Submission
No 57

DOWNSTREAM GAS SUPPLY AND AVAILABILITY IN NSW

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The Committee Manager
State and Regional Development Committee
Parliament House
Macquarie St
Sydney NSW 2000

By email: stateregional@parliament.nsw.gov.au

Dear Committee,

Re: Inquiry into downstream gas supply and availability in New South Wales

AGL Energy Ltd ("AGL") welcomes the opportunity to provide a submission to the State and Regional Development Committee Inquiry into downstream gas supply and availability in New South Wales ("NSW").

AGL is Australia's leading renewable energy company with the largest privately owned and operated renewable portfolio in the country. AGL is also one of Australia's largest retailers of gas and electricity with more than 3.5 million customers in Victoria, NSW, South Australia and Queensland. AGL is the largest supplier of gas to NSW providing approximately 60 per cent of the retail market or "downstream gas demand".

In addition AGL operates across the supply chain with investments in energy retailing, coal-fired electricity generation, gas fired electricity generation, renewable and upstream gas exploration and production projects. The diversity of AGL's portfolio has enabled AGL to develop a detailed understanding of the risks presented by wholesale and retail gas demand.

1. The adequacy of transmission pipeline systems and distribution networks for future downstream gas needs and supply challenges;

AGL does not own nor operate a transmission or distribution network. However we believe that the current level of infrastructure in place, both at the transmission and distribution level, is adequate to meet existing and near-term future demand in existing gas demand centres such as Sydney and large regional centres.

As a gas retailer, AGL's upstream gas division was established to create a portfolio of equity gas investments that will provide AGL with a more flexible, self-supply option to enable it to fill the gap between wholesale gas contract positions and AGL customer gas demand in the retail market. The intention is to ensure AGL will remain a cost competitive and a reliable supplier of natural gas into the future.

AGL has invested more than $800 million in the NSW coal seam gas ("CSG") industry and more than $350 million in the Queensland CSG industry. AGL wholly owns and operates NSW's largest CSG production facility at Camden, south-west Sydney, which has been operating for 13 years and supplies approximately 5 per cent of NSW's gas demand. AGL is also exploring for and developing new CSG resources at Gloucester and in the Hunter Valley; and is investing $300 million in a gas storage facility at Tomago near Newcastle. AGL is committed to ensuring that its gas exploration and production activities have a low impact on the environment and the community, and can comfortably co-exist with other land uses, including agricultural, pastoral, residential and industrial development.

Downstream gas supply needs and challenges

Other than AGL's Camden Gas Project, approximately 95 per cent of NSW's gas is imported from other states. This means that NSW faces limitations when it comes to the question of security of gas supply under constrained supply-side conditions. Gas demand is forecast to increase substantially due to liquefied natural gas ("LNG") projects coming which will come online in Queensland. Many long term gas contracts that nominally supply NSW will expire over the period to 2017, and some of those gas suppliers are likely to have committed non-trivial amounts of that existing gas supply to the LNG projects that will begin exporting gas internationally in 2015.

In contrast to Queensland, the focus in NSW is on the development of gas resources for domestic supply, and AGL is at the forefront of this development.

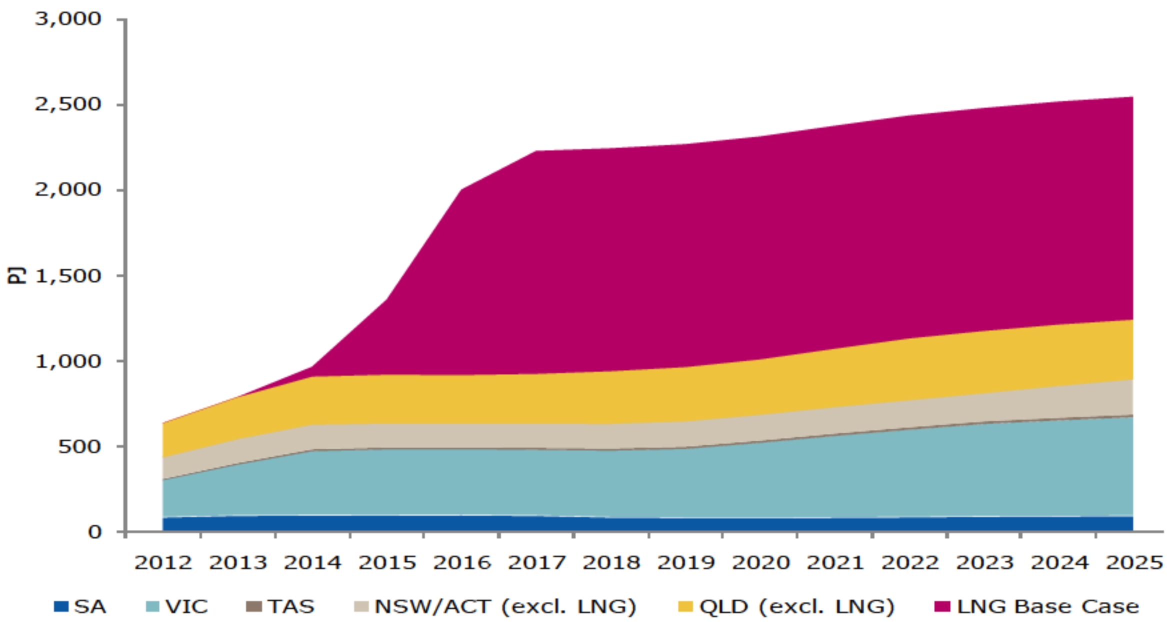


Figure 1: Eastern Australia forecast gas demand

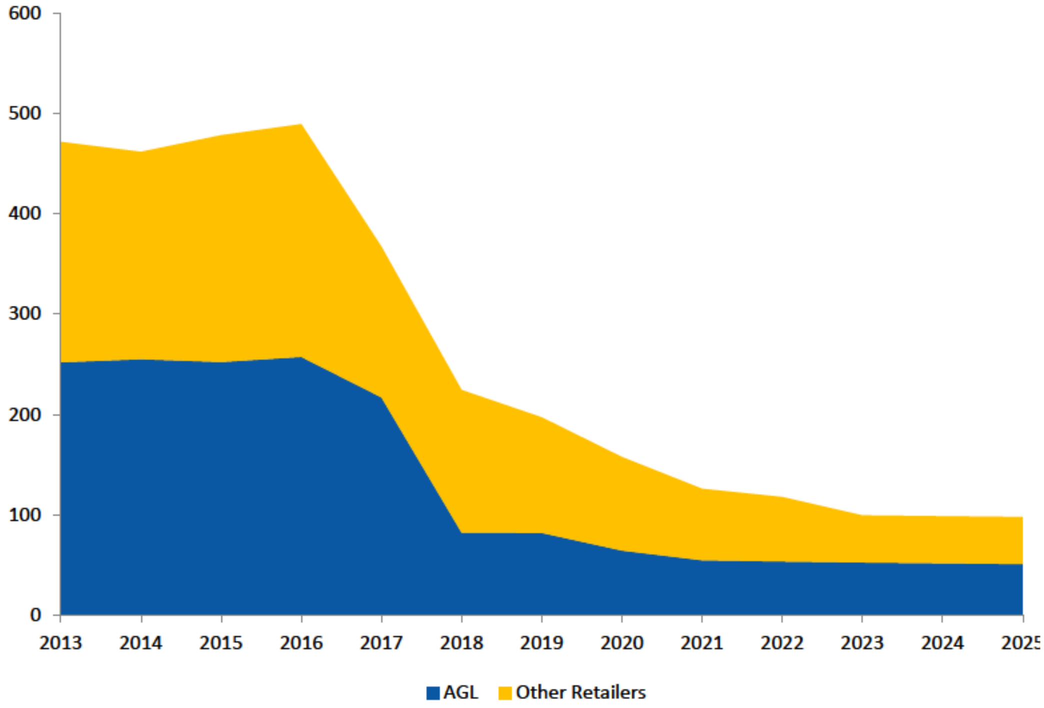


Figure 2: Eastern Australia estimates of contracted supply
Sources for Fig 1 and 2: AGL and ACIL Tasman

In the absence of a growing local natural gas industry, NSW will be significantly exposed to a risk of constrained gas supply and sharp upward price changes (ACIL Tasman, 2012). Currently, NSW homes and small businesses account for approximately of 20 per cent of NSW gas demand. This means that NSW could be left with critical gas supply shortages – a fact that will greatly disadvantage the many businesses within the State.

The potential for security of supply breaches later in the current decade is of particular concern to AGL Energy and NSW's manufacturing industries. More than half of NSW's gas supply is used by industry including food processing industries, fertiliser producers and manufacturing which rely on gas to do business.

In relation to the existing gas networks, if NSW gas sources cannot be brought online as previously anticipated, and current sources of gas are not available, then significant portions of the existing infrastructure will become either constrained during peak winter periods, or redundant and alternative transmission paths may need to be considered. This cost will then need to be passed through to NSW gas customers.

2. Barriers to the expansion of downstream gas supply and distribution networks;

Downstream Market

Barriers to single-fuel retailers retailing both electricity and gas are low, and in fact currently five active energy retailers in NSW are dual fuel retailers (AGL, Origin Energy, EnergyAustralia, Australian Power & Gas and Lumo Energy).

The same billing systems can be used to bill both electricity and gas customers, hence some cost advantages exist for dual fuel retailers. Not all premises in NSW have gas connections; therefore generally it is a commercially attractive proposition for gas retailers in NSW to sell electricity as well.

Upstream Market

Critical to the gas industry's ability to provide downstream gas supply is its ability to access gas from upstream gas sources within NSW. AGL believes that the most critical factor influencing NSW retail gas supply is the policy framework which will enable a viable CSG industry to develop supply for retailers in NSW. If the CSG industry is allowed to safely develop the proven gas reserves in NSW, there is enough natural gas in NSW to supply current levels of consumption for many decades.

AGL is advised that the NSW Government intends to implement its Draft *State Environmental Planning Policy (Mining, Petroleum Production and Extractive Industries) Amendment (Coal Seam Gas Exclusion Zones) 2013* ("Mining SEPP Amendment") in the coming weeks. AGL acknowledges that the NSW Government is attempting to respond to community concerns surrounding CSG projects by developing the Mining SEPP Amendment. Both Government and industry has a responsibility to re-engage with local communities in ways which ease concerns and facilitate safe and sustainable CSG development.

We expect the Mining SEPP Amendment to severely compromise AGL's ability to deliver a future indigenous supply of gas for NSW. It will exacerbate the gas supply crisis that NSW is facing in the later part of this decade as existing supply contracts end between 2014 and 2017 as well as increases in demand for gas as LNG export projects come on line in Queensland.

Since the CSG exclusion zones were announced by the NSW Government, three CSG operators have suspended their CSG activities in NSW, and another has written off all of its CSG investments in NSW, all citing regulatory uncertainty. NSW has now been termed a "high risk jurisdiction" by energy industry commentators and investors. This has already resulted in a loss of jobs, a loss of investment, a loss of royalty income and a loss of cost-effective gas supplies for the State.

<u>The Mining SEPP Amendment in its current form, will eliminate many years worth of natural gas supply for the entire NSW market from AGL's Camden North, Hunter and Gloucester Gas Projects. The Mining SEPP Amendment represents the greatest risk to NSW security of upstream gas supply and the subsequent downstream gas availability to NSW residential and business customers.</u>

3. The effectiveness of competition in the downstream gas market and consumer pricing implications;

In AGL's view, competition in NSW's downstream gas market is robust and effective. This is supported by the recent Australian Energy Market Commission ("AEMC") review of competition in retail electricity and natural gas markets in NSW. The AEMC released a Draft Report on 23 May 2013 in which it found that there is effective competition in respect of the retail sale of gas to small customers in NSW, and that competition is delivering benefits to customers. The AEMC also recommended the removal of retail price caps for all small retail customers of electricity and gas at the same time. AGL supports the AEMC's findings on these issues.

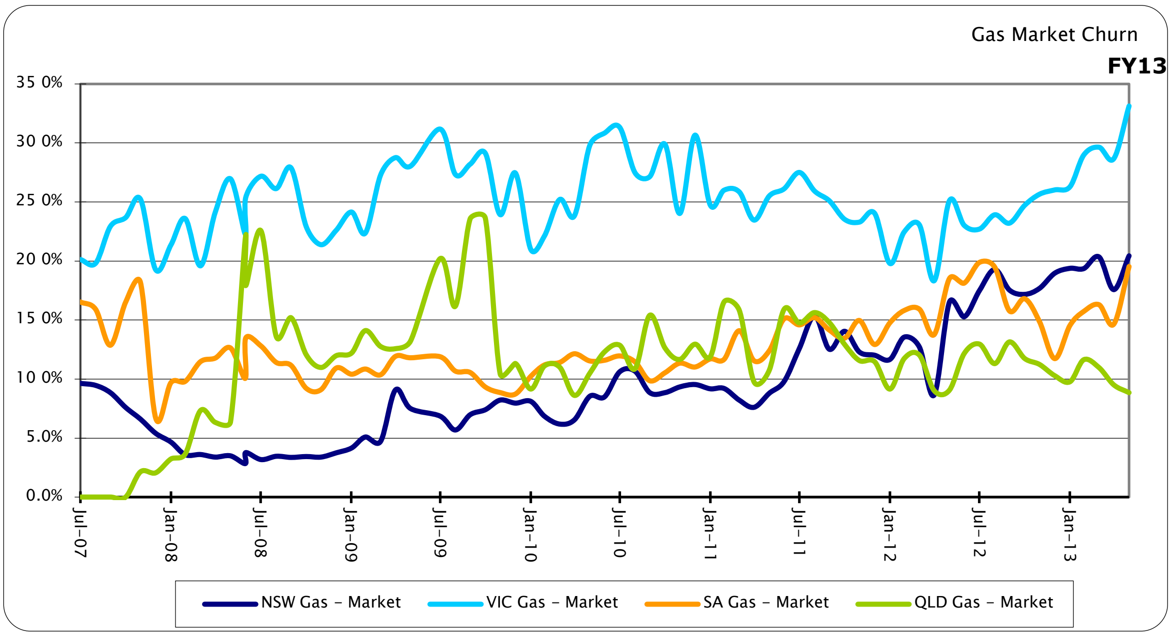
The commercial and policy uncertainty caused by regulatory intervention in retail pricing decisions however is the most significant structural element of the market that is likely to impact upon competition through the potential for supply constraints.

AGL believes that where price regulation is retained despite the existence of effective competition, then the only effective way to avoid inhibiting the competitive aspects of the market from operating is to ensure that the retail cost component of regulated default tariffs is set at a level which allows retailers to recover their costs, allowing them to develop products which provide appropriate returns in line with the market.

Currently Origin Energy, AGL, EnergyAustralia, Lumo Energy and Australian Power & Gas compete heavily to offer both gas and electricity products. They also compete strongly with Dodo Power & Gas, Momentum Energy, Red Energy and Click Energy for the sale of electricity.

Full retail contestability ("FRC") in the retail gas market in NSW commenced over 10 years ago in January 2002. The number of customers in NSW remaining on default tariffs has been steadily decreasing since FRC. Currently, less than 30 per cent of customers in NSW remain on default tariffs. The Independent Pricing and Regulatory Tribunal ("IPART") is responsible for regulating the maximum gas prices that regulated gas retailers can charge to default tariff customers in NSW. For the past 10 years, IPART have regulated these prices using a relatively light-handed approach. This involves making multi-year pricing agreements with each Standard Retailer (known as Voluntary Transitional Pricing Agreements). AGL notes that the AEMC has recommended that these price caps be removed in respect of retail gas prices to small customers.

AGL is the standard gas retailer with the largest supply area in NSW which covers Sydney, Wollongong, Newcastle, Dubbo, Orange, Parkes and parts of the Riverina. AGL also supplies gas to the border regions of NSW and Queensland.



Gas churn levels have been trending upwards in recent years, from around 9 per cent in September 2011 to approximately 20.4 per cent in May 2013. These figures demonstrate the relative ease and willingness with which customers move gas retailers to find a product which best suits their needs.

4. The effectiveness of existing protections for consumers and measures to facilitate access to gas connection and supply;

The National Energy Customer Framework ("NECF"), which will commence in NSW on 1 July 2013, is designed to provide a comprehensive consumer protection framework for a deregulated energy market. NECF provides a higher level of access to gas supply, with customers able to access a competitive market offer from any retailer, a standing offer from their existing retailer or a regulated offer from the local retailer. In contrast, pre-NECF introduction, customers could only access specific consumer protections if they reverted to a regulated offer with the local gas retailer.

Collective Connections

In NSW, under current arrangements, if a customer is not connected to the gas distribution network and the customer wishes to be connected, AGL as the gas retailer will raise a request for a quote to the gas network operator. The network operator will assess if gas is available nearby and if it is possible to extend the gas network to the premises that is applying. The network operator may advise that no gas is available as it is not viable for them to extend the gas network.

AGL has on a number of occasions received petitions from groups of street residents which are considered by the gas network operator on their merits. The network operator will however only provide one quote which means AGL requires one acceptance and one payment from the applicant group. Therefore, the network operator will charge only the individual who represents the group, and not each of the applicants individually.

In AGL's opinion there is opportunity to improve the current process to enable greater accessibility for residents not connected to the gas network. Network operators would need to negotiate how cost recovery for new connections, off existing mains and/or new mains extensions, might be facilitated with a view to enhancing the overall penetration of gas. Any approach that foists the bill on the first applicant for a new connection or mains extension may result in revenue certainty for the network operator but this approach makes it more challenging for the applicant communities. Network operators should see the value in their penetration rates being increased as this is how networks achieve scale economies.

There is no clause in the National Gas Rules ("NGR's") that requires *every* connection to be economic. As long as a *class or group of extensions and connections* is profitable at a collective level, then the network operator will be seen to be consistent with the NGR's and with normal commercial principles. If it is the case that incremental load from new connections and mains extensions is not viable and an up-front charge is required, there may a case for a government subsidy to bridge any gap if future growth in the area is envisaged, although clearly this a public policy matter for the NSW Government to determine.

5. Possible measures to encourage gas network operators to extend existing distribution networks, including financial incentives of licence obligations, particularly in regional centres that do not have access to reticulated gas.

As stated above, gas network operators are bound by the NGR's to only extend their network only where it is economically feasible to do so. In the absence of such a rule, a network operator may keep on extending the network and rolling the incremental costs into the asset base - with existing economic customers essentially subsidising new extensions. This in turn would put upward pressure on all NSW customer gas bills.

Government could as a matter of policy provide grants to help defray the costs of extension to more remote and less densely populated areas. By way of example, the Victorian Government has funded regional gas network expansion in 2005/6 and is engaged currently in another round of grants to ease the costs of natural gas extensions in remote areas.

6. Conclusion

AGL notes the AEMC's recent draft findings that effective competition exists in respect of the retail sale of gas to small customers in NSW, and that retail price caps should be lifted for gas and electricity. Such a reform would benefit all NSW energy consumers.

The major barrier to the supply of gas to NSW homes and businesses is the development barrier of upstream gas resources and the potential for material temporal constraints over the latter half of the current decade. The development of an indigenous NSW natural gas supply would assist in underpinning the security of NSW gas supply. Without this, AGL's view, which has been publicly disclosed to the ASX on 31 May 2013, is that there will be unnecessary upward pressure on gas prices in NSW over the coming years and genuine risks to the security of gas supply during winter peak periods in the latter half of this decade – adversely impacting NSW industry and the wider economy. Accordingly, in AGL's opinion, it is critical that the NSW Government set a clear and achievable CSG framework which would facilitate safe development to continue in order to satisfy NSW gas demand.

Should you have any further questions or comments, please do not hesitate to contact David Spree, Manager Government Affairs 03 9613 9621 or at dspree@agl.com.au.

Yours sincerely,

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Prof. Paul Simshauser
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