Comments on Australia's "*Domestic Gas Reservation Scheme - draft Design Framework*" of 25 May 2025
- The Institute of Energy Economics, Japan - IEEJ

Introduction

The Institute of Energy Economics, Japan - IEEJ wishes first to express its sincere appreciation for the longstanding contribution of Australian LNG to Japan's energy security. IEEJ is an independent research institute with over 60 years of history. Its membership comprises major Japanese energy suppliers, industrial energy consumers, and financial institutions. The institute engages closely with its member companies to understand their priorities and concerns, and, where appropriate, collaborates with relevant government bodies in Japan. It provides information and analysis to its members and develops policy recommendations in the fields of energy and the economy. The present set of comments has been prepared following a series of discussions and exchanges of views conducted over recent months with member companies, reflecting the perspectives and concerns expressed through this process. The institute also maintains close and ongoing engagement with companies and government institutions across Asia, with whom it regularly exchanges views on energy and economic issues. In the case of this new Australian proposal, the comments have been formulated following briefings provided by the Australian Embassy and consultations with stakeholders in Japanese industry. They are intended to convey, in a consolidated and structured manner, the key issues and considerations identified through these exchanges.

Since the commencement of LNG exports from Australia to Japan in 1989, Australian LNG has played a central role in supporting the foundations of the Japanese economy, particularly in the supply of city gas and electricity. This contribution has been especially significant during periods of disruption, including the period following the suspension of nuclear power generation in Japan in 2011, when increased LNG supply from Australia provided critical support in ensuring energy stability.

The development of LNG export projects in Australia, beginning with the North West Shelf project, has demonstrated a mutually beneficial model. LNG export developments have not only supported international markets but have also contributed to the expansion of domestic gas supply and the development of local economies, thereby fostering a robust and enduring partnership based on mutual trust.

Today, Australian LNG accounts for approximately 40% of Japan's LNG imports and around 10% of its primary energy supply, making it one of the most important pillars of Japan's energy system. Beyond Japan, Australian LNG continues to play a vital role as a reliable and stable source of energy for rapidly growing Asian economies, and is expected to remain

essential to regional and global energy security. In this context, policy developments relating to LNG in Australia are of particular importance to Japan and other Asian economies. The proposed Australian Domestic Gas Reservation Scheme is understood to have potential implications not only for new LNG export transactions and future projects, but also for projects currently under construction, recently agreed LNG contracts, and potentially existing LNG projects and long-term contractual arrangements.

Beyond the direct implications for individual LNG projects, governments and corporations in Japan and across Asia have, in recent months, been carefully reassessing future LNG supply options in light of geopolitical developments, including the evolving situation in the Middle East. Against this backdrop, there has been a heightened level of interest in how the proposed policy may affect Australia's long-term position as a key and reliable LNG supplier. Australia has traditionally been regarded as one of the most important and stable sources of LNG for the region, and any policy developments that may influence the scale, stability, or flexibility of its LNG exports are therefore of considerable significance. In this context, stakeholders are also seeking to assess the cumulative impact of recent policy developments in Australia that may affect LNG export projects. The present proposal is being considered as part of this broader policy landscape, with particular attention to its potential implications for investment conditions and supply reliability over the long term.

Stability, reliability, and flexibility have long been defining characteristics of Australian LNG supply and have underpinned its attractiveness to international buyers. Furthermore, LNG project developments in Australia have been among the most attractive investment opportunities for international investors and financial institutions, including those from Japan. A stable and predictable policy environment has historically been a key factor underpinning investment in Australian LNG, and remains essential for future developments.

It is fully recognised that Australia's gas resources are first and foremost a national resource intended to serve the interests of the Australian people. At the same time, international LNG buyers, including those in Japan and across Asia, have come to rely on Australian LNG as a key and trusted source of supply.

IEEJ understands that the proposed scheme is driven in part by concerns regarding potential gas supply shortfalls in the eastern Australian domestic market. The objective of ensuring reliable and affordable gas supply for Australian consumers is both legitimate and worthy of respect.

At the same time, it is hoped that policy settings will not only focus on reallocating existing supply, but also on expanding overall gas supply - thereby ensuring that the relationship between the Australian domestic market and international LNG markets continues to be mutually beneficial.

Against this background, IEEJ respectfully provides the following observations on the proposed framework. IEEJ would appreciate if these observations are received as constructive and pragmatic suggestions aimed at supporting the continued development and improvement of the proposed framework.

0 Overall Structure of the Proposed Scheme and Promotion of Investment

0.1 The proposed scheme is understood to be designed with the dual objective of ensuring sufficient gas supply to the eastern Australian domestic market and creating a modest oversupply that delivers reasonable and affordable market prices for Australian households and industries. This objective is indicated in the Draft Design Framework.

0.2 While some observations suggest that, at present, domestic gas supply conditions may not be critically constrained, achieving and maintaining a modest oversupply in the domestic market represents a more complex and forward-looking challenge. Ensuring sufficient and sustainably priced supply over the medium to long term requires a policy framework that effectively supports upstream investment.

0.3 In this regard, it is noted that the existing Domestic Gas Reservation Policy in Western Australia has demonstrated a track record of achieving both reliable LNG export growth and stable domestic gas supply. The Western Australian model has delivered outcomes consistent with the objective of maintaining adequate domestic supply while supporting continued investment and development.

0.4 As a constructive policy option, consideration may be given to adopting elements of the Western Australian model on a broader national basis. In particular, a reservation system based on a lifecycle approach (e.g., a reservation of approximately 15% over the life of a project) may provide a more investment-compatible framework compared to annual compliance-based obligations. Given the demonstrated success of this model in Western Australia, there is no clear structural reason why a similar approach would not contribute positively to outcomes in other regions.

0.5 More broadly, achieving both increased domestic gas supply and sustained LNG export growth will require a policy approach that prioritises investment promotion. In this context, complementary measures could include regulatory reforms to streamline approval processes, facilitate access to exploration acreage, and reduce barriers to upstream project development.

0.6 In relation to the proposed DSO framework, further consideration may also be given to introducing positive investment incentives linked to domestic supply

contributions. For example, LNG exporters that fulfil domestic reservation requirements could be supported through:

0.6.1 targeted fiscal incentives relating to upstream investment associated with domestic supply volumes; and/or

0.6.2 enhanced access to public financial support, including financing and risk-sharing mechanisms provided by public financial institutions.

0.6.3 Such measures could also, where appropriate, be extended to support upstream gas developments primarily serving the domestic market.

0.7 Such measures would help ensure that the policy framework not only reallocates existing supply but also actively contributes to expanding the overall supply base, thereby supporting both domestic energy security and the long-term reliability of Australia's LNG exports.

0.8 A framework that combines supply-side expansion with balanced reservation mechanisms is more likely to achieve durable and mutually beneficial outcomes than one focused solely on redistributive measures, which may result in the shrinkage of the supply base.

1 Investment Impact and Need for Investment Safeguards

1.1 The proposed scheme introduces a level of regulatory uncertainty that is likely to discourage additional upstream investment in Australia. In particular, investors will face difficulty in estimating future returns, not only because of the anticipated direct impact of the domestic supply obligation (DSO) on export volumes, but also due to the uncertainty associated with ministerial and regulatory discretion over DSO adjustments and compliance pathways.

1.2 To maintain Australia's attractiveness as a destination for long-term LNG investment, it is essential to introduce mechanisms that ensure an adequate and sufficient level of investment protection.

1.3 Fulfilment of DSO depends on the demand side taking the gas. However, the primary cause of under-compliance in DSOs is not negligence on the supply side. But rather it is likely to be demand-side factors such as inadequate or unclear systems for accepting supplies from domestic consumers (power plants and infrastructure), as well as unforeseen demand developments. Despite this, it is unreasonable to burden suppliers with civil penalties and variation, suspension or cancellation of approval to export.

1.4 The requirement that a regulated entity "must sell" gas into the domestic market may, depending on how it is interpreted and applied, create an expectation of

compulsory sales irrespective of commercial conditions. This may exert downward pressure on prices towards marginal cost levels and, as a result, discourage investment not only in LNG export projects but also in smaller-scale domestic gas developments. Such an outcome would risk undermining market-based investment incentives and may be perceived as inconsistent with fundamental principles of a market economy. It is therefore recommended that the framework clarify that DSO obligations are to be fulfilled through commercially negotiated transactions on reasonable market terms, rather than through compelled sales at uneconomic prices. Maintaining appropriate price signals is essential to ensuring continued investment in both domestic gas supply and LNG export capacity. Any interpretation of the obligation to "sell" that leads to non-commercial pricing outcomes could undermine these signals and ultimately reduce, rather than enhance, long-term gas supply.

1.4.1 It is further important that arrangements with third parties to fulfil DSO are structured in a manner that avoids unintended commercial imbalances. If the framework were to affect the relative bargaining positions of market participants, it may give rise to situations where LNG exporters lacking physical connectivity to the eastern market incur additional costs. Such outcomes may not necessarily contribute to an increase in physical gas supply and could, over time, influence perceptions of the investment environment in Australia's resource sector.

1.5 Such mechanisms to protect investment and avoid unreasonable burdens could include:

1.5.1 Clear and objective criteria for DSO variations,

1.5.2 Limits on discretionary adjustments and penalties

1.5.3 Long-term stability assurances for approved projects, and

1.5.4 Consideration to be given, in the design and implementation of the DSO framework, to the economic viability of LNG projects over their lifecycle. In particular, DSO settings and any variation decisions should take into account whether the resulting obligations would materially impair project economics or investment returns. This could be reflected through the incorporation of economic viability considerations into the criteria for DSO variations and periodic reviews, thereby ensuring that the framework continues to support sustainable levels of upstream investment.

2 Regulatory Discretion vs Predictability

2.1 While the proposed scheme incorporates flexibility through discretionary

decision-making by Ministers and regulators, this flexibility comes at the cost of reduced predictability. Flexibility is not problematic; however, from an investor's perspective, the current design creates a risk of adverse or unpredictable regulatory outcomes.

2.2 To support investment, flexibility should be accompanied by:

2.2.1 Transparent decision-making criteria,

2.2.2 Clearly defined boundaries for regulatory discretion, and

2.2.3 Procedural safeguards to ensure consistency and predictability.

2.2.4 It is assumed that the annual export approval will include the upper limit of spot LNG sales volume after meeting the DSO. If domestic gas demand fell short of prior expectations, flexibility should be allowed to increase spot LNG sales by leveraging the volumes set out for the DSO but no longer required to meet the domestic demand without incurring additional domestic supply obligations or any penalties. In such circumstances, increasing spot LNG sales should not require separate approval under the release valve mechanism.

2.2.5 The definition of an "LNG Exporter" must be strictly clarified to avoid structural and governance conflicts of those respectful investors. Depending on the structure of the Joint Venture Agreement (JVA), imposing direct domestic supply obligations on individual foreign investment participants - who often lack the corporate purpose or infrastructure for Australia's domestic commerce - may create critical conflicts with internal corporate governance and legal mandates. It is recognised that, in some cases, minority joint venture partners have been able to make arrangements with other participants or third parties to fulfil domestic marketing functions. However, such arrangements may not be universally available and may introduce additional complexity, cost and legal uncertainty.

3 Treatment of Existing Contracts

3.1 Although the scheme provides for the protection of pre-existing contracts, its practical application may be limited due to the broad interpretation of alternative supply and portfolio flexibility. In addition, the proposed scheme may have a retrospective effect by effectively replacing an existing contractual right to export with a requirement to obtain regulatory approval to continue exporting.

3.2 In particular:

3.2.1 Contractual extension rights should be recognised as part of existing contracts;

3.2.2 Upward Quantity Tolerance (UQT) provisions should be fully respected in

calculating the DSO. This should be applied on the basis that existing contracts are fully exempt from DSO obligations; otherwise, there is a risk that the inclusion of UQT volumes may result in an unintended increase in DSO requirements.

3.2.3 For example, where a contract includes a base volume of 1 million tonnes per year with a 10% UQT as the buyer's option, the full 1.1 million tonnes per year should be treated as protected volumes for the purpose of DSO calculation.

3.2.4 Equity lifting arrangements should also respected. In the LNG industry, it is a well-established practice that investments in LNG production projects are accompanied by the right to take delivery of LNG production equivalent to the investment. This equity-lifting arrangement should be respected, just like existing sales contracts.

3.2.5 Existing LNG export contracts should be fully grandfathered, such that contracted volumes are automatically exempt from DSO obligations without requiring additional regulatory approval, and are not subject to carry-forward or accrual mechanisms.

3.2.6 It should be clarified that existing LNG projects and contractual arrangements are not required, in order to maintain their protected status, to demonstrate the availability of “viable alternatives” for supplying domestic gas where such alternatives are not reasonably practicable. In particular, requiring participants in existing projects to explore or develop entirely new domestic supply pathways - including participation in geographically disconnected domestic markets or the development of new infrastructure - may not be feasible in practice and could give rise to unintended retrospective effects.

3.3 Clarification on these points is essential to ensure that contractual rights are preserved in practice.

4 Limitations of Third-Party Supply as a Compliance Tool

4.1 While the framework allows LNG exporters to meet their DSO through third-party supply arrangements, this pathway may be limited in practice due to:

4.1.1 the additionality requirement, and

4.1.2 the long lead times associated with upstream development.

4.2 As a result, third-party supply is unlikely to function as a reliable short-term compliance mechanism.

4.3 To address this, the Government should consider:

4.3.1 phased application of DSO obligations to new LNG projects, and

4.3.2 transitional arrangements that reflect the timing of new supply availability.

4.4 In applying the framework, practical and realistic criteria should be adopted for assessing DSO variations and third-party supply options. Requiring LNG exporters to demonstrate that all alternative commercial arrangements (including swaps and international sourcing) are entirely infeasible would impose an excessive operational and legal burden. Where regulated entities have made good faith and commercially reasonable efforts but are unable to secure alternative supply due to structural market constraints, such circumstances should be recognised as valid grounds for DSO relief or safe harbour treatment, rather than triggering penalties

4.5 It should also be recognised that LNG cargoes are not fully fungible in practice. Differences in technical specifications, infrastructure compatibility, and contractual arrangements mean that substituting LNG supply is often constrained by operational and physical limitations. As such, meeting DSO obligations cannot be treated as a purely commercial optimisation decision.

5 Transition Period and Phased Implementation

5.1 The time available before the commencement of the scheme is limited, making this a critical transition period for market participants. At the same time, given the complexity and breadth of the proposed framework, its development and implementation also represent a significant institutional challenge. Ensuring that the scheme is fully developed, clearly articulated and supported by adequate administrative capacity will be critical to its effective operation.

5.2 Companies will need to:

5.2.1 assess DSO compliance,

5.2.2 restructure contractual portfolios, and

5.2.3 secure domestic supply arrangements.

5.3 Given these challenges, a phased implementation approach is recommended, for example:

5.3.1 introducing the DSO at a lower percentage initially, and

5.3.2 gradually increasing it over time.

5.3.3 allowing sufficient time for policy refinement and implementation, including consideration of an adjusted commencement timeline if necessary to ensure the scheme is robust and operationally effective.

5.4 This would reduce disruption and allow the market to adjust efficiently.

5.5 Consideration should also be given to the alignment of the proposed implementation timeline with established LNG delivery programming cycles.

LNG supply chains operate through Annual Delivery Programs (ADPs), which are complex, multi-party arrangements covering production, shipping and terminal operations. Introducing the scheme within the current timeline may create misalignment with these established cycles, potentially increasing uncertainty and operational risks for both buyers and sellers. In this context, a deferred implementation timeline should be considered

6 Reservation Percentage and Market Design, as well as Regional Considerations

6.1 The proposed scheme represents a highly interventionist regulatory model, affecting not only reservation volumes but also market behaviour and contracting practices.

6.2 The uniform application of a 20% reservation ratio across all regions may not be optimal, given differences in domestic demand and infrastructure constraints, including well-recognised physical absence of East-West interconnectors. Regions not connected by pipeline to the eastern regions where additional supply is needed should not be subject to the DSO regulation. This is because fulfilling obligations is unrealistic from disconnected supply regions. It remains unclear whether the gas pipeline and future LNG receiving infrastructure to Sydney and Melbourne, the two largest consumption areas, has or will have sufficient capacity to accommodate additional volumes (exceeding the already committed volumes). Even if LNG receiving capacity is expanded in the eastern region in the future, it is likely to be more expensive for users than pipeline gas.

6.2.1 Furthermore, from the perspective of efficient resource allocation and regional energy security, priority should be given to structural measures that increase the physical availability of gas. Reallocation of notional supply credits without corresponding infrastructure connectivity is unlikely to increase actual gas availability in key demand centres such as Sydney and Melbourne. Enhancing upstream supply incentives within the eastern market or reflecting physically connected supply sources may provide a more effective means of addressing underlying supply-demand imbalances.

6.3 It is recommended that:

6.3.1 reservation percentages be calibrated based on regional market conditions, as well as insufficient infrastructure and shortages of gas consuming facilities;

6.3.2 The existing framework for domestic gas reservation in Western Australia, which has been implemented over many years, should be respected. The Western Australian Domestic Gas Reservation Policy should continue to

apply in that state, and the proposed new scheme should not be applied to projects located in Western Australia; and

6.3.3 periodic reviews be conducted based on objective demand and supply data.

7 Compliance Timeframe

7.1.1 While the framework provides that DSO compliance will be assessed on an annual basis, it remains to be seen whether export approvals will be granted on an annual basis or for longer durations.

7.1.2 Given the long-term and capital-intensive nature of LNG projects, the ability to obtain export approvals over an extended period is critical to ensuring investment certainty and facilitating long-term planning. If export approvals were to be limited to short-term or annually renewable periods, this could introduce significant regulatory risk and undermine confidence in long-term investment decisions. From the perspective of LNG buyers, long-term contracts require certainty of supply. An annual export approval regime subject to ministerial discretion may introduce uncertainty that could undermine confidence in the reliability of long-term supply arrangements.

7.1.3 It is therefore recommended that the framework clarify that export approvals can be granted for sufficiently long durations, consistent with the lifecycle and financing requirements of LNG projects.

8 Treatment of DSO Carry-Forward Obligations

8.1 The Carry-Forward Obligations in the new DSO scheme is intended to add some flexibility to the more rigid annual DSO obligation as proposed under *the Draft Design Framework*, unlike the lifetime fulfilment system incorporated in the *Western Australia's Domestic Gas Reservation Policy*. The annual DSO obligation is more burdensome than the lifetime obligation and should be avoided to maintain the attractiveness of the LNG sector investment in Australia.

8.2 The proposed mechanism for carrying forward under-compliance with DSO obligations may create a significant balance sheet burden for LNG exporters.

8.3 In particular, mandatory carry-forward of unmet obligations may be perceived as a future liability.

8.4 It is recommended that:

8.4.1 only excess supply (over-compliance) should be eligible for carry-forward credits; and

8.4.2 under-compliance should not automatically generate future obligations, or should be subject to flexible treatment. The primary cause of under-compliance in domestic supply obligations is not negligence on the supply

side, but rather is likely to be demand-side factors such as "inadequate or unclear systems for accepting supplies from domestic consumers (power plants and infrastructure), as well as unforeseen demand developments." Despite this, it is unreasonable to burden suppliers with this as a "future liability."

9 Northern Territory-Specific Considerations

9.1 LNG projects in the Northern Territory face unique challenges due to:

9.1.1 limited pipeline connectivity to domestic markets, including well-recognised physical absence of East-North interconnectors, and

9.1.2 relatively small local demand compared to export volumes.

9.2 In such cases, a uniform DSO percentage may not appropriately reflect the realities of the regional market.

9.3 The Government should consider:

9.3.1 alternative compliance frameworks for infrastructure-constrained regions, and

9.3.2 recognition of broader economic contributions by LNG projects.