Submission No 31

INQUIRY INTO THE SUPPLY AND COST OF GAS AND LIQUID FUELS IN NEW SOUTH WALES

Organisation: Business Council of Australia

Date received: 23/12/2014

Business Council of Australia

submission

Submission to the Legislative Council Select Committee Inquiry on the Supply and Cost of Gas and Liquid Fuels in New South Wales

DECEMBER 2014

Working to achieve economic, social and environmental goals that will benefit Australians now and into the future

Business Council of Australia ABN 75 483 216

www.bca.com.au

Contents

The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council of Australia submission to the Legislative Council Select Committee Inquiry on the Supply and Cost of Gas and Liquid Fuels in New South Wales.

This submission should be read in conjunction with the Business Council's energy statement – *Australia's Energy Advantage* – that sets out a vision for Australia's energy policy, including developing timely natural gas resources and improving gas market efficiency. The report is attached to this submission.

Key points

- The Business Council considers that developing additional gas supply is the best way to ensure that New South Wales consumers can access a reliable and competitively priced supply of gas.
- To restore investor confidence and unlock the state's gas resources, the New South Wales Government should support its own effectively regulated natural gas industry.
- Inappropriate regulations on gas development that restrict the market add to the pressure of rising gas prices and risk unmet demand during peak periods. These cost pressures will ultimately be borne by industry and the wider community.
- The natural gas industry should be supported by best-practice regulation that is risk-based and informed by science to provide the appropriate safeguards that protect the community and the environment. Bans on exploration and development of New South Wales gas resources should be lifted following community consultation and be based on scientific evidence.
- A domestic gas reservation policy is not an effective tool to place downward pressure on prices because it acts as a disincentive to developing the gas needed to meet demand.
- If a reservation policy were introduced in New South Wales tomorrow, it would not decrease the price of gas. In order to reserve gas there needs to be gas to reserve. In the case of New South Wales this is not the case. The state imports 95 per cent of its gas from other states and the five per cent of gas produced in New South Wales is sold in New South Wales.

Key recommendations

The Business Council has identified five key recommendations as outlined in *Australia's Energy Advantages* to support new gas supply development and to build a well-functioning and efficient gas market over time.

State governments hold most of the levers that enable natural gas resources to be developed but issues of market design are the responsibility of the Council of Australian Governments (COAG) Energy Council.

The Business Council's recommendations relate both to the action of state governments and the collective action that the COAG Energy Council can undertake to develop timely supply of gas and improve market efficiency.

The Business Council encourages the select committee to consider these recommendations as part of its inquiry.

1. Remove inappropriate regulatory barriers to natural gas development

The Business Council recommends that:

- the COAG Energy Council make the development of Australia's natural gas resources a national priority to meet demand, by:
  - introducing public milestone reporting to assess state government progress towards implementing a regulatory regime that:
    - supports the responsible, safe and sustainable development of Australia's natural gas resources
    - establishes a stable, efficient and evidence-based regulatory environment for gas development
    - removes a number of obstacles prohibiting additional supply capacity coming on stream
  - adopting the National Harmonised Regulatory Framework for CSG and the Multiple Land Use Framework.
- Australian governments address the regulatory barriers to gas development including:
  - removing duplication of regulation between Commonwealth and state governments, including the water trigger under the Environment Protection and Biodiversity Conservation Act 1999 (EPBC Act)
  - implementing the one-stop-shop under the EPBC Act, as underway by the Australian Government
  - streamlining and improving existing state approval processes, regulation and administration
  - removing the moratoriums on exploration and fracking following community consultation and based on scientific evidence.

2. Increase engagement of independent authorities with the community

The Business Council recommends that:

- Australian governments should seek to further engage independent authorities such as gas and land use commissioners and the CSIRO in community consultation on the science and safeguards supporting CSG development.
- Gas producers should actively engage with communities early to understand their concerns, and explain the science and precautions taken to ensure the safe and environmentally-responsible development of gas resources.

3. Expedite priority gas projects

The Business Council recommends that Australian governments expedite priority gas projects by:

- providing additional resources and expertise to the government administration of project approvals processes and/or National Productivity Payments
- seeking to develop reserves under retention lease arrangements, where they are commercial, through existing arrangements.

4. Improve transparency of information

The Business Council recommends that:

- the COAG Energy Council work with industry to determine how the current suite of gas market information may be improved and what further information may be needed to improve market transparency including:
  - how information can be collected efficiently, and by which entities
  - how information should be presented
  - how frequently information should be reported.
- the design of market information must also minimise the reporting burden on business, provide for cost recovery by business with reporting obligations and ensure the protection of commercially-sensitive information.

5. Support industry-led development of pipeline trading and gas supply hubs

The Business Council recommends that the COAG Energy Council:

- advance gas market reform to promote diversity of supply competition, market transparency, flexibility and liquidity
- improve the function of the east coast's facilitated markets to allow for the development of secondary products
- support the development of industry-led pipeline capacity trading and the gas supply hubs

  The Productivity Commission is the appropriate body to conduct a broad review 'examining barriers to more efficient gas markets' and a review by the Australian Competition and Consumer Commission (ACCC) is not warranted at this time.

Factors affecting supply, demand and cost of gas in New South Wales

Gas is a vital and growing part of Australia's economy. Asia's growing demand for gas is expected to increase by around 80 per cent[1]and our expertise in successfully producing and exporting gas is a key strength and source of comparative advantage for the economy.

Liquefied natural gas (LNG) is Australia's fastest growing energy export and presents a big opportunity for Australia to derive future export revenue.

If all LNG projects currently proposed are realised, they could:

- contribute an additional $320 billion in GDP over the life of the projects
- create 150,000 new jobs
- contribute $5 billion per annum in additional taxes and royalties.[2]

Australia is currently the fourth biggest exporter of LNG and is likely to be the largest by 2018. Western Australia and Northern Territory are currently operating LNG export facilities with a combined capacity of 24.3 million tonnes per annum and with another 36.5 million tonnes per annum under construction.[3]

The three LNG projects under construction on Curtis Island off the coast of Gladstone – Queensland Curtis LNG (QCLNG); Gladstone LNG (GLNG); and Australia Pacific LNG (APLNG) – will see an additional 25.3 million tonnes per annum of LNG export capacity.

With the first shipment from Queensland expected in late 2014, Australia will be the first country to liquefy coal seam gas (CSG) for export.

In Queensland, more than 27,000 people are working in the state's gas industry, with an increase of almost 7000 jobs in the first half of last year and a further increase of 8500 jobs reported in March 2013. In comparison, NSW's CSG industry grew from just 39 to 332 positions in the same period[4].

The east coast gas market is under transition

The export of LNG will link the previously isolated east coast gas market to higher priced international markets, creating a new market dynamic.

Production on the east coast will need to increase from around 732 petajoules (PJ) in 2012–13 to around 2,300PJ by 2016[5] to meet both domestic and export demand.

The east coast LNG industry will bring a net positive economic benefit to the Australian economy, but rising production costs and linking our gas price to international markets are increasing the price of gas.

Various analysts are projecting east coast wholesale gas prices to rise from 2014 towards LNG netback levels[6] to around $6–$12 a gigajoule.[7] This compares to historical low, long-term prices on the east coast at around $2–$3 a gigajoule. But historical prices are no longer high enough to provide the incentive to develop new supplies.

Gas production in the eastern market is traditionally from conventional gas resources (mainly the Cooper Basin in South Australia and the Gippsland Basin in Victoria) and this has been relatively

[1] BREE/Geoscience Australia, Australian Energy Resource Assessment 2014.
[2] McKinsey & Company, *Extending the LNG Boom: Improving Australian LNG productivity and competitiveness*, 2013.
[3] BREE, *Gas Market Report*, November 2014.
4.NSW Government, Trade & Investment Resources and Energy, accessed on 17 December 2014 http://www.resourcesandenergy.nsw.gov.au/landholders-and-community/coal-seam-gas/the-facts/energy-security-and-benefits.
[5] BREE, *Eastern Australian Domestic Gas Market Study*, 2014.
[6] LNG Netback is the export parity price minus the cost of liquefaction and transportation.
[7] The uncertainty in key drivers – oil prices, export volumes, cost of gas production and methodology - results in varied projections.

cheap to develop. These traditional sources of supply are in decline and new resources need to be unlocked to avoid supply shortages and price pressures. New gas sources are more costly to develop as they are in harder to access locations or in the form of unconventional gas.

Ad-hoc regulatory barriers to new onshore gas resource development are also impacting the domestic market.

Typically, the primary response to tightening supply and increasing prices would be the development of new gas resources, pipeline expansions and new gas storage facilities. However, there are significant barriers restricting new gas projects in New South Wales. This has constrained the market's ability to respond and is preventing gas from being developed to meet demand.

Additional gas supply is essential to put downward pressure on the price of gas and to provide supply certainty to domestic gas consumers.

Impact of tight supply and increasing costs on New South Wales consumers

Gas supplies Australia's domestic demand for industrial, mining and manufacturing processes, gas-fired electricity generation, heating, cooking and transport. New South Wales consumed 162 PJ of gas in 2012–13.[8] The state has approximately 1.1 million consumers who use gas for their homes and businesses. The industrial sector consumes around half of New South Wales' demand.

For household consumers average regulated retail prices will increase by up to 17.7 per cent across New South Wales over the next two years. And on average, small business will see gas bills increase by approximately $690 over the same period.[9] This is mainly driven by changes to the wholesale gas market.

The rising price of gas will also impact a number of gas-dependent businesses, particularly where fuel switching (such as a fertiliser manufacturer) is not an option.

New South Wales should unlock its own gas resources

The commercial production of CSG in Australia commenced in 1996 and has become an integral part of the upstream gas industry in eastern Australia. The major growth in both CSG reserves and production has been in the Bowen and Surat Basins of Queensland. CSG now supplies 80 per cent of the Queensland market.

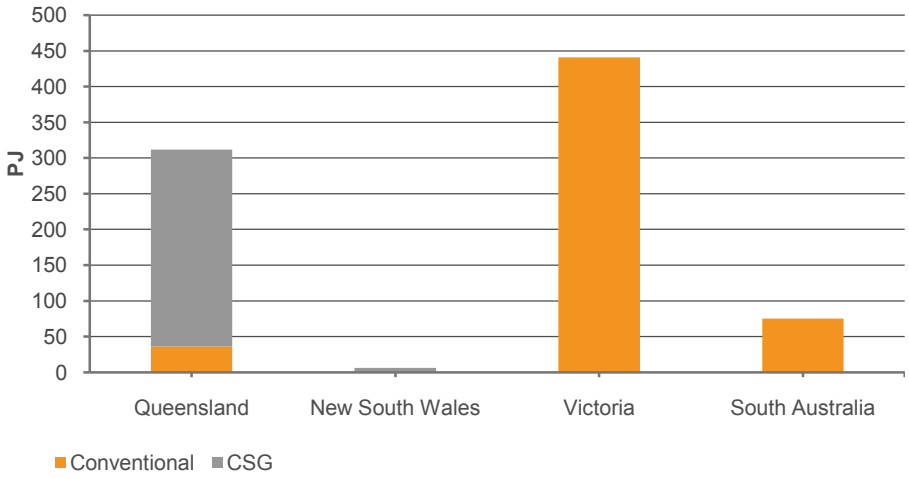
New South Wales also has an important reserve base in the Clarence, Moreton, Gloucester, Gunnedah and Sydney Basin. Potential developments include Santos Narrabri CSG project, AGL's Camden Gas Project expansion, Metgasco's Casino Projects and AGL's Gloucester CSG Project.

The development of further CSG in New South Wales has the potential to supply more than half of the state's current domestic demand.

This is significant as currently only five per cent of New South Wales' gas demand is met from its own resources – AGL's Camden Gas Project which has been producing coal seam gas for the state since 2001.[10]

[8] BREE, 2014 Australian energy statistics, BREE, Canberra, July 2014.
[9] IPART, *Changes in regulated retail gas prices from 1 July 2014 factsheet*, June 2014.
[10] NSW Government Chief Scientist & Engineer, *Initial report on the Independent Review of Coal Seam Gas Activities in NSW*, July 2013.

Figure 1: Eastern Australia production of gas, by type and state 2012-2013



Source: BREE, 2014 Australian energy statistics, BREE, Canberra, July.

The remaining demand is met from gas imported from South Australia, Queensland and Victoria through contracts with pipeline owners operating:

- the Moomba to Sydney Pipeline system out of the Cooper Basin located on the borders of New South Wales, South Australia and Queensland
- the Eastern Gas Pipeline out of the Gippsland Basin, Victoria
- the New South Wales/Victoria Interconnect system drawing gas from the Otway Basin, offshore of Victoria.

These interstate pipeline contracts begin to run out in 2014 and will be exhausted in 2017.[11] New South Wales may have difficulty in negotiating new domestic contracts due to increased demand for gas at higher prices. There is the potential risk that New South Wales may experience around 20 days of gas shortages from winter 2016[12]. In these circumstances business may be called on to curtail gas use, causing disruption to operations..

Additionally, due to its reliance on interstate suppliers New South Wales is further exposed to supply risks. In 2004, 2007, 2008 and 2010 gas consumption was restricted in the state due to infrastructure failures in other states.[13]

While New South Wales has sufficient gas reserves, it needs the right regulatory environment to develop and diversify its gas supply to reduce its reliance on interstate imports. This in turn would minimise the state's exposure to infrastructure failures in other states outside its control.

Constraints on the development of New South Wales' gas resources are expected to lead to significant losses of real economic output, real income and jobs in both New South Wales and for Australia overall.[14] This loss is associated with the relocation of gas production to states other than New South Wales and higher gas prices affecting other economic activities which use gas as an input, such as manufacturing.[15]

[11] Ibid.

12. AGL paper concludes potential gas shortages from winter 2016, Saturday, 15 March 2014. http://www.agl.com.au/about-agl/media-centre/article-list/2014/march/agl-paper-proposes-gas-shortages

[13] NSW Government, Trade & Investment Resources and Energy, accessed on 17 December 2014 http://www.resourcesandenergy.nsw.gov.au/landholders-and-community/coal-seam-gas/the-facts/energy-security-and-benefits.

[14] Acil Allen Consulting, *Future NSW Gas Supply and Usage: Economic benefits of increased coal seam gas development*, 2014.

[15] Ibid.

Gas reservation is an ineffective policy to reduce gas prices

A domestic gas reservation policy in its most basic format sets a requirement that gas producers must reserve a proportion of gas for domestic consumers. It is a distortion in a market that is aimed at reducing the price of gas.

If a reservation policy were introduced tomorrow, it would not decrease the price of gas. In order to reserve gas there needs to be gas to reserve. In the case of New South Wales, there is effectively no gas, as its gas is imported from other states. The current gas produced in New South Wales is sold in New South Wales.

As for the two projects already in the pipeline in New South Wales in the Pilliga and Gloucester, this gas is already earmarked for the domestic market so reserving it would have no impact.

The problem with gas reservation is that it actually leads to delays in developing the gas needed to meet demand. That is because it adds to costs that act as a disincentive to developing new gas resources.

Further, a gas reservation policy does not control price. Increasing production costs and international market pressures will continue to influence domestic prices in the presence of a reservation policy.

And any consideration about applying it to existing gas projects would mean breaching commercial contracts, raising issues of legal liability for government and putting at risk Australia's standing as a reliable supplier of energy and a safe place to invest.

Attempts to implement a gas reservation policy could also breach a range of Australia's international trade obligations and domestic agreements on competition policy.

Issues with a gas reservation policy can be witnessed in the Western Australian market. The current reservation policy in the west may have historically facilitated gas to market, but it has not lowered the price. In fact, Western Australia has the highest gas prices in Australia, and it has not solved timing and supply issues.

Accordingly, Western Australia's independent economic adviser, the Economic Regulation Authority, supports the removal of gas reservation and concluded that it:

- discourages investment in gas projects, reducing the availability of gas for future use
- perpetuates the existence of industries that may not have a comparative advantage in Western Australia, at the expense of investment in other industries
- increases reliance on subsidised gas prices
- discourages efficiency and technological innovation.

There is a reason no other commodity is reserved in the Australian economy and that is because it ultimately leads to inefficiencies in the allocation of resources.

Accordingly, the International Energy Agency in a report examining the effect of gas reservation in some non-OECD countries throughout the Middle East and North Africa, concluded: "Subsidies exacerbate demand and inevitably lead to shortages a decade later".[16]

[16] International Energy Agency, *Gas Medium-term Market Report,* 2014.

New South Wales needs a stable and efficient regulatory regime

Consumers expect a reliable and competitively priced supply of gas and producers of gas need to earn a reasonable return on their investments. The community also needs to be assured that gas developments are safe and well regulated. Governments and the gas industry need to work together to ensure Australia's regulatory regime and markets are actively working to enable both interests are being met.

But, while the gas supply industry in Queensland has experienced rapid growth; moratoriums, ad-hoc regulatory changes and uncertainty over new regulatory frameworks in New South Wales have impacted on the gas industry's ability to respond to changing market dynamics.

The continual change in regulatory approach is creating investment uncertainty. It has added time and cost to projects, stifled investment and caused substantial write down in assets. Metgasco's Casino Project was suspended following announcements on state environmental planning policy and project commencement remains uncertain.

There is potential for the development of AGL's Gloucester Gas Project which will produce up to 30 PJ per annum for 30 years, and Santos's Narrabri Gas project which proposes to produce up to 73 PJ per annum for 25 years.[17] Combined, the two projects could meet over 50 per cent of the state's gas demand. However, there is still significant uncertainty as to when these projects will finalise the approval process and begin producing.

Additionally, the New South Wales Government's new Gas Plan is sending conflicting message to the gas industry. Though the plan aims to secure gas supplies for New South Wales consumers and to establish a safe, sustainable industry, the government continues the freeze on new petroleum exploration licences and will extinguish all current petroleum exploration license applications.

Regulations on gas development that restrict the market from being able to deliver gas that is meeting environmental obligations add to the pressure of rising gas prices and increase the risk of unmet demand during peak periods.

These regulatory responses will not protect New South Wales gas consumers from increasing gas prices. Instead, the New South Wales Government risks investors abandoning projects altogether, prolonging tight market conditions and adding further pressures to the price of gas.

Community concerns need to be addressed

The safe, environmentally responsible and timely development of New South Wales' gas resources requires a stable and efficient regulatory regime. Any regulatory regime should be risk-based and informed by science. This stability provides investors with the confidence they need to make long-term capital-intensive investment decisions in new gas developments. Without a stable investment environment, decisions to invest will not occur and new gas supplies will not come into the market.

The Business Council acknowledges the significant concern from some sections of the community about the risks associated with gas developments.

The risks of gas development projects are generally well known and can be managed through engineering, technologies and best practice. Many of these solutions have been successfully employed in the natural gas industry for several decades.

This is acknowledged by a recent report from the New South Wales Chief Scientist and Engineer, which found that many of the technical challenges and risks posed by the CSG industry can in general be managed.[18]

[17] Geoscience Australia, *UPRWG Report to COAG Energy Council on Unconventional Reserves, Resources, Production, Forecasts and Drilling Rates*, November 2014.

[18] NSW Government Chief Scientist & Engineer, *Final Report of the Independent Review of Coal Seam Gas Activities in NSW*, September 2014.

It is also evidenced by the safe operation of CSG in Australia for over 18 years in Queensland and 13 years in New South Wales. This is not a new industry and has proven it can operate safely while upholding its environmental obligations.

Gas companies invest in good practices for the safety of their workers, the integrity of their operations and for the protection of the environment. It is in their interest to do so.

It is essential that New South Wales lifts its bans on CSG following transparent and informed community consultation. Better and earlier community engagement is needed by industry, alongside the replacement of these bans with a robust regulatory regime. Gas producers have a responsibility to work with landholders and communities to understand their concerns and explain how risks are managed early in the process.

The Business Council supports best-practice regulation that provides appropriate safeguards to protect the community and the environment. An example of this is the establishment of Queensland's Gasfields Commission, which has been a positive step towards building community trust in the industry.

Queensland's regulatory approach to its gas industry and community concerns has been recognised by the International Energy Agency which states: "*a good example comes from Queensland, Australia, where the authorities have pioneered an approach assessing cumulative groundwater impacts, from CBM {coal seam gas} production across the Surat basin*."[19]

South Australia has also developed a Roadmap for Unconventional Gas, which sets the course for the environmentally sustainable development of its unconventional gas and encourages safe exploration and production under the state's regulatory framework.

These high standards of practice should be replicated in New South Wales. A stable and effective regulatory regime should provide the community (and indeed business) with confidence that activities have the appropriate safeguards to manage multi-land use, minimise the risk to the environment, and provide a reliable and competitively priced supply of gas to New South Wales consumers.

[19] International Energy Agency, *World Energy Outlook 2014*, 2014.

BUSINESS COUNCIL OF AUSTRALIA
42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 **www.bca.com.au**