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DOWNSTREAM GAS SUPPLY AND AVAILABILITY IN NSW

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Inquiry into downstream gas supply and availability in New South Wales

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the New South Wales Legislative Council's (State and Regional Development Committee) inquiry into downstream gas supply and availability in NSW.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 51,000 people and contribute $16.5 billion directly to the nation's Gross Domestic Product.

The Association acknowledges the Committee's focus on downstream aspects of the NSW gas supply sector and has provided a response to specific items raised within the inquiry Terms of Reference (see Attachment 1). The removal of retail gas price regulation and minimisation of red tape costs for network connections is important to ensure further development of the retail gas sector and growth of the gas customer base. But in the broader context of the availability and cost of natural gas supply in NSW, the most influential factor over the short to medium term will be the development of indigenous coal seam gas (CSG) reserves and resources.

As conventional gas resources diminish, the liquefied natural gas (LNG) export industry will be a key driver of continued resource development in Australia, providing a level of demand and capital that is sufficient to underpin the development of significant and higher-priced CSG and other unconventional gas resources. Despite the obvious economic benefits this creates, linkages to LNG export markets do change the competitive environment relative to business as usual, exposing the domestic market to the influence of world prices and a competing source of demand that will far exceed domestic demand.

To provide an idea of the size of the export volumes that are anticipated, in 2016 LNG exports from the east coast are projected to exceed 1,200 PJ. This compares with total east coast domestic demand of around 700-900 PJ. By 2018, LNG exports are forecast to be three times larger than domestic demand.

While it is anticipated there is sufficient gas to support domestic and export demand over the next 40 years based on current reserves and resource estimates, this assessment is predicated on continued development of gas resources, including in NSW. Having historically imported around 95 per cent of its natural gas requirements from neighbouring states, the absence of developed CSG reserves leaves NSW acutely exposed to any tightening of the supply/demand balance over the short to medium term.

With the expiration of long-term NSW gas supply contracts over the next 3-4 years, the same period during which LNG exports are set to ramp up, NSW customers will be reliant on their suppliers being able to continue to access gas from resources developed in other states. As identified by the Grattan Institute, continued uncertainty over the development of CSG could potentially expose NSW consumers to supply shortfalls during future periods of peak gas demand.[1] Further, gas contracted for import into NSW is also likely to be priced at a premium to indigenous CSG, given higher production and transportation costs. Relative to a scenario where CSG production expands steadily, recent estimates suggest wholesale gas prices in NSW, Victoria, South Australia and Tasmania will be 25-32 per cent higher by 2030 should NSW CSG development be materially constrained.[2]

To date, the development of CSG reserves and resources in NSW has been constrained by persistent political/regulatory intervention. Most recently, the introduction of the *State Environmental Planning Policy (Mining, Petroleum Production and Extractive Industries) Amendment (Coal Seam Gas Exclusion Zones) 2013* in May 2013 caused a number of CSG operators to suspend their CSG activities indefinitely.

To ensure gas resource development is sufficient to support both domestic and export demand in the future, it is critical that government policies relating to the exploration and production of unconventional gas resources are carefully considered. In particular, government policies should give adequate consideration to the concerns of local communities, but also focus on the key role that natural gas plays in the Australian economy, both in terms of value creation and as an essential service.

If you require any further information in regard to this submission please contact Shaun Cole, [redacted] or [redacted]

Yours sincerely

[redacted]

Kieran Donoghue
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[1] Grattan Institute, *Australia's energy challenge*, June 2013.
[2] ACIL ALLEN CONSULTING – Report to the Australian Petroleum Production and Exploration Association, *Potential Economic Significance of NSW Coal Seam Gas*, May 2013.

Attachment 1

Adequacy of transmission pipeline systems and distribution networks for future downstream gas needs and supply challenges (Part a.)

Investment in gas infrastructure (including processing, transmission and distribution pipeline capacity) has historically been timely and efficient. Where additional infrastructure capacity is required to connect new resources (e.g. CSG fields in NSW) and/or expand existing infrastructure to support growth in demand, there is no reason to suppose this investment would not occur. Nonetheless, uncertainty relating to the availability of indigenous CSG does risk the timeliness of future infrastructure investment.

Capacity investment requires commitment from a downstream gas supplier who has a source of gas to transport through the pipeline. But suppliers may be inhibited from committing to the necessary long-term gas supply agreements with producers while there is continued uncertainty over the development of indigenous CSG. This risks delaying investment in transmission infrastructure requirements and by extension, the availability of supply to consumers.

Barriers to the expansion of downstream gas supply and distribution networks (Part b.) and 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 (Part e.)

It is in the interest of gas distribution network service providers (DNSPs) to promote the use of gas to improve the utilisation of gas assets and increase the size of the gas network. This in turn provides a more cost effective service to individual consumers by providing a larger customer base over which fixed costs may be amortised.

Despite this incentive, the penetration of natural gas at the mass market level remains low relative to Victoria and the Australian Capital Territory. While households in NSW connect to electricity as a matter of course, only 62 per cent of NSW households have gas infrastructure available and of those, only 70 per cent are connected.[3]

The discretionary nature of gas in NSW can be attributed to the moderate climate (which generally leads to lower demand than in Victoria) and the costs associated with connecting to the network. To connect to gas, a household that already has electricity connected will incur a range of costs, including: the cost of connection; the cost of gas appliances which are generally more expensive than equivalent electric appliances; and the cost of internal plumbing to connect the appliances to the meter. Coupled with a propensity for households to replace existing electric appliances with new electric appliances out of convenience, these costs limit additional uptake.

With respect to network expansions more broadly, it's important to consider the economics of investment. High sunk costs compared with relatively low populations

[3] Australian Energy Market Commission, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales*, May 2013.

and low forecast demand growth (particularly where customers have alternative energy supplies available) may mean the investment in pipeline infrastructure cannot be justified. This issue is often compounded in regional areas due to the large distances between demand centres and existing pipeline infrastructure. Further, for established regional towns, there are also additional costs due to the need to work with and around existing infrastructure.

To increase penetration and drive further cost efficiencies through improved utilisation, there are a range of issues that should be considered. On the demand side, the provision of subsidies to solar and heat pump hot water technology as part of the Small-Scale Renewable Energy Scheme (SRES) diminishes the economics of natural gas hot water relative to those alternate technologies. Addressing this inequality would likely increase the uptake of gas hot water, which in the absence of any subsidies has been identified as one of the least-cost options for delivering greenhouse gas abatement.[4]

On the supply side, addressing red tape around council requirements for new gas connections and harmonising technical and safety practices across states could assist in minimising costs for DNSPs. Further, given wholesale gas prices typically make up around 30 per cent[5] of the average consumer bill, having appropriate regard for the importance of continued resource development will ensure the delivery of least-cost gas supply to consumers.

Consistent with the National Gas Rules, extensions and expansions are subject to an economic test and DNSPs are only permitted to recover the costs of capital expenditure where it is determined to be prudent and efficient investment. To the extent the NSW Government considers it necessary to incentivise network extensions that may not be economically justifiable as part of broader social policy objectives, it is critical DNSPs are not exposed to costs they cannot recover. Further, any financial incentives this necessitates should be transparently applied and funded on budget. It would be inappropriate to require DNSPs to undertake uneconomic activity through explicit licence conditions.

The effectiveness of competition in the downstream gas market and consumer pricing implications (Part c.)

NSW has undertaken significant reform to improve the efficiency and competitiveness of the retail gas market. These reforms include the introduction of retail competition for all gas customers in January 2002 and the application of a transparent and light-handed consultative process to set the standing contract price path for small-use customers. There are now around 20 companies authorised to retail natural gas in NSW, five of which currently retail gas to small customers.[6] At 30

[4] Energy Networks Association, ENA Policy Proposal – Reducing emissions from residential hot water heating, May 2013.
[5] Independent Pricing and Regulatory Tribunal, *Review of regulated retail prices and charges for gas (2013-16) – Final Report*, June 2013.
[6] Australian Energy Market Commission, Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, December 2012.

June 2012, approximately 70 per cent of small use customers in NSW were on market offer contracts compared with below 50 per cent in June 2009.[7]

As part of its 2013-16 regulated retail gas price determination, the Independent Pricing and Regulatory Tribunal (IPART) suggested retail competition has developed to the point where price regulation may no longer be necessary. The Australian Energy Market Operator (AEMC) presented a similar view in its draft Review of Competition in the Retail Electricity and Natural Gas Markets in NSW, suggesting the removal of regulated price caps.

The esaa agrees with IPART's and the AEMC's assessment that retail competition in NSW is effective and that the most appropriate way to continue to drive competition is to remove retail price regulation. Retail prices that are competitive but still allow retail businesses to meet their costs and manage risks is becoming increasingly complicated, largely as a result of regulatory and market changes. Competitive markets free from regulatory intervention are the most appropriate way to address this risk and ensure retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

[7] Ibid.