DOMGAS ALLIANCE

Response to the Energy Green Paper

Summary of recommendations

1. Australia first

As a basic principle, Australia's national energy policy should put the needs of Australian industry and Australian jobs first. In the national interest, this must be the White Paper's core statement of belief. Other nations have adopted this approach without putting at risk exploration or capital investment. The White Paper should be significantly amended to strike a fair balance between exports of energy and the needs of Australian industry.

2. Domestic gas reservations

The Federal government should review its ideological opposition to domestic gas reservation policy in light of the real world experience in Western Australia. A national domestic reservation policy would apply a consistent requirement on all LNG export projects prior to approval. This would ensure a small but fair share of Australia's natural gas is directed to building our economy and protecting Australian jobs. This supply could be achieved either directly or indirectly through gas swaps. It is essential to have a national approach covering Commonwealth waters to ensure producers do not seek to avoid their obligation to supply into the domestic market.

3. Retention lease policy

It is time for Canberra to deliver on its "use it or lose it rhetoric". The White Paper must include a review of the retention lease system including a tougher external examination of producer claims in relation to commercial viability. The entire process must be made more transparent with a more immediate mechanism to allow the market to challenge claims made by producers. The Federal government must also re-commit to its legislative responsibility that requires producers to prove the absence of commercial viability applies in both a domestic and export setting.

4. Third party Infrastructure

The Federal government should commission a study to examine which offshore gas fields could achieve commercial viability and be brought to the domestic market sooner if there was access to third part infrastructure.

5. Review of competition in West coast market

The lack of gas-on-gas competition in the West coast market, exacerbated by the joint marketing exemptions for the North West Shelf and Gorgon projects, can no longer be ignored by Canberra.

The Green paper has very strong albeit short term focus on difficulties facing the East coast domestic market. It is unfathomable that the Green Paper should suggest an ACCC inquiry into competition in the interconnected East coast market and yet ignore the even more obvious and deleterious lack of competition in the West coast market.

The White Paper must include measures to address the problems created by the isolation of the West coast market and the lack of competitive forces at play in this market. This must include a call for joint marketing exemptions to be rejected when they come up for renewal in 2015.

6. **Impact of Floating LNG**

The White Paper must include a more balanced assessment of the policy, economic and social consequences of Floating LNG technology. This must include the key issue of domestic markets being effectively locked out of the gas from these fields but also an analysis of the negative impacts in terms of jobs, regional development and indigenous employment and economic opportunities.

7. **Fuel switching implications for greenhouse emissions**

The White Paper must include an assessment of the impact that higher gas prices, brought about by LNG exports, are having in terms of companies switching from gas back to coal or diesel. This has significant implications for Australia's greenhouse emission reduction efforts and could potentially undermine the government's Direct Action program.

Discussion

The Green Paper fails the fundamental test of defining what Australia needs and expects of its national energy policy. This is particularly so in relation to the development and potential end-use of our natural gas resources.

The overwhelming message of the paper is that Australia will be an exporter of energy, rather than a nation that seeks to use its energy resources to diversify its own economy, build its industrial base and create employment for its people.

The fixation of the Green paper on promoting the export of our natural gas comes at the expense of our domestic industry and the social, cultural and economic benefits it brings.

The paper makes no effort to consider a more nuanced or balanced approach that could see the development of a profitable LNG export sector with its associated job creation alongside a stronger domestic industry which would also generate significant new employment opportunities.

A second major (but just as significant) failure of the Green Paper is that it fails to adequately address the differences between the West and East coast markets.

Western Australia's energy context is completely different to that being faced by the East coast due to our heavy reliance on natural gas for our energy needs, the off-shore location of most of our natural gas resources, and our geographic isolation.

It should be noted that our State's heavy reliance on natural gas comes as a result of a conscious decision by governments – at both a State and Federal level – to help ensure the development of the North West Shelf project in the 1980s. This project – which was heavily underwritten by State taxpayers and domestic industry – would not have succeeded without the domestic market component. This support helped ensure the birth of Australia's successful LNG export industry and at the same time provided the reliable supply of natural gas that has driven the growth Western Australia's domestic economy.

It remains an ongoing frustration that our national energy policy fails to grasp the same vision shared by State and Federal governments in the 1980s and apply it to our current and future energy needs.

While the Green Paper references this history in part, it fails to make the logical link that Western Australia's current situation is dictated by this past.

The Grattan Institute has estimated that rising gas prices could cost industrial users up to $3.2 billion a year. In doing so it noted:

> "The cost will not be distributed evenly by state. … Over half of the total cost increases to industrial users, a total of almost $1.8 billion, could be borne in Western Australia."[1]

In other words, decisions taken by the Federal government on energy policy, particularly in relation to natural gas, disproportionately impact on Western Australia.

There is a strong undercurrent in the Green Paper about the need to address the emerging supply problems being faced on the East coast, brought about by the failure of governments to consider the impact of the new LNG export projects on supply for the domestic markets. It should be noted that when the Western Australian government introduced its domestic gas reservation policy in 2006 it warned:

> "the issues facing Western Australia regarding the long term security of domestic gas supply are ones that will soon also be facing the eastern states."[2]

This warning was ignored. As recently as 2012 the then Federal Labor government's Energy White Paper stated "There is no clear evidence at this time to suggest market failure or that our gas markets cannot deliver the necessary supply. "

While the Green Paper chooses to now focus on addressing the supply issues being faced by East coast gas users, particularly in New South Wales, it fails to address the significant supply concerns emerging in Western Australia – concerns which will be exacerbated by the introduction of new Floating LNG technology (discussed below).

Domestic Gas Reservations

The Green Paper makes several erroneous or unsubstantiated references to domestic gas reservation as a policy option.

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[1] "Getting gas right: Australia's energy challenge." T Wood & L Carter, Grattan Institute, June 2013

[2] Domestic Gas Reservation Policy, WA Government, 2006

The paper states:

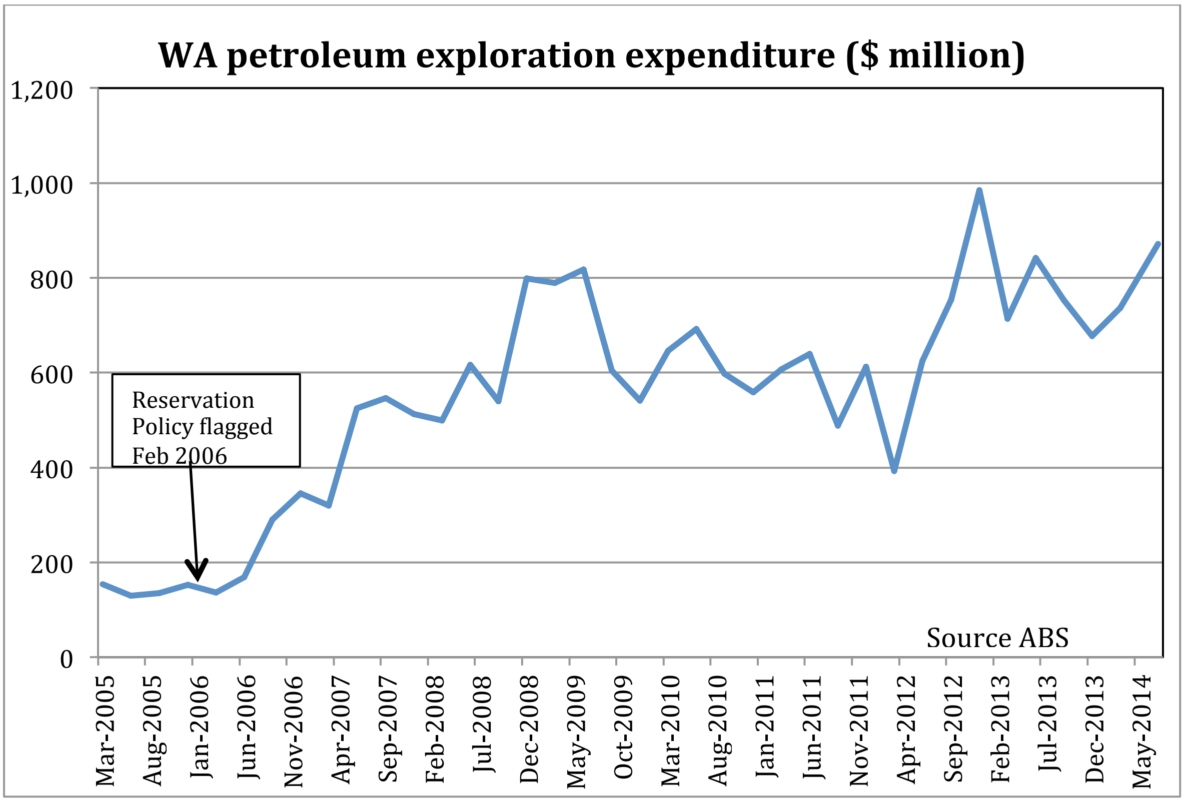
> "The Australian Government notes calls for domestic gas reservation policy and national interest tests. Such actions will not address current challenges in the market, and may result in negative long-term outcomes by deferring future investment."

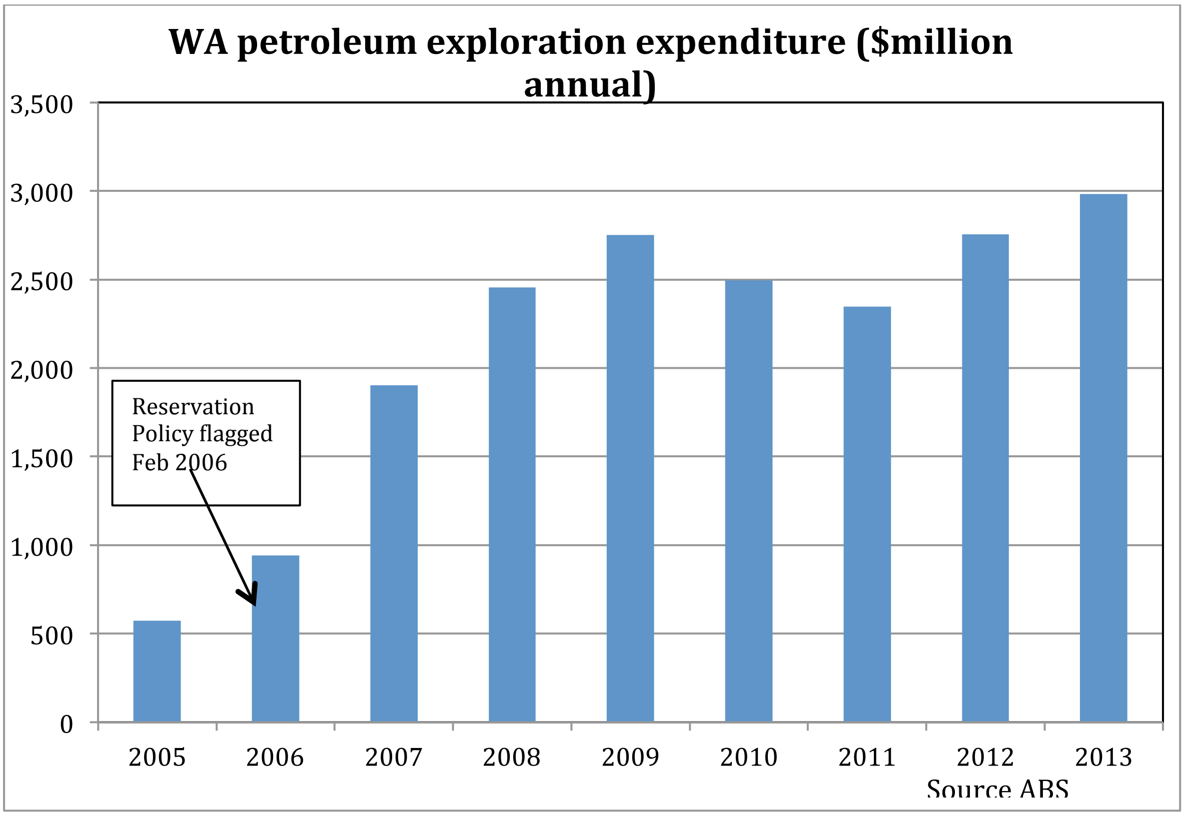
The reference to "current challenges" appears to be a confirmation, in part, that the Federal government should have considered these issues back in 2006 when it was first warned to do so.

There may be some logic in stating that a reservation policy will not immediately fix the New South Wales problem, where significant shortages are estimated to impact in 2016. It is, however, puzzling that the government would give no consideration to the benefits such a policy can deliver over the longer term. This simply reinforces the impression that the Green Paper is focused on dealing with today's East coast issues rather than setting a long-term direction for the future management of Australia's energy resources.

The second part of the statement – that domestic reservation policy "may result in negative long-term outcomes by deferring future investment" – simply repeats the mantra of oil and gas producers that reservations "destroy investment".

It is time for the Federal government to take a serious look at Western Australia – the only Australian state with an active domestic gas reservation policy. This policy has now been in force for eight years. The following charts identify the strong growth in investment in exploration in Western Australia since the introduction of the policy, firstly on a quarterly and then on an annual basis.





After eight years of domestic reservations as a formal policy, there has been no drop-off in investment in Western Australia. To the contrary, there have been five years where new records for investment have been posted, with only the impacts of the Global Financial Crisis slowing the surge in investment. Figures to date in 2014 indicate that yet another record will be posted this year.

There is simply no real world evidence in the Western Australian experience to support the Federal government's proposition that reservations are bad for investment.

The Green Paper itself references the Fraser Institute's "Investment Attractiveness Index" for petroleum (Figure 5, page 10). This chart shows that Western Australia's investment attractiveness grew strongly in 2009 and 2010 (allowing for a more than reasonable settling-in period for the new domestic gas reservation policy) and has been tracking no differently to any other Australian state.

The Federal government is not alone in making negative statements about reservation policy without supporting evidence. The Grattan Institute recently released a report that claimed that reservation policy would "reduce the development of Australian gas exports and reduce the incentive to develop further gas supplies."[3] In a news item covering this report, the ABC reported that the Grattan Institute "was not able to give examples of which investments had been discouraged by the WA gas policy."[4]

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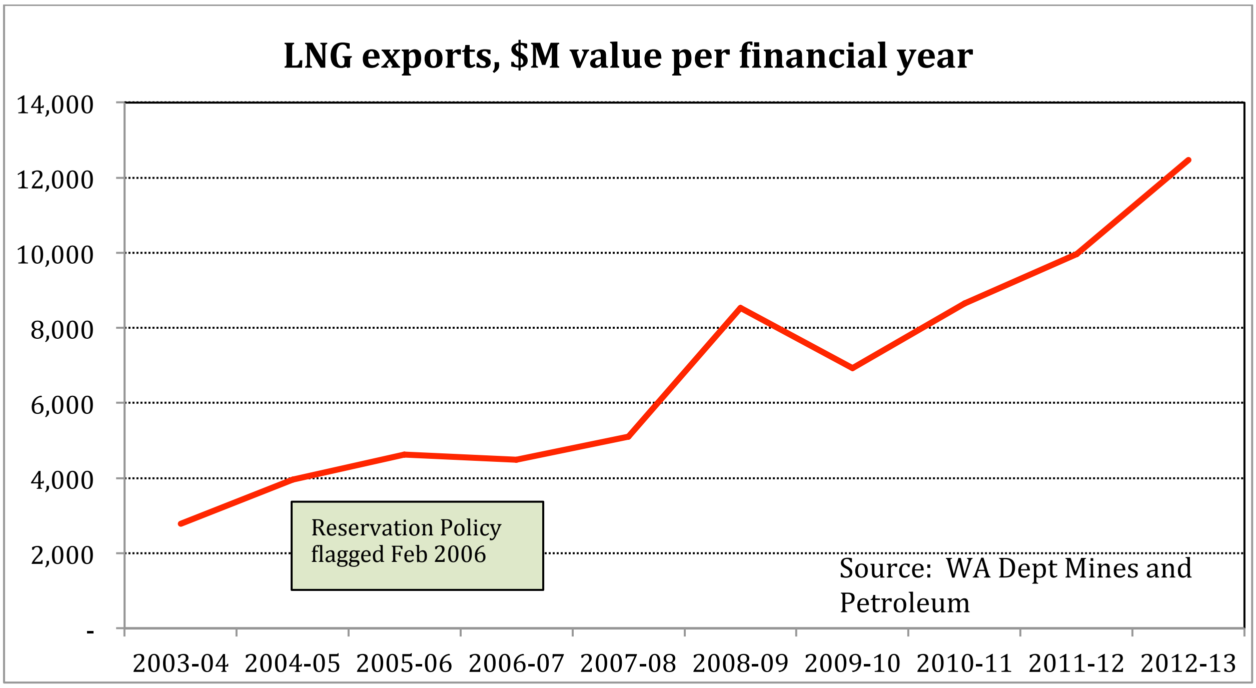
[3] "Gas at the crossroads; Australia's hard choice." T Wood, Grattan Institute, October 2014

[4] "Gas price increases no cause for reservation policy: report", ABC On-Line, 21 October 2014

In terms of reservation policy reducing development of Australian gas exports, the following chart shows the remarkable growth in LNG exports from Western Australia over the eight years that a domestic reservation policy has been in place.



There is a further misleading reference in the Green Paper in relation to the recommendation by the WA Economic Regulation Authority that the WA domestic gas reservation policy should be rescinded. It is important to note that, despite being advised to do so by its chosen consultant Acil-Allen, the ERA did no economic modelling of the impact of the domestic gas reservation on the WA market and also did no economic modelling to determine whether the policy's removal would deliver any quantifiable benefit or loss to the State's economy. The ERA could not point to any domestic or LNG export opportunity that had been deferred or lost because of the domestic gas reservation policy.

In fact, the ERA noted the DomGas Alliance's submission that "(i) investment in exploration for oil and gas has continued to grow to record levels; (ii) the LNG export industry continues to post record levels of LNG exports; and (iii) investment in new projects in 2013 alone stood at an estimated $116 billion" and stated "the ERA agrees with the three statements submitted by Domgas Alliance."[5] The ERA, surprisingly, then concluded that despite this almost overwhelming evidence that it "does not accept the suggestion that these statements demonstrate that the DGR policy does not hinder economic activities from gas producing sector", attempting to put the onus back on supporters of the policy to prove that investment and exports would not have been higher without the policy. This is nothing more than ideological sophistry on the part of the ERA in the absence of any evidence to support its own position.

Having noted that, it is misleading for the Green Paper to suggest that "the Western Australian Government is considering the authority's final report." This falsely implies the State government is considering the recommendation to rescind the domestic gas reservation policy.

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[5] "Micro-economic reform in Western Australia", Economic Regulation Authority, July 2014

This is not correct. While it is still considering the ERA report's recommendations across a number of public policy areas, the WA government has publicly ruled out removing the domestic gas reservation policy. Therefore this reference should be removed from any further iteration of this paper.

Retention Lease Policy

The Green Paper makes numerous references to the importance of "bringing on more supply" to gas markets and states that one of the government's goals is to "bring on new gas supply as quickly as possible" so as to "avoid potential supply shortages so that domestic gas users do not pay higher prices than necessary."

Much of the discussion around this topic in the paper focuses on the East coast supply issues and their relationship to various restrictions placed by State governments on the development of unconventional gas sources.

This East coast bias again overlooks the unique issues facing the West coast gas market.

It is remarkable and a major failing of the Green paper that there is not a single reference to retention lease management policy in the document.

In opposition, the now Minister for Industry, the Hon Ian Macfarlane MP, stated "In fact, if elected we will ensure equal if not more focus on retention leases. We must get this gas out of the ground."[6]

On coming to office the Minister stated "I want to put the industry on notice that if the deposits are able to be developed they've got to be developed."[7]

The Minister was even more specific in saying "There will be no knee-jerk reaction. I mean, we just want to see this stuff developed over the next two or three years so we know where we're going *and if the companies genuinely can't do it, or don't want to do it, or for whatever reason, then I think those tenders for retention leases when they come up for renewal should be put out to the market*."[8]

This final comment appears to have been directed at the New South Wales gas supply situation. It appears from the Green Paper that the same sense of urgency and decisiveness does not apply to the West coast supply situation.

Unlike the East coast, the overwhelming majority of our currently available gas reserves are located offshore.

Earlier this year the Fortescue Metals Group (a member of the DomGas Alliance) commissioned a report by Deloitte-Access Economics that detailed the rapid expansion in the number of retention leases being used by producers to warehouse natural gas fields for future LNG exports.[9]

[6] "Libs flag retention lease crack down", The West Australian, 27 May 2013
[7] "Use it or lose it; Miners warned by Coalition." The Australian, 18 September 2013
[8] "Macfarlane pushes to up production of natural gases." The World Today, ABC, 18 September 2013
[9] "Western Australia gas sector analysis", Deloitte Access Economics, 16 May 2014

The Deloitte Access Economics report noted that in 1990 less than 4% of the Commonwealth's offshore gas titles were held under retention leases but by 2009 this figure had grown to more than 40%.

Despite legislation aimed at ensuring fields are developed within 15 years, around 25% of the land area that is held under retention leases had been held for longer than this period – with one title being held for 27 years.

The report went further by modelling the commercial viability of two reserves held under retention lease; modelling which proved they would be commercially viable for domestic supply.

The current Commonwealth Offshore Petroleum and Greenhouse Gas Storage Act 2006 provides a simple test for the issuing of a retention lease in that the Joint Authority must be satisfied that "the recovery of petroleum from that area is not, at the time of the application, commercially viable but is likely to become commercially viable within 15 years after that time." (s142)

There is no differentiation in the Act between domestic or export supply when it comes to determining if an area is commercially viable.

The FMG-commissioned report has identified reserves currently under retention leases that could supply the domestic market and meet the test of commercial viability.

This issue is of particular relevance to the West coast domestic market. If the Federal government were to deliver on its pre-election statements and its legislative responsibility, significant additional supplies could be brought on-line by taking a tougher approach when assessing applications for retention leases. It should be noted that domestic reservations might still be required to ensure that a fair share of these resources is brought to the domestic market.

The White Paper must be clear in stating the Federal government's position on retention lease management. This should have as its starting point a commitment to greater transparency in the retention lease process and greater external scrutiny of the claims being made by producers to justify their applications. If a producer claims a lease is not commercially viable then the market should be given an opportunity to contest that claim. This should include allowing greater input from domestic gas users to provide a more accurate picture of local demand and whether it can provide a reasonable rate of return for a potential producer. Ultimately if another producer believes it can bring a field to the domestic market they should be given that opportunity.

Joint Marketing Arrangements

Market power in the western market is heavily concentrated in the hands of a small number of gas producers.

Far from being a "normal" market, this distortion of power is increased and reinforced by the allowance of joint marketing arrangements. The ACCC has issued exemptions to allow joint marketing for the North West Shelf project (despite the joint venture partners marketing their gas individually to the export market) and the Gorgon project.

The Green Paper states "competition encourages innovation, leading to better products and services. It also encourages better prices."

The DomGas Alliance believes that these exemptions have only one possible outcome: to significantly reduce competition in the domestic gas market.

The exemptions come up for review by the ACCC in 2015.

Given the Green Paper's statement of principle that competition leads to better prices, it is surprising that it does not take the opportunity to express a view on need to end the competition-destroying joint marketing arrangements.

In relation to the joint marketing exemptions operating in the West coast market the Green paper states "the Competition Policy Review should identify if there are any significant issues with the continuation of this arrangement."

Unfortunately the draft report of the Competition Policy Review does not reference these arrangements and appears to put the ball back in the court of the White Paper process by stating:

> "The Panel notes that the Australian Government will respond to the (Eastern Australian Domestic Gas Study) report through the Energy Green Paper. The Panel considers the Green Paper should, among other things, examine barriers to entry in the gas market, whether access regimes are working effectively to encourage upstream and downstream competition as well as regulatory and policy impediments to the efficient operation of Australia's gas market. The Panel would welcome the Green Paper committing to a more detailed review of competition in the gas sector in response to the Eastern Australian Domestic Gas Study and calls in other reports such as the Victorian Government's Gas Market Taskforce Final Report and Recommendations."[10]

It is therefore unclear which process is trying to determine a national approach to the issue of joint marketing exemptions for gas producers.

The White Paper must clarify this situation.

Joint marketing is not just an issue in Western Australia – it also affects the Eastern market. In 2013 the Victorian Gas Market Taskforce recommended that "The Victorian Government, with the objective of moving away from joint marketing arrangements, request the Australian Competition and Consumer Commission (ACCC) review the existing joint marketing arrangements for gas producers, assessing their relevance in light of the rapidly evolving eastern gas market." [11]

This submission has previously highlighted the strong East coast bias in the Green Paper. This is again apparent in the issue of competition and joint marketing arrangements.

The Green Paper states:

> "The Eastern Australian Domestic Gas Market Study looked at whether there were issues that could limit market competition and delay an efficient market response to potential near-term supply shortages. The study found these competition issues were difficult to assess using available public data. A review of competition by the ACCC or the Productivity Commission could be used to determine the effectiveness of competition in gas markets. "

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[10] Competition Policy Review Draft Report, September 2014

[11] "Gas Market Taskforce Final Report and Recommendations", Victorian Government, 2013,

It concludes:

> "An ACCC Price Inquiry into the eastern Australian wholesale gas market, under Part VIIA of the Competition and Consumer Act 2010, or a Productivity Commission review, could examine the levels of competition in the eastern gas market. Such an inquiry could inform consumers about future market conditions and opportunities to increase competition in the upstream market, including opportunities to remove unnecessary regulation, and issues that may limit wholesale market competition."

There is no suggestion that a similar piece of work be directed toward assessing the lack of competition in the West coast gas market and potential remedies for this.

If the White Paper intends to spell out a national direction for Australia's energy policy it needs to consider and address the unique context of the West coast market, particularly the lack of competitive forces.

Access to third party infrastructure

While oil and gas producers complain about the cost of doing business in Australia, three LNG projects have been built side-by-side in Queensland – with no shared infrastructure.

The Green Paper does not specifically address the issue of how to ensure or encourage project developers to gain the maximum benefit through the sensible sharing of common infrastructure.

On a related issue, the DomGas Alliance's original submission to the White Paper process argued that there would be considerable value in reviewing third party access to infrastructure to determine if such access could help bring on new supplies of gas, particularly from offshore fields.

This may allow alternative funding models that could help reduce the cost of gas supply. More of the infrastructure could be provided at lower rates of return than that required by the oil and gas industry.

The Green Paper at least acknowledges this point noting that "Shared use of private infrastructure is challenging, but duplication through not sharing is costly and reduces national competitiveness. Self-funded infrastructure can be a commercial advantage, and private interests are understandably reluctant to lose that advantage."

The DomGas Alliance believes there would be considerable value in the Federal government undertaking an analysis of current offshore gas fields to determine whether these could be brought to the domestic market sooner if access to third party infrastructure was available and then make recommendations about how this outcome should be achieved.

Floating LNG

The DomGas Alliance has previously stated that it is not wise to attempt to stand in the way of new technology. However, new technology always brings with it a range of consequences – some good, some bad, some ugly.

New technology should never be introduced into a public policy vacuum.

Unfortunately the Green Paper fails this test and at times reads like a cheer squad for the introduction of FLNG technology rather than a proper, sober assessment of the full impacts of this new development.

The Green Paper is correct to note that "FLNG has advantages, including predictable and reduced capital outlays and reduced environmental impact when compared to conventional onshore development."

The advantages of FLNG accrue, in the main, to gas producers.

The negative impacts for Western Australia have been detailed in considerable length through the groundbreaking work of the State Parliament's Economics and Industry Standing Committee in its 2013/14 inquiry into "The economic impact of floating LNG on Western Australia."

The inquiry reported that the use of FLNG technology would:

- Deliver no gas for domestic industry in Western Australia and the jobs it generates;
- Reduce opportunities for local content and the jobs it generates;
- See the loss of tens of thousands of potential Western Australian jobs in the construction industry;
- Generate more tax income for Canberra but will lead to a "serious loss of revenue" for Western Australia, with a loss of up to $1.7billion in income for the State government on the Browse project alone;
- Potentially lead to lower resource recovery, leaving larger amounts of gas in the ground; and
- Reduce development and economic opportunities for indigenous communities.

It is extraordinary that this report and the issues it raised are not mentioned or referenced in the Green Paper.

For example, the Green Paper advocates for "more Indigenous employment opportunities in the energy resources sector." FLNG technology is likely to significantly reduce indigenous employment opportunities, while at the same time reducing regional economic development.

The White Paper should include a more honest assessment of the full range of implications of FLNG technology.

In particular it should address how the introduction of this technology will help achieve the Federal government's stated aim of setting "the foundations for the future reliable supply of competitively-priced energy" when FLNG technology means that reserves which would have been directed (either partially or in full) toward the domestic market will now be exclusively directed for export.

As noted above, the benefits of FLNG accrue to producers. These benefits come at the expense of security of supply and affordable prices for Australian gas users.

Other comments

Affordable energy?

It is misleading for the Green Paper to attempt to blame increased prices on the East coast on barriers to the development of unconventional gas resources. It is clear the price pressures have come from the linking of domestic prices to export prices, brought about by the unfettered introduction of LNG export facilities in Queensland.

The Green paper makes numerous references to “affordable energy”. Recent comments by the Minister for Industry indicate that gas supply into NSW may be anything but affordable. The Minister stated, “Don’t think this is going to get cheap gas into NSW — it’s going to be expensive gas. We are literally talking about double-figure gas but double--figure gas is better than no gas at all. We’re talking about gas north of $10 a gigajoule.”[12]

The White Paper should be more upfront about the potential for domestic gas users to be faced with pricing which goes beyond LNG netback or export parity pricing. This has been the experience in Western Australia. The Federal government need only look to the 2011 “Inquiry into domestic gas prices” by the WA Economics and Industry Standing Commission for confirmation of this.

It is not sure how this is consistent with the Green Paper’s aim of “affordable” gas.

The White Paper should also give more detailed consideration to demand destruction resulting from higher prices.

Greenhouse implications

An associated issue is fuel switching and the potential for industry to move from natural gas back to coal-fired power or the use of diesel. This scenario is already underway on the East coast.

The recent Grattan Institute report stated:

> “What is clear is that the shift away from gas …. will mean a shift back to coal and an increase in emissions. Such a trend is already being seen today. If even half of the electricity produced from gas in 2012-13 had been produced from coal, Australia’s emissions would have been more than 15 million tonnes higher. This is bad news for the climate, and makes achieving Australia’s modest 2020 emissions reduction target just a bit harder.”[13]

There is no consideration of the greenhouse implications of higher domestic gas prices (and the resultant fuel switching) in the Green Paper.

Does “more sources” mean “more supply”?

The Green Paper states that “The potential for a near-term supply shortage in the eastern market is largely due to the start of LNG exports from Queensland. Decisions to restrict the development of CSG supply in New South Wales and Victoria have added to this problem.”

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[12] “Flooded market is ‘answer to gas shortage.’” The Australian, 9 September 2014
[13] “Gas at the crossroads; Australia’s hard choice.” T Wood, Grattan Institute, October 2014

It goes on to note “there are no ‘quick fixes’ for the potential near-term supply shortage and price pressures facing gas users. Most stakeholders agree that increasing gas supply will help reduce upward pressure on gas prices, but higher domestic prices are nonetheless inevitable.”

The bringing on of the development of new sources of gas is often held out as the answer to domestic supply issues.

The current supply crunch expected to hit New South Wales in 2016 is often blamed on that State’s reluctance to embrace the development of CSG resources. It should be noted that Queensland reportedly has around 4,000 agreements between farmers and companies seeking to extract coal seam gas. As noted in the Green Paper, the three new LNG projects in Queensland are as a result of the rapid expansion of CSG resources in that State.

And yet despite all this, the Green Paper notes “there will be potential gas shortfalls in New South Wales across four winter days, *and throughout the year in Queensland*, in 2020.”

It should also be noted that the Narabri CSG project was given “strategic energy project” status by the New South Wales government on the basis that it would be reserved for supply into the domestic market. It is obvious that the White Paper should recognise this as a form of a domestic reservation policy intervention.

The DomGas Alliance strongly supports the responsible and timely development of Australia’s unconventional gas reserves.

We note, however, that development of these reserves may not necessarily mean additional supply into the domestic market unless there is intervention of the type taken by the New South Wales government (on a specific project) or through the more consistent and logical approach of the Western Australian government’s domestic gas reservation policy.

#ends#