GRATTAN Institute

Designing a workable gas reservation scheme

How to make the proposed scheme acceptable for producers and consumers

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Summary

The federal government is consulting on a model for a gas reservation scheme, the stated objective being to ensure that Australians have access to the gas they need at an affordable price. Liquefied Natural Gas (LNG) producers and domestic gas consumers support the objective. But it will not be delivered by the draft design. Several of its central proposals are impractical or based on simplistic models of how markets respond to forced imbalances between supply and demand.

The good news that the draft framework can be fixed to deliver the gas that Australian consumers require at prices that avoid high and volatile international extremes, without onerous impacts on LNG producers and their customers. The scheme would still involve government intervention but be designed to deliver the objective as directly as possible while minimising adverse consequences. There are four major changes that should be made to the draft scheme.

First, in practice, there are three domestic regional markets to be supplied: the east coast, Western Australia, and the Northern Territory. The domestic supply obligation (DSO) on LNG producers should be based directly on the regional market with which they are connected and not on the level of LNG production. The DSO should not be subject to ministerial discretion.

Second, to place the downward price pressure sought by the government, the DSO for each domestic market should be set in petajoules at a modest volume above any shortfall projected by the Australian Energy Market Operator (AEMO). There is no theoretically correct level for this oversupply. A level of 2-to-5 per cent of domestic demand could be the initial setting. A combination of a 5 per cent oversupply and likely near-term domestic market shortfalls would mean a DSO of around 55 petajoules per annum, against an LNG production of around 1,300 petajoules.

This approach would largely negate the objection from producers to a DSO of 20 per cent of production, i.e. more that 250 petajoules. The DSO level should be reviewed periodically and adjusted to achieve a balance between high prices and supply destruction.

Once the domestic market is supplied, the remaining oversupply would still find a home if the obligation is to supply, and not just offer, that gas to the domestic market. That outcome would reduce the market available to other domestic gas suppliers.

This risk from oversupply leads to the third major change. The draft scheme includes both a firm obligation to supply and a form of commerciality test that if the market is fully supplied, then the oversupply can be exported. There is little detail as to how the caveat could be practically implemented. In the absence of such detail, variations to the firm DSO should not be allowed, and the consequences accepted.

The fourth major change that we recommend is to enable a return to multi-year contracting in the domestic market. The best way to achieve that would be to express the DSO as an amount of gas to be delivered every year for the next five years, with the first year being firm and the subsequent years reviewed and rolled forward annually as the energy market operator's projections are updated.

Making these changes to the draft scheme would achieve the government's objectives and provide a more predictable market for producers and consumers. Further detailed recommendations are contained in the remainder of this submission, together with supporting analysis.

Recommendations

1. The domestic gas market should be defined by three regional markets until they are materially connected with new infrastructure. These should be the east coast, Western Australia, and the Northern Territory.
2. A domestic supply obligation (DSO) should be set by the Australian Energy Regulator (AER) at a modest volume above any projected domestic shortfall for each regional market as calculated by the Australian Energy Market Ooperator (AEMO) in its annual Gas Statement of Opportunities (GSOO). An oversupply of 2-to-5 per cent of demand, capped at 20 per cent of LNG production, would be adequate. The level should be reviewed, initially annually, to get an acceptable balance in the domestic market.
3. The DSO should be a five-year obligation set on an annual basis against five-year forward domestic market projections from the GSOO, set in petajoules, revised and rolled forward annually.
4. The proposed scheme framework allows for DSOs to be varied from a firm obligation to supply if the market is assessed to be fully supplied, including an acceptable level of liquidity. Unless the operation of this condition in the market can be clearly defined, such variations should not be allowed.
5. If the firm supply obligation is maintained, then the market liquidity test and release valve should be removed because they no longer apply.
6. The proposal to deal with inadequate infrastructure will not work as an obligation on a single LNG exporter to secure infrastructure investment through commercial arrangements. An alternative would be for the Energy and Climate Change Ministerial Council (ECMC) to restart its consultation on an alternative solution to develop storage and/or transport infrastructure with some government underwriting of risk.
7. The proposal to accrue variations against future periods should be removed because it is unlikely to provide material benefit and will quickly become unworkable.
8. The first recommendation above means that a staged approach across the three sub-national markets should be implemented: begin with the east coast as described and with the DSOs for WA and the NT set to zero. Three years should be allowed for the WA scheme to be harmonised, while the NT will require substantial infrastructure to be integrated with the east coast market.
9. To avoid derailing emissions-reduction targets, the federal government should establish policies and regulations to reduce emissions from sources that include the use of gas in residential, industrial, and power generation sectors.

1 Introduction

This submission is by Tony Wood, Hamish McKenzie, and Alison Reeve of the Grattan Institute, an independent think tank focused on Australian domestic public policy. Grattan aims to improve policy by engaging with decision makers and the broader community.

This submission responds to the Draft Design Framework for a Domestic Gas Reservation Scheme, released by the Department of Climate Change, Energy, the Environment, and Water and the Department of Industry, Science, and Resources in May 2026.

We describe critical problems with the draft design and make recommendations as to how they should be addressed. These recommendations will ensure the government achieves its stated policy objectives, while minimising the risk to Australia's emissions-reduction targets.

We would welcome the opportunity to engage further with the government on any of the matters raised in this submission.

2 How to make the scheme work

Well-regulated markets connect demand and supply via pricing. Government intervention to directly regulate demand, supply, or price cannot be considered in isolation – controlling one will affect the others. So it is with Australia's domestic gas market.

The federal government's stated primary objective with the reservation scheme is to ensure the domestic gas market has adequate supply at prices protected from international price movements. The draft scheme design aims to achieve this objective by setting a domestic supply obligation (DSO) that slightly oversupplies the domestic market to put downward pressure on prices that would have applied otherwise.

There are several problems that arise from the way the draft scheme sets the DSO and how it aims to deliver lower prices. This section sets out the changes required to make the scheme deliver on its goals.

To begin, the government should split the scheme into three regions - WA, NT and the east coast - and focus first on the east coast region where the problem is most acute and the implementation most straightforward. It should implement obligations in the east coast beginning 1 January 2028, in WA on 1 January 2030, and for the NT when infrastructure providing a material connection to the east coast market is developed..

DSOs should be set based on forecast supply gaps in each region, and a modest oversupply of between 2-to-5 per cent. The regional DSO should be applied to individual exporters based on their share of LNG exports; there should be no Ministerial discretion to adjust individual obligations; and to encourage multi-year contracting, DSOs should be set for five years, updated annually based on the GSOO.

The gas reservation model outlined by government is workable – but only with significant changes.

2.1 Split the reservation into three regional gas markets

The draft design contemplates a national gas reservation, where the DSO is set based on domestic demand and LNG exports. Theoretically,this could involve using gas from WA or the NT to address gas shortages in Victoria.

In practice, Australia has three functionally separate gas markets with very different supply-demand balances, and with limited ability to transport gas between them. These markets are Western Australia, the Northern Territory, and the east coast.

Given the physical challenges of transporting gas between the markets, the fact of WA's existing gas reservation scheme, and the different shortfall expectations in each market, the government should, initially, at least, implement the scheme as three distinct regions, where the DSO is set based on regional demand, and applied to LNG exporters in each region.

This structure may evolve if connecting pipelines or coastal shipping of LNG becomes viable.

2.2 Stagger implementation, starting with the east coast

The government's proposal is to commence the DSO with approved export licences from 1 July 2027. This would involve setting DSOs for a six-month period, before implementing the first full-year DSO starting 1 January 2028.

Given the complexity of the design work it would be prudent for the government to delay implementation of the DSO until 1 January 2028. This would give both government and industry sufficient time to get the scheme right.

Splitting the reservation into three regions also allows the government to stagger implementation where it matters most. Aligning the national DSO and the WA scheme will take several years. And the DSO for NT-based LNG exporters is likely to combine with the east-coast market if/when infrastructure is developed.

The government should therefore start by implementing the scheme in the east coast market, and setting obligations under the national scheme at zero for WA and NT exporters until 2030. In this model, the reservation would set DSOs on the three east coast LNG exporters based on demand in the east coast market only.

2.3 Set the DSO based on domestic market projections plus a modest oversupply

The draft design proposes to set the DSO at 20 per cent of LNG production, with annual adjustments applied by ministers based on expected demand.

In practice, an obligation as 20 per cent of LNG production would deliver far too much gas to the domestic market for the foreseeable future. And a DSO to ensure supply to a domestic market should surely be set based on projections of the domestic market, not on LNG production which is driven primarily by export demand.

Instead, the DSO should be set at a modest volume above AEMO's projection of any regional shortfall, up to a cap of 20 per cent of exports

Greater market predictability would be provided by codifying the oversupply obligation rather than leaving it to ministerial discretion that creates unpredictability and greater risk for market participants. The government's objective would still be met.

2.4 The oversupply should be set at a modest percentage of the projected regional demand, reviewed over time

An initial level of 2-to-5 per cent above forecast demand would seem adequate. As an example, based on recent east coast demand and projected shortfalls, a 5 per cent oversupply would mean a DSO of around 55 petajoules, of which around 25 petajoules would be the oversupply.

There is no simple methodology to set the initial level of oversupply. Using a forced oversupply to meet demand is almost certain to result in too much or too little. If the firm obligation to supply is maintained then it would be prudent to allow a review period for this parameter to be adjusted.

2.5 There should be no DSO variations for individual exporters

Under the government's proposal, individual exporters can apply to the Minister to have their DSO adjusted based on, for example, infrastructure and production constraints, or contracting commitments. This is both arbitrary and unfair.

It is arbitrary because it introduces substantial discretion for ministers to allow individual exporters to avoid delivering domestic gas. And it is unfair because it would allocate the costs of the scheme onto the exporters with greater ability to deliver domestic gas and away from exporters that have failed to invest in domestic gas. The ability for minister to adjust individual DSOs should be deleted.

2.6 Restore the obligation to supply

The draft scheme requires that a level of oversupply must be provided to the domestic market. This gas will crowd into the market. Once contracted it will displace other domestic supply and the cycle will be repeated annually, likely leading to longer-term supply destruction.

To address this problem, the draft scheme includes a mechanism to release the oversupply for export once the domestic market is supplied, meets a level of liquidity requirement (up to 30 per cent of the DSO available to the short-term market) and has been offered the oversupply on domestically competitive terms.

This mechanism contradicts the government's position that the gas must be supplied and no commerciality test applies. Even if that position was softened, there is no detail in the draft scheme on how such a mechanism would operate in the market or how 'domestically competitive' could be defined.

The government must make a difficult choice: It could accept that the consequences of a modest oversupply are acceptable in the context of its objective. Alternatively, it could introduce an effective 'supplied market' test that allows oversupplied gas to be exported and is designed to avoid negating the downward price pressure of modest oversupply. It cannot have both.

In our original submission to the gas reservation design, we proposed maintaining the obligation to supply with no release valve because we cannot see a workable solution for a liquidity test that allows DSO gas to be exported while retaining the desired price and supply effects of the reservation. If the government is committed to a release valve, it will need to design a clear and robust liquidity test that cannot be exploited.

2.7 Set DSOs five years in advance

In the proposed model, DSOs are set annually in the last quarter of each year for the year ahead. This annual cycle would make long-term contracting difficult because LNG producers have little visibility of their future DSO obligations. Yet encouraging multi-year contracting is a desired goal of the scheme.

Instead, the scheme should set the DSO as a five-year obligation based on forecast supply and demand balance. The first year should be firm and later years updated and rolled forward on an annual basis in line with the supply-demand forecasts. Market participants would then have a level of predictability to guide their own assessment of forward price risks and contract exposure.

2.8 Reject the retrospectivity objection

In the east coast, LNG exporters are consortia of buyers and sellers of LNG. Some consortia members have argued that the imposition of a DSO breaks the government commitment to honour existing contracts.

The DSO is an obligation that did not exist when the current long-term contracts were created to finance the investment in the LNG trains in Queensland. In that sense the DSO is a retrospective obligation that applies indirectly to all the members of the export consortia, many of which are overseas companies and customers of the exports.

These objections from the LNG producers should be rejected for three reasons.

First, some form of export restrictions would probably have been applied if governments had foreseen the evolution of the market, and the reservation scheme is now being applied to future contracts to correct that oversight. It became clear very soon after the initial exports began in 2015 that LNG producers' decisions to divert gas from the domestic market would result in supply shortages, and that a responsible federal government would have to intervene to prevent such shortages.

Second, a floating DSO linked to a domestic market shortfall and a slight oversupply would result, at least initially, in very small volumes of gas, containing costs to modest levels.

Third, the east coast LNG producers are effectively managing a gap-based obligation already under the Australian Domestic Gas Security Mechanism and associated mechanisms. The reservation would replace these existing obligations.

2.9 Inadequate transport capacity

In December 2025, the Energy and Climate Change Ministerial Council (ECMC) initiated consultation on a proposal to avoid gas shortfalls in south-east Australia if the market did not respond. The concept would expand AEMO's powers to intervene in the market by supporting new infrastructure. The ECMC halted the work in May 2026 in the expectation that the reservation scheme could be the best way to support investment in new storage and transport infrastructure.

The draft reservation scheme allows ministers to vary a DSO if a regulated entity can prove that it cannot achieve the obligation due to infrastructure constraints. The draft places the obligation on regulated entities to pursue commercial arrangements to deliver this infrastructure if its absence is the barrier to a DSO being achieved.

There is a high risk that commercial arrangements to develop new infrastructure to deliver what may initially be modest volumes in an evolving market will be unachievable, at least by an individual exporter. Unless a workable version of this sub-mechanism can be determined, it would be preferable to return to the proposal previously initiated by the ECMC to consider some form of government underwriting to manage the risk of shortfalls in the south-east. Evolving market activity has made some progress in delaying the probability of shortfalls for a few years, so this may provide time for the ECMC's proposal to be pursued in some form.

2.10 Prioritise demand reduction measures

The draft design notes that measures are being taken in various places, including Victoria, the ACT, and Sydney, to reduce gas demand, primarily to meet emissions-reduction targets.

In the absence of clear, national policies, the design of the reservation scheme could undermine reaching such targets, by forcing additional gas supply into the market.

The best way to avoid this problem would be for the federal government, working with the jurisdictions to establish new policies and programs to reduce demand for gas across the residential, electricity, and industrial sectors.

Reducing gas demand is also an effective way to both reduce supply shortfalls and reduce gas prices. Instead of relying solely on the reservation, the government should prioritise these demand-side measures to achieve its goals.