

AUSTRALIAN FEDERAL GOVERNMENT GIVEN THE POWER TO RESTRICT LNG EXPORTS FROM 1 JULY 2017

The Australian Domestic Gas Security Mechanism (**ADGSM**) took effect on 1 July 2017. It gives the Minister administering the Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth) (currently the Minister for Industry, Innovation and Science) (**Minister**) the discretion to enliven LNG export restrictions if he considers there will be domestic gas shortages for Australian consumers in an upcoming calendar year and exports of LNG would contribute to that shortage.

The ADGSM is contained in the Customs (Prohibited Exports) Amendment (Liquefied Natural Gas) Regulations 2017 which amend the Customs (Prohibited Exports) Regulations 1958 under the Customs Act 1901 (Cth).

WHY ARE WE HERE

The Australian Prime Minister has recently declared that affordable and reliable power outweighs concerns about sovereign risk or increased government intervention in the energy sector in Australia and the ADGSM may be the Federal Government's latest measure to achieve this outcome.

The development of three large LNG projects in Queensland in late 2010 together with onshore gas exploration and development moratoria in New South Wales and Victoria has contributed to a fundamental shift in the structure of the east coast gas market with Australian households and manufacturers increasingly raising concerns about rising prices and security of supply.

This is occurring against the backdrop of rapid changes to the generation mix in Australia with a transition to high levels of renewable energy sources. These changes are said to have played a role in the "Black System" event in South Australia in September 2016 where approximately 850,000 South Australian customers lost electricity supply due to storm damage and an over reliance on renewable energy that was not available during that weather event.

Key issues

- The objective of the ADGSM is to deliver a short term solution to Australia's anticipated domestic gas shortage on the east coast.
- It is expected to be in place for approximately 5 years (until 1 January 2023) unless extended as part of a formal review process in 2020.
- We expect the Federal Government will come under pressure to enliven the LNG export restrictions in 2018 or 2019 if there are to be shortages.
- Industry participants should be preparing for the impact of any potential LNG export restrictions or export permissions on their existing contractual arrangements including GSAs, LNG SPAs and JVOAs as well as their investment decisions for existing and future projects.
- LNG SPAs may contain change in law clauses which allocate risk between the parties in these circumstances.
- Alternatively, a change in law may entitle the seller to claim force majeure under its LNG SPA and such provisions should be carefully considered.

SHORT TERM SOLUTION

The ADGSM is intended to be a short term solution to Australia's anticipated domestic gas shortage and operate for approximately 5 years (until 1 January 2023) unless extended as part of the Minister's formal review process in 2020.

However, during the stakeholder consultation process leading up to the commencement of the ADGSM the Federal Government has acknowledged that a long term solution to increase domestic gas supply must include the lifting of bans and restrictions on gas development imposed by certain states and territories in Australia. This is consistent with the recommendations of the Australian Competition and Consumer Commission in its 2015 East Coast Gas Inquiry (refer to our previous alert:

https://www.cliffordchance.com/briefings/2016/04/accc_foreshadowsaregulatoryshake-upofth.html).

OBJECTIVE OF ADGSM

The objective of the ADGSM is to increase domestic gas supply to Australian consumers by giving the Minister the discretion to restrict LNG exports if the Minister has:

- reasonable grounds to believe that there will be a domestic gas supply shortfall in the upcoming calendar year and exports of LNG will contribute to that lack of shortfall; and
- consulted with various stakeholders in reaching this decision including the Prime Minister, the Energy Minister, the Industry Minister and the Trade Minister as well as the Australian Energy Market Operator and the Australian Competition and Consumer Commission.

KEY STAGES IN THE PROCESS

Industry participants will have at least 3 months' prior notice to prepare for a domestic shortfall year:



STEPS FOLLOWING THE MINISTER'S DETERMINATION

Step 1 – Total Market Security Obligation

Following a determination by the Minister of a domestic gas shortfall the Minister will determine a provisional Total Market Security Obligation (**TMSO**) which is the proportion of the domestic gas shortfall that the Minister considers may be met by imposing export restrictions on LNG Projects to incentivise them to increase net gas supply to Australian consumers. The provisional TMSO will be finalised following consultation with other relevant Australian Government Ministers.

At the same time the Minister will determine each LNG Project's "net market position" as either a net deficit or net contributor.

An LNG Project will be in "net deficit" if:

- its total gas used is greater than its own gas and any third party export compatible gas; or
- its gas purchases from the domestic market are greater than sales to the domestic market.

Step 2 – Exporter Market Security Obligation

The Minister will allocate the TMSO on a pro-rata basis across all LNG Projects in net deficit (excluding LNG Projects located in a part of the Australian domestic gas market which is physically unconnected to the part of the Australian domestic gas market which is in shortfall) in proportion to the quantum of deficit for each LNG Project in net deficit.

This is referred to as the LNG Project's Exporter Market Security Obligation (**EMSO**). LNG Projects will be permitted to reduce their EMSO by reducing their LNG export quantities or making additional gas available to the domestic market.

When calculating the TMSO and EMSO the Minister may take into account the past performance of the LNG Project and LNG Exporters including any identified "gaming" of any aspects of the ADGSM and any behaviours that the Minister considers are against the spirit of the ADGSM.

Step 3 – Export Permissions

The Minister may grant the following types of export permissions (which are effectively written permissions to export LNG granted by the Minister):

- an unlimited volume (**UV**) permission which allows the LNG Exporter to export an unlimited volume of LNG from a particular LNG Project over the permission term (which may extend beyond the domestic shortfall year); or
- an allowable volume (**AV**) permission which allows the LNG Exporter to export up to a maximum volume of LNG from a specific LNG Project over the permission term (which may extend beyond the domestic shortfall year). Maximum exports under the AV permission will typically be equal to an LNG Project's EMSO (refer to Step 2 above) subcontracted from its proposed total export quantity.

These export permissions will generally be assignable with the written consent of the Minister.

POTENTIAL IMPACT ON INDUSTRY PARTICIPANTS

Gas and LNG buyers and sellers should be prepared for the impact of these LNG export restrictions or export permissions on their GSAs and LNG SPAs and their investment decisions for existing and future projects.

The enactment of these new regulations under the Customs Act 1901 (Cth) may constitute a change in law under existing GSAs or LNG SPAs. To the extent that there is not a separate change in law mechanism under the agreement, a change in law is sometimes treated as force majeure which gives the affected party relief from its obligation to take or deliver (as the case may be) its contracted quantity of gas or LNG (as the case may be). If this occurs, this is likely to have flow on effects for both the buyers and sellers in their respective value chains. Expert advice should be obtained on these issues.

CLIFFORD CHANCE CONTACTS

We have extensive experience advising buyers, sellers and joint venture participants in relation to their upstream, midstream and downstream gas and LNG projects and would be pleased to provide you with further information about the ADGSM upon request. Please refer to our contact details overleaf.

Key definitions

- **LNG Exporter** means a person who exports LNG from Australia.
- **LNG Project** means the entity, or group of entities, which own, control or operate an LNG facility and its associated upstream operations, and any related bodies corporate.
- **Own gas** means gas produced from one or more tenements:
 - (a) owned by the LNG Project to the extent of the LNG Project's participating interest share of such gas; or
 - (b) owned by one or more entities of the LNG Project, where:
 - (i) the gas is contracted directly by such entity or entities to supply the LNG Project; and
 - (ii) the gas was primarily developed for the purpose of supplying the export market.
- **Third party export compatible gas** means gas produced from tenements owned by a third party where:
 - (a) the gas is contracted directly by such third party to supply the LNG Project; and
 - (b) either:
 - (i) the gas was primarily developed for the purpose of supplying the export market; or
 - (ii) the contract for the supply of gas was entered into for the purpose of supplying the LNG Project, before a final investment decision was made in relation to the LNG Project.
- **Total gas used** means the sum of gas:
 - (a) proposed to be exported; and
 - (b) any other gas that is forecast to be consumed or lost in the LNG Project's operations.

C L I F F O R D C H A N C E

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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