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Securing Australia's Domestic Gas Supply

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and Industry

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Introduction

The Australian Chamber of Commerce and Industry welcomes the opportunity to contribute to the Securing Australia's Domestic Gas Supply Review.

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/his 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 further 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 gas 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 its current state, the east coast gas market is dysfunctional. Increased supply and greater competition is needed to put downward pressure on the price of gas in the east coast market. C&I gas users need access to short- and long-term supply contracts affordable.

ACCI has always regarded the ADGSM as a temporary, stop-gap measure ahead of broader reforms. These broader reforms are still required. We recommend the development of a comprehensive national gas strategy. The strategy would aim to achieve a functioning gas market, by removing supply constraints, freeing-up the market to competition and bringing down domestic gas prices, rather adding further regulation.

C&I Gas Users

The current gas situation is particularly severe for C&I gas users that need 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 rapidly increasing 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, Incitec Pivot recently 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. Incitec Pivot's announcement follows the departure of a number of other gas-reliant facilities, including Dow Chemicals in Melbourne, RemaPak in Sydney and Claypave in Queensland.

Activation at short notice

As we have seen in recent months, the ADGSM is not fit for purpose. It is not achieving its objective of ensuring sufficient supply for domestic C&I gas users and residential customers.

In May 2022, the east coast gas market was in crisis. Surging LNG export demand and very high international prices following the Russian invasion of Ukraine, coincided with a spike in domestic gas demand for power generation to offset a sharp reduction in coal-fired power generation. There was insufficient gas available to meet domestic demand and the network proved incapable of transporting gas from the main distribution hubs to regions where it was most needed. This sent the spot market gas price spiralling. The Australian Energy Market Operator was forced to take the unprecedented step to intervene in the market and impose a cap on spot market gas prices in Queensland, NSW and Victoria.

Even with the price of gas capped at \$40 per GJ, commercial and industrial (C&I) gas users were paying over four times more than what they were paying only a few weeks earlier. These prices are unsustainable. Many C&I gas users are under extreme pressure and indicating that if the price pressures cannot be relieved shortly, they will soon be forced to close and/or leave Australian shores.

Despite the gas market being in complete crisis, the ADGSM could not be activated to provide relief to domestic gas customers. The responsible Minister announcing that it would require 6 months of consultation with gas producers and other stakeholders before she was able to activate the ADGSM. This is unacceptable. It is vital that the ADGSM can be able to be activated in a timely manner in times of crisis in the gas market.

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.

Price based activation

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, gas prices on a regional basis, and detail on the costs of production and delivery of gas to customers, would improve transparency and help the market operate more effectively.

Incentivise domestic supply

The ability to increase supply to meet the needs of domestic gas uses and put downward pressure on prices is being held back by regulatory barriers to investment in gas exploration and new gas field developments.

State regulation — such as the Victorian Government’s moratorium on unconventional (coal-seam) on-shore gas exploration and all forms of off-shore unconventional (coal seam gas) exploration, and the NSW Government’s ‘go-slow’ on environmental assessment for unconventional gas field development — is having a substantial impact on gas exploration and investment decisions.

In Victoria, despite dwindling supply from existing reserves in the Gippsland and Otway Basins, the Victorian Government has effectively banned gas exploration and the opening of new gas reserves. Victorian C&I gas users and residential retailers are becoming increasingly reliant on gas transported from northern Australia. Similarly, in NSW which relies on the importation of 98 per cent of its gas requirements from other states, the environmental approval process for the Narrabri gas field development has been extremely slow. This project was first proposed in 2016, but as a result of the extremely slow approval process, if the proponent does decide to develop this reserve, it will be at least 2024 before it begins to supply gas to the network.

Federal and State Governments must focus their attention on lifting restrictions on gas exploration and extraction and facilitating faster approvals for new gas projects to increase the volume of gas available in the network.

Improve administration of export permits

Improving the current Total Market Security Obligation (TMSO) to ensure that activation of the ADGSM is suitably increasing supply whilst acting equally upon LNG producers should be a focus of the review. The 2019 ADGSM review revealed the TMSO may not be recognising the differing levels of commitment and contribution that each LNG producer is making to the domestic market. This does not incentivise the contribution of supply to the domestic market and can consequently reduce the commitment LNG producers have to supplying the domestic market.

However, any changes to export permits should be careful and considered due to the reliance the Australian economy has on LNG exports and the already significant regulation burdening a free and competitive gas market. 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, consideration must be given to the importance of LNG exports and limit any disruption to this trade.

State and territory measures to increase supply

Discontinuity between the states and territories measures is impeding domestic supply. The ADGSM views the east coast market as a whole and is based solely on balancing supply and demand across the total market. Yet at the state and regional level, there are significant shortfalls in supply making it very difficult for gas reliant C&I customers to secure long term supply and purchase gas at reasonable prices.

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.

National Gas Strategy

With the ACCC and AEMO 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, the east coast gas market has become dysfunctional. To provide relief to domestic gas customers, the Government should look to trigger the ADGSM immediately. 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.

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

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.

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

About the Australian Chamber of Commerce and Industry

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