecasts provided by Core Energy to AEMO . At least in the short term, these forecasts are not independent of the level of gas the LNG Projects agree to supply under the ADGSM. On this basis it is correct to say that even though the ADGSM has not been formally triggered (based on the Heads of Agreement between suppliers and the Commonwealth) that it has meet the objective of providing the gas that the AEMO/Core Energy forecasts suggest is the projected shortfall.

However, we would argue that a "sufficient supply of natural gas to meet the forecast needs of Australian gas consumers" is a greater volume than the AEMO/Core Energy forecasts and hence while domestic gas supply may have increased, it has been insufficient gas supply to meet both supply and price objectives. In considering this, we do not believe the ADGSM has achieved its objective.

If the gas shortfall continues to be based on the Core Energy forecasting model and the ADGSM only seeks to balance the market, gas user interpretation of its objective will not be met. Evidence is beginning to mount that the longer gas prices remain elevated the ultimate result will be demand destruction. Therefore, the logical end of this process is that the ADGSM will not be required because there is no shortfall because of the fall in domestic demand.

[3] https://www.legislation.gov.au/Details/F2017N00050

We would note that a number of other initiatives outside of the ADGSM are likely to have had a far greater impact on the domestic gas market. Many of these initiatives fall under the umbrella of the ACCC, and have provided greater transparency of key gas market indicators and public scrutiny of seller behaviour. These include regular ACCC interim reports, regular publication of the LNG Netback series, reporting on average production costs and information of gas pipeline costs. This has helped to reduce, but not remove, information asymmetry and has certainly increased the level of scrutiny of the gas industry which has most likely led to some small improvements for energy users.

As these measures are designed to improve domestic gas market competition it is highly unlikely they would have created any material disruption to Australia's liquified natural gas industry. We would also note that the Queensland Government's prospective gas reservation policy, which was heavily criticised by the gas industry, is beginning to make a material contribution to domestic gas supply.

Therefore, any assessment of the ADGSM relies on how effective it has been in creating a credible threat to LNG exporters of it being triggered by the Commonwealth, and as part of a much broader set of initiatives to improve transparency, reduce information asymmetry and increase new sources of supply for domestic use.

Finally, as the legislation states, the ADGSM is focused on balancing domestic supply and demand. We understand that the assumption that when supply is improved, so too will pricing outcomes for consumers. As the EUAA and others warned in our 2017 submission to the initial ADGSM consultation, balancing supply alone will not drive down prices, especially in the absence of a genuine competition and a transparent and liquid market.

The ADGSM is not a panacea (irrespective of whether it is met with a Heads of Agreement or a formal trigger) and is just a small part of what needs to be a much broader set of policy and regulatory responses to the gas crisis.

2. <u>The impact of the ADGSM on the competitiveness of Australia's liquified natural gas export industry, Australia's investment reputation and Australia's international reputation for quality and reliability.</u>

We do not believe the ADGSM has had any material impact on the competitiveness of Australia's LNG industry or Australia's investment reputation because:

a) The ADGSM has never been triggered
b) The LNG exporters have willingly signed a heads-of-agreement with the Commonwealth
c) Other initiatives being pursued by the ACCC are focussed on improving competition
d) New sources of gas have been developed in Queensland and Northern Territory over the same period

3. <u>The impact of the ADGSM on the Australian domestic gas market, including the development of new and additional resources and market functions.</u>

We are not aware of evidence that the ADGSM has driven the development of new and additional resources. We would note that the Queensland Governments prospective gas reservation policy, which was heavily criticised by the gas industry, is beginning to make a material contribution to domestic gas supply.

4. <u>Whether improvements can be made to the operation of the ADGSM and whether there are appropriate alternative mechanisms to achieve the objectives of the ADGSM.</u>

The ADGSM is focussed on balancing supply. We assume this was in the hope that balancing supply alone would result in improved price outcomes for consumers. This has not proven to be the case.

As we pointed out in our April 2019 Gas Policy Options Paper, one of the key issues facing gas users is the lack of competition. Therefore, many of the policy and regulatory options that we proposed had a dual objective of not only delivering more gas but to have more entities selling it, therefore improving competition.

We do not see how the ADGSM alone, or in its current form, can play a significant role in achieving these objectives given it relatively narrow scope of simply balancing domestic supply.

However, if the objective of the ADGSM was to provide a surplus of supply in the domestic market, and that surplus was utilised as part of a market maker obligation (a market maker obligation is being developed as part of the Retailer Reliability Obligation[4]) then we could see a pathway where greater liquidity and improved competition could occur.

We think that a market maker obligation for the gas market is worth considering given it is being developed to resolve similar issues of market power and low liquidity in electricity markets.

5. Whether the ADGSM should be amended or repealed before 1 January 2023 and the timing of any such amendment or repeal.

We do not think the ADGSM should be repealed before the 1 January 2023 timeframe. By repealing the ADGSM before that date the Commonwealth would be surrendering one of the points of leverage it has over the LNG exporters.

A possible amendment to the ADGSM, that would bring price into consideration, could be to change the objective from balancing supply and demand to one that is focussed on providing an excess supply to the domestic market and/or coupling this with a market maker obligation. This could operate as part of a short-term strategy while medium to longer term policy and regulatory reforms begin to take effect. A 1 January 2023 sunset date would still be appropriate provided improved supply and price outcomes for consumers have come about.

This would represent a more market-based approach when compared to including an arbitrary price trigger or cap in the ADGSM. It would also provide the LNG exporters the opportunity to play a positive and pro-active role in delivering better outcomes for consumers rather than having a harsh solution forced upon them, of which they would receive no credit or recognition for the role they have played.

6. The review will examine other relevant considerations, including investigating the ongoing effectiveness of the ADGSM's Total Market Security Obligation arrangements and the ACCC's Netback Price series.

Our response to this question is detailed in the following section.

Additional Considerations and Policy Options

1. Short Term Policy Options

   a) Do nothing. This would resolve the supply problem through domestic demand destruction.
   b) The Federal Government and ACCC put in place a revised domestic LNG netback cost methodology that subtracts the capital and financing costs associated with the gas trains themselves. The argument, supported by the EUAA, is that these fixed costs should not be included in LNG netback calculation given domestically sold gas is never processed by these facilities so it should not incur a cost associated with it. This would remove between $2.00GJ to $2.20GJ from the current LNG netback price that is being used by sellers as a benchmark price. Aside from this general view, we see no case for inclusion of these costs when the gas trains are operating at or above the take or pay level of long-term contracts. The revenue from

[4] https://www.aemc.gov.au/rule-changes/market-making-arrangements-nem

these ToP contracts is already providing the return on those assets to their equity owners and the opportunity cost of exporting gas should exclude these costs.

c) The Federal Government consider a short-term domestic gas support fund where a direct subsidy is provided to gas intensive manufacturing with the goal of ensuring critical industries such as food processing, industrial metals processing and gas intensive manufacturing such as building products, chemicals, plastics, glass and paper are provided with a sustainable basis for continuing to operate until broader gas market reforms come into effect .
d) If desired this could also be extended to new entrant gas generators (who may also have access to the proposed asset underwriting scheme) for the purpose of lowering wholesale electricity prices, creating additional competition and assisting the rapid deployment of the highly flexible generation that the evolving electricity market requires.

2. Medium to Long Term Policy Options

a) Implementing option 4 of the Measures to Improve Transparency in the Gas Market as outlined in the recent COAG Regulatory Impact Statement. Ensuring that the relevant bodies – the ACCC, AER and GMRG – are appropriately staffed and funded to continue work on gas market reform.
b) Develop a wholesale domestic gas market similar to the wholesale domestic electricity market. Electricity is currently traded through a "gross pool" market where all energy is traded in an open, transparent fashion that facilitates high levels of liquidity and price discovery. Gas market reform should seek to replicate this outcome.
c) Consider "market maker" requirements on major wholesale participants in regions where there is low liquidity and little price discovery. Market marker requirements are already being considered for the South Australian wholesale electricity market for these same reasons.
d) Replacing moratoria with transparent technical assessment, robust planning/monitoring and a just compensation framework for landowners.
e) Identification of new fields, with an allocation for the domestic market. Queensland has already set a precedent and while it is still early in the process, it has been well received by market participants.
f) Incentives/assistance (i.e. asset underwriting, capital fund) for junior developers to provide more gas from more sellers for the domestic market (we can't allow them to be "swallowed up") – ACCC must continue to monitor market structure and market power.
g) Incentives for more gas pipeline development. This could include asset underwriting, accelerated planning approvals and favorable regulatory treatment in exchange for price guarantees for shippers.
h) Replicate energy efficiency schemes to create a gas efficiency initiative.
i) To assist with the above we would suggest development of new funding sources, potentially paid out of royalties to replicate electricity initiatives like ARENA, CEFC, RET and the proposed "asset underwriting". The establishment of a gas transition fund to assist with energy efficiency, fuel switching and acceleration of alternative fuels such as hydrogen.

3. Last Resort Policy Options

a) Establish a Commonwealth Gas Company in two stages. Stage one would be a central body responsible for managing new funding and support programs identified previously. Stage two, if necessary to act as a wholesale participant who can provide longer term contracting for new gas developments. If a Commonwealth Gas Company was established it would have an immediate impact of bringing increased competition to the wholesale market, facilitating the establishment of tier two retailers and potentially underwriting new sources of supply including LNG import cargoes.
b) Retrospective gas reservation. This would involve identifying those gas reserves that were originally developed for the domestic gas market and are now being re-directed to LNG export. Essentially

retrospective gas reservation is more like a re-allocation of previously developed gas reserves to the domestic market.

c) Arbitrary price caps similar to those being applied in the electricity market