Australian Government

Department of Industry, Science, Energy and Resources

PDR no. MS21-001755

Adviser

Ministerial Submission Coversheet

Subject	Options for a Prospective National Gas Reservation Scheme
Client (if applicable)	

Division	Resources		
Contact officer	s47F [redacted]	Telephone	s47F [redacted]
Cleared by (SES)	David Lawrence	Telephone	s47F [redacted]

FOR MO/AMO USE ONLY:	**Scheduled date**	**Actual date**
Date registered		4/11/2021
Dept to Minister's Office		10/11/2021
DLO to Adviser(s)		
Adviser(s) to Chief of Staff		
Chief of Staff to Minister		

FOR ADVISERS/CHIEF OF STAFF USE ONLY:	**Yes / No**	**Comments**
Relevant	☐ Yes / ☐ No	
Timely	☐ Yes / ☐ No	
Quality/Accuracy	☐ Yes / ☐ No	

Australian Government
Department of Industry, Science, Energy and Resources

PROTECTED: CABINET

Minister for Resources and Water Min ID: MS21-001755

For Action

Subject: OPTIONS FOR PROSPECTIVE NATIONAL GAS RESERVATION SCHEME

Timing: Routine – by 24 November 2021

Recommendations:

That you **sign** the letter to the Prime Minister at Attachment A, seeking his agreement to: **Signed/Not signed/Please discuss**

a. not introduce a national prospective gas reservation scheme; and

b. extend the Australian Domestic Gas Security Mechanism (ADGSM) and Heads of Agreement with east coast Liquefied Natural Gas (LNG) exporters to 2030.

Keith Pitt .... **Date: / /2021**

Comments:

Key Points:

1. The Australian Government has publicly committed to exploring options for a prospective national gas reservation scheme on several occasions.
2. In October and November 2020, the department sought public comment on an issues paper and undertook targeted stakeholder consultations (**MS20-000762** refers). Over 40 submissions were received.
   a. Gas producers argued a national reservation scheme would discourage investment.
   b. Gas users argued a national reservation scheme would contribute to the goals of the gas-fired recovery. These goals are to boost energy affordability and support jobs as part of Australia's recovery from the COVID-19 recession.
   c. Of the states and territories, only Victoria supported the introduction of a national gas reservation scheme.
3. Based on consultation and desktop research, the department does not recommend the introduction of a prospective national gas reservation scheme. The department considered the views of stakeholders and assessed the benefits of [redacted] policy options (see Attachment B). On balance, the risks of a national gas reservation scheme outweigh likely benefits.
4. The draft letter at Attachment A seeks the Prime Minister's agreement not to introduce a national prospective gas reservation scheme. To coordinate implementation with other Gas-Fired Recovery measures, the letter proposes you work with the Minister for Industry, Energy and Emissions Reduction and the Prime Minister's office on the timing of any announcement.

   a. The Options Paper (see Attachment B) is not suitable for publication. It contains legal advice and analysis which may raise diplomatic sensitivities. The department can produce a version suitable for publication on request.

5. The draft letter also seeks the Prime Minister's agreement to extend the ADGSM and Heads of Agreement to 2030 for the reasons outlined in Attachment B. This precautionary approach aligns with the Australian Energy Market Commission's (AEMC) recommendation to extend the Gas Supply Guarantee.
   a. Like the ADGSM and Heads of Agreement, the Gas Supply Guarantee was established as a safety net to encourage gas producers to make gas available. Since its introduction, additional measures have been introduced to manage potential gas supply shortages. However, the AEMC still recommended a precautionary approach given:
      i. the energy market is in transition; and
      ii. the mechanism is a low-cost option to help manage the risk of any potential shortage.
6. The Prime Minister will likely seek assurances you have relevant Ministers' support prior to agreeing to your policy recommendations. In the interests of expediency, we recommend your office uses the Options Paper (see Attachment B) to consult with relevant ministers' offices instead of an exchange of letters with Ministers.
   a. The draft letter to the Prime Minister (see Attachment A) states your office has consulted relevant Ministers' offices and encloses the Options Paper (see Attachment B).
7. You wrote to the Australian Petroleum Production and Exploration Association (APPEA) and to relevant Ministers from the states, territories and countries with an interest in Australian LNG exports to inform them of the late 2020 consultation.
   a. Subject to the Prime Minister's agreement and the decision's announcement, we recommend you write again to this group to inform them of the decision. We will provide you with draft letters to those stakeholders for your signature at that time.

Data referenced: Nil

Consultation: PM&C, Gas Taskforce.

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Contact Officer:
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MLO Version: 10/11/2021

ATTACHMENTS

A: Draft letter to the Prime Minister
B: Prospective National Gas Reservation Scheme Options Paper

The Hon Keith Pitt MP

Minister for Resources and Water

MS21-001755

The Hon Scott Morrison MP
Prime Minister
Parliament House
CANBERRA ACT 2600

Dear Prime Minister

In October 2020, you asked me to consult on the *Options for a prospective national gas reservation scheme* issues paper and write back to you on next steps (your reference, MC20-159897).

On 27 October 2020, my department released the issues paper. Over 40 submissions were received from a range of stakeholders including gas producers, LNG exporters, large industrial gas users, industry associations and state and territory governments. My department also conducted targeted stakeholder consultations in late 2020.

As set out in the attached options paper, the clear feedback from gas producers was that a prospective reservation scheme would have a chilling effect on gas exploration and development investment. Some gas users argued a prospective reservation scheme would increase domestic supply in the short term, putting downward pressure on gas prices. However, suppressed investment in upstream gas exploration and development would reduce Australian gas production in the medium to long term, putting upward pressure on domestic gas prices and reducing trade revenue.

The experience of other countries and Australian jurisdictions like Queensland and Western Australia shows the impacts of reservation policies are sensitive to the level of reservation. By international comparison, Western Australia and Queensland's levels of reservation are low. As set out in the Productivity Commissions *Resources Sector Regulation*, reservation acts as an effective tax on gas production paid to gas users. At low levels, gas producers are able to absorb costs associated with reservation. But the distortionary impact of these policies imposes costs and creates risks to the economy as a whole.

For this reason, I do not support the introduction of a national prospective gas reservation scheme. To protect the security of Australia's gas supply, I seek your policy authority to extend the Australian Domestic Gas Reservation Mechanism (ADGSM) and Heads of Agreement with east coast LNG exporters to 2030. These are both due to expire on 1 January 2023. Maintaining the ADGSM and Heads of Agreement until 2030 best balances the need to prevent domestic gas shortfalls with the need to attract investment to bring on new gas. I expect the extension of these measures to be sufficient to avoid any future shortfalls.

Subject to your agreement and an announcement of the extensions, I will progress changes to the ADGSM through regular legislative channels and commence negotiations on the Heads of Agreement for your signature. To enhance Australia's reputation as a stable investment destination, I propose the next Heads of Agreement cover a period of seven years, to 2030.

My office has consulted on this recommendation with the offices of:

- Treasurer, the Hon Josh Frydenberg MP;
- Senator the Hon Marise Payne, Minister for Foreign Affairs;
- The Hon Dan Tehan MP, Minister for Trade, Investment and Tourism;
- The Hon Angus Taylor MP, Minister for Industry, Energy and Emissions Reductions; and
- The Hon Karen Andrews MP, Minister for Home Affairs.

Given potential interactions with the implementation of other gas-fired recovery measures, I propose I work with the Minister for Industry, Energy and Emissions Reduction and your office on the timing of:

- the announcement of the decision not to introduce a national prospective gas reservation scheme, and notification of the decision to key domestic and international stakeholders; and
- commencement of negotiations to extend the Heads of Agreement.

I have copied this letter to relevant Ministers (listed below).

Yours sincerely

Keith Pitt / / 2021

Encl. (1)

CC: Treasurer, the Hon Josh Frydenberg MP
Senator the Hon Marise Payne, Minister for Foreign Affairs
The Hon Dan Tehan MP, Minister for Trade, Investment and Tourism
The Hon Angus Taylor MP, Minister for Industry, Energy and Emissions Reductions
The Hon Karen Andrews MP, Minister for Home Affairs

Australian Government

Department of Industry, Science, Energy and Resources

Options for a prospective national gas reservation scheme

Department of Industry, Science, Energy and Resources

October 2021

Table of Contents

ACRONYMS AND ABBREVIATIONS

ABF	Australian Border Force
ACCC	Australian Competition and Consumer Commission
ADGSM	Australian Domestic Gas Security Mechanism
AEMO	Australian Energy Market Operator
ASL	Average Staffing Levels
APGA	Australian Pipelines and Gas Association Ltd
AMSC	Australian Market Supply Condition
APPEA	The Australian Petroleum Production and Exploration Association
BITs	Bilateral Investment Treaties
CO_2	Carbon dioxide
The department	Department of Industry, Science, Energy and Resources
DFAT	Department of Foreign Affairs and Trade
EUAA	Energy Users Association of Australia
FID	Final investment decisions
FTAs	Free Trade Agreements
GSOO	Gas Statement of Opportunities
Interim NGIP	National Gas Infrastructure Plan NGIP: Interim Report
LNG	Liquefied Natural Gas
MYEFO	Mid-Year Economic and Fiscal Outlook
NGIP	National Gas Infrastructure Plan
NSW	New South Wales
NT	Northern Territory
PC	Productivity Commission
PACE	Plan for Accelerating Gas Exploration
PJ	Petajoule
QLD	Queensland
SA	South Australia
TJ	Terajoule
WA	Western Australia
WTO	World Trade Organization

EXECUTIVE SUMMARY

In August 2019, the Commonwealth Government announced it would implement new measures to deliver affordable, reliable gas to domestic consumers.[1] These measures included the consideration of options for a prospective national gas reservation scheme. The Prime Minister, the Hon. Scott Morrison MP's subsequent announcement of the Gas-fired Recovery on 15 September 2020 reaffirmed the Commonwealth's intention to explore options for a prospective national gas reservation scheme.[2]

In October and November 2020, the Department of Industry, Science, Energy and Resources (the department) sought comments on a prospective national gas reservation issues paper.[3] During this time, the department conducted more than 20 targeted stakeholder consultations. Gas producers, LNG exporters, industrial gas users, industry associations, and State and Territory governments made over 40 submissions in response.

These consultations confirmed gas users support gas reservation as a way to push producers towards offering longer-term, lower-cost supply contracts. Gas suppliers and most users recognise the downside of gas reservation: it can distort the domestic market, with negative long term consequences for gas users, producers and exporters. Artificially increasing domestic supply by regulating the proportion of gas production used domestically can put downward pressure on domestic gas prices, stimulating demand. Limiting to whom producers can sell their gas reduces opportunities for producers to seek better prices and returns on investment. This ultimately discourages investment, which in turn reduces supply. Other countries with high-level reservation or fuel subsidy policies show that market regulation can result in negative long-term implications for domestic gas security and cost.

The magnitude of the economic risks created by gas reservation depends on their design and the portion of reserved gas. Higher levels of reservation have a greater distortionary impact, putting greater downward pressure on prices and creating greater risks. This paper presents design options for prospective national gas reservation, but does not recommend a quantitative reservation level for the options considered.[4]

. . .

Collectively, the Gas-Fired Recovery measures aim to:

- get more gas into the market
- boost the gas transport network, and
- better empower gas consumers.

These aims do not align perfectly with what gas users ultimately want: lower prices. But by achieving these aims, the Gas-Fired Recovery measures may lower prices. If gas users remain unsatisfied with the progress of Gas-Fired Recovery measures or with prices, they will likely increase advocacy for further

[1] https://www.minister.industry.gov.au/ministers/taylor/media-releases/government-acts-deliver-affordable-reliable-gas
[2] https://www.pm.gov.au/media/gas-fired-recovery
[3] https://consult.industry.gov.au/onshore-minerals/gas-options/supporting_documents/optionsforaprospectivenationalgasreservationschemeissuespaper.pdf
[4] For example, 10 per cent of gas production to be reserved.

government intervention in the domestic gas market, which may include the introduction of a national gas reservation scheme.

Realising the aims of the Gas-Fired Recovery will take time. First gas is expected from the Strategic Basin Plans and the States under bilateral energy and emissions deals from 2023, with volumes ramping up closer to 2030.

Other countries and Australian jurisdictions have implemented gas reservation policies. The impact of these policies on domestic gas production has varied according to their design and how often they change. Some of these policies appear to have minimal impacts, whereas others have resulted in no new investment in gas production or even domestic industries leaving the country. These policies either:

- require producers to supply gas domestically as it is produced (Western Australia (WA), Queensland (QLD), Peru, Israel), or
- reserve the right to restrict gas exports to address a forecast domestic supply shortfall (the US, Canada, Australia's Australian Domestic Gas Security Mechanism (ADGSM)).

This paper presents [redacted] design options, a summary of which is on the next page. Two options maintain the status quo (Options 1 and 2), [redacted]

The department recommends Option 2: extending the ADGSM and Heads of Agreement to 2030. Maintaining the ADGSM and Heads of Agreement until 2030 best balances the need to prevent domestic gas shortfalls with the need to attract investment to bring on new gas.

[5] www.pm.gov.au/media/gas-fired-recovery

SUMMARY OF OPTIONS

			RECOMMENDED	
		STATUS QUO		
		Option 1: Allow ADGSM and Heads of Agreement to expire in 2023	Option 2: Extend the ADGSM and Heads of Agreement to 2030	
	See	p23	p26	
IMPACTS ON BUSINESS	Will it increase domestic gas supply or prevent a shortfall until 2030?	No. No mechanism in place to avoid a domestic shortfall after 1 January 2023. Gas-Fired Recovery measures may not be producing extra supply optimally by 2023.	Yes. The ADGSM would continue to act as a last resort to prevent a domestic shortfall. LNG exporters would continue to be incentivised to supply domestically.	[redacted] s33
	Impact on Australia's attractiveness and competitiveness as a global investment destination?	Positive. Maintains Australia's reputation as a stable destination for international investment.	Minimal. Unlikely to deter investment.	
	Likely to be supported by gas producers?	Yes. Gas producers would support deregulation.	No. ADGSM is unpopular with gas producers, but they may accept it as a 'least worst' option.	
	Likely to be supported by gas users?	No. Gas users support the ADGSM and Heads of Agreement.	Yes. Gas users support the ADGSM and Heads of Agreement.	
	Does it decrease the cost of doing business? (regulatory burden assessment)	Yes. Deregulatory from 2023.	No, although additional costs would be minimal.	
IMPACTS ON GOVERNMENT	Is it compatible with other Gas-Fired Recovery measures?	Yes. Other Gas-Fired Recovery measures have been designed in this context.	Yes. Other Gas-Fired Recovery measures have been designed in this context.	
	Implementation cost and complexity	None. No implementation required, zero cost.	Minimal. Implementation relatively straightforward. Costs can be absorbed.	
	s42 & s33 [redacted] international trade law?	s42 & s33 [redacted]	s42 & s33 [redacted]	s42 & s33

Background

The supply-demand balance in south-east Australia

In August 2019, the Commonwealth announced it would consider options for a prospective national gas reservation scheme to deliver affordable, reliable gas. This announcement responded to forecast supply shortfalls and higher than historical gas prices in the east coast gas market. Shortfalls have not eventuated, but production in south-eastern gas fields has declined since 2017. Infrastructure constraints can limit gas flow from northern gas fields to southern demand centres. On an annualised basis, AEMO projects sufficient supply to cover demand requirements until at least 2029, if committed and anticipated projects go ahead (see Figure 1).

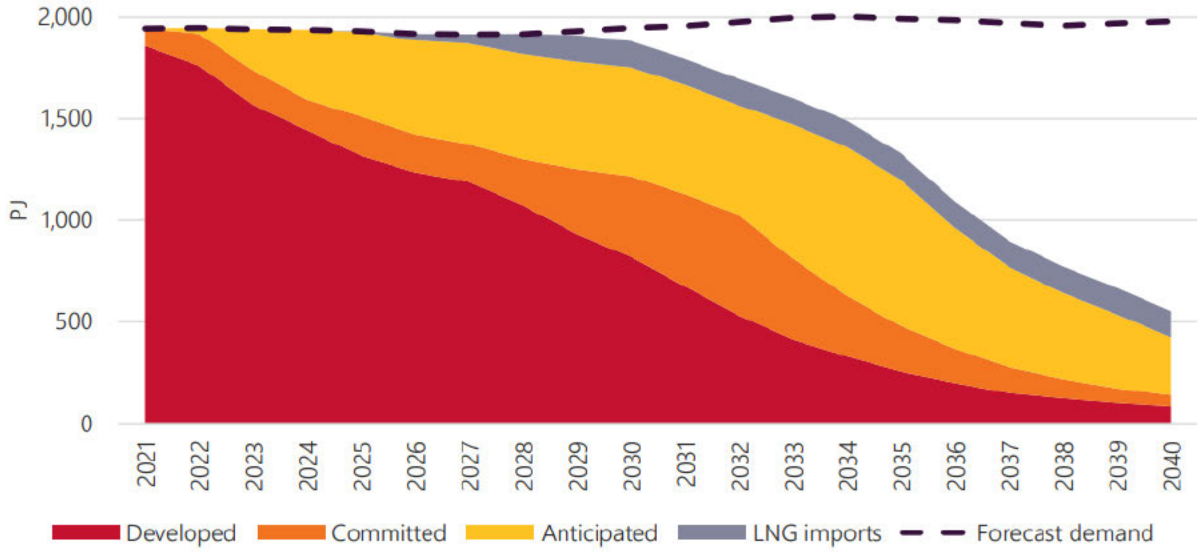

__Figure 1:__ Projected eastern and south-eastern Australia gas production (including export liquid natural gas (LNG)), existing, committed, and anticipated developments 2021-40.[6]

The Australian Competition and Consumer Commission (ACCC) has reported a similar outlook for the eastern gas market. In July 2021, the ACCC predicted east coast gas supply and demand balance will be very tight in 2022. For the southern states, demand is forecast to be 6 PJ greater than production and withdrawals from storage in 2022. This means the southern states will rely on gas transported from QLD to avoid a shortfall next year. Similarly, the National Gas Infrastructure Plan (NGIP): Interim Report (Interim NGIP), released on 7 May 2021, found supplies of gas in the south would fall short of residential, commercial and industrial demand by 2024 if targeted action is not taken.

Market forces tend to, and are intended to, resolve forecast shortfalls. As an energy user group commented recently, AEMO and ACCC forecasts are meant to inspire action, not predict the future.[7] Nonetheless, the tight supply-demand balance projected this decade makes gas users in Australia's south-east vulnerable to shocks and compounding events like those that led to the spot market price spike in early July 2021 (see Figure 2). Gas-Fired Recovery measures are intended to address this vulnerability, among other policy goals.

[6] https://aemo.com.au/en/energy-systems/gas/gas-forecasting-and-planning/gas-statement-of-opportunities-gsoo
[7] See Attachment C in MC12-001360.

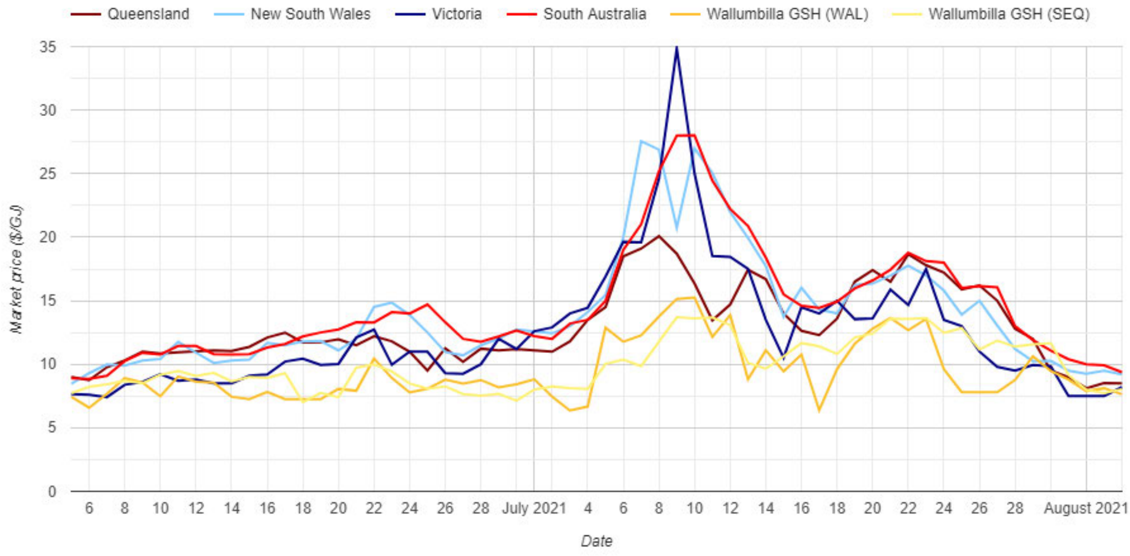

***Figure 2**: A confluence of unforeseen industrial incidents, pipeline capacity constraints and high gas demand caused by cold, calm and cloudy weather caused a price spike in spot markets in July 2021. Price spikes can indicate heightened supply interruption risk and are more likely when the supply-demand balance is tight.*

Gas-Fired Recovery implementation

A well-designed prospective national gas reservation scheme accounts for interactions with Gas-Fired Recovery measures, as well as the domestic gas supply outlook. A year after the Gas-Fired Recovery's announcement, Gas-Fired Recovery measures are at various stages of implementation. Those most relevant to gas supply, and thus gas reservation, are listed below.

- In January 2021, east coast LNG exporters signed on to the new Heads of Agreement. The new Heads of Agreement commits them to offer uncontracted gas to the domestic market on competitive terms before the export market.[8]
- New South Wales (NSW) and South Australia (SA) committed to new gas supply targets in bilateral energy and emissions reduction agreements (see details below).
    - The NSW Government agreed to inject an additional 70 PJ of gas per year into the NSW market by 2022. [9]
    - The SA Government agreed to supply an extra 50 PJ of gas per year into the east coast market by 2023 and 80 PJ of gas per year by 2030.[10]
    - Negotiations are ongoing with the NT, WA, Victorian and QLD Governments.
- Two Strategic Basin Plans have been released. First gas is expected from the agreements as early as 2023, with volumes ramping up closer to 2030.
    - The Beetaloo Strategic Basin Plan was released in January 2021.
    - The North Bowen Galilee Strategic Basin Plan was released in September 2021.

[8] https://www.industry.gov.au/regulations-and-standards/securing-australian-domestic-gas-supply
[9]https://www.energy.gov.au/government-priorities/Energy-and-emissions-reduction
[10] https://www.energy.gov.au/government-priorities/Energy-and-emissions-reduction

  - The Cooper-Adavale Basin Plan is scheduled for Cabinet consideration in Mid-Year Economic and Fiscal Outlook (MYEFO) 2021-22.

- Gas producers and users are negotiating a voluntary industry-led code of conduct. Gas users may seek to include gas pricing clauses in the code of conduct.
- The Interim NGIP was released on 7 May 2021. The Interim NGIP focuses on short term supply issues in the east coast gas market. The 2021 NGIP will take a longer term view of infrastructure development (out to 2041).

Once implemented, Gas-Fired Recovery measures will take time to achieve their objectives, including bringing on more gas supply. The impacts of Gas-Fired Recovery measures should be evident by 2030, coinciding with AEMO's current shortfall forecast (see Figure 1).

There are risks Gas-Fired Recovery measures will not achieve their objectives. For example, delays to developing Narrabri gas and LNG import terminals may mean NSW does not deliver on its gas supply target. The approval of the Narrabri gas project has been challenged in the NSW Land and Environment Court. The timing of final investment decisions (FID) on the two LNG import terminals identified as priority projects remain uncertain. Squadron Energy is aiming for the Port Kembla LNG import terminal to be operational by 2023.[11] The NSW Government has given the gas-fired power station associated with the import terminal status as Critical State Significant Infrastructure in an attempt to accelerate a decision on the project.[12] The Commonwealth has awarded $30m to the station's early works before its FID.[13]

THE AUSTRALIAN DOMESTIC GAS SECURITY MECHANISM (ADGSM)

Australia has had an LNG export control mechanism, the ADGSM, since 2017. The ADGSM is arguably a form of emergency gas reservation policy. The Minister for Resources can trigger the ADGSM by determining a shortfall market exists. In doing so, the Minister must consider all relevant and available information, exercising judgement as to its credibility and integrity. This information includes advice from AEMO, the ACCC, industry and other government sources. If the Minister triggers the ADGSM, LNG exporters determined to be in net-deficit to the market in shortfall can be required to supply gas domestically.

In 2019, a review found the ADGSM has been working effectively to safeguard domestic gas supplies and recommended retaining it until its scheduled repeal on 1 January 2023.[14] The fact that the ADGSM has never been triggered is testament to its effectiveness at securing domestic gas supply. It continues to be a measure of last resort for the Commonwealth to intervene in domestic gas markets to prevent an imminent shortfall. The ADGSM incentivises LNG exporters to:

- monitor the domestic supply-demand balance; and
- sell gas to domestic users when the supply-demand balance is tight.

[11] https://www.energynewsbulletin.net/development/news/1416628/port-kembla-power-station-declared-critical
[12] https://www.planning.nsw.gov.au/News/2021/Proposed-Port-Kembla-power-station-declared-critical
[13] https://www.minister.industry.gov.au/ministers/taylor/media-releases/advancing-gas-fired-recovery-and-affordable-reliable-power
[14] https://www.industry.gov.au/data-and-publications/australian-domestic-gas-security-mechanism-review-2019

Some are more critical of the ADGSM. Professor Andrew Garnett from the University of Queensland's Centre for Natural Gas has argued the ADGSM is inconsistent with the policy aim of maximising supply and minimising prices.[15]

The Department of Foreign Affairs and Trade (DFAT) has provided legal advice that [redacted] s42 & s33

Heads of Agreement with East Coast LNG exporters

The Commonwealth signed Heads of Agreement with the East Coast LNG exporters in 2017, 2018 and 2020. The East Coast LNG exporters signed the current agreement in 2020, committing them to the following.

1. Uncontracted gas (spot cargoes) will not be offered to the international market unless equivalent volumes of gas have first been offered with reasonable notice on competitive market terms to the Australian domestic gas market.

2. The signatories note that LNG netback prices based on Asian LNG spot prices play a role in influencing domestic gas prices in the East Coast gas market (as referenced by the ACCC LNG netback price series). Individual prices offered to domestic gas users will be internationally competitive and have regard to the producer's cost of supply and factors that may be relevant to users' individual circumstances, including the terms and conditions of their gas supply agreement and any applicable transportation or retailer charges.

    a. Spot prices offered to the domestic market will have regard to the spot price LNG exporters could reasonably expect to receive for uncontracted gas in overseas markets.

    b. Term prices offered to the domestic market will have regard to forward term prices LNG exporters could reasonably expect to receive for uncontracted gas in overseas markets.

3. The LNG exporters, as part of the East Coast gas industry, will continue to engage with AEMO on the gas supply balance and provide information to aid in forecasting supply needs for gas powered generation. This will include supporting efforts to make gas available to meet peak demand periods in the National Electricity Market through the Gas Supply Guarantee recognising that this may include industrial, commercial and residential demand.

[15] https://www.pc.gov.au/__data/assets/pdf_file/0006/247191/sub024-resources.pdf

4. The LNG exporters' compliance with these commitments will be conveyed to the Australian Government through regular reporting to the ACCC on sales, offers to sell and bids declined, the terms and conditions attached to these transactions and the notice given to the domestic gas market in respect of any offers made. It will also include the price expectations and assumptions for international spot and term markets for the relevant supply period.

In July 2021, the ACCC noted the new Heads of Agreement may prove vital in avoiding potential shortfalls in 2022.[16] The report found that although the ACCC has yet to receive sufficient information to determine compliance with the previous Heads of Agreement, users have reported suppliers are now more flexible and willing to negotiate on non-price terms and conditions, like volume splitting and delivery scheduling. The Heads of Agreement is thus an important market-based and industry-led solution to safeguard against any potential domestic gas supply shortages.

DFAT has provided legal advice that [redacted] s42 & s33

The Global Resources Strategy

On 7 May 2021, the Commonwealth announced $20.1 million over two years to deliver a Global Resources Strategy which:

- identifies new markets for our resources commodities, and
- facilitates opportunities for expanding trade with these markets.

A new national gas reservation policy could undermine the Global Resources Strategy's activities. Subject to design, reservation could reduce returns on gas investments. This conflicts with the following goals of the Global Resources Strategy:

- the resources sector to be the most commercially viable investment destination, and
- Australia to meet the global demand for energy resources and technology minerals.

The Global Resources Strategy intends to leverage Australia's existing FTAs and other trading arrangements to achieve its goals. [redacted] s42 & s33

The Productivity Commission's Review of Resources Sector Regulation

In 2020, the Productivity Commission (PC) examined how resources regulation is designed, administered and enforced in Australia. The PC identified the ADGSM, QLD's Australian Market Supply Condition (AMSC) and WA's domestic gas policy as Australian examples of gas reservation. The PC argued gas

[16] https://www.accc.gov.au/publications/serial-publications/gas-inquiry-2017-2025/gas-inquiry-july-2021-interim-report

reservation acts as a tax on gas production, paid as a subsidy to domestic gas users. The lower gas prices achieved by such a subsidy appear to benefit domestic gas consumers. But gas reservation lowers returns on gas exploration and development, suppressing investment. In the medium to long term, this limits gas supply, which hurts consumers. The PC concluded domestic gas reservation policies that remove the link between domestic and export gas prices lead to higher gas prices in the long run and impose net costs on the community.

Some of the international case studies in this paper illustrate the PC's argument in practice. [redacted] s33

GAS RESERVATION IN AUSTRALIA

Australia arguably has a national emergency gas reservation policy in the ADGSM. Australia's major gas producing and LNG exporting states, WA and QLD, have domestic reservation policies. The NT is the only Australian jurisdiction with an LNG export terminal but no domestic gas reservation policy. Market dynamics, influenced by geography, mean gas produced in NSW, SA and Victoria is unlikely to be exported. Nonetheless, NSW and Victoria have domestic prioritisation policies. SA claims to oppose gas reservation, but conditions gas grants to projects for SA supply. Tasmania does not produce gas.[17] The Australian Capital Territory has no known gas reserves.

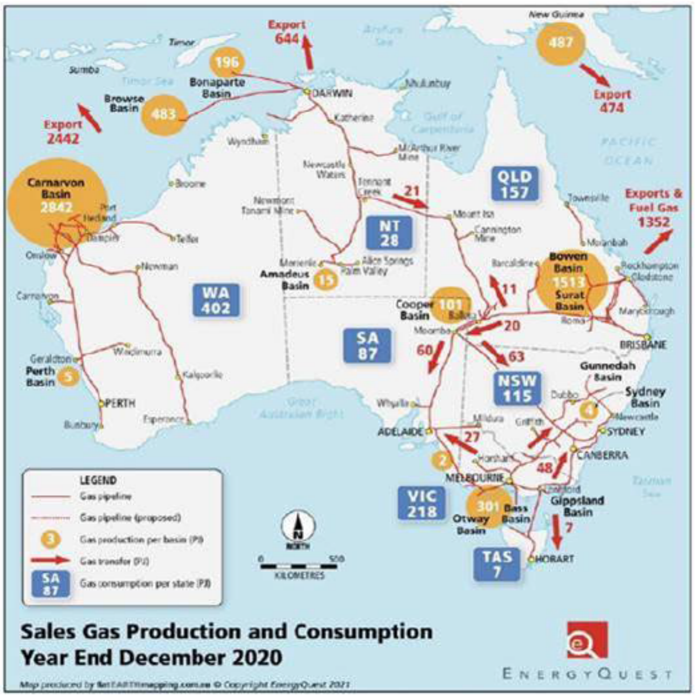

Figure 3: WA and QLD are Australia's gas production giants. Both have domestic reservation policies.

Western Australia

The WA Government has had some form of domestic gas reservation since 1979. Formalised in 2006, WA's Domestic Gas Policy requires LNG projects to make the equivalent of 15 per cent of LNG exports

[17] Tasmania has no onshore gas production. There is some production in Commonwealth waters offshore of Tasmania. This gas comes onshore in Victoria and is regulated by the Commonwealth.

available to WA consumers as a condition of project approval.[18] This policy has contributed to surplus domestic gas supply forecasts in WA, with prices on par with US Henry Hub prices (see Figure 4).[19]

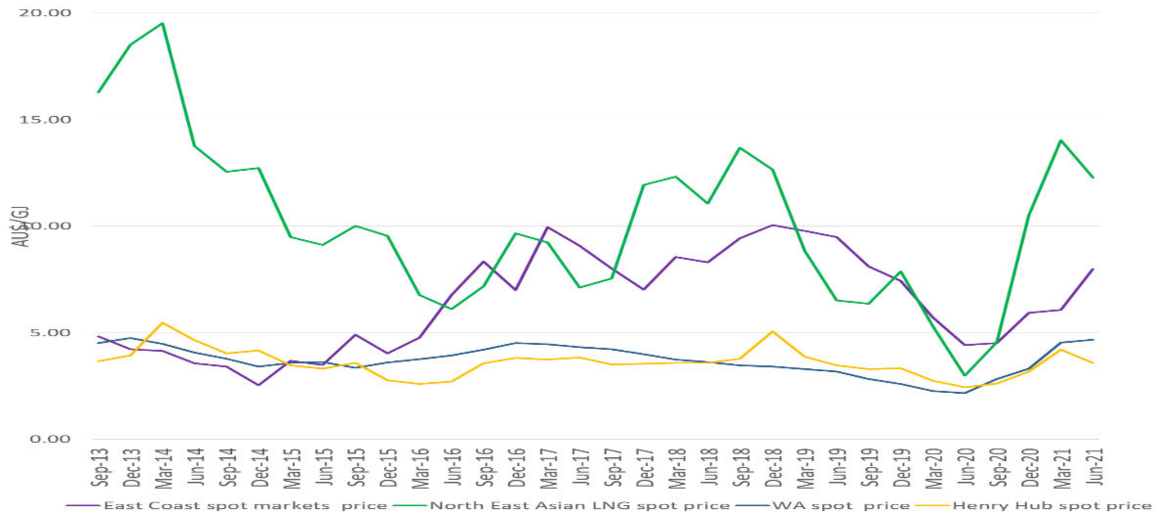

***Figure 4**: Domestic WA, east coast and international gas average quarterly spot prices, 2013-2020*[20]

The domestic gas reservation policy is given effect through long-term contractual agreements between developers of LNG export projects and the WA Government.[21] In the agreements, the WA Government commits to providing a range of supporting infrastructure and services in return for domestic gas supply. These services include approving ports, building bridges and roads and social services such as schools and hospitals to support the communities servicing LNG projects.[22]

WA's Domestic Gas Policy now applies to onshore gas projects. In 2020, the WA Government announced it will not agree to the export (including to eastern states) of gas via the existing WA pipeline network other than in exceptional circumstances.[23] This means 100 per cent of gas produced onshore in WA is reserved for WA users. However, the Waitsia Joint Venture gas project was given an in-principle exemption to the domestic reservation policy.[24] The exemption allows Waitsia to export gas, but requires it to supply 15 per cent of gas production to WA users.[25] A second exemption has been granted to Black Mountain Resources. Negotiations are underway determining export limits for the Valhalla project.

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[18] https://www.wa.gov.au/government/publications/wa-domestic-gas-policy

[19] AEMO's base scenario forecasts WA's potential domestic gas supply to exceed demand until 2028. https://aemo.com.au/en/energy-systems/gas/gas-forecasting-and-planning/wa-gas-statement-of-opportunities-wa-gsoo

[20] The east coast spot market price is the unweighted average of the Brisbane STTM, Sydney STTM, Victorian DWGM, Adelaide STTM, and Wallumbilla Hub markets. Energy Edge, Gas Market Analysis Tool. www.energyedge.com.au/Products/GasMarketAnalysisTool.aspx. Gas Trading Australia Pty Ltd Spot Market data, http://www.gastrading.com.au/spot-market/historical-prices-and-volume; Bloomberg (2020); Argus (2020).

[21] https://www.wa.gov.au/government/publications/wa-domestic-gas-policy

[22] https://www.legislation.wa.gov.au/legislation/prod/filestore.nsf/FileURL/mrdoc_1507.pdf/$FILE/North%20West%20Gas%20Development%20(Woodside)%20Agreement%20Act%201979%20-%20%5B01-a0-08%5D.pdf?OpenElement

[23] https://www.wa.gov.au/government/publications/wa-domestic-gas-policy

[24] https://www.mediastatements.wa.gov.au/Pages/McGowan/2020/08/Revised-policy-to-secure-domestic-gas-supply-and-create-jobs.aspx

[25] https://www.wa.gov.au/sites/default/files/2021-01/Domestic-Gas-Commitment-for-the-Waitsia-Gas-Project_0.pdf

While economic theory supports the negative impacts of gas domestic reservation on investment and supply, WA's experience shows supply expansion is possible with domestic reservation policies. Supply growth or contraction depends on the fundamental economics underpinning possible projects (production costs and returns). The economics are sensitive to international demand and prices. WA's policy has come to be accepted by the state's LNG exporters because their projects' financial margins have allowed them to absorb the costs associated with the policy to date.

Although beneficial to WA's gas users, the broader economic impact of WA's policy is negative. A 2019 peer-reviewed study found the policy has no net economic benefits.[26] WA's gas-fired electricity, aluminium and chemicals industries are sensitive to price, and benefit from cheaper gas. But the WA and Australian economies lose overall. Annually, the study estimated the overall net loss to the economy at $600 million and to Australian households at $300 million.

> *“ …an expansion in domestic gas using industries does not necessarily imply an increase in overall employment or capital income for Australians in the long run. The labour and capital diverted to* [domestic] *gas-using industries could otherwise have been employed in industries where no subsidy is necessary; that is, in industries where those primary factors have a higher value.*
>
> *Neill et al.*

Queensland

In 2017, the QLD Government introduced the AMSC on certain new tenements, requiring any gas developed to be sold and used only in Australia.[27] The AMSC is prospective. Gas developers choose to participate, avoiding any perceptions of sovereign risk. The QLD Government decides on which tenements to apply the AMSC based on the gas supply outlook.

In 2019, a QLD Government commissioned review of the AMSC found it is generally accepted by the gas industry and has not hindered investment while domestic gas prices have been similar to LNG netback prices.[28]

> *…it is strongly recommended that a scheme such as that employed in Queensland is enacted. That is, a scheme which is genuinely prospective and known before title ownership, does not change any rights relating to title, and therefore does not act to discourage investment. ”*
>
> *Senex Energy[29] (CONFIDENTIAL)*

[26] Neill *et al.* (2019), *Western Australia's Domestic Gas Reservation Policy: Modelling the Economic Impact with a Computable General Equilibrium Approach,* Economic Record, Vol. 95, No. 308, March, 2019, pp90–113.
[27] https://www.dnrme.qld.gov.au/mining-resources/initiatives/review-of-domestic-gas-pilot-program
[28] https://www.resources.qld.gov.au/__data/assets/pdf_file/0004/1486309/review-australian-market-supply-condition.pdf
[29] Senex Energy has four blocks subject to the AMSC, including the Atlas project. These blocks could supply up to nine per cent of QLD's gas demand and currently supply gas to regional energy generators and domestic manufacturers.

Industry support for the AMSC was evident in submissions to the issues paper, the PC's 2020 Resources Regulation Study Report and in the department's ongoing contact with gas users and producers (see for example MS21-001360).

> *"The alternative concept* [to the ADGSM] *in Queensland of tenement release for domestic supply only, has the big advantage of being clear 'up front', which improves the investment environment from the perspective of predictability, though, if it impacts price significantly, it is not likely to improve the economic attractiveness.*
>
> *Centre for Natural Gas, University of Queensland*[30]

A key difference between the AMSC and WA's Domestic Gas Policy, in addition to the tenement-specific application, is to whom the reserved gas is available. WA's policy reserves gas for WA users, except where the project is exempt; QLD reserves gas for Australian users, particularly manufacturers.

Northern Territory

The NT is the only Australian LNG-exporting jurisdiction that does not have some form of domestic gas reservation. The NT market is not in shortfall, gas supply in the NT outstrips gas demand. There is no indication the Territory is considering domestic gas reservation.

The NT aspires to be a world-class gas production, manufacturing and services hub,[31] but is at the nascent stages of establishing an oil and gas regulatory framework. Through implementation of the Beetaloo Strategic Basin Plan and negotiations on a bilateral energy and emission reduction agreement, the Commonwealth is encouraging the Territory to ensure the Territory's policy settings enable timely exploration and development of gas resources.

Victoria

Victoria does not have a domestic gas reservation policy. Similar to the Heads of Agreement though, section 152A of Victoria's *Offshore Petroleum and Greenhouse Gas Storage Act 2010* requires new gas to be offered on reasonable terms to Australian users first. Victoria refers to this as Domestic Gas Prioritisation. The Victorian Gas Program's Progress Report, No. 5 December 2020, argues Domestic Gas Prioritisation is sufficient to ensure Victoria's energy security by commercial means because the closest LNG export terminal is in Gladstone.[32]

> *"…the most likely customers for Victorian gas are those closer to the supply source, because the only avenue for gas export in the east-coast gas market is through Gladstone in Queensland. This was a function of market dynamics.*[33]

Further, the Report also argues the Australian Constitution prevents Victoria from implementing a state-based domestic gas reservations scheme.

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[30] Submission 24 to the Productivity Commission's *Resources Sector Regulation Study Report* (2020), available: https://www.pc.gov.au/__data/assets/pdf_file/0006/247191/sub024-resources.pdf
[31] https://cmc.nt.gov.au/advancing-industry/northern-territory-gas-strategy
[32] https://earthresources.vic.gov.au/__data/assets/pdf_file/0020/613091/VGP_PR05-161926-Low-res.pdf
[33] Ibid.

> *… implementing a true gas reservation strategy, similar to that in Western Australia, would be extremely challenging for Victoria. This is because Victoria is part of an interconnected east coast gas market and the Australian Constitution prevents any impediment to trade between the states and territories.*[34] ”

Victoria lifted bans on onshore conventional gas exploration and development in July 2021 and is currently consulting on regulations to re-open the onshore conventional gas industry.[35]

New South Wales

NSW does not have a domestic gas reservation policy, but does have a soft version of domestic gas prioritisation. Action 15 of NSW's Gas Plan is "Gas companies will be asked to demonstrate how projects that develop NSW gas reserves will benefit NSW gas consumers".[36] Only projects verified through this process are eligible to receive 'Strategic Energy Project' status, which fast-tracks approvals.[37]

Prioritisation aside, it is likely new NSW gas will go to domestic users. On 21 July 2021, the NSW Government released a statement outlining its plan for the state's gas industry.[38] The statement effectively limits future gas exploration and development in NSW to a single project – Santos' Narrabri Gas Project. Santos has committed to supplying 100 per cent of Narrabri gas to the domestic market.[39]

South Australia

SA does not have or support a gas reservation policy. The Hon Dan van Holst Pellekaan MP, SA Minister for Energy and Mining wrote to the Commonwealth stating:

> “ *…to date a gas reservation policy has not been supported by the SA Government. It continues to be the state government's view that greater supply will lead to better pricing and availability of gas for energy retailers and large gas users.*[40]

The SA Government encourages the development of petroleum resources by having a supportive regulatory regime and favourable royalty regime.

SA's programs do not perfectly align with the views set out in Mr van Holt Pellekaan's letter. The Plan for Accelerating Exploration Gas (PACE) grant program required SA gas users to have the first right to agree commercial terms to contract gas from supported projects.[41] PACE increased SA gas production and prioritised it to SA users.

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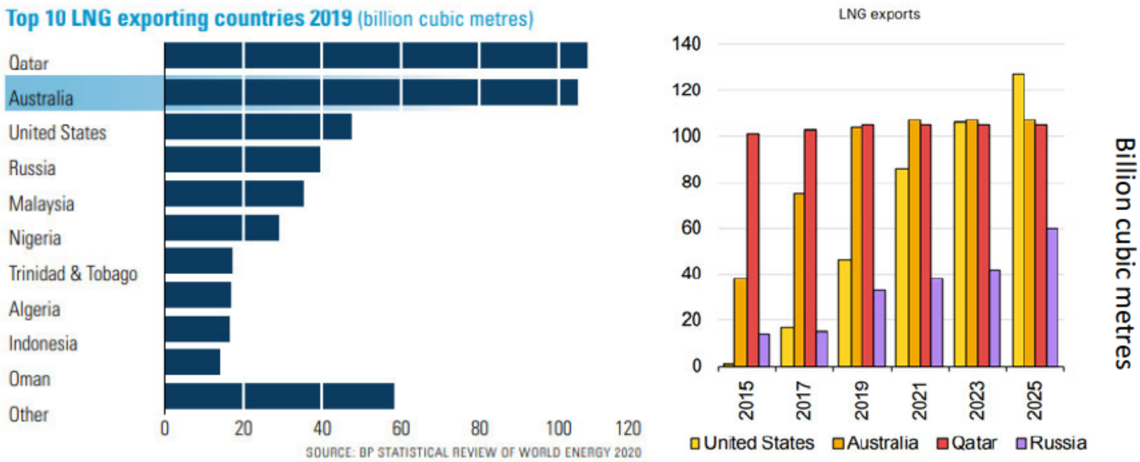
[34] Ibid.
[35] https://engage.vic.gov.au/regulatory-impact-statement-draft-petroleum-regulations.
[36] https://resourcesandgeoscience.nsw.gov.au/__data/assets/pdf_file/0005/534830/NSW-Gas-Plan.pdf
[37]https://resourcesandgeoscience.nsw.gov.au/__data/assets/pdf_file/0006/534831/NSW-Gas-Plan-Common-Questions-and-Answers.pdf
[38] https://www.nsw.gov.au/regional-nsw/future-of-gas-statement
[39] https://www.santos.com/news/nsw-government-future-of-gas-statement/
[40] Letter from Minister Pellekaan, 20 November 2020 (MC20-063265 refers).
[41] https://www.petroleum.sa.gov.au/industry-activity/pace-gas-grants

GAS RESERVATION IN OTHER COUNTRIES: LESSONS FROM ABROAD

Internationally, major LNG exporting countries have export restriction policies or are centrally managed economies. Australia's ADGM is a type of export restriction policy. Policies requiring a portion of production to be sold to domestic users, like WA or QLD's policies, are uncommon among top tier gas exporting countries. Where the reserved production portion is high or policy changes frequently, there is evidence of a dampening effect on a country's gas production. This dampening effect includes suppressed investment in gas production and even offshored existing gas industries.

This section presents international case studies of domestic gas policies. The first case studies are of the other major LNG exporters, Qatar and the US. Malaysia and Indonesia are then included as the largest LNG exporters in our region with two different approaches: price control in Malaysia and production-linked reservation in Indonesia. Finally, we present case studies on Peru and Israel, [redacted] s33



SOURCE: IEA GAS 2020

Figures 5 and 6: *The US, Australia and Qatar dominate global LNG trade. In our region, Malaysia and Indonesia are the other major LNG exporters.*

Some gas users use the presence of international domestic gas reservation schemes to support government intervention in Australia's gas market.

> *"Virtually all major LNG producing nations have some form of domestic gas policy or export control aimed at ensuring local industry and consumers are not disadvantaged by gas exports. Although schemes introduced by governments across the world vary, the common goal is to ensure the national advantage of affordable gas is not given away through linking to a global LNG price.*
>
> *Energy Users Association of Australia (EUAA)*

The Australian Petroleum Production and Exploration Association (APPEA) went further in its submission, analysing the impacts of domestic gas market interventions in other countries, rather than their mere presence or absence. According to an international study APPEA commissioned, domestic gas market interventions like price-setting or reservation tend to suppress investment in exploration and production.[42] Investment suppression leads to reduced supply and higher prices, with Thailand,

[42] https://www.appea.com.au/wp-content/uploads/2020/11/EnergyQuest-APPEA-Report_2020.pdf

Malaysia, Argentina, Mexico, India and China cited as examples of countries where this scenario has eventuated. The study examined the gas market policies of 20 major gas-producing countries, accounting for more than 70 per cent of the world's gas production.

United States

The US requires export approvals for gas to countries with which it does not have an FTA.[43] In approving a proposed gas export, the US considers the domestic need for the gas and whether the export promotes competition by allowing commercial parties to freely negotiate their own trade.[44]

Large volumes of gas exports are approved. As of August 2020, the US had issued 43 long-term non-FTA authorisations to export domestically produced gas. These authorisations originally had a 20 year term, but last year were extended to 31 December 2050, and a total volume of nearly 20,000 PJ per year.[45] In its submission, APPEA claimed the US has never denied a gas export application.

> "*Of the five developed OECD countries reviewed, none have made material use of government interventions in their gas markets. The US and Canadian export controls have not been used in practice to restrict gas exports.*
>
> *APPEA*

The US' high approval rate may be a function of statutory design. Section 3(a) of the US *Natural Gas Act 1938* established a rebuttable presumption so that gas exports are approved as a default unless it can be proven there is a domestic requirement for the gas.

Qatar

Qatar's gas demand is met by local production without formal gas reservation policies.[46] However, all gas assets, including those associated with LNG export, are state-controlled. As recognised by the EUAA, this sidesteps the need for formal policy or regulatory frameworks to ensure domestic supply.

> *Our biggest LNG rival Qatar, does not have formal gas reservation policies. However, all gas assets, including those associated with LNG export are state controlled, therefore allowing the government to manage domestic and export priorities.*"
>
> *EUAA*

In 2013, Qatar consumed 1,163 billion cubic feet of natural gas, or 20 per cent of production.[47] This ratio is expected to decrease as Qatar's gas production and exports increase over coming years.[48]

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[43] The US has FTAs with 20 countries. Only 2 of these are among its top 5 LNG export destinations (since 2014 by volume). https://ustr.gov/trade-agreements/free-trade-agreements
[44] https://www.govinfo.gov/content/pkg/FR-2019-03-26/html/2019-05732.htm
[45] The authorised volume is 16.7 Tcf, and includes existing authorizations involving US natural gas produced in the lower 48 states and liquefied in Canada and Mexico for export to non-FTA countries. https://www.federalregister.gov/documents/2020/08/25/2020-16836/extending-natural-gas-export-authorizations-to-non-free-trade-agreement-countries-through-the-year#footnote-15-p52239
[46] https://www.iea.org/countries/qatar
[47] https://www.eia.gov/international/content/analysis/countries_long/Qatar/qatar.pdf
[48] Ibid.

Malaysia

Like Australia, Malaysia has two unconnected gas consuming and producing regions, Borneo and Peninsular Malaysia. Also like Australia, Malaysia is a major LNG Exporter (see Figure 5). Peninsular Malaysia imports offshore gas and LNG, then exports it to Singapore. Borneo gas is exported under long term LNG supply agreements.[49]

Instead of having a domestic gas reservation policy, Malaysia regulated domestic gas prices. Price controls created large domestic demand in Peninsular Malaysia, supporting industrial growth and energy generation as the country developed.[50] [redacted] s33

[redacted] s33

Indonesia

Indonesia reserves gas for domestic use as part of project approvals, applying reservations of up to 40 per cent of production in recent years. Since the mid-2000s, the Indonesian Government has attempted to limit gas exports to ensure domestic supplies and has encouraged fuel-switching to gas. [redacted] s33

Peru

According to APPEA, Peru is the only LNG exporter with domestic gas reservation.[54] [redacted] s33

The Peruvian Government developed the Camisea gas field for domestic use in the 1990s. In 2010, Peru allowed the export of gas reserves by a privately developed LNG project. In response to public pressure, the Peruvian Government introduced a domestic gas reservation policy that capped exports at 40 per cent of reserves.

The policy was initially very successful. Peru's gas production and exports grew rapidly from 2010, resulting in the export of an estimated one third of Peru's gas reserves.[56] APPEA argues the quickly used

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[49] https://www.oxfordenergy.org/wpcms/wp-content/uploads/2020/08/The-dilemma-of-gas-importing-and-exporting-countries-NG-161.pdf

[50] Ibid.

[redacted] s33

[54] https://www.appea.com.au/all_news/gas-market-interventions-can-risk-investment-and-supply/

[redacted] s33

[56]. https://cri-world.com/publications/qed_dp_227.pdf

reserves have caused exploration investment to collapse, with known reserves not being replaced. This situation is unsustainable, setting the broader Peruvian gas industry up for collapse.

[redacted]

Israel

Israel is not a major gas exporter, in part because of its severe domestic gas reservation policies. Frequent policy changes have also resulted in a reputation for high sovereign risk. The characteristics of Israeli gas policy have reduced investment and delayed, or perhaps prevented, new gas production.

Between 2011 and 2013, two events threatened Israeli gas supply.[57] First, in 2011 continued attacks on Egyptian pipelines suspended gas supply via Israel's main gas supply route. Second, the only developed Israeli gas field was depleted at the beginning of 2012. As a result, the Israeli Government sought to accelerate new domestic supply [redacted]

Throughout this period, Israel reserved the majority of gas for domestic use. At various stages, the reservations included:

- any discovered gas fields must be connected to the domestic market
- no more than 50 per cent of gas reserves can be exported
- only gas in excess of expected domestic consumption for the next 25 years can be exported
- a minimal quantity of natural gas must be supplied to the domestic market from each field, according to the field's size
- small fields (up to 50 billion cubic metres (bcm)) will not be required to connect to the shore, and
- medium to large fields (between 50 and 200 bcm), from which commercial production will start before 2028, will not be required to connect to the shore prior to the end of 2032.[58]

[redacted]

[57] https://www.swp-berlin.org/10.18449/2019C43/#:~:text=After%20disputes%20between%20the%20IEC%20and%20the%20government,of%20natural%20gas%20to%20Egypt%20for%2010%20years.
[58] https://www.energy-sea.gov.il/English-Site/Pages/Gas%20Markets/Israels-Export-Options.aspx

[redacted] s33

[redacted] s33

Conclusion

The supply-demand balance in the south-east gas market is tight. The ADGSM and Heads of Agreement have been effective in preventing shortfall, but tight markets are vulnerable to shocks and compounding events. Prices are the first response to a shock or compound event, followed by supply interruptions.

Nonetheless, the Commonwealth should be circumspect in intervening to prevent shortfalls forecast more than two years in the future. Forecasts like AEMO's Gas Statement of Opportunities (GSOO) are intended to highlight investment opportunities, not predict the future. The Gas-Fired Recovery is a comprehensive set of gas market reforms, but its impacts will take some years to boost supply by a meaningful amount.

Gas reservation acts as a tax on gas production, paid as a subsidy to domestic gas users. The lower gas prices achieved by such a subsidy initially benefit domestic gas consumers. But gas reservation lowers returns on gas exploration and development, suppressing investment. In the medium to long term, this suppresses supply and increases prices.

Australia's major competitors also have emergency export controls instead of production-linked gas reservation. But the level of reservation is at least as important as the policy design. WA and QLD's policies show gas reservation can coexist with growing gas industries where the reserved amount is low. Stable policy, sectoral subsidies (like publicly-funded infrastructure) and voluntary participation can mitigate negative investment impacts.

[59] Ibid.
[60] https://www.timesofisrael.com/israel-reportedly-set-to-ease-export-quotas-of-natural-gas/

OPTION 1: NO NEW POLICY ACTION

Option 1 involves no new policy action. The existing Gas-Fired Recovery measures would continue to be implemented. The ADGSM and Heads of Agreement with east coast LNG exporters would expire as scheduled on 1 January 2023.

✓ PROS

- Consistent with the deregulation agenda, reducing the cost of doing business
- Maintains Australia's reputation as a stable destination for international investment
- Supports the Global Resources Strategy goals
- Supported by gas producers and international trade partners
- Compatible with other Gas-Fired Recovery measures
- No implementation required
- [redacted] s42 & s33

✗ CONS

- No additional supply
- No mechanism in place to avoid a domestic shortfall after 1 January 2023
- Not supported by gas users

DISCUSSION OF PROS

Gas producers, those uniquely positioned to comment given their first-hand experience, argued the best way to increase domestic gas supply was to encourage investment by minimising government intervention and removing unnecessary restrictions on gas exploration and development opportunities.

> "*...[W]e have seen a number of changes, including the current proposal of a national gas reservation scheme, which have caused consternation in the minds of potential investors. This uncertainty has caused some parties to withdraw from the process [of capital raising] or seek amendment of terms to account for their higher perceived risk.*
> *Denison Gas*
>
> *INPEX's view is that the best way to ensure the market is well supplied in the future is to encourage investment, minimise government intervention and remove unnecessary restrictions on gas exploration and development opportunities...*
> *INPEX*"

Option 1 performs very well in terms of encouraging investment and minimising government intervention. It is the most consistent with the Commonwealth's deregulation agenda. Not only does Option 1 not introduce any new regulation, it is deregulatory, with the ADGSM and Heads of Agreement expiring in 2023.

By allowing existing regulation to expire as scheduled, Option 1 also supports Australia's reputation as a stable investment destination. Australia's competitiveness for global gas investment may improve with less regulation, which would promote new gas development. Option 1 thus supports National Resources Statement's goal to "deliver the most globally attractive and competitive investment destination for resources projects" and the Global Resources Strategy's goal of "the Australian resources sector being the most commercially viable investment destination".

Not only do investors like policy stability, they are particularly critical of retrospective regulation like the ADGSM because it changes factors on which investment decisions were made. Allowing the ADGSM to expire will be popular with investors, producers and exporters. Option 1 would allow investment and operating decisions to be based more on market outlook, without the need to monitor for and respond to potential domestic supply shortfalls. Australia's international trade partners would similarly support Option 1, as it would relieve concerns an Australian domestic gas supply shortfall could impact their energy security.

[redacted] s45 ”

Some submissions argued gas reservation should only be considered once the existing suite of Gas-Fired Recovery measures had been evaluated.

> *“The government's recently announced Gas-Fired Recovery Agenda involves additional potential reforms... Several of these reforms could overlap with a domestic gas reservation scheme. As such, ConocoPhillips Australia urges the Federal Government to finalise and assess this suite of measures before embarking on additional regulatory interventions such as a domestic gas reservation scheme.*
> *ConocoPhillips*

Option 1 is compatible with the Gas-Fired Recovery measures. Option 1 relies on the Gas-Fired Recovery measures to get more gas into the market and avoid any shortfalls. AEMO projects sufficient supply to cover demand requirements until at least 2029, if committed and anticipated projects follow predicted timelines. By 2029, additional gas will be flowing into the east coast gas market from Gas-Fired Recovery measures like the gas supply targets in the bilateral energy and emissions reduction agreements and Strategic Basin Plans. This means, if all goes to plan, there should be no domestic shortfalls, rendering the ADGSM and Heads of Agreement redundant.

Because Option 1 involves no action, it requires no implementation, no new funding and no new ASL.

[redacted] s42 & s33

DISCUSSION OF CONS

Option 1 will not increase gas supply to the domestic market or help to avoid a shortfall. Gas supply and demand on the east coast will remain tightly balanced. While AEMO does not forecast a shortfall until 2029, delays to major projects like Narrabri or Port Kembla import terminal could result in shortfalls in the short to medium term. Higher and more volatile prices are more likely in a tight market, e.g. the spot market price spike in early July 2021 (see Figure 2, p8).

Under Option 1, the Commonwealth would not have a standing mechanism to respond to a supply interruption or worsening forecast. But the lack of a standing mechanism doesn't necessarily indicate an inability for the Commonwealth to respond to such a situation. Under Option 1, the Commonwealth could call on producers to increase domestic supply or introduce export control regulations with immediate effect in the event of an imminent supply interruption.

Gas users are unlikely to support an option which does not explicitly ensure increased domestic supply. Option 1 is thus unlikely to be supported by gas users, particularly because current supply security mechanisms – the ADGSM and Heads of Agreement – would expire.

> *We do support the need for a mechanism to provide greater security to domestic gas users, as part of a wider strategy for energy advantage and economic recovery. Whether this is an ADGSM extension, a national interest assessment or a PNGRS, the security measure must be designed and implemented to be functional and worthwhile.*
>
> *Ai Group*

CONCLUSION

Option 1 is low cost, low complexity, and deregulatory, reducing government intervention in gas markets. It signals the Commonwealth's confidence in its Gas-Fired Recovery plan and [redacted] s42 & s33 Large gas users are likely to oppose deregulation of the gas industry given ongoing tight gas supply demand balances, continued exposure to international prices and possible price spikes. A tight supply-demand balance is likely to persist in the east coast gas market under Option 1 until the full effects of the Gas-Fired Recovery measures are realised towards 2030. This leaves gas users vulnerable to shocks and compounding events in the meantime.

Option 2: Extend the ADGSM and the Heads of Agreement to 2030

RECOMMENDED: Option 2 is to extend the ADGSM and Heads of Agreement to 31 December 2030. They are currently due to expire on 1 January 2023.

✓ PROS	✗ CONS
• Secures gas supply until Gas-Fired Recovery measures have an impact on the ground • Unlikely to deter investment • Continues to incentivise LNG exporters to supply domestically, putting downward pressure on prices • Implementation for Government is low cost, low complexity • Compatible with other Gas-Fired Recovery measures • No additional regulatory costs to business • Gas users supportive	• ADGSM is unpopular with gas producers • [redacted] s42 & s33 • East coast LNG exporters may resist a new Heads of Agreement • Continues existing incentives for gas users to not enter contract negotiations in good faith

Discussion of pros

Option 2 is similar to Option 1 in that it does not introduce any new policy or regulation. Option 2's advantage in comparison to Option 1 is it increases the resilience of the east coast market during a vulnerable time.

During the extension proposed in Option 2, the Gas-Fired Recovery measures are expected to take effect. Also around 2030, east coast LNG exporters' long term supply contracts will start to terminate. These events are expected to boost domestic gas supply, mitigating the risk of AEMO's currently forecast domestic gas shortfalls from 2029 eventuating.

Option 1's positive impacts on supply is not resilient to shocks. Forecasting to 2030, a myriad of risks could materialise and lead to shortfalls. For example, the states could fail to agree to, or deliver on, gas supply targets in their bilateral emissions and energy deals. Court proceedings could delay or stop key projects like Narrabri or the LNG import terminals. Some of the Strategic Basin Plans may result in less gas than hoped. [redacted] s33 The current global energy crisis could continue or reappear.

While the likelihood and consequences of each of these risks vary, the risk that none of these events will occur is quite low. For this reason, we recommend Option 2. Option 2 retains two policies which have proved effective in dealing with the possibility of a supply shortfall, providing an insurance policy while the Gas-Fired Recovery is implemented.

> *APGA does not agree that a physical gas supply shortfall is a very likely scenario. Market forces and other mechanisms (e.g. the Heads of Agreement and ADGSM) will continue to ensure that Australia doesn't experience a physical supply shortfall.*
>
> *Australian Pipelines and Gas Association (APGA)*

Option 2 can also be framed as policy stability, especially compared with [redacted] If investors can be convinced Option 2 represents policy stability, Option 2 is unlikely to deter investments. Most concerns around the ADGSM and Heads of Agreement centre on the ADGSM's retrospective application. [redacted]

In conjunction with the recent decommissioning levy, foreign investors have warned Australia is at risk of losing its reputation as a stable investment destination. As these concerns are primarily based on the stability of the regulatory environment, they can be managed under Option 2 by communicating the extension with sufficient notice.

Implementing Option 2 is low cost, low complexity, and simpler than for [redacted] Extending the ADGSM would require amending customs regulations, a relatively straightforward and low risk legislative process which could be undertaken with existing resources. Extending the Heads of Agreement would be more difficult than extending the ADGSM because it relies on the cooperation of LNG exporters. [redacted]

Option 2 is simpler for producers to comply with than [redacted] Renegotiating the Heads of Agreement periodically would entail some regulatory costs for impacted exporters. The regulatory burden is therefore relatively low. Industry is familiar with the ADGSM and Heads of Agreement, meaning unlike [redacted] there are negligible costs associated with learning about and complying with the policy.

Option 2 is also the option most compatible with other Gas-Fired Recovery measures. These measures were designed in a market subject to the ADGSM, and decrease the likelihood the ADGSM needing to be triggered.

Gas users support the ADGSM and the Heads of Agreement. They are generally seen to increase domestic gas supply security and competition between producers.

> *"A well designed and coordinated prospective scheme, used in conjunction with other targeted policies and measures aimed at ensuring strong and competitive gas markets in Australia (such as the ADGSM and Heads of Agreement), is required to provide a level of certainty for domestic users over the medium to long term.*
>
> *Cement Industry Federation*

> *We do support the need for a mechanism to provide greater security to domestic gas users, as part of a wider strategy for energy advantage and economic recovery. Whether this is an ADGSM extension, a national interest assessment or a PNGRS [prospective national gas reservation scheme], the security measure must be designed and implemented to be functional and worthwhile* ”
>
> *Australian Industry Group*

However, gas users may remain unsatisfied extending the ADGSM and Heads of Agreement is sufficient government intervention.

Discussion of cons

Gas producers may prefer Option 2 to [redacted] s33 But this doesn't mean they'll support it. [redacted] s45

[redacted] s45

- [redacted] s45
- [redacted] s45
- [redacted] s45
- [redacted] s45

[redacted] s42 & s33

However, as discussed above, the ADGSM is now a known entity in the operating landscape and can be framed as policy stability to manage any impacts on Australia's attractiveness as an investment destination.

[redacted] s42 & s33

As argued by the PC, gas reservation schemes that remove the link between domestic and export prices discourages investment leading to higher gas prices in the long run and imposing net costs on the economy (see Background). Unlike other gas reservation options the ADGSM does not completely remove the link between domestic and export prices. Nonetheless, the ADGSM also incentivises large gas users to create political pressure prior to negotiating gas supply contracts. If a domestic gas shortfall

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[redacted] s42 & s33

is forecast, users may not negotiate with producers in good faith because they know the Commonwealth could trigger the ADGSM.

CONCLUSION

Gas producers and exporters don't like the ADGSM, but they could accept its extension as a 'least worst' option for gas reservation. Gas users would support extending the ADGSM and Heads of Agreement. Option 2 retains two policies which have proven effective in dealing with the possibility of a supply shortfall, smoothing over potential Gas-Fired Recovery implementation delays.

[redacted]

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