



Australian Government

Department of Industry,
Science and Resources

Securing Australia's domestic gas supply

Options to improve the Australian Domestic Gas Security Mechanism

1 August 2022

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Australia's domestic gas supply

Over the last 20 years, Australian gas has played an increasing role in our domestic economy and our trade with other countries. As a reliable supplier of liquefied natural gas (LNG), Australia also plays an important role in the energy security of the region. Currently, Australia is experiencing challenges to the security of its domestic gas supply, specifically in the east coast gas market.

The Australian Government expects a shortfall of gas in the east coast market in 2023.

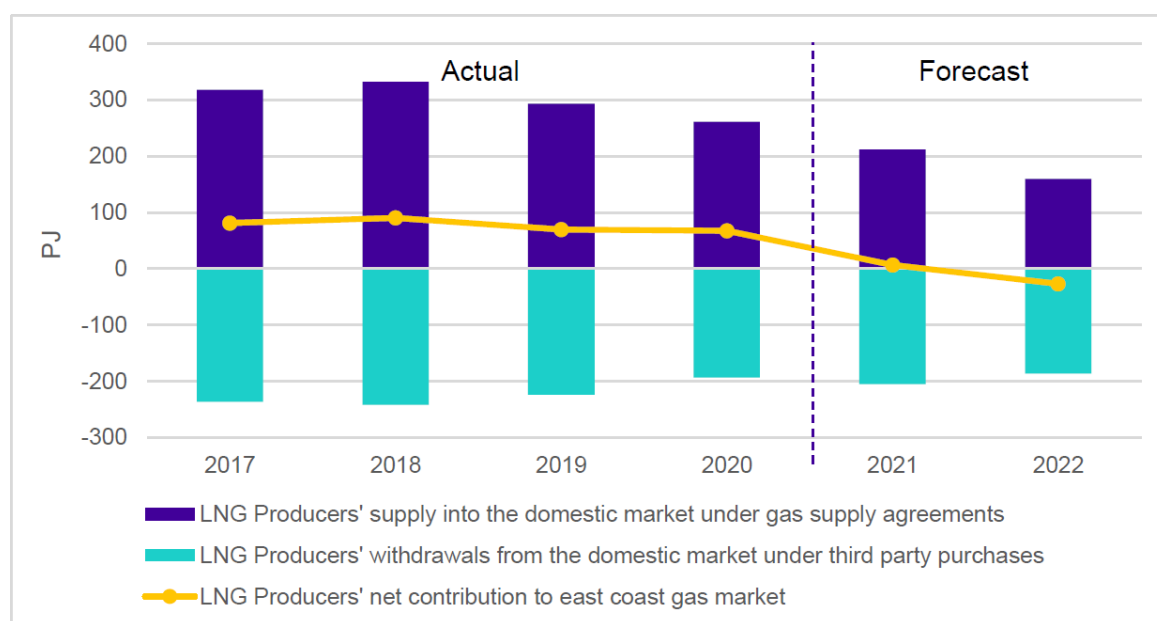
A domestic gas shortfall could have serious consequences for Australians. Gas is critical for Australian industry and manufacturers, being used as an energy source and a feedstock. Australian businesses and households rely on gas to heat their homes, water and to cook. Gas-fired generation supports the reliable and stable operation of Australia's electricity system, and is particularly important when renewables and coal-fired generators are unavailable.

The Australian Domestic Gas Security Mechanism (ADGSM) provides the Minister for Resources the regulatory power to manage LNG exports during a year when a gas shortfall has been forecast in the domestic market. While the ADGSM is an important tool, it has shortcomings. The ADGSM's operation is complex and, if activated, would take a long time to produce results. In today's volatile and interconnected energy markets, the ADGSM's current design may be insufficient to avoid a shortfall in the supply of domestic gas to the east coast of Australia.

Alongside the ADGSM, the Government has a Heads of Agreement (HoA) with Australia's east coast LNG exporters. Under the HoA, exporters commit to offer uncontracted gas to the Australian market on competitive terms before exporting it. The Government intends to negotiate a new HoA to replace the current HoA before it expires on 1 January 2023.

Together, the ADGSM and HoA are intended to encourage industry-led supply solutions which ensure Australia's energy needs are met alongside those of our trade partners. Since their creation, the ADGSM and HoA appear to have had a diminishing effect. The net contribution of gas to the east coast domestic market by LNG exporters has declined in recent years.

Figure 1: LNG Producers' net contribution to the east coast gas market



Obtained from ACCC analysis of data as reported in the July 2020 report and LNG producers as at February 2020, September 2020, March 2021 and August 2021.

Process

On 9 June 2022 the Australian Government announced it would review the ADGSM to identify improvements that could be made, and consider other options to strengthen the security of Australia's domestic gas supply.

The review is being led by the Department of Industry, Science and Resources (DISR).

The Government encourages stakeholders to make submissions about the key topics highlighted in this Issues Paper. Submissions should be provided in written format by 22 August 2022 via the Department's website. Public submissions are encouraged, and confidential submissions will also be accepted and treated accordingly.

DISR will also conduct face-to-face consultations with key stakeholders during the review period.

Timeline

Release of issues paper: 1 August 2022

Due date for written submissions on issues paper: 22 August 2022

Principles

The ADGSM review will be guided by seven principles. These principles provide a frame of reference for balancing the different objectives and implications of measures to improve Australia's domestic gas security.

1. Ensure sufficient supply of gas to the domestic market to support manufacturing and energy security

Australia's domestic gas supply-demand balance has continued to tighten. The solutions pursued should increase the certainty of Australia's domestic gas supply for manufacturers and other consumers, and increase the market's ability to respond to unforeseen domestic and international shocks. Continued investment in new gas supply will be needed to achieve security in Australia's supply, so solutions should encourage investment to maintain and grow supply.

2. Put downward pressure on domestic gas prices.

High and volatile gas prices impact the ability of domestic gas users to secure reliable and affordable gas. Ensuring sufficient domestic gas supply is one issue, but it must be available at a price level that is affordable to gas users, particularly manufacturers reliant on gas as a feedstock. Alongside increasing supply, the solutions should work to put downward pressure on the price of domestic gas, including through improving market competition. Actions on price must be carefully balanced to avoid unintended consequences, including deterring investment needed for long term supply security, and undermining the effective operation of the market.

3. Maintain Australia's position as a leading contributor to global energy security

Australia makes an important contribution to the world's energy security, and our region's energy security in particular. Recent global events have increased the importance of Australia as a trusted energy export partner both in the short and longer term. The solutions pursued should be consistent with Australia continuing to play its role as a highly trusted provider of energy security to our major trading partners.

4. Respect the trust trading partners and international investors have shown in Australia's resources and energy sectors

The development of Australia's LNG industry has forged strong international energy partnerships, underpinned by a high level of trust in Australia as a reliable energy supplier and attractive foreign investment destination. Australia is also trusted by investors as a stable and secure destination for investment in energy production.

Australia is a trusted energy export partner. Solutions pursued should respect this trust, honour those energy partnerships and existing commercial agreements, and consider the views of international stakeholders.

5. Supports energy transition in line with climate action goals

The role of gas in the energy sector has implications for achieving Australia’s climate goals. The solutions pursued should support effective energy transitions and emission reductions over time while maintaining energy security and affordability for industry during the transition to a net zero economy.

6. Enhance transparency and processes that support competitive pricing outcomes for gas consumers

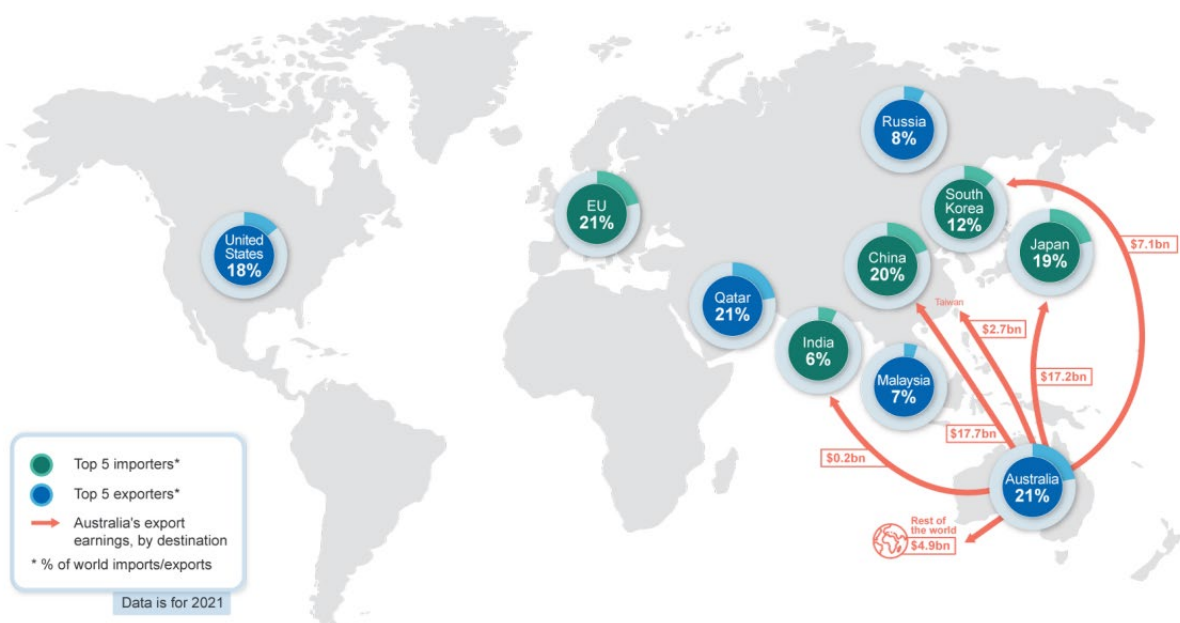
Increased market transparency supports increased market competition and a more liquid market. Gas users have advised they don’t currently have visibility of if, and when, gas will be offered to the domestic market. This lack of transparency impacts gas users’ investment decisions and puts them at a competitive disadvantage.

Improved transparency would also support market bodies, such as the Australian Energy Market Operator in their management of gas and electricity markets.

7. Minimise implementation cost and complexity for government and industry

Implementing different options to improve Australia’s domestic gas security would bring varying levels of cost and complexity. The solutions pursued should provide the greatest possible benefit while imposing minimal implementation costs on government and industry.

Figure 2: LNG trade map



Options

The Australian Government invites stakeholder views on the options being explored to improve Australia's domestic gas security. You are invited to respond to the consultation questions, comment on the options more broadly, or suggest alternate options. Alternate options could include measures to promote competition in the domestic gas market.

We welcome views on the impact each option would have on Australia's existing LNG export commitments, the investment outlook in Australia, and on the competitive functioning of the market.

1. Strengthen the ADGSM

The ADGSM could be improved by enabling it to be activated more flexibly and quickly, and to ensure that its activation is effective in delivering more gas to the domestic market.

Activation at short notice

The ADGSM was designed to address gas supply shortfall risks using year-ahead forecasts, and can only be activated as part of an annual cycle. Between July and November the Minister for Resources may activate the ADGSM if a shortfall is forecast to occur the following calendar year. The ADGSM cannot be applied outside of this annual cycle, or with immediate effect. The ADGSM could be amended to enable its activation in response to exceptional, shorter term shocks that threaten the security of Australia's gas supply.

Consultation Questions:

1. Would a short term activation power effectively address sudden shocks or shortfall risks?
2. What timeframes and limitations should apply to shorter-term activation powers?
3. How would short-term activation interact with other energy security measures, like the Gas Supply Guarantee?¹
4. What should be the threshold for a short-term activation mechanism?

Price based activation

The current design of the ADGSM does not allow activation on the basis of price. If sufficient gas supply exists but prices rise to unaffordable levels, this effectively restricts domestic users from accessing available supply. The ADGSM could be expanded to enable its activation in the event domestic gas prices rise beyond a reference price. The reference prices could be determined through a legislated calculation, factoring in international prices, costs of production, reasonable profit margins for gas suppliers and the capacity of gas purchasers' capacity to pay.

¹ <https://aemo.com.au/en/energy-systems/electricity/emergency-management/gas-supply-guarantee>

Consultation Questions:

5. What factors should a reference price take into account? How should each factor be measured or monitored?
6. Which entity is best placed to determine the price, and what should that process include?
7. What implications or unintended consequences could price-base activation have, including on new supply and the competitive functioning of the market?

Incentivise domestic supply

Currently, the ADGSM provides for the management of LNG exports, but doesn't incentivise nor compel (by legal or other means) LNG producers to increase sales to the domestic market. The ADGSM could be redesigned to include commercial incentives for LNG producers to supply the domestic market. For example, following activation of the ADGSM, the Minister for Resources could be given the power to increase the volume of LNG that a producer can export - proportionate to additional volumes of gas that the LNG exporter has contracted to supply to the domestic market.

Consultation Question:

8. How could the ADGSM be amended so that during a shortfall year, stronger incentives exist for LNG exporters to increase domestic supply?

Improve administration of export permits

There are opportunities to improve the way export permits would be administered after the ADGSM has been activated. For example, under current arrangements the ADGSM uses the Total Market Security Obligation (TMSO) to determine which LNG producers will supply gas to the domestic market. The TMSO calculates which LNG producers are in net-deficit in their supply of gas to the domestic market, and manages those producers' exports accordingly. A producer is in net-deficit if they're contributing less gas to the domestic market than they're withdrawing from the domestic market to export as LNG. As identified in the [2019 ADGSM review](#), the TMSO may not be effective in ensuring activation of the ADGSM results in increased supply to the domestic market. It may also have different effects on LNG producers, and fail to recognise that they have made differing levels of commitment and contribution to the domestic market.

Consultation Question:

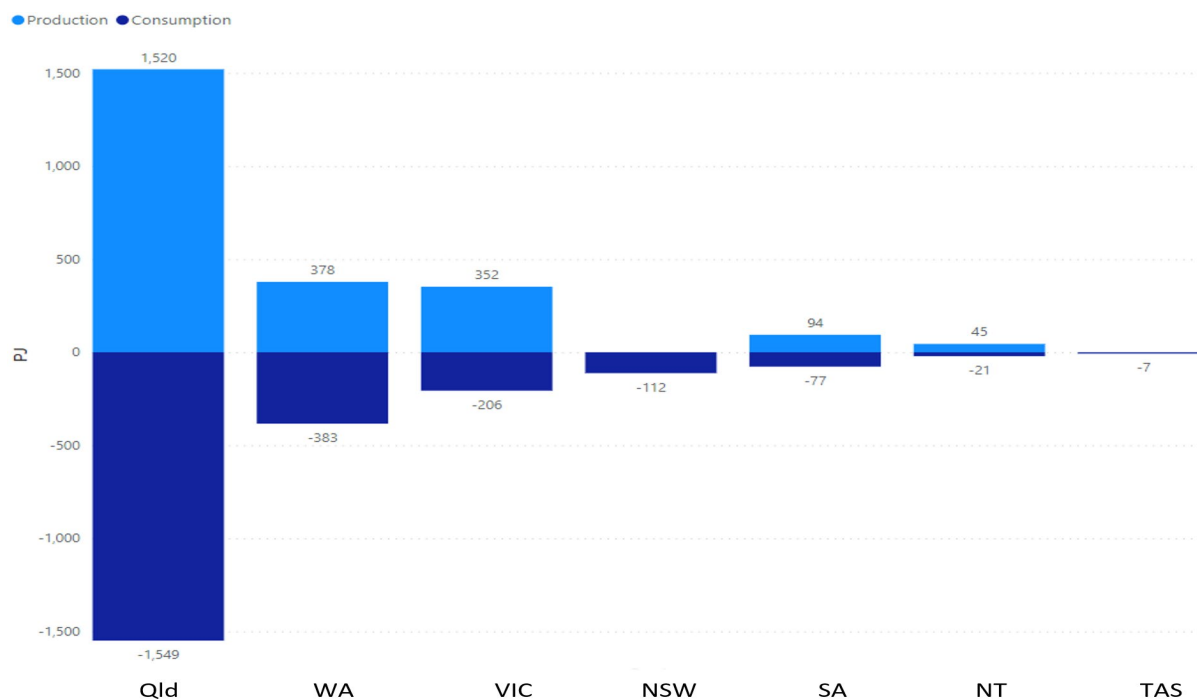
9. How could the TMSO be improved?
10. What features would effective LNG export permits have?
11. Should contracted gas be exempt from the ADGSM? If so, how could this exemption be designed to ensure the objectives of the mechanism are met?

2. State and territory measures to increase supply

Australia's east coast gas market is increasingly sensitive to external shocks due to a tightening supply-demand balance as supply from Bass Strait fields decline. Domestic east coast gas consumption was 578 PJ in 2020. For decades, Bass Strait gas has dominated southern production with an average of around 500 PJ per year. However, the Bass Strait is in decline with just 352 PJ produced in 2021 and 200 PJ forecast for 2026. This is causing the east coast to increasingly rely on Queensland supply.

The impact of a shortfall will have varied consequences for different jurisdictions, depending on the nature of household and industry use. There is a large disparity between the level of gas produced within some jurisdictions, and the volume of gas they consume. This is contributing to the challenges the east coast market faces.

Figure 3: State and Territory gas production and use 20212



12. What can the states and territories do to ensure their gas needs are met during the energy transition?

- a. How can the Commonwealth support the states and territories to do this?

Concluding remarks

The Government is committed to acting to ensure security of domestic gas supply. It is intended that the final design of the ADGSM or its replacement will work in tandem with a range of other measures, including a new Heads of Agreement, and be complemented by [broader energy market reforms](#) being considered by Energy Ministers.

The Government encourages stakeholders to make submissions about the key topics highlighted in this Issues Paper. Submissions should be provided in written format by 22 August 2022 via the Department's website. Public submissions are encouraged, and confidential submissions will also be

² AEMO data – excludes offshore WA. Consumption in 2021 includes stored gas produced in earlier years. ACT demand aggregated with NSW demand. Production is the total production and storage received by jurisdiction, except for Victoria where the data relates to the Victorian Transmission System. Consumption is the total demand in each state, except for Victoria where the data relates to the Victorian Transmission System. Some GPG data may be omitted due to methodology.

accepted and treated accordingly. DISR may also conduct face-to-face consultations with key stakeholders during the review period.