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Australian Domestic Gas Security Mechanism Extension

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1 Introduction

The Australian Chamber of Commerce and Industry welcomes the opportunity to comment on the extension of the Australian Domestic Gas Market Security Mechanism (ADGSM).

The aim of the ADGSM was to ensure that there is sufficient supply of natural gas to meet the forecast needs of Australian gas consumers. If a shortfall in the supply of natural gas is forecast, the ADGSM gives the Minister for Resources, at her discretion, the power to direct LNG projects that are drawing gas from the domestic market to either limit exports or find offsetting sources of new gas, to make up any domestic shortfall.

Since the ADGSM took effect on 1 July 2017, the gas market has remained extremely tight and there have been events resulting in major disruptions to gas supply and surging prices in 2019 and now in 2022. Yet, thus far, there has not been an instance where the responsible Minister has made the decision to trigger the ADGSM.

The criteria for activation of the ADGSM is too limited. It views the east coast market as a whole and is based solely on balancing supply and demand across the total market. There is no consideration of state or regional supply shortfalls. There is no consideration of the ability of the transmission network to transport gas across the network to meet local demand. There is no consideration of gas prices. There is no consideration of the ability of major C&I gas users to secure long-term supply contracts.

Technically, the east coast market, when viewed as a whole, can be shown to be in balance. Gas producers have maintained supply marginally higher than demand from domestic customers and LNG exporters. Yet, when viewed at a more granular level, supply shortfalls can be observed in numerous regions. Local spot gas market prices are very high, particularly in the southern states. The opportunity for many C&I gas users to negotiate long-term supply contracts is very limited, with many forced to rely on the spot market.

An earlier Review of the ADGSM in 2019, appears to have delivered few tangible outcomes. The market has continued business as usual, with a very tight supply demand balance, domestic gas prices at or above international equivalence. In the current market, no east coast gas supplier is willing to offer C&I gas users long-term contracts at any price which significantly impedes effective business planning and investment.

2 The current gas crisis

The current gas crisis is the confluence of a perfect storm, domestically and internationally.

Domestically, gas demand for power generation has greatly increased to offset a reduction in generation of coal-fired power, with over 25% of coal-fired power out-of-service due to scheduled and unscheduled maintenance. This coincided with an early winter cold snap on the east coast, resulting in a spike in gas demand for heating and to meet increased electricity use.

Internationally, the Russian invasion of Ukraine and subsequent trade sanctions imposed on Russian exports, including gas supplies to Europe, led to surging international demand. This drove

many European countries to seek alternative gas sources, which dramatically increased international gas demand and prices.

In May 2022, the spot market gas price spiralled, forcing the Australian Energy Market Operator to take the unprecedented step to intervene in the market and impose a cap on spot market gas prices in Queensland, NSW and Victoria. Yet even with the price of gas capped at \$40 per GJ, commercial and industrial (C&I) gas users are paying over four times more than what they were paying only a few weeks earlier.

These prices are unsustainable. Already we are seeing C&I gas users under extreme pressure and indicating that if the price pressures cannot be relieved shortly, they will be forced to close and/or leave Australian shores.

3 Commercial and Industrial Gas Users

The situation is particularly severe for C&I gas users that use gas as a feedstock, such as plastics, fertiliser and chemical manufacturers. Natural gas is the main input for these manufactures and can represent up to three quarters of their operating costs in normal times. In the current environment, with a four-fold increase in gas input costs, unless they are able to pass these costs onto the customer, they cannot continue to operate. Many businesses with fixed long-term contracts are operating at a loss, and very soon will no longer be viable.

Even if they can afford to pay the elevated prices, many C&I gas users are finding it very difficult to source gas on the spot market. Many businesses relying directly or indirectly on gas as feedstock, heat or power generation, face closure as they cannot continue to operate at current gas prices.

Most large C&I gas users seek to rely on long-term contracts for security of supply and use the spot market to deal with variability in their production cycles. For example, a plastic manufacturer using gas as a feedstock may have a long-term contract for 80% of supply and purchase the remainder through the spot market, when operating above their long-term average production levels.

Even before the current gas crisis, C&I gas users nearing the end of their current gas supply contract were finding it extremely difficult to negotiate new long-term contracts at affordable prices. In the current market, no east coast gas supplier is willing to offer long-term contracts at any price. Many must accept short-term contracts (12 months) at very high prices. Others cannot secure a contract at all and are left to source their gas through the highly volatile spot market. Few large C&I gas users can continue to operate at the current, extremely high spot gas market price for even a short period of time.

Reliance on short-term contracts and the spot market also has ramifications for investment and the ongoing operation of many businesses. Many gas users have maintenance schedules that align with their gas supply contracts, as they will often need to shut down operations for 3 to 6 months to carry out major refurbishments, upgrade or replacement of machinery. If these C&I users cannot secure long-term gas contracts at reasonable prices, it limits their ability to secure finance to support this investment.

By way of example, recently, Incitec Pivot announced it will cease manufacturing of AdBlue at its Brisbane-based Gibson Island plant at the end of 2022, as it had been unable to secure a long-term contract for affordable gas supply from 2023 onwards. Incitec Pivot is the only Australian producer of AdBlue, which is an important fuel additive to reduce greenhouse gas emissions from diesel engines. With the departure of Incitec Pivot, Australia will become fully reliant on the import of AdBlue in the future.

4 Gas demand and supply imbalance

The Australian Competition and Consumer Commission (ACCC) Gas Inquiry 2017-2025: Interim Report January 2022 was already reporting deteriorating market conditions for gas users from 2022 and beyond. While supply from proved and probable reserves in total able to meet demand across the east coast, this supply was skewed to Queensland, with a shortfall of 10 PJ in the southern states.

The shortfall in gas supply in the south could be alleviated by supply from the north, but there is very limited capacity for this. As noted in the Gas Inquiry Report, capacity is fully contracted or near to fully contracted on pipelines and compression facilities used to transport gas south from Queensland. The ACCC was forecasting that the shortfall to the southern states would continue in 2023.

Similarly, the Australian Energy Market Operator's (AEMO's) Gas Statement of Opportunities (GSOO), while identifying adequate gas supplies to meet consumers' changing consumer needs from now until 2041, did note that its future forecasts were highly uncertain. Given this uncertainty, AEMO was unable to accurately predict supply and demand, so it presented its forecasts as five potential scenarios.

A key concern for gas users is that the GSOO is based on information provided by the gas industry. It does not appear to take into consideration the experience of gas users in accessing affordable gas or their ability to negotiate and secure long-term supply contracts.

It is expected the current pressures on the gas market (which weren't apparent when the ACCC and AEMO reports were released) will continue over the remainder of the year. Australia is now in the middle of the peak winter demand period and it will still take some month before the backlog of scheduled and unscheduled maintenance at coal-fired power stations will be cleared to reduce demand on gas fired generators. International gas prices will continue to spiral higher, with the war in Ukraine likely to drag on for some time yet, European countries soon be completely shut off from Russian gas supply and European gas demand rising as winter approaches.

5 ADGSM is not fit-for-purpose

As we have seen in recent months, the ADGSM does not serve its intended purpose of ensuring sufficient supply for domestic C&I gas users and residential customers.

The ADGSM must be able to be activated in a timely manner in times of crisis in the gas market. It should not require 6 months of consultation with gas producers and other stakeholders before the responsible Minister makes a determination and the ADGSM is activated.

There needs to be more regular monitoring of the supply-demand balance, at intervals of 3 months rather than 12 months, so that it is responsive to changing market conditions. It should be able to be triggered before there is a gas shortfall, to prevent, rather than respond to a gas market crisis.

To be effective, the scope of the ADGSM must be broadened to focus not just on the sufficiency of supply at an aggregate level across the east coast market, but consider the sufficiency of supply at the state and regional level.

The ADGSM must be better targeted to improve the outcomes for domestic gas consumers. There are a wide range of problems in the domestic gas market related to the availability of supply contracts and gas prices. In its current form, the ADGSM is not addressing these issues, particularly from the perspective of C&I gas users.

The ADGSM must ensure certainty of both supply and prices to households and C&I gas users. Therefore, in addition to the gas supply trigger, the ADGSM should also have a price trigger to ensure gas users are not exposed to exorbitantly high gas prices.

It should also ensure domestic customers, particularly C&I users, have access to short- and long-term supply contracts, on reasonable terms and at affordable prices.

In addition, to support the functioning of the ADGSM, there is a case for greater transparency in the domestic gas market. New measures to require gas producers and LNG exporters to publish real time information on the volume of available gas supply, and detail on the costs of production and delivery of gas to customers, would improve transparency and help the market operate more effectively.

6 Extending the ADGSM beyond 2023

ADGSM is a significant regulatory intervention that should only be viewed as temporary.

Notwithstanding the above, in the current dysfunctional gas market, **the ADGSM should be triggered immediately**, to provide relief to domestic gas customers. First and foremost, domestic C&I gas users must have access to affordable gas and must be able to secure long-term contracts on reasonable terms.

As noted above, the ACCC and AEMO are currently forecasting the gas market to be extremely tight at an aggregate level, and in shortfall in some states and regions, in 2022, 2023 and beyond.

Therefore, **the ADGSM should be extended beyond 2023** until such time as the gas market has returned to a more functional state, with adequate supply to meet demand in aggregate, as well as sufficient transmission capacity to ensure no state or regions have a supply shortfall, so that domestic gas prices remain low and customers can secure long-term contracts on reasonable terms.

However, **the ADGSM should only be viewed as a stop-gap measure**, while a more comprehensive national gas strategy is developed and implemented.

7 National Gas Strategy

A national gas strategy should aim to achieve a functioning competitive gas market, with a focus on improving its efficiency and effectiveness, increasing competition and removing supply constraints. A key component of this strategy must be increasing supply, through increased exploration and the development of gas resources on the east coast.

To be consistent with the National Gas Objective, the strategy would be consumer focused, catering for the needs of C&I gas users and residential customers. At the same time, it needs to support the LNG export sector, which is a major contributor to Australia's trade balance and GDP.

In a very short time, LNG exports have grown to become Queensland's second largest merchandise export, after coal, estimated to be valued at \$49 billion in 2021-22. In addition to meeting the needs of domestic gas users, the strategy also needs to factor in the importance of these exports and limit any disruption to this trade.

The national gas strategy should aim to ensure domestic gas consumers have access to a functioning gas market. Short-term policy priorities should aim to increase competition, create a more interconnected network and improve the efficiency and effectiveness of the gas market. Long-term policy priorities should aim to remove constraints on exploration and gas-field development to increase domestic supply and drive down prices.

The strategy should focus on freeing-up the market to competition, rather than the addition of further regulation on what is an already heavily regulated and highly distorted market.

In developing the national gas strategy, we recommend the Government work with its State and Territory counterparts through the Energy National Cabinet Reform Committee and Energy Ministers' Meetings to ensure consistency of policy and regulation in the highly integrated east coast gas market.

About the Australian Chamber of Commerce and Industry

The Australian Chamber represents hundreds of thousands of businesses in every state and territory and across all industries. Ranging from small and medium enterprises to the largest companies, our network employs millions of people.

The Australian Chamber strives to make Australia the best place in the world to do business – so that Australians have the jobs, living standards and opportunities to which they aspire.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

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