

**Submission
No 32**

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

Organisation: METGASCO

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30 December 2014

The Director
Select Committee on the supply and cost of gas and liquid fuels in New South Wales
Parliament House
Macquarie Street
Sydney NSW 2000

Dear Sir/Madam

Subject: A reliable and low cost source of NSW gas?

Metgasco makes the following submission to the NSW select committee referred to above:

- A reliable supply of competitively priced gas is essential to NSW industry and in turn to the welfare of the state of NSW.
- NSW has plentiful gas resources if it chooses to develop them in a sensible manner, yet it currently only produces about 5% of its needs.
- The best way to ensure a reliable, competitively priced supply of gas is:
 - ✓ not to rely on other states of Australia;
 - ✓ to encourage a gas industry to develop in NSW; and
 - ✓ to provide clear, rational and consistent policy settings.

About Metgasco

Metgasco is an Australian company, listed on the Australian Securities Exchange, with the majority of our 5,000 investors being Australians. Most of the shareholders are small investors, many of them living in the Northern Rivers region. Our largest shareholder, ERM Power, joined our shareholder register in 2011 and increased its holding over the next three years. It now owns about 12.6% of our shares. The next largest shareholder owns about 3%.

During the ten years we have operated in the Casino area (North East NSW) we have drilled more than 50 wells, acquired 400km of seismic data and invested about \$120 million on gas exploration. We have established significant coal seam gas reserves, approximately 400 billion cubic feet of 2P reserves and 2 trillion cubic feet of 3P reserves, with another 2.5 TCF of contingent resources. To put this into perspective, the 2P reserves are the equivalent of about 3 years of NSW's gas requirements and the 3P reserves are the equivalent of more than 15 years of NSW's gas requirements. Metgasco recently decided to reclassify the gas from "reserves" to "resources" status. The gas remains in the ground, but with the regulatory and

policy uncertainty (and indeed sovereign risk) that has characterised the industry's operating environment for the past four years, the reclassification was necessary.

We have also identified significant gas potential in traditional sandstone reservoirs (conventional and tight gas, not coal seam gas) with the 2009 Kingfisher exploration well and in May 2014 we were prepared to test the size of the identified structure with the Rosella conventional gas exploration well. Unfortunately, drilling approval for the well was suspended by the NSW Government only days before the drilling rig was due to arrive on site. The basis for this suspension was the alleged failure of Metgasco to comply with community consultation guidelines. Metgasco disputes this and had no alternative but to take the matter to the NSW Supreme Court in order to have the suspension lifted. The suspension decision resulted in millions of dollars lost to Metgasco and caused its share price to drop by 40%.

Our exploration program has been supported by more than 300 access agreements with local landholders, all voluntary, and extensive consultation with local communities.

Metgasco has a board of directors with extensive experience and qualifications in the petroleum energy and finance industries. For over a decade we have employed highly qualified technical, commercial and financial staff who have conducted our business operations in good faith and in accordance with regulatory requirements in New South Wales.

Metgasco's objective is to supply natural gas to the domestic market (household and industry) in eastern Australia, with its first priority to service the areas around our exploration licences in the Northern Rivers region of NSW.

Why we need the natural gas industry and why it should not be controversial

A reliable, low-cost source of natural gas is essential to keep household costs low and industry competitive in NSW. Natural gas, whether it be from conventional fields or unconventional sources (shales, tight gas or coal seams), provides an economically competitive source of energy which creates jobs in industry, income for farmers and royalty payments to government.

Our society depends heavily on oil and gas as a source of fuel and energy and as a feedstock for plastics and fertiliser manufacture. All of this gas comes from wells like those Metgasco has drilled and wishes to drill.

To put our industry into perspective, in Queensland 3,000 conventional wells have been drilled over the last 50 years, and about 5,000 coal seam gas wells have been drilled in the past 20 years. In the USA, there are more than 1,000,000 oil and gas wells producing today and this figure does not include all the wells drilled over the last 100 years that no longer produce. Texas has about 250,000 producing wells, many of which are located in prime agricultural land, and has a greater gross farm product than Queensland or NSW. Despite the scale of the operations and the long history, it is difficult to find any verified examples of environmental water or health problems, despite the wave of social media propaganda suggesting otherwise.

Recently, the NSW Chief Scientist produced a report that concluded that a gas industry in NSW can be managed safely.

Natural gas itself should be completely uncontroversial. The natural gas distributed to households and industry is almost solely methane. It is non-toxic and has been used widely in peoples' homes for 50 years. It is distributed through pipes under roads to homes throughout the country. Methane is also produced from compost heaps and from cows.

Requirements for a successful NSW gas industry

For a gas industry to develop and thrive in NSW it needs a certain, stable and consistent regulatory environment, including:

- Regulations that encourage companies and investors to provide financial resources for exploration initially and then for ongoing development and operation (if exploration programs are successful).
- Regulations that manage risk, not regulations for the sake of regulation.

Regulations should be based on science and risk management principles. The “toughest” regulations in the world might be totally inappropriate if the control measures they introduce are not consistent with the underlying risks they are trying to manage. Regulations need to be the “smartest” in the world, not the “toughest”.

- Regulations need to be stable across the life-cycle of exploration, development and operation, and they should not be retrospective, if NSW is to avoid being negatively regarded by investors as a jurisdiction of high sovereign risk.
- The regulatory process should be simple, with preferably no more than one government department to deal with and one act of parliament to comply with.
- Exploration and development approvals should be provided on a timely basis to avoid unnecessary costs and delays.

These needs have been contrary to our experience in NSW over the last four years. For example:

- The NSW Government introduced an effective moratorium in NSW after coming to office in March 2011 by not renewing exploration licences while it reviewed and debated new regulations and approval processes for nearly 18 months (new policy announced in September 2012, along with exploration licence renewals).
- The new approaches introduced in September 2012 confused an already complicated approval process with the introduction of a “gateway” between the exploration and development phases – what else are the exploration and development approvals if not “gateways”, steps that a company pass through before they have approval to proceed. The approach was unnecessarily complicated and burdensome.
- The NSW Government unilaterally removed the rights of exploration companies to a five year royalty holiday, one of the original inducements offered to companies such as Metgasco to commence exploration in NSW. It seems paradoxical that the new NSW Gas Policy is reviewing the “settings” of its gas policy with the laudable aim to ensure that State is competitively positioned for gas exploration and development. These competing actions are creating confusion in the investment community.

- In 2011 and 2012 the NSW Government changed its position on the handling of water produced from coal seam gas wells. It arbitrarily increased the freeboard requirement for the ponds, without any technical or risk based assessment, forcing Metgasco to truck water to a Queensland waste disposal facility at considerable cost and with safety and environmental exposures that significantly exceeded any spill risk from the ponds. The pond water, which has been approved for stock watering without any need of treatment, represented very little, if any risk, to the local environment.
- In February 2013, the NSW Government announced a ban on any CSG drilling within a 2 km radius of residential areas, including wells drilled horizontally under this exclusion zone. This decision had no scientific basis whatsoever. It reduced Metgasco's reserves by about 20% as well as undermining general community confidence in the industry. People in the general community can be excused for thinking "Why would a responsible government impose this exclusion zone if the risks of the gas industry are acceptable?"
- At the same time (February 2013), the NSW Government announced changes in the responsibilities of different government departments, an act which naturally created confusion and caused approval delays while the departments developed new procedures and re-defined inter-department interfaces.
- In May 2014, the NSW Government suspended Metgasco's drilling approval for the Rosella conventional exploration well only days before drilling was about to commence, on the basis that Metgasco had not complied with the NSW Government's community consultation guidelines. Metgasco believes that: 1) the NSW Government did not have the lawful right under the Petroleum Onshore Act to suspend the drilling approval; 2) did not follow normal procedural fairness or the procedures explicit in the Petroleum Onshore Act; and 3) the decision itself was irrational – Metgasco had complied with the consultation guidelines.
- In late 2014, the NSW Labor Party (formerly in government but now in Opposition) reversed its support of over 10 years for a gas industry in the Northern Rivers. This policy change was made without any scientific basis and despite the 2014 findings of the Chief Scientist.
- In November, 2014, the NSW Government announced a new gas policy which: 1) throws into doubt its ongoing support for gas exploration in our exploration licence areas; 2) changes the responsibilities of government departments once again; and 3) questions basic land access rights and remuneration. We can draw no other conclusion other than that the regulatory environment will *remain unstable and uncertain for some time, providing a disincentive to all gas companies to invest in NSW.*

There should be no confusion about the impact of the NSW Government's actions on investment in the state. Responsible investors and qualified, competent gas companies will shun the state and take their businesses elsewhere or defer expenditure in this environment. For example, Metgasco recently announced a planned merger with another listed Australian company which operates in the USA. The USA offers a much more favourable investment climate than NSW. Further NSW investment might need to be deferred until the regulatory environment is satisfactory. Similarly, larger companies will allocate the exploration and development budgets to other states in Australia and overseas rather than waste them in

NSW, particularly if their financing resources are constrained due to factors such as low oil prices.

The Way Forward

NSW can have a reliable and competitively priced gas supply. To achieve this it should not rely on gas supplies from other states but should encourage an active industry within NSW by actively promoting the industry and putting in place an efficient, stable and scientifically based regulatory system.

Queensland and other Australian states are benefiting from the gas industry. The USA has recognised huge benefits from the oil and gas industry over the last five years in particular. Allowing the industry to work efficiently in the USA has:

- increased the supply of gas so much that: 1) the USA is no longer investing in LNG terminals to import gas but is considering them as a means to export gas; and 2) gas prices have fallen significantly, resulting in gas dependent industries returning to the USA; and
- increased the supply of domestic crude oil to such a level that the USA is close to being self-sufficient in its oil needs and international oil prices have plummeted.

We submit that the negative NSW regulatory environment Metgasco and other gas exploration and development companies have experienced over the last four years has resulted in NSW being regarded as a state of sovereign risk, discouraging investment and weakening NSW's potential to have a low cost, reliable supply of energy.

This negative sentiment can be arrested before it develops further - the problems are not insurmountable. NSW can have a thriving and sustainable gas industry with the right policy settings.

Metgasco stands ready and willing to cooperate and consult with the NSW Government to develop those policy settings.

We would be pleased to respond to any inquiries.

Yours sincerely,

Peter J Henderson
Managing Director and CEO