



# Energy White Paper 2014

## Green Paper submission form (including confidential)

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The Australian Government seeks comments on ways the Goals set out at the beginning of each chapter of the Energy Green Paper, could be achieved. A field for general comments is provided at the end of the template.

# **Energy Green Paper 2014**

Submission by an alliance of industry associations

Australian Aluminium Council

Australian Food and Grocery Council

Australian Industry Group

Australian Steel Institute

Energy Users Association of Australia

Plastics and Chemicals Industries Association

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## **Introduction**

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This submission is made by an alliance of the following leading industry associations:

- Aluminium Council of Australia
- Australian Food and Grocery Council
- Australian Industry Group
- Australian Steel Institute
- Energy Users Association of Australia
- Plastics and Chemicals Industries Association

Alliance members are Australia's major industrial gas users. Collectively they represent the domestic manufacturing sector employing 950,000 Australians (8.2 % of domestic employment), transforming at least 32% of Australia's domestic gas consumption into value-adding products and services throughout the entire economy and its supply chains and contributing 6.7% of the nation's total GDP. Outputs include food, building products and infrastructure, chemicals and plastics, aluminium, steel, paper and cardboard, electricity, mining and minerals, commerce, trade, education, newspapers, governments and institutions.

While all members of the alliance hold concerns about broader energy policy issues, this submission focuses specifically on the issue of natural gas, as set out in Chapter 3 of the Energy Green Paper: 'Building gas supply and improving market operation'. This submission is also relevant to the broader themes in the Energy Green Paper seen in Chapter 1: "Attracting energy resources investment" and Chapter 4: "Security, Innovation and Energy Productivity".

While individual associations have made their own submissions to the Energy Green Paper, they have deferred detailed comments on natural gas issues to this joint submission.

## **Executive summary and recommendations**

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The overall context of the Energy Green Paper appears to be calibrated towards energy supply and related investment, including the export of LNG as an energy source. What it misses are the needs and opportunities on the demand side of our energy system: the use of gas both as a chemical feedstock and a source of process energy for the broader economy; the consequential stimulation of investment, jobs, economic growth; and how these contribute to a diverse, robust and competitive economy.

Reliable access to a competitive, efficient gas market is crucial to Australian gas users and the Australian economy.

If the Australian gas market were competitive and efficient, it would display the following features: large number of buyers and sellers; buyers and sellers have knowledge about the market including supply, demand and price; there would be no barriers to entry or exit; and no buyers or sellers would be able to distort price and supply through the use of market power. This is far from the case.

While the export of LNG and linkage to world markets are leading to changes in the domestic gas market, the alliance is concerned that the gas market structure and policy settings are preventing the market from responding to these changes efficiently. The alliance is particularly concerned at the lack of short term action to address the shortage of gas as forecast to occur in the NSW market in 2016.

This is most acutely evidenced by examples of gas users receiving no offers to requests to tender for gas supplies extending beyond the next couple of years. This is not evidence of the market working for the benefit of all stakeholders. This imbalance would not occur in a competitive market as a real or confected shortage of gas should stimulate new production and new entrants. However, current policy settings are

preventing that occurrence, and there is no countervailing power to a small number of large players in the domestic market.

The Energy Green Paper acknowledges that the gas market is facing a shortage and has made recommendations for reform in the areas of supply, improved flexibility and transparency. The alliance welcomes and supports these recommendations.

However, **the Energy Green Paper's discussion of gas issues falls short in three main areas:**

**1. Scant regard is paid to the importance and opportunity of downstream gas transformation and value-adding to the future economic growth and environmental performance of the Australian economy**

One could not imagine a health policy that did not address the needs of patients, or an education policy that did not address the needs of students; yet the Government's gas policy has little regard to how gas is used in the Australian economy. In addition, the Green Paper pays little regard to the full economic and environmental potential of Australia's gas reserves.

**2. Too much emphasis is placed on new gas supplies as being the panacea to gas market pressures**

While increased gas supply is crucial, more gas from existing suppliers is not going to address fundamental flaws in the market, including the effect of market power and the lack of competition.

**3. There is no certainty that policy reform will be delivered**

The Energy Green Paper risks falling into the same trap as previous reviews, which had similar recommendations but lack a mechanism to ensure their delivery.

To address these shortcomings, we **recommend that the Energy White Paper be amended as follows:**

1. The Energy White Paper should explicitly acknowledge the full nature of energy use in Australia, the needs of energy users for an efficient, competitive market, and the full economic and environmental opportunities that are linked to the outcomes in the gas market. This should include recognition of the opportunities presented by the significant and diverse value-adding of gas to the objectives of the Australian Government's Industry Investment and Competitiveness Agenda.
2. Gas market issues are of such importance and beyond the jurisdiction of the Australian Government alone that they warrant a response from COAG Heads of Government. The Energy White Paper should state that the Australian Government will recommend that COAG amend the Gas Market Development Plan to reflect the full range of identified market-based reforms for the gas market, including:
  - Review of retention lease policies with a view to preventing the retention or withholding of reserves that are commercially viable,
  - National framework for unconventional gas development,
  - Completion of SCER reforms, including Wallumbilla hub and voluntary pipeline capacity trading,
  - Implementation of reforms from Parer Review, EADGMS and the alliance's submission to the EADGMS,
  - Disclosure of available capacity at all stages of the gas value-chain,
  - Consideration of a transitional national mechanism to require all stages of the gas value chain that have capacity available to provide an offer to the domestic market,

- Establishment of a daily balancing mechanism for the gas wholesale markets, as occurs in the electricity market, and
  - Fast tracking the Moomba Gas Hub to facilitate the supply of gas by junior producers.
3. The Energy White Paper should include a timeframe for urgent and coherent implementation of all reforms by the responsible Australian and State Governments, and a mechanism to incentivise reform.
  4. The Energy White Paper should state that the Australian Government will require the Australian Competition and Consumer Commission to conduct a full inquiry into competition in the Australian gas market. This needs to consider all of the upstream and downstream components of the industry.
  5. The Energy White Paper should state that the Australian Government will commission a report that fills the critical evidence gap relating to the current and potential use of gas transformed throughout the manufacturing sector and its supply chains, including:
    - a. How value is added using gas as a feedstock and energy source,
    - b. How gas flows through value-chains and into to the broader economy,
    - c. The implications of critical supply chains moving offshore where gas supply and price are a key factor, including supply vulnerability and market failure,
    - d. The economic growth opportunities in domestic use of gas alongside its energy export potential, and
    - e. How recognising and working with gas producers, value-adding industries and consumers of all types to realise a value-chain approach has benefits for all parties.

The alliance would welcome the opportunity to work with Government to provide further information to assist with these additional recommendations, either in the Energy White Paper, or the processes that follow.

## Critical role of gas for a diverse and competitive economy

Australia's energy policy should reflect:

- the benefits to the Australian economy from exporting our resources, including LNG,
- the importance of efficient and competitive energy markets to the Australian economy and energy users, including the objectives of a strong manufacturing sector, as articulated in the Industry Investment and Competitiveness Agenda (IICA), and
- the need for affordable and secure energy supplies for Australian domestic consumers.

It is crucial then that the Energy White Paper be developed with a strong focus on the full range of competitive advantage provided by Australian gas. As such, a clear, deliberate and strategic vision supported by a robust evidence base and analysis informing a national plan is required to enable the whole economy to make full use of our national endowment in energy resources.

The lack of strategic understanding of the economic capability and contribution of gas through manufacturing leaves a yawning gap in the evidence base for Australian energy policy. The economic benefits of increased LNG exports have been extensively researched, evaluated and modelled by public and private organisations, including the Bureau for Resource and Energy Economics (BREE). However, there has been comparatively little analysis of the impacts and opportunities associated with the use of gas throughout Australian manufacturing value chains for a broad range of materials and products in daily use.

Evidence of this imbalance is seen in the Energy Green Paper's references the "Benefits of LNG export industry" (page 39, Box 2), which is extracted from BREE's work for the Eastern Australian Domestic Gas Market Study (EADGMS). It is disappointing that the Energy Green Paper has no comparable reference to the economic activity associated with gas in manufacturing, despite it being identified as consuming one third of domestic demand.

The EADGMS cites BREE's data reporting manufacturing as the largest domestic consumer of gas, accounting for 32% in 2011/12. Yet there remains no consultation process or commissioned report that details how manufacturing uses gas as feedstock and energy source to create materials and products essential to our quality of life.

To help fill this gap the alliance partners commissioned Deloitte Access Economics to investigate the likely impacts from official gas price projections in Australia. The resulting report: "*Gas market transformations – economic consequences for the manufacturing sector*" was released in July 2014. Deloitte's research found that the most plausible price projections would lead to \$118 billion of cumulative lost output from manufacturing to 2021. The sector would lose an additional 14,600 jobs as a result. The alliance is dismayed and alarmed that the Energy Green paper does not even reference this study.

However the evidence gap is not only on the extent of the likely damage to Australia's economic diversity. There is also little sense of the opportunities at risk from a narrowing of economic capability at a time of falling competitiveness. The Government's recent IICA details the competitiveness challenge, while also setting out opportunities for growth in key sectors. These include food and agriculture and advanced manufacturing.

Gas plays a key role in these sectors as a chemical feedstock for ammonia, fertilisers, polymers and methanol, and as an energy source for food and agriculture, aluminium, steel, paper and cardboard, bricks and other building materials. All play a critical role in a future Australian growth strategy, yet energy policy and economic strategy are currently not well connected. The Energy Green Paper significantly addresses investment in gas supply, but does not adequately consider gas demand nor its connection to the types of

opportunities identified in the IICA. Australia needs whole-of-government policy, and the Energy White Paper should reflect this.

Alongside the market reform process proposed by the Government, there should be strategic, informed deliberation over how gas can yield its full potential through the economy. This needs to include governments working with the gas value chain to best engage with consumers and communities and communicate the value of gas to our quality of life and the broader economy.

## **Gas market reform**

This alliance recognises the consultation process of the Australian Government in the development of the EADGMS and the Energy White Paper. The inclusion of a range of market-based reforms shows awareness of the significant problems with current gas market dynamics, competitiveness, liquidity and supply. These are now urgent and require a coordinated effort between the Commonwealth and State governments for their implementation. A timely increase in gas supply into a competitive market is essential.

Reform is urgent since price and supply challenges are compounding other impacts on Australia's manufacturing capabilities. Some of the latest recommendations were originally identified in the 2002 Parer report.<sup>1</sup> While welcome progress has been made on some recommendations of that report, many are yet to be implemented 12 years later.

The issues are now of such concern and importance that they warrant commitment and action by COAG Heads of Government. This includes a full reform process addressing recommendations from the Parer Review, the EADGMS and the alliance's previous submission to the EADGMS.

These recommendations encompass a range of reforms to expand the market (increase the quantity of gas supply); strengthen the market (increase the diversity of gas suppliers); and support the market (increase transparency and information). These three elements are critical, as too often an increase in gas supply is seen as the panacea to gas market distortions. However, additional gas supplies from existing players, particularly those linked to the export LNG projects is inadequate on its own to improve the efficiency and competitiveness in the gas market.

In addition, the alliance considers that there is a need for an overarching strategic plan for the development of the gas market, which acknowledges the appropriate role of transitional mechanisms in the evolution towards more developed gas and pipeline trading mechanisms.

The gas market needs to evolve over time to meet the needs of market participants, moving from a bilateral market to include more balancing and spot trading mechanisms for gas and pipeline capacity.

As a step in this natural progression, consideration should be given to introducing a transitional mechanism that requires all stages of the gas value chain that have capacity available to provide an offer to the domestic market.

This obligation should be underpinned by improved disclosure of capacity at all stages of the gas value chain. If for example, the improved supply and demand information available to the market showed that there is available capacity at any stage in the value chain, then participants should have an obligation to at least 'be open for business', that is to provide an offer of terms and conditions to requests to tender. This is not the same as reservation, as we are not recommending that a certain proportion of gas be reserved to the domestic market, but rather that available capacity should at least be offered to the domestic market,

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<sup>1</sup> "Towards a truly national and efficient energy market", COAG Independent Review of Energy Market Directions, December 2002.



rather than potentially withdrawn for strategic reasons that are inconsistent with the efficient operation of the market.

## **Gas market review**

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The alliance welcomes the EADGMS and Energy Green Paper's recommendation that there be a broad review into competition issues in the gas market.

The alliance recommends that this review is best undertaken by the ACCC and should assess the depth, liquidity and competitiveness of the Australian domestic gas market. The review should consider a broad range of issues, including but not limited to: pricing, availability of supply, duration of supply, contractual terms and number of potential suppliers. The review needs to include all upstream and downstream components of the market.

The alliance notes that the ACCC's current price inquiry powers may not provide sufficient scope for such a review but also notes that the question of a broader ACCC market inquiry power is being considered in the Harper Competition Policy Review.

The alliance notes that the Productivity Commission has commenced a review examining barriers to a more efficient gas market and that while this will provide valuable insights, it is focussed on developing tools to assess gas market policies. Given this work, the alliance considers that the PC would be well placed to conduct a comprehensive review and cost benefit analysis of potential reform options relating to the eastern gas market, taking into account the rapid change in market dynamics and with the aim of increasing efficiency, transparency and competitiveness of the eastern gas market.

## Energy Green Paper feedback

We offer the following joint feedback on specific Green Paper recommendations.

| Actions  | Feedback and comments   |
|--|---|
| <ul style="list-style-type: none"> <li>• <u>Addressing near-term east coast gas supply</u></li> </ul> <p>More gas needs to be supplied quickly to avoid potential near-term east coast shortages. Social licence and landholder concerns have led state governments to introduce regulatory barriers.</p>  | <p>Support these actions, though it is important to not only increase gas supply but also to ensure that the existing market is more competitive. Additional gas supplies from existing players linked to export LNG markets, will not be adequate to address concerns. The market also needs to be more competitive to offset the market power of the few existing producers selling into the domestic market.</p> <p><u>Alliance policy position (#1:Expanding the market)</u></p> <ul style="list-style-type: none"> <li>• Remove excessive regulatory barriers to new gas production, by streamlining and harmonising approvals processes across jurisdictions, while maintaining strong standards.</li> <li>• Prevent retention or withholding of existing reserves that are commercially viable – for example, a use-it-or-lose-it approach to retention leases or mandatory development of such reserves.</li> </ul> <p>As a matter of urgency, the Australian Government should collaborate with the States / Territories to promptly:</p> <ul style="list-style-type: none"> <li>- facilitate the construction of the pipeline link(s) between the Northern Territory and the East Coast gas grid;</li> <li>- work with the New South Wales and Victorian governments to withdraw their on-shore drilling moratoriums; and</li> <li>- agree Australia-wide standards for the protection of the environment and landowner rights associated with onshore gas drilling.</li> </ul> |
| <ul style="list-style-type: none"> <li>• <u>Sustaining national gas supply</u></li> </ul> <p>Environmental and social concerns about new onshore gas projects have led to restrictive regulation and community disruption of projects. The Australian Government can apply the capabilities of national science institutions to improve the independent evidence base for assessing the impact of proposed projects. It will also work with states and territories to remove unnecessary barriers to new projects.</p> | <p><b>Support this goal.</b></p>  |

• Gas prices are not transparent

There is limited reporting of gas production potential, and limited trading information on the extent of competition in gas markets. There are also some exemptions from competition laws to allow joint marketing. Many of the underlying sources of competition are therefore difficult to assess.

The Australian Government is considering either an ACCC Price Inquiry or Productivity Commission Review into these competition issues to help identify any barriers to competition as the market responds to current high gas price signals.

**Support this goal.**

Alliance policy position (#3: Supporting the market)

- Better information is needed on many basic facts about the market which are currently obscure or disputed: the availability of contracts; average prices; and ability of the exporters to meet their full commitments, the nature of any penalty clauses for short supply in their contracts, and the consequent scope for domestic prices to exceed export parity.
- The capacity for the exercise of market power is very real. The ACCC should be tasked with reviewing the depth, liquidity and competitiveness of the Australian domestic gas market. The review should consider a broad range of issues, including but not limited to: pricing, availability of supply, duration of supply, contractual terms and number of potential suppliers.
- Improve planning and transparency mechanisms such as the Gas Statement of Opportunities and Bulletin Board.
- Continuing reforms to publish available transmission pipeline capacity and accelerating efforts to develop a published gas price index.
- In future the impacts of major gas market decisions and developments need to be independently assessed in light of the national economic interest before investments are made.

Any and all efforts to improve competition in the domestic gas market will have direct, positive and lasting effect.

A formal investigation of competition in the gas sector will be very valuable as long as it is focussed and practical. The most appropriate body to conduct the inquiry is the ACCC, which has conducted similar inquiries on other sectors. The Productivity Commission can offer its valuable perspective through a submission to an ACCC Inquiry.

• Improving gas market function

The nature of gas market bilateral trading means there is limited supply and price information available for consumers to understand market conditions. The Australian Government will implement further reporting through BREE and AEMO to provide greater transparency.

Domestic gas market function would be enhanced by a comprehensive development strategy for the unconventional gas industry. Improved trading mechanisms could include further trading hubs and pipeline capacity trading.

**Support this goal.**

Alliance policy position (#1:Expanding the market)

- Remove excessive regulatory barriers to new gas production, by streamlining and harmonising approvals processes across jurisdictions, while maintaining strong standards.
- Prevent retention or withholding of existing reserves that are commercially viable – for example, a use-it-or-lose-it approach to retention leases or mandatory development of such reserves.

In particular, gas supply constraints should be removed so that gas suppliers can enter the market, provided appropriate environmental standards and landowner rights are met. Further, both Australian and State/Territory Governments need to tighten their “use it or lose it” provisions so as to discourage gas “warehousing”.