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Manufacturing Australia Submission
Australian Domestic Gas Security Mechanism

2019 Review of the Australian Domestic Gas Security Mechanism (ADGSM)
Department of Industry Innovation and Science
Onshore Gas Team
By email: ADGSM@industry.gov.au

To whom it may concern,

Thank-you for the opportunity to input to the review of the Australian Domestic Gas Security Mechanism (ADGSM).

Manufacturing Australia (MA) is led by the CEOs of some of Australia's largest manufacturing companies: Adelaide Brighton, BlueScope, Brickworks, Capral, Cement Australia, CSR, DuluxGroup, Incitec Pivot, Orora, Rheem and Tomago Aluminium. MA's members provide direct and indirect employment to more than 100,000 Australians and operate some 500 plants or smaller facilities around Australia, notably in outer suburban and regional Australia.

Gas is a fundamental input to Australian manufacturing:

1. Gas is used as a feedstock in plastics and chemical manufacturing. In these applications it is not substitutable.
2. Gas is widely used to produce heat and steam, generate electricity and power processes in manufacturing.
3. Gas is a fundamental driver of electricity prices in Australia's National Electricity Market, where high gas prices and high electricity prices are inextricably linked.

Today manufacturers in Eastern Australia pay, on average, 150 per cent more for gas and 175 per cent more for electricity than they did a decade ago. As a consequence, plants have closed, manufacturing jobs have been lost and Australia has missed investment opportunities by both Australian and international manufacturers.

By contrast, in the United States of America, manufacturers pay around 63 per cent less for gas and 30 per cent less for electricity than they did a decade ago, in large part because gas has transformed energy competitiveness in that country, and underpinned a manufacturing revival in the process.

In the above context, the review of ADGSM and broader gas policy settings is vital to the competitiveness of Australian manufacturing, and its ability to underpin the next generation of industrial investment and employment in Australia.

Manufacturing Australia's gas position:

Manufacturing Australia (MA) supports regulations to ensure security of gas supply, at globally competitive prices, for the Australian domestic market, for the benefit of households and industry. Such regulation should aim to ensure that not only is supply secure, but that gas prices in the domestic market reflect the cost of production and are delivered via a competitive and transparent domestic market. Gas prices for domestic customers should not be inflated by market concentration, supply scarcity, regulatory failure or the expectation that domestic customers pay a return on capital for export infrastructure that is irrelevant to their needs. As a gas rich nation, it is reasonable to expect Australians should enjoy gas prices in at least the lowest quartile of OECD gas prices.

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MA believes there are six key roles for governments in resolving Australia's East Coast gas challenge:

1. *Encouraging more supply:* moratoria on exploration and development should be lifted and replaced with consistent, evidence based assessment of prospective projects. Development of proven and probable gas reserves should be encouraged and actively facilitated, providing projects meet relevant safety, environment, social and planning conditions.
2. *Encouraging more suppliers:* governments should encourage and offer incentives for new gas market participants, to increase the diversity of suppliers and competitive tension in the gas market. The Underwriting New Generation Investment program used in the electricity market could provide a template for expansion to gas exploration and development as well as the broader gas supply chain.
3. *Securing domestic supply:* prospective gas reservation, such as that which now applies in Western Australia and Queensland, is working. It has proven very effective in enabling competitively priced gas for manufacturers, without deterring investment in gas exploration and development. The success in these jurisdictions of combining support for exploration with *prospective* reservation is a model for other States and, if possible, the nation.
4. *Preventing gas banking:* stronger application of retention licenses in onshore and offshore gas projects should be prioritised to prevent commercially viable gas being withheld from the domestic market for commercial or strategic reasons that are not in the national interest or the interests of customers.
5. *Transparency and market data:* the valuable work undertaken by the ACCC to establish a benchmark price series for domestic gas should be continued and broadened. In particular, the ACCC should work with other relevant agencies and market participants to develop comprehensive data on the cost "stack" for domestic gas, such as was developed for the electricity market in recent years. Better insight into the costs of exploration, development, processing, transport and, in the case of LNG, liquefaction and shipping, is valuable to both market participants and policymakers.
6. *Supporting transition:* if adopted, the above measures will take time to enact and to materially lower domestic gas costs. Meanwhile, pressure on gas intensive manufacturing is immediate. Therefore, other measures should be considered as part of a transition plan to prevent demand destruction and ensure viable businesses do not fail before Australia's gas market and policy failure is restored. The ADGSM should be viewed as a key part of this transition, and is the focus of the remainder of this submission.

The ADGSM

MA notes that the ADGSM has never been triggered. Therefore, any efforts to review its effectiveness or impact on the domestic gas market, as is suggested by the terms of reference for this review, are entirely speculative. Nobody knows what impact the ADGSM has had on the gas market as it has never been used.

At the time of its introduction, MA noted that while the ADGSM was a welcome safeguard against a "worst case scenario" of actual shortage of gas it was unlikely to lead to materially lower gas prices in Eastern Australia.

The review of the ADGSM presents an opportunity to redefine the objective of the mechanism as being to materially lower gas prices for at-risk industries as part of a bridge to longer term, sustainable, gas market reforms.

Improvements to the mechanism, such as those recommended below, may increase the likelihood of lowering domestic gas prices, but again, that is all moot if the mechanism is never used.

MA offers the following recommendations that would strengthen the ADGSM and increase the likelihood of reducing gas prices:

1. Allow the mechanism to be activated at any time:

Currently, 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. Forecasts of gas supply and demand are inherently unreliable and influenced by myriad unpredictable factors. In that context, a single determination made

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well in advance of the winter period (when gas demand in Australia peaks) is insufficient. MA recommends that the Minister should have the ability to trigger the ADGSM at any time in response to advice from relevant authorities including the ACCC and AEMO.

2. Introduce a price trigger:
The ACCC has provided valuable information to the gas supply chain in its series of reports on competition, transparency and related issues in the domestic gas market. The establishment of an LNG netback price series by the ACCC should become the basis for a price trigger as part of the ADGSM, whereby advice from the ACCC of a persistent and material gap between its reasonable benchmark price and average contracted gas prices should form sufficient basis to trigger the ADGSM. Further, MA contends that a domestic price benchmark should be based upon an LNG netback price, minus a reasonably determined return on equity for LNG capital investments. This is because it is not reasonable to expect the domestic market to subsidise investments in LNG export infrastructure from which it derives no benefit. Rather, the customers of that infrastructure (ie gas importers overseas) should repay the capital invested in that infrastructure.

3. **Target domestic gas surplus**
The ADGSM is focused on delivering a balanced market, ensuring that "sufficient supply" is available. However, if the objective is to lower gas prices, a surplus market is required. A fully supplied but 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 the ADGSM should have a target of ~10% surplus gas in the domestic market, ensuring there is sufficient gas available to meet the growing needs of the domestic gas market, including for power generation, and in turn reduce prices.

4. Maintain 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.

Finally, MA reiterates that the ADGSM should be considered one part of a package of measures to provide a bridge to assist at risk customers to sustain their operations until such time as longer term, sustainable, gas market reforms, such as those outlined above, are able to take effect. Other elements of such a transition package will need to be considered, but are outside the scope of this review.

Thankyou for the opportunity to input into the review of the ADGSM. I would be delighted to expand on the issues raised on request.

Yours Faithfully,

Ben Eade
Chief Executive Officer