DomGas Alliance

Options for a prospective national gas reservation scheme

Response to Issues Paper

Fortescue The New Force in Iron Ore

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FOREWORD

The DomGas Alliance (DGA) welcomes the opportunity to comment on the proposal for an Australian domestic gas reservation policy.

The DGA was formed in 2006 by industry members, in response to a serious shortage of gas supply for new developments in WA. Since its formation, the DGA has successfully advocated for a domestic gas reservation policy to apply in Western Australia for gas developed for export LNG production and for gas projects within Western Australia. The DGA represents the largest gas users in WA, who collectively use about 50% of all gas consumed in the State – for mineral processing, power generation, LPG production and conversion to ammonia for fertilisers.

The WA gas reservation policy requires gas producers to reserve 15% by volume of LNG production for domestic use. This policy originated in the 1980s with the development of the North West Shelf LNG project, which committed the owners to supply domestic gas under the State Agreement negotiated for the project. The project was underpinned by a large take-or-pay contract from the then State Energy Commission of WA to supply gas for domestic consumption.

Subsequent gas projects developed off the north west coast of WA which bring the gas onshore for processing and liquification prior to export have all had a commitment in their State Agreements to reserve a significant amount of the production for domestic use.

The policy has been successful in providing certainty to domestic gas users as well as LNG developers. It has enabled WA to become a powerhouse in the resources sector by providing plentiful, low-cost energy for our extensive and large mining and mineral resources projects. It has also facilitated WA's expansion into chemical processing with some of the world's largest ammonia plants using as a feedstock for fertiliser production.

There is no doubt that WA has become a gas-centric state. The expansive network of pipelines and processing facilities supply gas over vast distances to projects and communities in all corners of the jurisdiction.

A report by ACIL Allen commissioned by DGA in 2018, identified that in 2016-17 the domestic gas supply chain generated output to the value of $30.9 billion and accounted for almost 18,000 direct FTE jobs. In addition, gas purchased as a key input by WA industries generated $165 billion of economic activity that accounted for 39% of activity in the state.

The policy was enhanced in August 2020 when the state government ring-fenced WA's domestic-only gas projects, securing their supplies for the local market. The policy now underlines that LNG exporters' domestic gas commitments are intended to complement supply from domestic-only projects using the WA gas pipeline network.

WA's policy has ensured that supply over the last decade has been relatively stable and prices have come down to the point where industry is being attracted to the state because of its lower energy costs.

The proposal for a national domestic gas reservation policy is a worthwhile initiative, intending to secure future supplies of gas for industry, particularly manufacturing. Its focus is rightly on the eastern states market where supply has been tight, driving up the price of gas which also feeds into electricity prices.

While the DGA sees benefits in a domestic gas reservation policy for the east coast, we do not think it should cover Western Australia which has been served well with its own policy for nearly four decades. There are certainly learnings that we are happy to share to ensure that an east coast domestic gas policy works well, and we have sought to address the questions in the paper that go to detail design issues for a robust policy.

Richard Harris

SPOKESPERSON
DomGas Alliance

“How would a prospective national gas reservation scheme address a potential domestic gas shortfall and impact gas markets in the medium or the longer term?”

A national gas reservation scheme could be a useful mechanism to address potential domestic gas shortfalls facing the east coast of Australia in the next 10 years. Its success, however, depends on a number of different factors.

At the outset it is important to note that this scheme should only apply to prospective gas export projects. Imposing a national gas reservation scheme on existing projects would be too onerous for gas producers, in some cases, requiring the development of additional infrastructure to meet policy requirements. This would significantly alter the economics of existing LNG projects and potentially undermine the viability of these critical facilities which in 2018-19 exported $50 billion worth of gas. Furthermore, backdating the reservation scheme would raise sovereign risk issues for future investments in Australia.

Instead, the reservation scheme must be forward looking - applying to all prospective LNG export projects which fall under it. This feature has been a key reason for the success of Western Australia’s Domestic Gas Reservation Policy, creating a clear framework for both LNG and domestic gas industry stakeholders.

If the national gas reservation scheme were to capture solely future LNG project, its success would be tied to the capacity of producers to develop Australia’s gas fields. Without new gas export projects, no gas would be reserved.

Therefore, to optimise the success of the scheme and overcome medium – long term domestic gas shortfalls, the Commonwealth Government must encourage gas producers to unlock Australia’s natural gas reserves. Specifically, the “use it or lose it” provisions attached to Retention Leases must be upheld to allow other producers to access and develop resources where existing leaseholders have been inactive. This would enable Australia to capitalise on the significant economic and environmental opportunity to boost LNG exports, supporting the global transition to cleaner fuel sources, while also securing domestic energy supplies. Importantly, the increased production of LNG under the scheme would significantly bolster domestic gas reserves, helping to negate future shortfalls in the domestic market.

On the other hand, if new gas projects are not developed in the short – medium term, the remaining gas reserves could become economically or environmentally unviable by the time the gas becomes available. Again, this underlines the need for the enforcement of Retention Leases by the Commonwealth Government to support a national gas reservation scheme.

"How would a prospective national reservation scheme affect investments in oil and gas projects?"

The operation of a prospective national reservation scheme would be unlikely to undermine investment in oil and gas projects. In Western Australia, where all LNG export projects must reserve 15% of gas for domestic use, gas exploration and project development has experienced significant investment in the last decade. This is equally true for both LNG export projects and onshore domestic gas fields.

In terms of LNG export projects, Chevron's Gorgon LNG facility exported its first cargo from Barrow Island for delivery into Japan in 2016. The following year, Train 1 at Wheatstone began production, with Train 2 coming online in June 2018. Currently, Woodside and BHP are together exploring the opportunity to develop a production unit on the Scarborough gas field as well as a second LNG train at the Pluto facility. This month, Woodside accepted two production licenses for the project ahead of a final investment decision expected next year.

The Browse Joint Venture - which includes participants such as Woodside, Shell and BP – is also in the pipeline to develop the Brecknock, Calliance and Torosa fields located in the offshore Browse Basin. As Australia's largest untapped conventional gas resource, the project is estimated to underpin WA's domestic gas market in the coming decade, supplying 230TJ/day when fully operational.

These recent investments and proposed developments in Western Australia have all been made against a backdrop of a clear blanket domestic gas reservation policy. Therefore, by no means can the existence of a domestic gas reservation policy be said to have dissuaded these sunk and proposed investments.

Even more significant has been the surge in investment towards the exploration and development of onshore gas reserves in Western Australia. Major discoveries in the Perth Basin for example, including the Beharra Springs, Waitsia and West Erregulla gas fields, have seen numerous producers propose and develop domestic gas projects throughout the State. Once more, these investments come despite the existence of a domestic gas reservation policy in the jurisdiction.

Overall, it is clear that in Western Australia the existence of a domestic gas reservation policy has not had an impact on gas project investments. On the contrary, both the domestic and LNG export markets have experienced significant developments with further major investments expected in the near future. This is a result of the policy providing certainty for developers, with the various clarifications of the policy being consistent with the overall approach, allowing both gas producers and consumers to understand its intent.

The position and forecast of the global oil and gas market will undoubtably be the deciding factor as to whether investments in Australian projects go ahead. Developing a clear reservation scheme in consultation with industry will allow prospective projects the certainty to account for these changes and invest appropriately. The DGA welcomes the Morrison Government's industry-focused approach to developing a national gas reservation scheme.

“What would be the quantifiable benefits of a prospective national reservation scheme for domestic gas users and for power generation?”

A national reservation scheme would have considerable benefits for domestic gas users. By ensuring a secure and reliable supply of gas, a reservation scheme would help to drive down and stabilise energy costs for local gas users.

A recent 2018 study from ACIL Allen commissioned by the DGA highlighted the cost benefits for local gas users associated with a domestic reservation policy. The report assessed the average nominal price for gas delivered into the Western Australian domestic gas market compared to the east coast gas market which does not benefit from a blanket gas reservation scheme like Western Australia.

The analysis illustrated a clear divergence in average nominal prices from 2015 onward between the two markets, with east coast prices rising to above $6/GJ in late December while prices in WA dropped to a five-year low around $4/GJ at the same time. ACIL Allen noted supply constraints were the key driving force behind the rapid price rise across eastern Australia. Conversely, additional supply becoming available through new LNG gas projects underpinned the average nominal price fall in Western Australia’s domestic gas market. Therefore, the benefit of a reservation scheme clearly lies in reduced energy prices and secure gas supply.

Providing an affordable and reliable gas supply has helped fuel significant minerals processing, mining and chemical production projects throughout Western Australia. In 2016-17, the State’s domestic gas supply chain generated output to the value of $30.9 billion, according to estimates from ACIL Allen. The majority of this output ($25.1 billion) was exported to international markets, with $3.9 billion purchased by WA industry as a key input into their production of their goods and services such as power generation.

The availability of domestic gas has been one of the leading factors behind the adoption of gas-fired electricity generation in Western Australia. In 2017-18 Western Australia’s share of Australian gas fired electricity generation totalled 46%, playing a vital role in powering local mining operations, heavy industry, businesses and households across the State.

Beyond power generation, the availability of domestic gas in Western Australia has allowed mining, minerals processing and chemicals projects to flourish – delivering a major boost for the Western Australian economy. Importantly, the interest in developing gas-fired projects in Western Australia, largely due to its strong domestic gas market, has continued to remain strong, with significant fertilizers, chemicals, mineral processing and blue-hydrogen projects being recently proposed. The benefits of a reservation scheme would, therefore, extend beyond lowering household electricity bills to stimulating industry and delivering a significant boost to the domestic economy.

“Are there gas reservation models that have worked in other jurisdictions which could work at the national level in Australia or are there examples of unsuccessful policies Australia can learn from?”

The blanket domestic gas reservation model used in Western Australia has been successful since being drafted into the *North West Gas Development (Woodside) Agreement Act 1979* (WA) (State Agreement), governing the North West Shelf facility. The policy was formalised in 2006 in response to shortfalls in the domestic market and has received ongoing bi-partisan support as a key state development mechanism.

The policy is based on three pillars. The primary requirement of the policy requires each LNG export project to reserve equivalent of 15% of production for the domestic market. The second pillar requires LNG exporters to develop the necessary infrastructure to bring the domestic gas to market. Finally, obligation holders must show diligence and good faith when marketing their reserved gas to local consumers. These policy obligations are commonly entrenched in State Agreement Acts between the project developers and the State of Western Australia.

Given the capital intensity and long lead times required to develop LNG project,s the use of State Agreements Acts has been valuable for gas producers by providing a certain policy and regulatory setting. This also gives financiers comfort that the projects are supported by the State, as well as ensuring the State can negotiate to ensure benefits for the community, expressed in the domestic gas reservation policy.

Part of the success of Western Australia’s reservation model is also based in its clear intent and simplicity. This has provided certainty to both LNG developers and large gas consumers, once more supporting major investment decisions. Recent amendments to the policy have been made in line with the general intentions of the policy and in consultation with the industry stakeholders.

For example, the recent revision to the policy in August 2020 stipulated all gas in the State’s domestic gas network is for use solely in Western Australia, unless exceptional circumstances warrant otherwise. This amendment does not significantly change the policy but clarifies what was always intended by successive State governments. The gas fields in question are largely in the Perth Basin and have been producing gas for the domestic market since the 1970s, supported by infrastructure including the Parmelia Pipeline, the Dampier to Bunbury Pipeline and the Mondara Gas Storage Facility. The policy clarification is intended to ensure Perth Basin gas is reserved for state development purposes including mining, minerals processing and other chemical processing, such as for methanol and fertiliser production. As such, the policy intent has remained clear and consistent, upholding Western Australia’s position as a leading jurisdiction for both gas production and gas-fired project development.

Another recent amendment to the policy has been to clarify the reporting and transparency requirements under the policy. This includes the need for LNG export companies to report on the domestic gas contracted and supplied as well as relevant marketing activities and operational infrastructure. Once more, this revision does not alter the intention of the policy but rather provides a further mechanism to hold LNG exporters accountable against their obligations under the policy’s three pillars. Furthermore, this change was made to universally state a number of requirements already entrenched in the State Agreements between LNG exporters and the State Government. The DGA welcomes this revision to the policy. Greater accountability and transparency in the domestic gas market will create a more level playing field for large gas users to negotiate long-term gas supply contracts with LNG export companies, supporting local industry. These reporting mechanisms are still being developed in consultation with industry.

While Western Australia’s blanket policy has been widely successful, potential features are still available to improve the domestic gas market. The DGA believes the information reported by LNG export companies about how they are meeting their domestic gas policy obligations should largely be public. Firstly, this would further support local industry to negotiate fair domestic gas supply agreements with LNG exporters by providing a more even distribution of vital information, such as available gas supplies. Importantly, publishing the performance of each LNG export producer would also create greater public accountability, ensuring their best endeavours are used to produce, make available and sell the gas to local consumers.

The development of a comprehensive gas bulletin board containing current information gathered from the mandatory reporting, would be also useful for the domestic gas market, offering clear, easy to navigate data in a single, public online platform. The data published would include, for example, the volume of gas available from each producer and the volume of sold. For Western Australia, this could be a valuable state development tool to inform and attract prospective energy intensive projects to Western Australia, such as petrochemical plants and mineral extraction and processing operations.

A gas clearing house operated by an independent third-party could be another valuable addition to Western Australia's domestic gas market. This forum would help to marry the demand of local industry with the supply and marketing obligations held by LNG producers. A clearing house would also streamline the currently burdensome negotiation and procurement process for all parties. All parties to the contract would benefit from a solely market-driven price.

Moreover, this system would enable a market price index to be introduced, providing much needed long-term price transparency to the WA domestic gas market. Having pricing point for domestic gas futures would also be beneficial to underpin major investment decisions.

Examples where third-party traders have been used successfully in energy markets include the 'Henry Hub' in Erath, Louisiana which informs the natural gas price on the New York Mercantile Exchange.

Overall, since being formalised in 2006, the domestic gas reservation policy has been a successfully delivered a secure and reliable gas supply for the local market. Importantly, the policy has also provided certainty for industry to make clear investment decisions since its implementation with revisions and amendments remaining true to original policy intentions. While a valuable mechanism, greater transparency and the introduction of a gas trading hub could make significant improvements to Western Australia's domestic gas market. These changes would further encourage investment and support local industry across the State.

"How would a prospective national gas reservation scheme interact with state and territory policies and regulations?"

The DGA supports Western Australia's domestic gas reservation policy. If a national reservation scheme were to be introduced, it must not impede the existing framework and market operating in Western Australia. This position is largely based on the success of the current blanket policy in the jurisdiction. A national reservation scheme may also be in conflict with Western Australia's policy which prohibits the export of domestic gas.

A national gas reservation scheme would also require a nation-wide gas infrastructure network. Currently, the transmission network is fragmented, split between the west and east coasts of Australia. To bridge this divide, either a west-east pipeline would need to be developed or domestic gas in Western Australia would need to be shipped as LNG to a terminal on the east coast. Both options come with significant costs, both economically and environmentally.

The economics of a west-east pipeline were recently assessed in ACIL Allen's 2018 West–East Pipeline Pre-Feasibility Study, commissioned by the Department of Environment and Energy, which found that a West-East pipeline was not the best or most economic option for solving gas supply issues in Eastern Australia. Similarly, the environmental cost of liquifying, transporting and re-gasifying domestic gas exported from Western Australia to the east coast would be significant. In an increasingly carbon-conscious world, this option may not be viable to execute. Furthermore, while bolstering national gas reserves, transporting LNG from coast-to-coast would likely increase gas prices and add an additional input cost for power generation.

Crucially, any proposed interaction between a national reservation scheme and Western Australia's valuable blanket policy must undergo widespread consultation to ensure both mechanisms operate effectively while continuing to support and attract local industry and gas investment.

CLOSING COMMENTS

Policy must be forward looking

"While this may limit volume of gas available for reservation, back-dating the reservation policy raises sovereign risk issues. WA's policy has always been forward looking, and the various clarifications of policy have been consistent with the overall approach, so LNG producers and consumers understand the intent of the policy."

The impact on investments in oil and gas projects?

"From what we've learned in WA, a reservation scheme would actually provide added certainty for developers, particularly if the policy is part of an overall approach which provides the infrastructure and market mechanisms to assist gas getting to domestic customers efficiently."

'Use it or lose it'

"In ten years', the gas left in the ground may not be economically or environmentally viable to extract. The 'use it or lose it' approach to Retention Leases must be upheld to enable other producers to access and develop the gas if existing leaseholders have been inactive."

WA’s Domestic Gas Reservation Policy

“It is a good policy. It is clear in its intent and gives certainty to both LNG developers and large gas consumers. It could be improved by increasing transparency and public accountability to ensure LNG producers meet their obligations to market their reserved gas in good faith, to local industry. These reforms are underway.”

Gas playing a vital role to a cleaner environment

“Gas will continue to play an important role in the energy mix going forward, as we transition to a low and even net zero carbon environment. A gas reservation policy encourages industry to use gas in preference to coal for power generation and to complement renewable energy.”

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