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Dear Sir,

The DomGas Alliance welcomes the opportunity to make a submission to the issues paper on the Eastern Australia Gas Market Study published by the Department of Industry.

I would note that while the DomGas Alliance includes member companies that operate both on the East and West coasts, our focus is on securing a diverse supply of competitively priced gas to support domestic industry and protect local jobs in Western Australia.

Our interest in the Eastern Australia Gas Market Study relates solely to the discussion of policy options that, if adopted, could impact on the Western Australian market. This primarily relates to the study's discussion of reservation policy and the potential for national interest tests.

As discussed in our submission, the DomGas Alliance strongly supports the concept of domestic gas reservations and believes that the Western Australian policy has, to a significant extent, provided some security to domestic industry and jobs in our State.

It is unlikely that the introduction of a reservation policy or the alternative concept of a national interest test would provide a timely solution to the supply problems expected to emerge in New South Wales from around 2016.

It would, however, be both extraordinary and shortsighted for government to remove this policy option from the suite of tools it could choose from to provide a long-term solution.

The DomGas Alliance would also strongly note that while policy makers may not see reservations as a suitable option for the Eastern Australian market, to rule out the option completely could impact negatively on the Western Australian market and have significant implications for domestic industry and local jobs in our State. This would be a grave concern given the historic reluctance of upstream producers to meaningfully engage in the domestic market and instead focus on LNG exports. This is a broader issue of policy and principle that needs to be addressed in the upcoming Energy White Paper.

For further information I can be contacted at [matt@domgas.com.au](mailto:matt@domgas.com.au) or on 0419 813 171.

Yours sincerely,

**MATT BROWN**  
Executive Director  
7 February 2014



**SUBMISSION TO THE  
EASTERN AUSTRALIA GAS MARKET STUDY**

**7 February 2014**

**The DomGas Alliance**

The DomGas Alliance was formed in 2006 to respond to consumer concerns about domestic natural gas supplies and pricing. The Alliance aims to promote security, affordability and diversity of gas supply for industry and households in Western Australia.

The members of the DomGas Alliance purchase around 80% of the gas produced for domestic use in WA and generate significant employment and economic opportunities for the State. Our members include Alcoa of Australia Limited, Alinta Energy, DBP (WA) Transmission, Synergy, Fortescue metals Group, Gold Fields Australia Pty Ltd, and Horizon Power.

**This submission**

The DomGas Alliance represents a number of industry members who operate both in Western Australia and in other States. Having noted that, the Alliance works to ensure a diverse and reliable supply of competitively priced gas into the Western Australian market.

The DomGas Alliance was pivotal in securing the adoption of a domestic gas reservation policy by the Western Australian government in 2006 and worked with the State government to further strengthen and refine that policy as part of the Strategic Energy Initiative 2031.

The Alliance continues to strongly support the domestic gas reservation policy as it has, to an extent, delivered security of supply of gas for domestic industry. The objectives of the policy could be further strengthened by complementary actions on the issues of retention leases, access to third party infrastructure, removal of joint marketing arrangements and promoting new sources of unconventional gas supplies.

As such, the Alliance's comments relate primarily to the issue of non-market interventions and domestic gas reservations.

In doing so, the Alliance notes its disappointment in the negative framing of the question; "Should non-market interventions like reservation policy or export controls be ruled out?"

The actual study notes: "Two positions on domestic reservation policy are available to governments: either interventions of this type could be firmly dismissed or reservation policy could be set aside for further consideration."

The framing of the question would appear to seek negative views on the issue and would have been better worded as “Should non-market interventions like reservation policy or export controls be ruled out or set aside for further consideration?”

The Alliance is concerned that the wording of the question as it stands indicates a pre-determined view of the government on the issue.

Having noted that concern, the Alliance provides the following information for consideration.

### **Overview**

There is little argument that the supply and pricing scenario emerging in the East coast gas market due to the advent of an LNG export industry reflects the reality faced for some time by West coast gas users.

In the Western Australian gas market prices started to rise sharply in 2004, from a base of under \$3.00 per GJ to what appears to have been a peak in 2008/9 of around \$16.00 per GJ.<sup>1</sup>

Eastern Australian users are now also facing a combination of significant price rises and potential lack of supply as the LNG export industry begins to ramp up in Queensland. The exposure to international pricing for gas will have significant implications for domestic industry on the East coast.

These implications have been acknowledged by the Federal Minister for Industry, the Hon Ian Macfarlane, who noted;

“So gas in New South Wales means that we will lose thousands of jobs between Newcastle, Sydney, and Wollongong. ... When the gas gets short in a year or so's time, probably very short by 2016, and it gets very expensive, it's going to be average mum and dads who will lose their jobs because we haven't acted fast enough.”<sup>2</sup>

A range of policy options or actions have been raised in public debate about how to respond to the emerging supply/price situation in the Eastern Australian market. These include taking a hands-off “let the market sort it out” approach, the potential for the introduction of domestic reservations, the introduction of a “national interest” test, removal of regulatory burdens to bring on new supply and the acceleration of the development of the unconventional gas industry, particularly in New South Wales.

The report of the Gas Market Taskforce commissioned by the Victorian government flagged the issue of a “use it or lose it” approach to retention leases and also recommended that:

“The Victorian Government, with the objective of moving away from joint marketing arrangements, request the Australian Competition and Consumer Commission (ACCC) review the existing joint marketing arrangements for gas producers, assessing their relevance in light of the rapidly evolving eastern gas market.”<sup>3</sup>

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<sup>1</sup> Recent Price Developments in Australian Gas Markets, M Lauer, October 2013

<sup>2</sup> The Hon Ian Macfarlane, Media Conference, NSW Energy Security Summit 26 September 2013

<sup>3</sup> Gas Market Taskforce Final Report, Victorian government, November 2013

Many of these issues reflect the concerns of gas users in the Western Australian market in particular in relation to the effective management of retention leases, joint marketing arrangements and access to third party infrastructure. These issues are touched on at a later stage in this submission.

### **Domestic reservation policy**

While domestic gas reservations were introduced as a formal policy in Western Australia in 2006, the reality is that domestic gas commitments have always been a part of the policy landscape in Western Australia having been a part of the State Agreement that facilitated the establishment of the North West Shelf Project. They had also been included in the State Agreement for the Gorgon project.

What is often lost in the debate over domestic reservation policy is that the North West Shelf project had significant financial and commercial support from both the State and the Commonwealth. The WA government built and funded the DGNGP and Alcoa and SECWA were strongly encouraged to guarantee secure and predictable cash flows to the NWS project via 20 year take-or-pay agreements. As has previously been reported, the commitments that large end users, electricity generators and gas reticulation companies had to make to gas producers in Australia have historically been far greater than would be that observed overseas.<sup>4</sup>

There can be no greater demonstration of the DomGas Alliance's belief that LNG and domestic gas should be seen as mutually beneficial and not as an "either, or" scenario.

The development of the North West Shelf project is also an example of government intervention being welcomed by the upstream sector.

Most, if not all, major oil and gas developments will require or see intervention from either State or Federal government, most commonly in the form of tax breaks/incentives or in assistance with regulatory or environmental approvals.

Government intervention, in some form, in the sector therefore is the norm, not the exception.

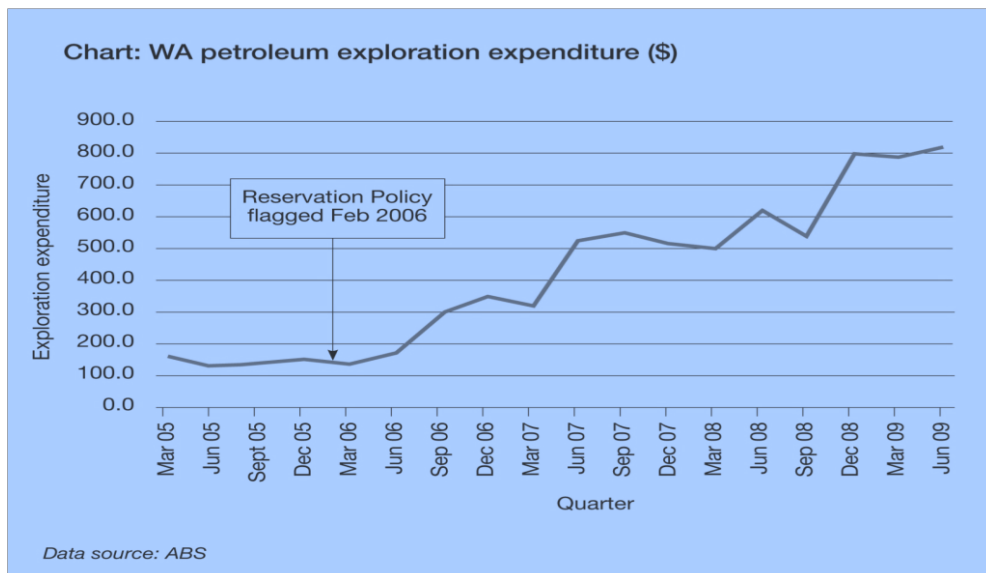
The domestic reservation policy has attracted sustained but unjustified criticism from upstream producers and their representative body, the Australian Petroleum Production and Exploration Association (APPEA).

At the time the policy was formally introduced, APPEA and their member companies claimed it would lead to a loss of investment and exploration in Western Australia. Despite almost eight years of evidence to the contrary, APPEA maintains this line of criticism today. In 2013, APPEA claimed the policy would stifle investment in onshore gas in the Canning Basin, again despite any evidence to support the claim.

The reality is that investment in exploration in Western Australia increased significantly in the years immediately following the introduction of the domestic gas reservation policy and remains strong today.

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<sup>4</sup> Australia Domestic Gas Policy Report, G Gill, November 2012



This was confirmed by the Western Australian Economic Regulation Authority in its submission to the 2011 Inquiry into WA Domestic Gas Prices by the (State) Economics and Industry Standing Committee which stated

“Exploration in the petroleum sector has also stood up well following the global financial downturn. .... A number of major international corporations have taken up exploration acreage and commenced significant exploration programs in Western Australia. In addition, established operators in the State have increased their exploration activities resulting in a number of sizeable gas discoveries in offshore northwest Australia. ... The information available on exploration and development of natural gas in Western Australia indicates strong economic activity in this sector in spite of a general downturn in activity more generally.”<sup>5</sup>

The Wheatstone (\$29billion) and Pluto (\$15billion) projects have both been developed with domestic gas reservation requirements under the WA policy.

According to Mr Roy Krzywosinski, Managing Director of Chevron Australia (operators of the Wheatstone project);

“First of all, let me say this: it is important when companies make decisions to understand the parameters of the investment. Whether it is domestic gas or whatever other requirements might be out there, you need to understand the demands of the investment. You need to understand how that money will be used and so on and so forth. **We understood that situation for Wheatstone. We went into that investment with eyes wide open that there would be a domestic gas reservation policy.** As a result, we are doing it; we are providing domestic gas. Between Gorgon and Wheatstone there is 500 terajoules a day, as you mentioned. That represents probably over 40 per cent, probably close to 50 per cent, of the current market. That is good news—there is more domestic gas, more competition. It is good news for everybody.”<sup>6</sup>

<sup>5</sup> Submission to the Inquiry into Domestic Gas Prices, Economic Regulation Authority, July 2010

<sup>6</sup> Inquiry into the Economic Impacts of Floating LNG Operations, WA Standing Committee on Economics and Industry, 24 October 2013

As noted, despite claims to the contrary, there has been no evidence that the introduction of a domestic gas reservation policy in Western Australia has led to a downturn in exploration or investment in the State.

## **Outcomes**

The crucial role played by natural gas in the development of Western Australia's domestic industry base is well understood and documented.

Western Australia is the nation's largest consumer of gas with gas representing almost 60% of the primary energy fuel source in the State.<sup>7</sup> More than 80% of the domestic gas purchased in Western Australia is used for power generation, alumina refining and resource processing and manufacturing in the State's South West.<sup>8</sup>

The 2011 inquiry in WA gas prices by the (State) Standing Committee on Economics and Industry reported that "Western Australia's economic future is inexorably tied to the development and use of the state's large reserves of natural gas."

The inquiry also found that:

"Despite the large expansion in reserves and investment in LNG production, domestic gas prices have risen sharply in recent years. Indeed, there have been reports that prices on some new domestic contracts have exceeded LNG contract prices. In other words, some domestic prices are being set at levels reflecting or exceeding that of high priced Asian LNG markets.

The concern is that the recent high gas prices are seriously undermining the state's competitiveness and imposing high and excessive costs on businesses and households. There is also a related concern that export markets are getting a preference over the domestic market in terms of access to the state's gas reserves."<sup>9</sup>

The Committee's concerns remain relevant in 2014 with the outlook for the domestic gas market in Western Australia remaining tight, a situation likely to continue for the foreseeable future.

The domestic gas reservation policy has, to a large extent, worked to ensure that domestic industry has access to a reliable source of competitively priced gas. While the current situation is not ideal, there is no question that the scenario for domestic industry would be far worse in the absence of a domestic reservation policy.

Currently the Gorgon and Wheatstone projects are understood to be the only near to medium term developments which have un-contracted offshore gas.

Even with these projects delivering some gas into the domestic market, it is likely supply will not meet demand (in fact they do not fully off-set an expected decline in North West Shelf output).

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<sup>7</sup> ABARE, Energy in Australia 2010, Canberra, 2010

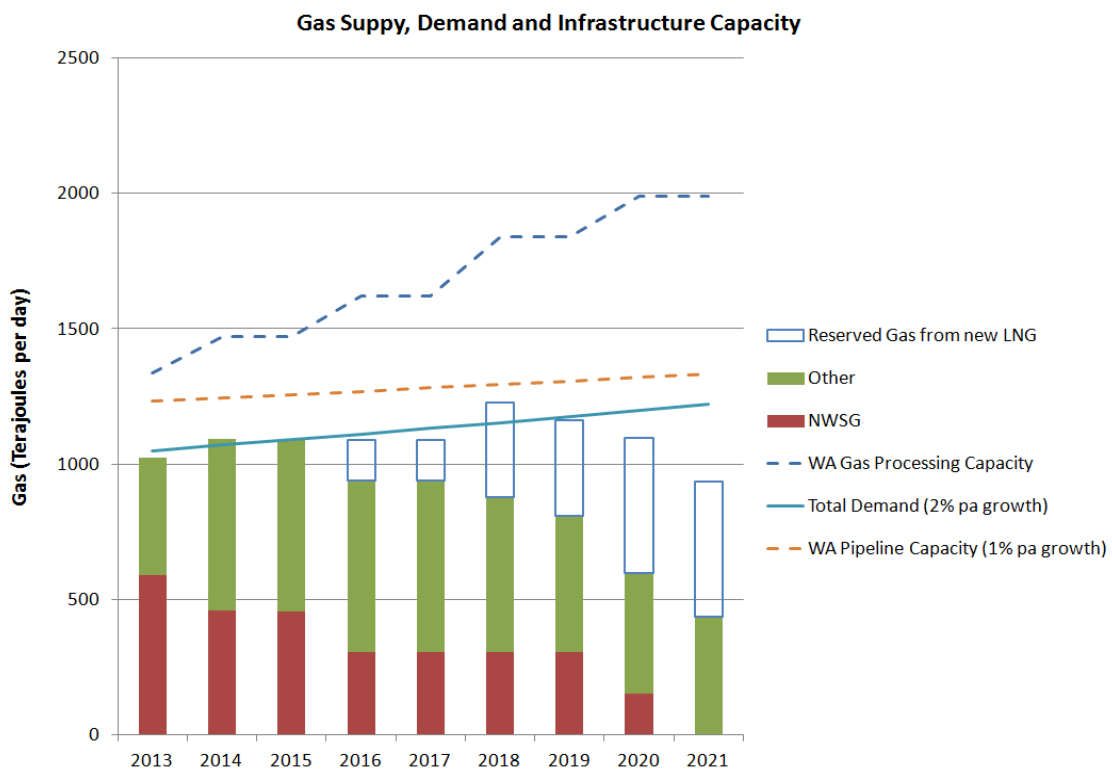
<sup>8</sup> Gas price in Western Australia: Review of inputs to the WA Wholesale Energy Market, ACIL Tasman, May 2010

<sup>9</sup> "Inquiry into Domestic Gas Prices", WA Standing Committee on Economics and Industry, 2011

The consequence of this will be a slow-down in State growth, the real likelihood that local industry will continue to pay some of the highest prices for gas in Australia, amongst the highest prices of any gas exporting country in the world, and the possibility of supply shortfalls.

Critics of the domestic gas reservation try to paint this as an illustration of the policy not working. However without the domestic reservation requirements applied to the Gorgon and Wheatstone projects, there is little question that going forward what is currently a very tight outlook for the market for domestic gas would in fact become an alarming shortfall in supply.

The following chart graphically illustrates this with the reserved gas from Gorgon and Wheatstone helping to bridge the gap between supply and domestic demand as the output of the North West Shelf inevitably begins to taper off.



The chart shows that even with domestic reservations, there is a potential shortfall between supply and demand as early as 2016. This starts to widen significantly in 2020. It should be noted that if the proposed domestic gas start-up for Gorgon (2016) is delayed, then the shortfall in supply for that year could significantly widen. If Wheatstone faces similar delays, then the potential over-supply in 2018 would become a shortage of supply.

Floating LNG has the potential to make the State’s domestic gas situation significantly more challenging.

This chart shows that even with Wheatstone and Gorgon, there is a widening supply gap from 2020 and beyond. It had always been assumed that this gap would be met, at least in large part, by domestic gas that would have been delivered under reservation from the Browse and Scarborough projects.

The joint venture partners for Browse have announced the project will now be pursued as FLNG. While a final concept selection for the delivery of Scarborough has not yet been made, the joint venture partners have signaled “floating LNG is considered the best option for developing Scarborough at this stage.”<sup>10</sup> These decisions suggest that strong consideration needs to be given to strengthening the domestic gas reservation policy through the adoption of a similar approach from the Commonwealth.

### **Release of Second GSOO (January 2014)**

In January 2014, the Independent Market Operator released the Second Gas State of Opportunities (GSOO) that highlighted the uncertainty over supply for the domestic market and, of greater concern, confirmed that higher prices have already begun suppressing demand.

The North West Shelf’s (NWS) Karratha Gas Plant provides almost half the total domestic gas market but the GSOO warned that due to a range of factors “the continued availability of domestic gas supply from the KGP for the 2014 to 2023 period is uncertain.”

The GSOO has also confirmed the sensitivity of domestic industry to the surge in domestic gas prices pointing to data showing “recent price increases have started to affect domestic gas demand.” The report notes, “This means increases in average medium to long-term new contract gas prices will be reflected more rapidly by suppression of gas demand over the forecast period.”<sup>11</sup>

As the DomGas Alliance has previously reported, this drop in demand is being compounded by a range of investment and development opportunities which the State has missed out on due to the unavailability of competitively priced gas.

The DomGas Alliance believes the outlook facing the Western Australian market is potentially worse than that outlined by the latest GSOO, with the outlook for the domestic gas market in Western Australia remaining tight, a situation likely to continue for the foreseeable future.

### **To intervene or not?**

The Eastern Australian Domestic Gas Market Study poses the question: “should the government maintain a reservation option?”

As previously noted, this is a different question to that posed in the discussion paper that appears to invite a negative response.

The short answer to this proposition is; why wouldn’t the government maintain the option to consider a reservation policy?

There is little argument that market failure exists in both the Western and Eastern domestic gas markets. Arguments that this does not constitute market dysfunction and therefore does not warrant government intervention are self-serving. Governments regularly intervene in a range of imperfect markets using a range of policy tools.

Energy markets, domestic and international, are under constant change. It would be irresponsible of any government to pre-emptively rule out any policy tool that could ultimately deliver a better outcome in terms of supply of competitively priced gas.

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<sup>10</sup> “BHP says Scarborough tracking well.” The Australian, 26/9/13

<sup>11</sup> Second Gas Statement of Opportunities, Independent Market Operator (WA), January 2014



The Study's logic is confused, to say the least, in relation to this issue. The report argues that from a purist economic perspective it would be inappropriate for the Federal government to use domestic reservations as a policy tool but then immediately contradicts this by suggesting it would be appropriate for governments at a State level to do so.

In relation to this point, the DomGas Alliance would particularly challenge the statement that "acreage reservation (for domestic gas) should only apply to the release of new acreage to avoid sovereign risk." This statement ignores the reality of the Western Australian market where domestic gas commitments have been a central element of the sector since its inception and there is a clear understanding and knowledge of this commitment. As the application of such a requirement (if contemplated) by the Commonwealth would primarily affect offshore exploration in Western Australia, it is difficult to argue that such a move would amount to sovereign risk.

Australia's domestic energy policy has consistently lacked a statement of intent by the national government on behalf of the community that those companies that wish to access our natural resources for commercial gain in the export market also have a responsibility to meaningfully engage in the domestic market.

Australia remains the only country where international oil companies can access and export gas without facing controls aimed at prioritising domestic supply. Even in the US, where the market is undergoing significant change due to the shale gas boom, the approval of agreements to export LNG to non-FTA countries have included so-called revocation clauses based on an assessment of whether the public interest is being met. As the Centre for Strategic and International Studies noted, this is a "tacit recognition that some level of export is against the public interest" and that the US administration was trying to chart a course which allowed exports "without harming the US economy."<sup>12</sup>

Major upstream producers in Australia also operate in nations where domestic supply is prioritised.

It may be, as the study notes, that a domestic reservation option or a national interest test model will not deliver a timely solution to the situation which has evolved on the East coast.

But to completely remove the option of domestic reservations would further weaken the position of the government in relation to ensuring the community's expectations that upstream producers engage in domestic supply are met.

Domestic supply of natural gas should be the central element of any producer's license to operate. If our national government continues to send the signal to producers that it will not act to ensure this responsibility to the community is met, then the situation in both the Western and Eastern domestic markets can only deteriorate.

### **Complementary Actions**

While the DomGas Alliance strongly supports domestic reservation, our members believe there are a range of policy actions, which could be taken by government to improve the diversity and reliability of supply of competitively priced gas into the domestic market.

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<sup>12</sup> Centre for Strategic and International Studies, S Ladislav, July 2013

## 1. Accelerate development of unconventional gas

The Alliance strongly supports moves by governments and industry to accelerate the development of Australia's unconventional gas reserves. This is proving to be a sensitive issue due to the misinformation being spread by opponents of the extraction processes involved.

The Alliance believes that governments should work together to harmonise approvals processes to provide a consistent national approach and, in doing so, resist the politically-based campaigns of some special interest groups who are opposed to unconventional gas.

A key part of this will be a joint effort by industry and government to inform, educate and reassure the community about the safety and reliability of the processes involved.

Governments will also need to deal with the question of how to ensure a fair proportion of these resources reach the domestic market and are not simply directed to LNG exports.

## 2. Retention Leases

Government needs to ensure that once discovered, resources of natural gas are brought to the market in a timely manner in the national interest.

As previously noted, the Victorian Gas Market Task Force report was the latest to reference "use it or lose it" policy.

The DomGas Alliance believes it is time to get serious about the "use it or lose it" principle and use it to ensure producers bring discovered gas to market as quickly as possible.

It is not longer sustainable for producers to argue that increasing sources of supply is preferable to domestic reservations, while at the same time being allowed to sit on such sources (thereby denying them to the domestic market) for their own commercial benefit.

The DomGas Alliance believes a more rigorous test should be implemented with greater emphasis on whether domestic supply is commercially viable.

The Alliance is particularly concerned that additional fields are being labeled as unviable to develop when they are, in essence, being stockpiled as future supply for the out-years of long-term LNG export contracts.

## 3. Third party access to infrastructure

The DomGas Alliance believes there would be considerable value in reviewing third party access to infrastructure to determine if such access could help bring on new supplies of gas, particularly from offshore fields. This may allow alternative funding models that could help reduce the cost of gas supply. More of the infrastructure could be provided at lower rates of return than that required by the oil and gas industry.

## 4. Removal of approval for joint marketing

As previously noted, this issue was raised, in an East coast context, in the Victorian Gas Market Task Force report which recommended that the Victorian government call on the ACCC to remove the exemption for joint marketing of gas.

Similar conditional authorisations have been granted by the ACCC for joint marketing of gas in the Western Australian market by the North West Shelf and Gorgon venture partners.

There is no question that such arrangements have reduced competition and suppressed the maturing of the WA gas market.

The DomGas Alliance has previously noted that joint selling and a lack of gas on gas competition has resulted in monopolistic pricing and driven significant price increases for gas and electricity customers. Joint selling also frustrates the development of a competitive efficient and fair commercial environment.

The 2011 Economics and Industry Standing Committee inquiry into Western Australian gas prices recommended that:

“The government should rigorously pursue the elimination of the joint marketing authority currently granted to the North West Shelf and Gorgon joint venturers when the applications come up for renewal in 2015.”<sup>13</sup>

## **Conclusion**

The DomGas Alliance is not opposed to LNG exports and has consistently recognised the importance of developing our LNG export industry as a means of unlocking natural gas resources that could also provide supply to domestic markets.

The LNG export/domestic gas debate should not be an “either or” scenario. The Western Australian experience (which incorporates the principle of domestic commitment) is that a vibrant LNG export industry can evolve while, at the same time, the community and State can benefit from economic activity and jobs which are generated by a reliable, long-term supply of competitively priced domestic gas.

The DomGas Alliance urges the Federal government to retain the policy option of domestic gas reservations (or a national interest test option which would achieve the same outcome) in the interests of ensuring job security and continued growth in Australia’s domestic industries while rigorously pursuing a range of complementary measures designed to increase the range and diversity of sources of supply.

#ends

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<sup>13</sup> Inquiry into Domestic Gas Prices, Economics and Industry Standing Committee, March 2011

