

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

Organisation: Australian Petroleum Production and Exploration Association
(APPEA)

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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,

RE: Inquiry into the supply and cost of gas and liquid fuels in New South Wales

APPEA welcomes the opportunity to contribute to Select Committee's inquiry ('the Inquiry') into the supply and cost of gas and liquid fuels in New South Wales (NSW).

APPEA offers the following comments based on the Inquiry's terms of reference.

1. Factors affecting the supply, demand and cost of natural gas and liquid fuels in New South Wales

If the state's gas reserves are not developed, the state will face significant energy supply and cost challenges within the next few years. APPEA has long argued that downward pressure cannot be applied to rising gas prices if restrictions on developing natural gas from coal seams in NSW are allowed to continue. Clearly, the best way to impose downward pressure on gas prices is by increasing gas supply.

NSW has considerable onshore gas potential, Australia's second largest onshore natural gas field is located within the state, yet energy pricing has become a serious and impending challenge. A report undertaken for the Australian Energy Market Operator – *Eastern & Southern Australia: Existing Gas Reserves & Resources*¹ estimated that NSW has up to 85,000 petajoules (PJ) of undeveloped gas resources. To provide context, the state's current demand is approximately 156PJ per annum.

Gas prices are increasing for a number of reasons, many of them not directly related to the transition of the eastern Australian market to supply export markets. A key factor is the increasing costs pressures that the industry has faced in recent years. New analysis by EnergyQuest in their report *Oil and Gas Industry Cost Trends*² shows petroleum industry costs have been increasing globally and in Australia since 2000. Exploration and development costs for new reserves increased six-fold between 2000 and 2013.

APPEA submits that the Committee should in particular focus on efficient and competitive markets, where prices are determined by demand and supply forces and negotiations between willing buyers and willing sellers. Only then do you extract the maximum value for natural gas resources to the benefit of the whole Australian economy. The Committee should particularly focus on increases in

¹ Core Energy Group (2012) *Eastern & Southern Australia: Existing Gas Reserves & Resources* (available at www.appea.com.au/wp-content/uploads/2014/07/Eastern-Southern-Australia-Existing-Gas-Reserves-Resources.pdf).

² EnergyQuest (2014) *Oil and Gas Industry Cost Trends* (available at www.appea.com.au/wp-content/uploads/2014/11/APPEA-Cost-Report-Final.pdf).

new energy sources to ease demand/supply constraints, regulatory reform and the need for removal of unnecessary barriers to continued investment in exploration and production in NSW.

2. The impact of tight supply and increasing cost of natural gas and liquid fuels on New South Wales consumers, including manufacturing, agriculture, energy production, small business, public services and household consumers

APPEA submits that the solution to rising east coast prices lies in increasing gas supply NSW; not in market interventions or in new protectionism or subsidies for gas users, as advocated by others.

In July 2014, ACIL Allen Consulting released a report, *Future NSW Gas Supply and Usage: Economic Benefits of Increased Coal Seam Gas Development*³, the study examined the economic impacts of policies that constrain the development of natural gas from coal seams. The report, commissioned by AGL, used a gas market model and a Computable General Equilibrium (CGE) model of the Australian economy to determine economic activity in NSW across a range of scenarios.

Two scenarios were examined:

- “CSG Freeze” – in this scenario, no natural gas from the coal seams, or coal seam gas (CSG) projects in New South Wales are developed; and
- “Gloucester Only” – in this scenario, AGL’s Gloucester CSG project produces 22.6PJ per annum from 2017 onwards.

The outcomes, in terms of gas supply, wholesale gas prices and economy development, from these two scenarios are significant – even though the Gloucester project produces a small proportion of the aggregate east coast gas demand, its output has the effect of reducing wholesale gas prices immediately in NSW. By 2025, the Gloucester project is forecast to reduce wholesale gas prices by eight per cent. The study also considers a “Base Case” scenario whereby the gas industry in NSW grows steadily, and by 2030 is producing 160PJ per annum – effectively making NSW ‘self-sufficient’ in relation to gas supplies. Such a scenario would result in wholesale gas prices being twelve per cent lower than the “CSG Freeze” scenario in 2025.

We refer the Committee to this analysis which demonstrates that increased gas supply in NSW can place downward pressure on wholesale gas prices.

The report also made the observation that current policy settings in NSW are limiting access to and the potential development of indigenous resources. This is expected to lead to significant losses of real economic output, real income and jobs in both the state and for Australia overall. Major consequences of such constraints include a greater reliance on gas imports from other states and higher gas prices in NSW.

Moreover, the report highlighted that the loss of real economic output in NSW is linked to the relocation of gas production to other Australian states and higher gas prices in NSW affecting other economic activities which use gas as an input. Industries that are most likely to be affected in NSW are price sensitive large industrial/commercial customers where gas is a significant input to their processes.

³ See aglblog.com.au/wp-content/uploads/2014/07/Final-ACIL-Allen-Report-July-2014.pdf for further information.

3. The commercial conduct of gas producers and the operation of the international and domestic gas markets

In all sectors of the economy – not just oil and gas – maintaining access to open and competitive markets is in Australia's best interest. Australia's gas industry is a source of comparative advantage that should be harnessed, not hindered. Just as Australia's long-term national interest is served by maintaining access to open and competitive markets for wine, coal, wheat, and iron ore, the same is true for gas.

It will be vital that the Committee join with all eastern Australian governments and the Australian Government⁴ to reject calls for inefficient, inappropriate and ineffective regulatory interventions and focus instead on market-based energy policies. Examples of such regulatory instruments are the proposed domestic reservation policy or national interest test. APPEA rejects these protectionist tools and advocates for a market-based policy approach by all governments.

The Council of Australian Governments' (COAG) Energy Council has echoed APPEA's concern regarding national market reform. During its recent meeting in December 2014, the Council confirmed its commitment to gas market reform and development through the Gas Market Development Plan by identifying four specific policy work streams: Competitive Supply; Transparency and Price Discovery; Risk Management; and Removing Unnecessary Regulatory Barriers. The Council's goals will be to assist in the development of gas projects, improve access to market information and improve market function. In addition, the Council rejected calls for a national reservation policy or national interest test.

In relation to calls for further market information and transparency, APPEA notes that the gas market already has abundant information available to it. Before imposing further information provision requirements on the industry, governments should undertake a stocktake of the information already provided to different jurisdictions under various regulatory regimes and conduct a thorough cost-benefit analysis of the need for additional regulatory burdens on the upstream oil and gas industry.

APPEA supports the Council's finding that the time has come to remove regulatory restrictions and allow gas exploration and development to proceed. A rapid and efficient supply response to meet domestic needs depends largely on clear market signals, and efficient government regulation is required to address any gas supply issues in NSW. A freely operating and competitive market is the best way to allow gas resources to be developed.

Australia's upstream oil and gas industry is delivering substantial, economy-wide benefits in terms of investment, jobs, and regional development. For this benefit to be sustained, governments must resist calls for policy interventions that force non-commercial outcomes or are not guided by a focus on correcting genuine and identified market failure.

Too often, calls for policy interventions reflect dissatisfaction with the operation of competitive markets, or have an 'industry development' justification. They do not reflect genuine market failure. Calls for intervention on this basis should be resisted by the Committee.

⁴ Council of Australian Governments (2014), *COAG Energy Council Meeting Communiqué*, 11 December (available at scer.govspace.gov.au/files/2014/05/COAG-Energy-Council-Communique-11-Dec-2014-FINAL2.pdf).

4. The adequacy of Commonwealth and State cooperation in gas market regulation

This month's COAG Energy Council meeting provides an example of national cooperation to facilitate the development of a national resource. The Council acknowledged the increasing importance of unconventional gas resources and the role of the eastern Australian gas market. The Australian gas industry offers the Australian economy critical investment opportunities in infrastructure, employment and skills to name a few. Furthermore, the Council recognised that the only way the NSW gas industry can become a player in the provision of indigenous gas supply is to remove the restrictions to supply.

APPEA welcomes the cross-jurisdictional alignment on approaches to a gas market policy. We reiterate COAG's belief that access to availability to factual information and robust science must be improved and the importance of an engaged community.

One outcome from the meeting of particular note was the release of the Australian Gas Market Vision. The Council Vision's is the following:

The Council's vision is for the establishment of a liquid wholesale gas market that provides market signals for investment and supply, where responses to those signals are facilitated by a supportive investment and regulatory environment, where trade is focused at a point that best serves the needs of participants, where an efficient reference price is established, and producers, consumers and trading markets are connected to infrastructure that enables participants the opportunity to readily trade between locations and arbitrage trading opportunities.

Through the meeting's communiqué, governments have signaled a commitment to continuing a gas market reform program. APPEA welcomes COAG's commitment to a sophisticated interconnected gas market and will work with the Australian and NSW Governments to assist in the further development of the gas market, in the face of a strong misinformation campaign fuelled by interest groups.

5. The possible regulatory responses to protect New South Wales gas consumers from adverse market fluctuations and failures

Despite possessing substantial gas reserves within its borders, NSW currently imports 95 per cent of its supply from South Australia and Victoria, at a time when regulated gas prices are rising. The key means by which to reduce the cost of gas to consumers is to develop an indigenous gas supply. To do so, we must create a marketplace in which explorers, producers, investors, consumers and Governments have confidence.

In order to achieve this we must firstly understand our resource, and to do so we must explore. The natural gas industry in NSW is world-class with a solid track record in exploration underpinned by science. APPEA welcomed the NSW Chief Scientist and Engineer's findings in her review of coal seam gas exploration activity in NSW⁵. The Report concluded that technical challenges and risks posed by the natural gas industry can be managed and praised the industry's high standards of engineering and professionalism.

⁵ NSW Chief Scientist and Engineer (2014), *Final Report of the Independent Review of Coal Seam Gas Activities in NSW*, (available at www.chiefscientist.nsw.gov.au/_data/assets/pdf_file/0005/56912/140930-CSG-Final-Report.pdf).

New production depends upon successful exploration activity. Without new exploration and production in NSW, it will be very difficult to put downward pressure on NSW gas prices, which are increasing by more than ten per cent this year⁶.

Over the past several years, the NSW Government has signalled a hesitation for fostering exploration activity. We have seen exploration licences cancelled, application fees increased and regulatory burden imposed. The industry has experienced a range of policy and regulatory restrictions over the past three years which has undermined the industry's confidence in NSW as a viable market for investment. NSW requires policy and regulatory stability in order to attract investment for gas exploration and production.

The recently-released NSW Gas Plan is a step in the right direction for the development of a substantial indigenous gas supply; however this is the third plan in three years. The industry is concerned that unnecessary restrictions and red tape placed on producers and explorers will continue to impede resource development and hamper further investment.

Every step in the exploration, development and production of crude oil and natural gas is highly regulated. APPEA supports objectives/risk-based regulatory regimes that are based on sound scientific principles. Currently, the NSW regulatory model is prescriptive, duplicative, complex and difficult to navigate. As a result, an appropriate level of transparency is lacking. The commitment to streamline regulations recognises that governments at all levels have the opportunity to add considerable value through ensuring inconsistent and duplicative regulations are removed as a matter of priority. A harmonised approach to operations management and safety regulation across jurisdictions should be an immediate priority.

APPEA believes that reform is needed to continue to remove unnecessary and duplicative regulation at all levels of government. The reduction of 'red tape' and removing regulatory hurdles is the most efficient avenue to fostering confidence in the industry to commit to the development of our indigenous gas reserves.

The industry acknowledges the Government's declaration that it is intent on bringing on new gas supply in the state. However, before the policy principles can be translated into positive action, the Government must clarify some important details:

- The Government's plan appears to shut down opportunities for new investment in the state and does not allow for new exploration. Today's exploration is tomorrow's production.
- The suggestion that gas production be reserved for use in NSW is clearly at odds with the fact that NSW has relied on the willingness of other states to supply gas into NSW for many decades. The type of 'reservation' policy outlined has been widely condemned by many reputable parties.
- Benchmark farmer compensation agreements must not reduce the scope for flexible negotiation between the parties. They have the potential to create significant problems for gas companies and farmers alike, as they fail to recognise that every farm is different.
- The extension of "exclusion zones" is a clear case of arbitrary and politically driven regulation. The gas industry has no issue with the regulation of its activities, but the rules must be based on science and risk management principles.

⁶ Independent Pricing And Regulatory Tribunal (2014) (available at www.ipart.nsw.gov.au/Home/Industries/Gas/Reviews/Retail_Pricing/Changes_in_regulated_gas_retail_prices_from_1_July_2014/15_Aug_2014_-_Fact_Sheet_-_Removing_carbon_costs/Fact_Sheet_-_Removing_carbon_costs_from_regulated_gas_prices_-_15_August_2014).

Additional legislated costs to investors – whether related to compensation agreements, community contributions, or compliance – must be balanced with the need to ensure costs are not so high as to jeopardise development.

In Queensland, agriculture and gas production are working side-by-side through more than 4,700 land access agreements that allow for the safe production of gas and the provision of income to farmers that is not dependent on the weather. The 2013-14 financial year saw more than 1,600 wells drilled in Queensland, while in NSW only ten exploration wells were drilled and not one production well.

The NSW Government can look to the Queensland example as a model for a safe and sustainable industry underpinned by scientific principles, with strong political leadership and a transparent and sensible regulatory framework.

The Australian economy is facing an increased level of competitiveness with a focus on attracting new project investments central to the national interest. To foster new project development, the Government must ease existing regulatory and policy barriers to investment rather than impose new hurdles such as a gas reservation policy. Reservation has been almost universally rejected globally throughout free-market economies for a very good reason: gas reservation actually makes worse the very situation it is supposed to fix. Rather than generating more gas or driving down prices, reservation policy reduces investment needed to bring on new, or cheaper, supplies.

Western Australia provides an insight in to the ineffectiveness of the reservation policy in practice. The state introduced a gas reservation policy in 2006, however, in July this year Western Australia's Economic Regulatory Authority (ERA) stated⁷ that the costs the policy imposes on the Western Australian economy far outweigh any benefits that it is believed to have. The ERA recommended that the domestic gas reservation policy should be rescinded because the policy:

- Discourages investment in gas projects;
- 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; and
- Discourages efficiency and innovation.

Campaigns that pin hopes on domestic gas reservation policies to solve complex gas supply issues are misguided particularly when there are other workable and achievable options available to policy makers.

The Australian Government's *Energy Green Paper*⁸, recognised the call for a domestic gas reservation policy and rejected the concept as a solution to the current challenges facing the energy market and argues for "*more competitive markets need better market information, informed community participation, operational transparency, and accelerated project development*".

⁷ Economic Regulatory Authority (2014) (available at www.erawa.com.au/cproot/12754/2/Preface,%20Executive%20Summary%20and%20Recommendations.PDF).

⁸ Commonwealth Government (2014), *Energy Green Paper*, (available at ewp.industry.gov.au/pages/energy-green-paper).

Oil and gas is one of Australia's highest value-adding industries, as PwC found in their recent report *Value-adding: Australian Oil and Gas Industry*⁹, that the oil and gas sector is a high returning sector that is attracting substantial investment, generating significant value relative to its inputs and is experiencing rapid growth, compared to other sectors of the economy.

As such, Australia's oil and gas industry should be a key part in any government policy measures aimed at developing high value-added products and services whether for domestic or export markets.

APPEA therefore recommends to the Committee that the key to addressing the energy supply/demand challenges faced in NSW is through increased indigenous supply. The state is gas-rich, however in order for industry to develop these natural resources it requires the removal of regulatory and other barriers. Additionally, the Government must definitively rule out any possibility of a domestic gas reservation policy and/or introduction of a so called 'national interest' test. Only when regulatory certainty and confidence is achieved can the state attract the investment it requires to build the necessary infrastructure to allow more gas to flow into the market which will, in turn, place downward pressure on domestic gas prices.

Yours sincerely

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⁹ PwC (2014), *Value-adding: Australian Oil and Gas Industry, September 2014* (available at www.appea.com.au/wp-content/uploads/2014/11/PwC-Report-Oil-and-Gas-Industry-Sept-2014-FINAL.pdf).