Securing domestic gas supply to support our commercial and industrial users

Speakers:
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Commissioner Anna Brakey addressed the Australian Domestic Gas Outlook conference on 22 March 2022. She addressed the supply of gas, possible supply shortages and the role of the ACCC.

Transcript:

Check against delivery

Introduction

Thank you for the opportunity to speak here today. Many of you will have become accustomed to hearing the ACCC's annual address at this event from my now former colleague, Rod Sims. Although Rod's tenure ended last week, the ACCC's inquiry into the east coast gas market continues, and there is so much for us to talk about at the moment.

The word 'unprecedented' became a cliché during the pandemic, if it wasn't already. But when it comes to energy markets, it's fair to say that what we're currently seeing is unprecedented.

In gas markets, this has been driven by strong demand due to a rebound in industrial activity, and cold weather in Europe and Asia. There were also supply shortfalls in Europe and East Asia during the second half of last year and the start of this year. The shocking situation in Ukraine has pushed us further into the unknown, but we know enough to realise that gas supply into Europe could get much worse.

The tightness of global gas and LNG markets can be seen in the international price movements over the past two years. Following the lows of 2020, LNG prices increased last year to record levels in both Europe and Asia, and coal and oil prices followed. Asian LNG spot market prices increased by 350% from March last year to March this year, and as of a week ago, the average LNG netback price for this year was almost $39/gigajoule (GJ).

So far, this has only had a limited effect on our east coast gas market. Prices offered for supply in 2022 increased from $6-8/GJ in late-2020 to around $7-$9.50 in mid-2021. This increase is much less than the rise in international LNG prices, and domestic short-term markets currently price gas between $10-12/GJ, which is a bit more than one-third of the international price.

But developments overseas raise longer-term concerns, especially given the tight supply outlook for our east coast gas market. Supply shortfalls are exceeding the ACCC's previous forecasts, particularly in Australia's southern states.

In light of this, I'm going to cover 3 main topics in my speech today:

- Firstly, I'll describe the finely balanced supply of gas and impending shortfalls
- Secondly, I'm going to tell you what I think needs to be done to address the looming supply shortages
- I'll then finish by talking about the future work of the ACCC's gas inquiry.

Finely balanced supply and impending shortfalls

Our most recent gas inquiry report found there's likely to be enough supply this year, but the demand-supply outlook is finely balanced. We've updated our forecast since then, and while that revised version isn't quite as grim, it's still very concerning.

We forecast a surplus of just 11 petajoules (PJ), or less than 3% of the forecast demand, for the southern states. The north is forecast to have a surplus of 19 PJ, or just over 1%, so supply to the south could be boosted from the north if necessary.

However, the longer-term outlook is more concerning. We forecast a shortfall in the south from 2024, largely due to gas from the Cooper Basin being redirected into Queensland. The southern states will therefore rely on gas being sent down from Queensland, or an import terminal, to avoid a shortfall.

More concerning still is that by 2026 or 2027, we expect a shortfall over the whole east coast.

Australia's commercial and industrial, or 'C&I', gas users are feeling the impact of this. C&I users told us last year they are receiving limited offers from suppliers, and they face higher prices and less flexible terms for supply from next year. This trend of tightening supply has been building over the last seven years.

A case in point is Incitec Pivot, which recently announced it will stop manufacturing at its Brisbane-based Gibson Island plant at the end of this year. Why? Because it's been unable to secure affordable gas supply from 2023 onwards.

Subsequent to the decision to close the plant, but thankfully prior to ceasing production, Incitec Pivot proved crucial in addressing Australia's AdBlue shortage during the recent global supply crisis. For anyone who missed that, AdBlue is a diesel exhaust fluid that trucks use, and which is essential to our transport and logistics sector. Incitec Pivot's ability to resolve Australia's shortage should be a reminder to everyone about the important domestic manufacturing capabilities of our C&I gas users.

And it's not just large C&I users who are feeling the pinch. High gas prices and availability of supply are also major issues for smaller gas users.

So, what's caused the expected shortfall in supply? At least in part, it's been driven by further write-downs of proved and probable (2P) reserves, mainly by LNG producers in Queensland.

2P reserves were written down by more than 1,000 PJ in the last financial year. This is the fourth consecutive year the ACCC has reported significant write downs. Since 2017, 2P reserves have been written down by almost 9,000 PJ, or about 20%. The majority of these have been written down by LNG producers in Queensland.

There's alternative supply that could be brought online, but the sources are more speculative and haven't yet been approved for development. These projects will need to overcome a range of barriers, and there will need to be significant infrastructure investment to bring the gas to market.

Given how tight the supply outlook is, it's critically important that LNG producers continue to supply gas into our domestic market. They are the ones who own or control the majority of reserves and resources on the east coast.

Concerningly, our recent report found LNG producers are likely to export more gas this year than they'll contribute to the east coast market. To be precise, they expect to withdraw 27 PJ more from the east coast gas market this year than they'll supply into it.

LNG producers have been supplying less and less gas into the domestic market for the last five years, and the downward trend is concerning. In 2022, the expected domestic supply from the LNG producers is about 50% less than actual supply in 2017 and 2018.

It's this rapid and significant reduction in domestic supply from the LNG producers that's contributed to the tight and uncertain conditions in our domestic market. And let's be clear - this is at odds with what government was told before the LNG projects were developed. Gas companies assured governments that there was sufficient supply and that domestic gas prices wouldn't go up, but it hasn't turned out that way.

What more needs to be done?

So, what can be done about the tight supply outlook? It goes without saying that the gas market needs more supply. But this will only happen if the LNG producers, who control the majority of proven reserves and resources, continue to direct gas to our domestic market. And this brings us to the Heads of Agreement that LNG producers entered into with the Australian Government.

It's absolutely vital that LNG producers meet their commitments under the Heads of Agreement. LNG exporters have committed to offering their uncontracted gas to Australia's domestic market before offering it overseas. Furthermore, the offers must be made with reasonable notice and on competitive market terms.

The way in which LNG producers report their offers has recently improved, but we're concerned about how some have approached demonstrating compliance with the Heads of Agreement.

We're particularly concerned about whether some gas was originally offered in expressions of interest but ultimately wasn't able to be supplied to domestic customers, as well as whether reasonable notice was provided.

One example involved an LNG exporter that, due to a change in circumstances, wasn't able to supply all of the gas originally offered. In negotiations with a major domestic supplier, the LNG exporter said it could no longer provide firm gas supply over the period it had originally offered. As a result, the expression of interest process didn't result in any gas supply agreements.

Another example involved an expression of interest being issued less than one month before the gas was offered overseas. In this case, domestic supply was to start less than two weeks after responses to the expression of interest were due. Some gas buyers, particularly C&I users, may not be able to accept large volumes at such short notice.

We'd like to see competitive offers made to the domestic market on terms that meet the needs of domestic buyers. In addition, we'd like to see more offers actually resulting in domestic supply, which we consider to be a clear indicator of whether the offers were made on competitive terms.

We acknowledge that average prices in short term markets haven't reflected the large increases in expected LNG netback prices, and that's very welcome. The Heads of Agreement doesn't expressly require prices to align with LNG netback prices, but it does say that offers must be internationally competitive and made on competitive market terms. In that context, we encourage all suppliers and LNG producers to ensure their offers remain below what is being seen in international markets for LNG.

Given the precarious international conditions, as well as the difficulty C&I users have had receiving gas supply offers, we've recommended the Australian Government consider extending the Heads of Agreement well before it expires at the start of next year.

In terms of other regulatory improvements that could be made, we recommended a range of reforms after completing the first stage of our review into upstream competition in gas supply.

This review found there are a number of structural factors impeding both upstream competition and the timeliness of gas being brought to market.

Firstly, we recommend state, territory and Commonwealth governments make reforms to encourage greater diversity of suppliers. This includes governments not granting acreage to producers that have substantial existing acreage unless they're satisfied it won't affect the timing of their developments. We also suggest governments follow Queensland's lead and consider both the diversity of suppliers and efficiency in which gas can be brought to market. And we suggest governments proactively encourage shorter development timeframes where appropriate, and have greater oversight.

In addition to this, we think governments could reduce the barriers that producers sometimes face by considering implementing a third-party access regime for upstream infrastructure and storage facilities. This includes infrastructure such as gathering pipelines, water treatment, and compression facilities. As there is with gas pipelines, this would also provide for a dispute resolution mechanism if an access dispute arises. We also think some regulatory duplication in approval processes could be removed, particularly between the Commonwealth and states.

Just to continue on pipelines for a moment, given the southern states will require more Queensland gas from 2024, it'll be vital that shippers have access to reasonably priced pipeline transportation.

We continue to see evidence of monopoly pricing on many pipelines, and shippers have expressed concerns to us about high transport prices, limited service flexibility and bargaining power, and unused pipeline capacity. Given this, upcoming changes to pipeline regulation should provide more price transparency and help shippers make informed decisions when dealing with pipeliners. The Australian Energy Regulator's monitoring and enforcing of these reforms will be critical in ensuring they have the intended effect.

We're still concerned South Australia's proposed derogation from individual price reporting will place users in that state at a comparative disadvantage in negotiations with pipeline operators.

We'll also be monitoring the supplier code of conduct, which is due to commence in a few months. We'll be watching for its impact in the market and whether it improves outcomes for gas users. We strongly encourage all gas producers and retailers to sign up, as the more signatories there are, the greater the benefits will be for gas users.

I'd also like to stress that the way the code is both implemented and reviewed 12 months later will be critical. The review should be used as an opportunity to assess retailers' participation, to maximise the code's effectiveness. We note that many C&I users are directly supplied by retailers who are not currently captured by the code, which is why it's so important that retailers sign up.

Future work of the inquiry

LNG producers, suppliers, pipeline operators and governments all have a role to play in solving supply issues in the gas market. I've outlined what industry and government can do, and before I finish up, I want to quickly cover what the ACCC can do.

Of course, we'll continue to closely monitor and report on the east coast gas market. Our reports will continue looking at prices offered and agreed, the short and long-term supply outlook, the C&I gas user experience, and the price of pipeline transportation.

For the rest of this year, we'll also focus on monitoring LNG producers' compliance with the Heads of Agreement, which we expect to improve.

We're also moving to the second stage of our upstream competition review. It will look at the behavioural factors that may be impeding competition or the timeliness of supply. This includes things like joint venture arrangements, marketing arrangements, mergers, exclusivity provisions and supply decisions.

You might recall that in 2015 we were concerned the joint marketing arrangements between BHP and Esso for Gippsland Basin gas were likely to result in a substantial lessening of competition in the southern states market. We thought competition was negatively affected by eliminating independent rivalry between BHP and Esso.

An ACCC investigation resulted in the two companies providing court enforceable undertakings to separately market their share of gas produced under the joint venture. Pleasingly, separate marketing since 2019 has resulted in greater competition between the two parties. I mention this because it highlights the importance of our upcoming work examining joint venture and marketing arrangements.

Later this year, we'll also be monitoring supplier compliance with the code of conduct as a component of our gas inquiry. As I said earlier, we encourage all gas producers and retailers to participate so C&I users see the maximum benefit.

As well, we'll be undertaking a more comprehensive examination of competition for the supply of gas to C&I users.

Our upcoming work also includes publishing longer-term forward LNG netback prices based on an oil index. And we'll be monitoring market developments so we can be confident our methodology for calculating LNG netback prices remains appropriate.

Conclusion

Before I finish, I'd like to reiterate that the ACCC believes governments and market participants must do more to ensure there is enough supply of gas. This has become even more urgent because of how bleak the picture is globally.

This is not the time to go backwards. Rather, it's a critical time in which governments should look at extending the Heads of Agreement well before it expires, and implementing a range of reforms to encourage more diversity of suppliers and reduce barriers faced by producers.

It's also the time for LNG producers to improve their compliance with the Heads of Agreement and continue to supply gas domestically. And it's the time for all suppliers to participate in the code of conduct and ensure meaningful implementation, so some of the fundamental inadequacies in the market are addressed.

For our part, we'll continue playing a very important role monitoring the actions of all market participants.