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GETTING GAS INTO A MARKET - ANY MARKET

Robert Pritchard and Keith Orchison

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Key Points:

- Eastern Australia, mainly New South Wales, faces a potential gas supply crisis
- There is plenty of gas in the ground in eastern and central Australia but it is too often blocked from getting into any market by a combination of regulatory, environmental and social constraints that have created an investment imbroglio
- Some elements of the gas industry contributed to the problem in the early days by not fully appreciating and not adequately responding to community concerns
- The root cause is nonetheless policy failure in New South Wales, the remedy for which is to immediately establish a well-resourced task force with all affected stakeholders to proactively eliminate the blockages

Australia is an energy-rich country. This may in part explain why, for many years, eastern Australian consumers have been complacent about their security of supply of gas and its relatively low cost. Their complacency is, however, now being replaced by disquiet, even fear.

Central to these concerns is the apparent inability or unwillingness of governments, on whom consumers have depended to look after their energy interests, to develop a forward perspective of unfolding problems and to take effective, timely action to address them. It is related to the broader criticism leveled at governments by the Energy Policy Institute last year that Australia lacks an 'investment-grade' energy policy, i.e. a well-balanced, robust and stable policy to attract investment and manage regulatory risk in the energy industry.

Gas consumers in eastern Australia, principally in New South Wales, are now faced with potential shortfalls in supply and very large increases in prices as a result of, first, the pressure from the export of coal seam gas (CSG) as LNG and, secondly, the inability of successive New South Wales governments to come to terms with the implications of existing contracts from interstate suppliers 'rolling off' from the middle of this decade.

In November 2012, the New South Wales Parliamentary Accounts Committee recommended to the NSW State Government that an expert panel be convened 'to explore strategies to maintain affordable supplies of gas.' The NSW Government has failed to respond adequately to this recommendation. In February 2013, it announced a package of what it called 'tough new measures to further strengthen the regulation of the [CSG] industry ...to build on what are already the toughest controls in the country." In April 2013, it established another NSW parliamentary inquiry to inquire into downstream gas supply and availability, leaving the upstream gas supply issue hanging in the air,

In the meantime, the Australian Government announced a major new study into what it recognised as 'an unprecedented scale of change' in the gas market; the South Australian Government published after careful stakeholder consultation its "Roadmap for Unconventional Gas Projects in South Australia"; the Queensland Government legislated to establish a GasFields Commission to foster improved stakeholder coexistence; the Victorian Government established an investigative task force led by former Federal Minister Peter Reith; and the intergovernmental Standing Council on Energy and Resources (SCER) issued its national harmonised regulatory framework for CSG.

It seems to be 'the Australian way', when faced with a substantial problem, to reach for a committee, and often further complicate the situation by running federal and state inquiries separately. This is exactly what is happening in the current situation.

While the commitment to scrutinising the issue is laudable, multiple stand-alone inquiries do not encourage confidence that there will be timely, efficient, market-wide resolution of current problems – the cornerstone of investor confidence.

The current consumer disquiet arises at a time when households are suffering cost-of-living pressures (including much more expensive power bills) and businesses are afflicted by the effects of the global financial crisis, by a range of rising domestic input costs and by increasing difficulty in competing with their overseas rivals.

A doubling of east coast wholesale gas prices will flow through to households and businesses as a rise of up to 30 per cent in their final bills; and it is widely feared that wholesale costs may even treble.

In New South Wales, it is possible that in 2016-18 there will be be an actual shortage of available gas at times of peak demand, a ridiculous scenario for a State where the resources of coal seam methane under its ground should be able to meet today's level of demand for decades ahead.

The New South Wales problem has not cropped up suddenly – as occurred in Western Australia when the critical Varanus Island gas pipeline ruptured – but has been evident since at least 2005 when the then Carr Government published an energy green paper foreseeing supply difficulties without then appreciating (because the issue had not yet arisen) the added pressure of east coast gas being required in large volumes for LNG exports.

When the State's long-lived Labor Government fell from office in 2011, the new Coalition administration inherited a situation in which contracts covering 95 per cent of the State's needs will commence to 'roll off' as the LNG trains in Gladstone start to "hoover up" available resources and in which radical green activists have actively inflamed and exploited the concerns of rural communities for the purpose of opposing production of the large quantities of "proven and probable" resources of CSG.

Unfortunately, the past two years have not seen the NSW Government taking charge of the issue and resolving it but rather making things worse through creating substantial regulatory uncertainty for investors – to the point where some have withdrawn from activity in the State – while the Australian Government has announced increased scrutiny of approval processes under the Environmental Protection & Biodiversity Conservation Act ahead of September's federal election.

The situation has reached the stage where the chief executive of New South Wales' largest gas supplier has warned that ongoing restrictions on developing coal seam gas in the State are "coming at exactly the wrong time" when contracts need to be closed for new supplies after 2016: "If you get to a point post-2016 where some of the state's major manufacturers can't afford the price of gas, the way the supply/demand balance gets solved is that demand actually just gets knocked off the system – and that flows through to jobs."

In the firing line are industries such as plastics and chemicals manufacturing, cement production, glass manufacture and metals processing. These are industries that have large value-add and provide important inputs to the wider manufacturing and construction sectors, which are vital for full employment and a healthy economy.

Beyond these industries, companies across the spectrum of the national economy will feel a ripple effect. The plastics and chemicals industry, for example, provides products that, according to the CSIRO, underpin 109 of the 111 industries operating in this country.

The problem does not only affect existing businesses. Much higher gas prices can, and probably will, when taken with other issues such as high labor costs, discourage large industrial users from locating new developments in eastern Australia.

Perhaps inevitably, this has led to demands from some parts of the manufacturing sector for government intervention in the form of reservation of gas resources for sale only in Australia. Intervention in markets should, however, only be used in emergencies and then reserved only for essential services. Understandably, intervention is strongly resisted by the upstream gas industry. The gas industry's stance is supported by both the Federal Government and the Coalition.

A key element of the gas industry's argument is that the relatively small size of Australia's domestic gas market means the country cannot create adequate value from its very large east coast resources by reliance on this market solely or to a substantial extent. The industry argues that unfettered access to export markets provides a price incentive that is necessary if it is to further unlock the technologically challenging CSM and shale gas resources that are obviously abundant in eastern and central Australia.

Where manufacturers and the upstream gas sector agree is that a way has to be found to overcome resistance in the community to gas development in order to enable resources to be efficiently and adequately exploited in a timely manner.

In part, the current gas problem reflects a much bigger issue: the falling confidence of the community in the standard of governance at federal and state levels, fed by a well-documented series of failures of government programs (such as "pink batts", overly generous solar feed-in tariffs and arguably an inflated Renewable Energy Target), made worse by corruption scandals affecting coal mining licences in NSW.

The gas investment imbroglio is made more intractable by the fact that issues of public concern about unconventional exploration and production technology and of the conditions of access to farming land were poorly handled by both industry and government in the early days of CSG development.

Nonetheless, we have not the slightest doubt that policy failure is the root cause of the present situation. Governments should have been working proactively and collaboratively with industry and other stakeholders to delineate an appropriate gas development strategy far in advance of the first well being drilled and, at the very least, since the Gladstone LNG projects were first mooted.

The efforts now being made to address the policy failure – for example, the creation of the GasFields Commission in Queensland to be an "honest broker" between the industry and the community in that State - are welcome but the inability of governments to work together to resolve common problems that are crippling development remains unaltered.

While, under the Constitution, resources underground belong to the states and territories – and those further offshore to the people of Australia as a whole – the reality of the looming east coast gas shortage is that it stretches across jurisdictional boundaries. Problems in New South Wales will ripple across the whole of eastern Australia and impact on the national economy. This is not some new revelation. The late 1990s Longford explosion in Victoria and, to a lesser extent, the more recent Varanus Island explosion in Western Australia both demonstrated that a failure in gas supply will have interstate ramifications.

Today, the reality on the east coast is that wholesale gas prices are likely to double, supply is already squeezed by the need to meet LNG contracts and significant gas development is stalled in response to community fears about 'fracking' and other processes, exacerbated by environmental activism.

We assert that politicians – in Canberra, Sydney and Melbourne in particular – have become distracted by politicking and have allowed the problem of gas supply to reach dangerous proportions. However, little purpose is to be gained by looking back and allocating blame to anyone.

The coming federal election may provide a circuit breaker as it appears certain to lead to a change of national government – and the BREE report could contribute to a new sense of purpose and direction.

We believe that, for New South Wales at least, the time for procrastination and politicking has run out. Even if the situation is resolved during what remains of 2013, it is likely to take three to five years to bring the gas to market, whether from interstate or intrastate. Any solution now will be a "damned near-run thing" and the implications of failure will be serious.

The urgent and immediate need is for New South Wales to establish a proactive, well-resourced task force, in collaboration with all stakeholders, with the function of eliminating all unnecessary blockages to the removal of gas from the ground and its delivery to the market, and backing the task force with full authority. The task force should look at what has been initiated by the South Australian and Queensland Governments. For its part, the upstream gas industry may need to pursue more creative reform itself, working more closely together to address common challenges.

Authors...

Robert Pritchard is Executive Director of the Energy Policy Institute of Australia and Managing Director of ResourcesLaw International in Sydney. He has over 40 years' experience as a lawyer and consultant to the energy industry, advising governments, IGOs, NGOs and major corporations. Robert was the founding Chairman of the Section on Energy and Natural Resources Law of the International Bar Association (IBA) and served for four years on the IBA Council. He edited the IBA book "Economic Development, Foreign Investment and the Law." Robert served for nine years on the Finance Committee of the World Energy Council and has been a Fellow of the Australian Institute of Energy since 1980.

Keith Orchison is the principal of Coolibah Pty Ltd, editor of OnPower website, publisher of the "This is Power" blog and a commentator for Business Spectator. He was managing director of the Electricity Supply Association of Australia for 12 years until 2003 and chief executive of the Australian Petroleum Exploration Association for 11 years before that. He also served as chairman of the energy committee of the Federal Government's Critical Infrastructure Advisory Council from 2003 to 2007. He was editor of the Powering Australia yearbook from 2007 to 2012. Keith was made a Member of the Order of Australia in 2004 for service to the petroleum and electricity industries through fostering co-operation between energy producers and government agencies.