

22nd February 2023

Australian Domestic Gas Security Mechanism
Department of Industry, Science and Resources

Australian Domestic Gas Security Mechanism Draft Guidelines - Chemistry Australia Submission

Preamble

1. Chemistry Australia welcomes the opportunity to provide this submission on the draft Guidelines for the Australian Domestic Security Mechanism. It will be important that ADGSM is fit for purpose for current and future market demands and opportunities. The mechanism needs to be improved from its limitations as a blunt instrument initially designed to be applied when market conditions and the Australian economy were facing much lower sovereign risk and uncertainty.
2. Chemistry Australia also welcomes the Government taking on board the views of major industrial and other gas users in response to the 'Securing Australia's Domestic Gas Supply / ADGSM' consultation, and which have been incorporated into the draft Guidelines.
3. Broadly, Chemistry Australia agrees with the proposed Guidelines and the intent to provide increased transparency and process for the market and regulators, that also has the potential to improve competitiveness.
4. Gas is a critical transition fuel necessary to facilitate industry and the broader economy transition to lower carbon emissions. Unless properly functioning domestic gas markets are able to operate, Australia will be at risk of continuing to lose industrial scale and complexity in the decarbonised economy of the next decade.
5. A properly functioning and competitive domestic gas market should exhibit sufficient resource depth, with adequate levels of liquidity within a competitive and transparent operating environment. It should enable gas to be available at demonstrably competitive prices, in volumes and for periods suitable to buyer's needs, and with sufficient notice. Competitiveness should not be limited by the exercise of available market power, including where high levels of market concentration exist. Chemistry Australia continues to advocate for reforms that address the current concentration of market power with the LNG producers and that improve competition.
6. It is hoped that these guidelines further incentivise producers to engage meaningfully with users and provide net benefit outcomes for the economy and society through the significant value-adding to gas via chemistry and other major industrial sectors.

Recommendations:

7. That the proposed quarterly assessment of supply shortfall and proposed remedies be implemented.
8. That the definition and calculation of 'suitable supply' specifically include the amount of gas actually being provided to the domestic market so it delivers enough depth and liquidity for a competitive operating environment. This is necessary to improve upon the current dynamic of constrained supply as a result of

suppliers exercising market power, which does not allow for the laws of supply and demand to shape availability and price. This is particularly relevant given the ongoing problems created by LNG exporters not being net market contributors, as evidenced by the ACCC. Consideration should also be given as to how much gas is required to achieve a reasonable depth and liquidity objective. For example, it could be expressed as either a market percentage, PJ or other meaningful metric able to be measured and assessed for its effectiveness.

9. That the Minister's consideration of supply includes if LNG exporters are net market contributors, or not.
10. That the consideration of supply adequacy be carefully considered taking into account any changes in market dynamics, and issues created by gas import terminals and associated arrangements. This is particularly relevant given the increasing potential for import terminals to theoretically reduce the prospect of a supply shortfall and introducing the possibility of LNG exporters to export LNG and leave the domestic market exposed to LNG import pricing. Both supply and price remain relevant for buyers, recognising that trade exposed industry cannot compete at LNG import and export parity pricing.
11. That the Ministers' consideration of demand includes the cyclical, long-term contract needs of major industrial consumers seeking to re-invest in significant capital requirements of plant major maintenance turn-arounds for both gas feedstock and gas process energy requirements. This would include competitive prices, in volumes and for periods suitable to buyer's needs, and with sufficient notice. This can be achieved by a suitable engagement process with industrial users.
12. That the trade and otherwise market operation of Authorised Volumes does not result in producers being able to exercise market power, or otherwise negatively impact users
13. That clarity is provided about how the Government will calculate how the economic and social impacts of a shortfall are determined. [Clause 10 (8)].
14. That the proposed Guidelines consider how changes might impact users purchasing from retailers, the largest purchaser and on-seller sector of the market, with their own market power capabilities.
15. That the Guidelines also address the need for a price trigger in addition to a volume trigger. This acknowledges the welcome reforms in place to introduce reasonable pricing provisions for some large users. It also acknowledges that LNG import pricing should not be a default floor.

Body of submission

16. On the basis of current domestic market conditions, a well-designed ADGSM would already have been triggered, given the ongoing domestic market shortfalls, rapid changes in market conditions faced by gas users, including being faced with unprecedented pricing levels.
17. Chemistry Australia acknowledges the ACCC Gas Inquiry Reports with their strong and consistent evidence base of ongoing market failures, the identified limitations of the ADGSM and their recommendations for its strengthening, to address the urgent need to protect east coast energy security. While the ACCC has highlighted 'unconscionable conduct' in past reviews, it should be noted that the Commission has now identified a distortion in market power. This can only be addressed by introducing a clear pricing mechanism within the ADGSM framework.
18. The widely acknowledged gas market dysfunction is such that increased supply does not enable affordability for industrial gas buyers, of all company types and sizes. This has been the user experience for some time and remains the case today. However, with LNG producers no longer being net market contributors, an additional threshold has been crossed which further locks in constrained supply and its flow on implications for domestic affordability. The

ACCC notes that “the outlook for the east coast gas market has significantly worsened¹”

19. Therefore, it is crucial that the ADGSM review ensures it delivers timely, meaningful and durable price-focused reforms, alongside supply improvements. This is urgently required so that feedstock and other major industrial users requiring term contracts can continue to play their role in ensuring Australia is a modern economy that value-adds to its abundant gas resources and is able to continue providing Australians with the highly skilled employment the economy requires.
20. The market demand requirements of feedstock gas users are structured, cyclical and predictable. There are a known number of companies operating plants in Australia using gas for both feedstock and process energy.
21. Chemical feedstock plants typically require regular major maintenance ‘turnarounds’ of some 5-7 years (with some up to 10 years). Planning for plant turnarounds is part of normal, long term investment cycles which chemical companies commence planning for at least 2 years out for existing plant. Planning for new plant construction requires decision at least 5 years ahead. This provides a highly predictable operating environment for contract gas contracts to be developed. To attract the ~\$ 50M capital required for the existing plant turnarounds, gas contracts need to be secured for the same period. With feedstock gas comprising 50-60 % of input costs, this results in gas feedstock contracts making up the largest domestic gas contracts in the economy. However, currently these contracts cannot be secured under the current market conditions.
22. The mechanism could consider the following stages:
 - a. Feedstock contracts predictions per annum (2-5 years ahead of turnaround dates for existing plants and minimum 5 years for new plant)
 - b. The use of the ADGSM, Heads of Agreement and / or other mechanisms to match gas availability and pricing within a band that buyers and producers / sellers could then negotiate. This could include arrangements for sharing risks associated with global and domestic pricing factors.
 - c. Monitoring of the gas contracts would then revert to the ACCC and other regulatory bodies.

Chemistry Australia would welcome further engagement with the review team, including the opportunity to meet and discuss how the ADGSM can be further strengthened.

Yours sincerely,



Peter Bury

Director – Strategy, Energy and Research

¹ ACCC media release 1 August 2022 re its Gas Inquiry Interim Report, July 2022.