

Manufacturing Australia Submission
Australian Domestic Gas Security Mechanism

Manufacturing Australia (MA) is supportive of regulation that aims to ensure security of gas supply to the Australian domestic market for the benefit of households and industry. Equally MA is supportive of regulation that aims to ensure that not only is supply secure but that prices for gas are reflective of the cost of production and not artificially inflated by shortfalls in supply, supply scarcity or lack of market competition.

Government policies should seek to strike a balance that encourages growth in gas supply and gas suppliers, alongside growth in gas-intensive manufacturing, which underpins employment and economic security in regional and outer suburban communities around Australia.

The draft Australian Domestic Gas Security Mechanism (ADGSM) is a welcome safeguard against a “worst case scenario” of an actual shortage of gas supply being available for domestic users.

However, as currently drafted, the ADGSM is unlikely to lead to materially lower gas prices in Eastern Australia. Improvements to the mechanism, such as those recommended below, may increase the likelihood of lowering domestic gas prices. Also important will be how the ADGSM complements other initiatives from Federal and State governments to encourage more gas supply, more gas suppliers and more competitive gas markets, including State Government rules to ensure new gas developments directly benefit domestic users.

MA offers the following recommendations that would strengthen the ADGSM and make it more likely to achieve the goals of securing domestic gas supply and reducing gas prices for domestic households and industry. The recommendations are made in 5 broad categories:

1. Timing of shortfall determination and reliability of forecasting
2. Treatment of “third party” gas
3. Targeting domestic gas surplus
4. Maintaining inter-producer competition
5. Balancing producer and consumer feedback and input

Timing of shortfall determination and reliability of forecasting

As drafted, the Minister must make a determination of a shortfall year effectively by 1 November in the prior year at the latest, with no mechanism to make a determination after this date. In recent years, forecasts of gas supply and demand by regulatory authorities or analysts have been unreliable. In that context, a single determination made well in advance of the winter period (when gas demand in Australia peaks) is insufficient. MA recommends:

1. that there should at least one additional scheduled opportunity for the Minister to declare a domestic shortfall year during the year, ahead of winter;
2. that the Minister should have the ability to make an emergency declaration at any time during the year where there has been a material change in the gas market condition. This could include the failure of a major gas production, gas processing, gas transportation or gas storage facility that will materially affect the supply of gas in the domestic market for an extended period of time. It could also include extreme pricing of gas in the STTM and/or DWGM over an extended period (which would operate as an indicator that there is a shortage of gas in the domestic gas market).
3. that the Minister should have the power to reinstate the determination at any time if it is removed. Currently the draft allows for it to be revoked but not reinstated, which seems particularly imbalanced.
4. that consideration be given to complementary measures that would require AEMO to ensure the gas market is in balance on a daily basis, and have the power to curtail LNG exports on any given day if there is a likelihood of a gas shortage due to weather or other events such as those above.

In the absence of additional safeguards such as the above, the best available option under the mechanism as currently drafted would be to err significantly on the side of caution by determining a shortfall year when there was any possibility one would occur. Failure to do so would leave the Federal Government unable to revisit a determination even if a damaging shortage developed during the course of the year.

Treatment of “third party” gas

As drafted, the ADGSM will calculate the net market position of an LNG project by reference to that LNG Project’s Tenements, including all tenements that can be considered own gas or third party export compatible gas. Following a decade of rapid consolidation and restructuring of the Australian gas market, it is not sufficiently clear which tenements were developed specifically for the export market. Therefore, MA recommends:

1. third party gas should be excluded from the calculation where the tenement formerly or at any time provided gas to the domestic market.
2. third party gas should only be considered in the calculation where the tenement was brought into production specifically for the purpose of export under contract to the LNG Project. ie: it did not previously exist.
3. new tenements, including own or third party tenements, should not be committed to export until the Minister is satisfied that there is no domestic shortfall.

Targeting domestic gas surplus

The ADGSM is focused on delivering a balanced market, ensuring that "sufficient supply" is available. However, the announcement of the ADGSM emphasised an objective of placing “downward pressure on prices.” If downward pressure on prices is an objective, it is unlikely to be achieved by only targeting “sufficient supply,” especially in light of the broadly recognised competitiveness and transparency constraints in the gas supply chain. A very tight market, in which gas users suffer onerous terms and conditions and prices exceed those in competing countries, remains extremely damaging to manufacturing competitiveness. Therefore, MA recommends:

1. the ADGSM should have a target of 10%-15% surplus gas in the domestic market each year, ensuring there is sufficient gas available to meet the growing needs of the domestic gas market and creating real downward pressure on prices. This would see the Australian domestic gas market return to something akin to a "pre LNG" state of supply and demand, with the capacity for demand growth, which is especially likely in the power generation sector as Australia transitions to a lower emissions energy sector.

Maintaining inter-producer competition

If downward pressure on prices is to be realised, then the existing level of inter-producer competition must be maintained at a minimum and built upon. If a potential shortage of gas is averted, but only by virtue of a monopoly supplier offering gas to market, then downward pressure on prices is not a realistic expectation. MA proposes the following model of how the ADGSM could overcome this risk and ensure a competitive East Coast domestic gas supply market, whereby the existing competitive tension – at a minimum – ought be maintained:

1. Identify the mass balance of domestic supply pre-export and the specific percentages supplied by individual companies.
2. Require those companies to supply the same percentage of the domestic market as pre-export. This means price in the domestic market would be set from the position of a balanced supply/demand equilibrium and recreates competition amongst gas producers.
3. If the quantum changes (ie through demand destruction or new players entering the domestic market), the same companies are required to supply the same percentage of the revised quantum.

Balancing producer and consumer feedback and input

The ADGSM as drafted, and the accompanying explanatory material, places significant emphasis on consultation with LNG exporters and consideration of feedback, input, data and advice from gas producers. While this is understandable, a balanced assessment of the overall gas market should include equal emphasis on consultation with domestic end users of gas. MA recommends:

1. the Minister must give “due weight” to the submissions of gas users, recognising that gas users includes different categories, including large domestic industrial users (feedstock), large domestic industrial users (energy), domestic energy generation, minor commercial and industrial users and households. Each of these groups interact with the gas market in different ways and experience different supply and price structures.
2. in all places indicated in the guidelines where the Minister is compelled to consult with LNG exporters, corresponding consultation should be required specifically with Australian industry end-users bodies, rather than just “other stakeholders”.
3. consultation with gas producers should include emerging junior and mid-cap gas producers in order to provide a holistic understanding of production costs and return expectations, barriers to entry and opportunities to increase competition in the gas market by encouraging new suppliers.
4. a mechanism must exist to override confidentiality clauses or requirements imposed on gas buyers, in order to enable accurate data on pricing, quantities, volumes and terms to be provided to the Minister. This might require a role for the ACCC or confidential portals in acquiring and de-identifying data.
5. The ADGSM states that the Minister may choose not to declare a domestic shortfall year, even where he or she determines there will be a shortage of gas in the market, if he or she considers the likely shortfall to be immaterial. Assessment of materiality should be undertaken at the level of an individual firm or domestic business using gas.
6. where consultation leading to Ministerial decision making relies on gas industry assessments of the supply/demand outlook, either directly or via AEMO and ACCC, this advice should be made public and allow the opportunity for clarification and challenge by other market participants.
7. the ADGSM should explicitly reference as its guiding principle the National Gas Objective, which aims to deliver outcomes in "the long-term interest of consumers."