

2 July 2015

Rod Sims
Chairman
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601
gas.inquiry@accc.gov.au

Response to the Australian Competition and Consumer Commission East Coast Gas Inquiry

Dear Mr Sims,

The ENA welcomes the ACCC inquiry into east coast gas supply issues. Recent inquiries have focused on transmission side issues and whilst these have produced results, the ENA supports the use of ACCC's greater investigational powers to examine all aspects involved in the production and transmission of the supply of gas to domestic consumers. These powers will give stakeholders certainty that the issues have been thoroughly examined and increase the confidence in the result so that further inquiries at the State or Federal level are only required if circumstances change significantly.

The Energy Networks Association (ENA) is the peak national body for Australia's energy networks and represents gas distribution networks responsible for operating approximately \$9 billion in gas infrastructure.

ENA members deliver gas to 3.7 million residential gas customers and 123,000 businesses on the east coast of Australia. The 'mass market' serviced by gas distributors, consumes approximately 26% (or 175PJ) of total east coast gas demand¹. Mass market demand is seasonal and highly correlated to temperature with a strong winter peak.

ENA believes that, to date, the mass market segment represented by residential and commercial customers has not been effectively considered when examining the significant impacts of rising wholesale gas prices and potential supply issues.

ENA considers the key objective for eastern Australian gas market reform should be to support market development and a level playing field for gas, through removal of unnecessary barriers to new gas supply, developing measures to promote greater transparency in the gas market and to ensure that energy schemes designed to reduce emissions are fuel neutral.

ENA's response to the Inquiry will focus on questions that are relevant to residential and commercial customers and the distribution networks that serve them.

ENA understands that our members also intend to submit individual responses in some cases.

¹ Page 8, ENA Gas Network Study, Core Energy 2014.

ENA responses to questions:

Question 1: How are changes in the gas industry affecting gas buyers? Provide details of the key changes and explain their effects, including whether the effects vary by location and whether these effects are expected to be temporary in nature.

The effect of significant rises in wholesale gas prices for manufacturers and other large domestic users are often cited in the media, in part because large businesses have access to data to monitor energy costs on a regular basis and can quantify the impacts of changes in gas price to production. However high level inquiries into rising wholesale gas prices often overlook or specifically discount the impacts on roughly 3.9 million smaller gas buyers on the east coast. Whilst these buyers do not directly deal with upstream gas suppliers, increases in wholesale prices directly impact these users and thus the distribution networks that service them.

Gas distribution networks are responding to rising wholesale prices by simplifying their network pricing structures, providing assistance to vulnerable customers and encouraging customers to look for the best retail deal. In addition, negotiations between the Australian Energy Regulator (AER) and gas distributors are likely to lower gas network charges across the east coast of Australia as Access Arrangements are renegotiated in the coming years. Jemena's negotiations with the AER provide an early indication of the results for Victoria and South Australia and have led to new pricing on gas network costs providing reductions of up to 34 per cent for residential customers in 2015-16. Despite these efforts by gas distributors, wholesale gas prices remain a concern. Western Australian residential customers have experienced the effects of higher wholesale gas prices for a number of years. In 2011 The Western Australian Parliament initiated the Western Australian Inquiry into domestic gas prices. The final report noted that the ... *wholesale price of gas has had a significant impact on the regulated gas tariffs facing householders.*

The Inquiry also cited media reports that:

- household energy costs (for both gas and electricity) in Western Australia had risen by 40% between 2009 and 2011;
- outstanding energy bills had increased from \$1 million to \$9 million from 2010 to 2011;
- pensioners and low income earners were foregoing heating their homes due to the expense of their energy bills; and
- that there was a doubling in the number of Synergy customers who received assistance via the Hardship Utility Grants Scheme with similar experiences for other energy providers.

Other inquiries have found similar effects from rising wholesale gas prices. The 2013 final report of the Victorian Government's Gas Market Taskforce concluded that:

Victorian customers are likely to experience the largest price rises with the average annual bill increasing by around \$170 by 2020. Modelling commissioned by the Victorian Government estimates that, if all the LNG projects that are currently under construction commence production and export as planned, the annual average residential gas bill in Victoria could increase by almost 20 per cent over the period from 2013 to 2020, rising by \$180 by 2020, after peaking in 2015 at 30 per cent higher than current rates.

Rising wholesale gas prices will place pressure on 3.9 million east coast retail and commercial gas customers. It is therefore critical to ensure that policy and regulatory frameworks allow downstream business such as gas distributors to reduce the impact on retail prices.

In addition the lack of transparency in the gas supply market and processes such as tenure allocations for exploration and production allow for considerable speculation on the impact of wholesale gas prices. A wholesale gas market with more transparency would enable all stakeholders, including regulators and the media to develop a more accurate assessment of future wholesale market conditions.

ENA believes that:

- energy policy must allow for energy regulators to provide flexible responses to wholesale price increases; and
- opaque market structures will continue to provoke alarmist media reports of increasing gas prices.

Question 2: Are gas suppliers in Eastern Australia likely to meet both LNG export commitments and domestic gas demand over the life of the LNG projects, given the gas reserves base and the expected gas production schedule? Explain why or why not.

ENA is concerned that equilibrium between supply and demand (for LNG and domestic commitments of suppliers) may be achieved not as a result of economic outcomes in the long-term interest of consumers but through domestic demand destruction driven by short-term price volatility. The Australian Energy Market Operator (AEMO) forecast for 2015–2025 suggests that demand destruction, particularly in NSW, rather than a supply response, will achieve market equilibrium. In releasing the 2015 Gas Statement of Opportunities (GSOO), the Australian Energy Market Operator (AEMO) stated that:

AEMO expects that changes to infrastructure capacity and lower forecast consumption will result in short-term gas supply needs being met, and potential medium and long-term gaps reduced.

According to AEMO, the reduction (to zero) of the expected gap between production and consumption was in part due to *a 17% decline in NSW gas consumption in 2019².*

ENA is concerned that the public perception of increasing retail gas prices and potential supply shortages will drive customer disconnections from gas networks. Large numbers of disconnections would require gas networks to increase network tariffs to service the existing infrastructure – leading to the potential for further demand destruction. Gas networks are therefore focussed on proactively attracting new customers—through measures such as marketing campaigns—which will act to reduce average network prices.

Question 3: Are there currently any factors that are significantly restricting or limiting the ability or incentive for gas producers to explore for, or develop, new gas reserves? If so, explain.

Recently concerns over the environmental issues surrounding the extraction of Coal Seam Gas (CSG) have created a series of barriers for further exploration of onshore gas. State Government moratoria or arbitrary restrictions on upstream development would appear to be in contrast to the endorsement of the National Harmonised Regulatory Framework for Natural Gas from Coal Seams and also the Multiple Land Use Framework in 2013 by State and Territory Governments. The intention of these frameworks is to provide guidance to regulatory authorities, industry and the community in the development of leading practices for Coal Seam Gas (CSG) development.

On 13 May 2014, the government announced the introduction of the Exploration Development Incentive. The scheme will allow small mineral exploration companies with no taxable income to provide exploration credits, paid as a refundable tax offset to their Australian resident shareholders for greenfields mineral exploration. This scheme could potentially support the entry of diverse small operators into supplying gas for domestic use however, critically, the incentive is not available for petroleum exploration. The scheme potentially places an indirect limitation on exploration for further gas reserves by directing drill rig operators and other equipment and experts into minerals exploration. Retasking equipment and experts to exploration for minerals only will act to expand timelines of exploration for further gas deposits.

Agencies responsible for economic modelling of markets such as AEMO can also provide significant limitations on further development of gas supply. After the release of the 2015 GSOO which suggested there was unlikely to be any shortfall of supply, EnergyQuest's Dr Graeme Bethune stated that:

² 2015 Gas Statement of Opportunities, AEMO, 2015

AEMO sees no need for CSG developments in NSW or the proposed new pipeline from the Northern Territory

and that:

AEMO's erroneous conclusions would do little more than act as a barrier to further east coast gas development in NSW and onshore Victoria. ... This is an unprecedented market development globally and has, as yet, uncertain results on longer term volumes of gas available for domestic consumption³.

Energy Quest considered that, by suggesting there was no issue with supply, AEMO had provided support for governments and community groups that suggest moratoria on development and exploration will not affect the supply of gas. Additionally, any extra supply would act to reduce the wholesale price of gas over the medium to longer term.

ENA believes there are also a significant number of regulatory barriers to increasing domestic supply of gas and these are covered in the response to question 11 below.

Question 4: Does vertical integration of domestic gas producers with the LNG export projects materially affect the incentives of those or other gas producers to supply domestic gas users? If so, does this effect vary by location?

LNG proponents with significant direct exposure to export contractual commitments have demonstrated a preference for short-term contracting or premium pricing to domestic customers, reflecting the consequential increase in LNG project supply risk. Uncertainty in the ability of vertically integrated LNG proponents to secure adequate supply may alter contracting behaviour of upstream suppliers towards domestic customers – an outcome demonstrated by widespread reporting of difficulties for large domestic customers in securing long term contract offers.

This theme of lack of competition due to a small number of vertically integrated suppliers was developed during hearings for the Select Committee on the Supply and Cost of Gas and Liquid Fuels in New South Wales⁴. As part of submission for the committee, CSR explained that:

a concentrated gas market leads to a high degree of integration with little competition within the gas supply chain – in effect, where an operator controls the gas from the point it leaves the ground to the point it reaches the consumer.

The Committee's report also noted that:

CSR advocated for the 'separation of resource, transport, and commercial activities [as it] is a pre-requisite to the development of vibrant and competitive markets'. To support its call for less vertical integration, CSR referred to a report undertaken by the International Energy Agency, the OECD's energy policy body, that argued a key to achieving competition within gas markets is creating 'less vertically integrated energy companies'.

Question 5: Has the development of LNG export facilities created opportunities for gas suppliers to exercise market power in any location in Eastern Australia? If so, explain where and how.

As noted in the ACCC issues paper, the three LNG Joint ventures in east coast Australia *control over 75 per cent of gas reserves and a significant proportion of total gas production in Eastern Australia⁵*. This indicates that LNG production has rapidly become the main focus of Australian gas production. While larger industry participants have some, albeit it limited, market power to negotiate gas supply due to volume, individual residential and commercial users have effectively no market power and must take the prices gas retailers are able to negotiate on their behalf.

In developing modelling to test policy scenarios, the Productivity Commission noted that:

³ AEMO asleep at the wheel, EnergyQuest, June 2015

⁴ Supply and cost of gas and liquid fuels in New South Wales, NSW Legislative Council, 2015

⁵ Page 7, East Coast Gas Inquiry Issues paper, ACCC, June 2015

...there is limited scope to shift supply to the eastern Australian gas market in response to a decline in the LNG price. This leads to modelled prices for users in the eastern market that temporarily exceed LNG netback prices.

A shortage of supply for eastern Australia LNG trains could potentially see price spikes for residential and commercial mass market users and a shortage of supply as these users have very limited ability to apply market power. As suggested above, the effects of price spikes are more likely to be seen in Adelaide and Sydney as they are more reliant on the Moomba hub supply. In the case of Sydney these issues are potentially further heightened by ongoing restrictions on upstream exploration and development.

Question 7: What factors dictate whether it is commercially viable for gas users to employ strategies (such as vertical integration or sponsorship of new entry) to respond to the changing environment?

Large gas customers may undertake direct investment in upstream supply, long-term supply contracts to underwrite development or 'farm in' arrangements. They would need to evaluate commercial factors including the cost structure and risk profile associated with the resource development; planning and development approvals; establishing or accessing processing facilities and pipeline infrastructure; and commercial contracting with upstream industry suppliers. This may represent a substantial step-change in the corporate scope of the gas user, requiring fundamental changes in its funding requirements and its assessment by investors and financiers.

Small gas users are clearly dependent on gas retailers, which may take – and have taken – upstream positions to secure contractual obligations. Clearly, retailers are also likely to seek to optimise their trading strategies to their commercial interest. For instance, in April 2015 AGL announced a deal with Esso Australia Resources Pty Ltd and BHP Billiton Petroleum (Bass Strait) Pty Ltd to purchase 198 PJ from Bass Strait fields. The announcement stated that the agreement *enabled AGL to secure competitively priced gas supply until 2020 for our 1.5 million residential and small business gas customers*⁶. In the same announcement however there is an indication that AGL intends to *release 30 to 50 PJ per annum for sale into the high value Queensland market between FY18 and FY20*.

In practice, the most likely risk mitigation strategy of small customers concerned about an uncertain outlook for gas prices in a temporarily volatile market may be to pre-emptively switch to electricity appliances, with potentially long-term cumulative ramifications for gas consumption, infrastructure utilisation and average system costs.

Question 8: What opportunities are available to gas users for switching to alternative types of energy sources in response to rising gas pricing? What factors affect the ability of gas users to do so? How likely is this outcome? To what extent is any response from gas users likely to affect the broader dynamics of the domestic gas industry?

Gas is a fuel of choice for residences and alternative appliances are readily available and highly marketed (i.e. reverse cycle air conditioners or solar hot water systems) as being competitive to gas alternatives. Switching these appliances often has no effect on retailers or appliance manufacturers – who are able to supply the equivalent electrical product. Gas distributors are however highly affected as are gas customers. A reduction of gas through a distribution network caused by customers switching fuels to electricity has the potential to drive gas prices higher for remaining customers because infrastructure costs would have to be recovered over a smaller customer base.

There are a number of distorting policy measures which already incentivise customers to move from gas appliances. For instance, the Small-scale Renewable Energy Scheme (SRES) distorts appliance markets by providing significant subsidies to solar hot water heaters and heat pumps on the basis of their emissions abatement benefit (compared to electric hot water systems) while providing no subsidy to gas hot water heaters which can have equivalent or greater abatement benefits. The impact of the scheme is

⁶ AGL secures gas supply until 2020 with Bass Strait agreement, AGL, 9 April 2015

that it artificially distorts gas volumes, increasing average gas network charges. A report from CORE Energy⁷ found that the effect of removal of such incentives would lower retail gas bills in 2034 by about \$50 per year (or 5.4%) whereas the continuation of current solar policy settings like SRES will mean 170,000 fewer gas consumers in 2034 than will occur if a fuel-neutral policy was adopted.

Consequently it would be concerning if unnecessary wholesale price volatility and customer perceptions of its impact on retail prices were to provide further impetus to distorting policy measures which encourage customers to switch from gas appliances.

ENA notes that there are diverse views about the potential response from customers to higher wholesale gas prices. For instance, section 3.4 of the Department of Industry's 2014 Eastern Australian Domestic Gas Market Study states that residential and commercial demand will not be affected by rising wholesale prices because *consumers are relatively slow in switching from gas to electricity appliances*⁸ and the models used later in the Study suggest a relatively flat residential and commercial gas demand. However, ENA considers this study used historical information which failed to take into account rising consumer awareness of energy costs and in particular media reports of rising gas prices.

ENA is concerned with the potential for some commentary to cause a pre-emptive flight from gas which is not in the best interests of gas consumers in Australia. For instance, some commentators such as the Grattan Institute and the Alternative Technology Association (ATA) have produced analysis that suggests significant advantages for gas customers that switch their appliances to electrical equivalents.

ENA has identified a number of methodological issues in the analysis which overstates the competitive position of electric appliances. While clearly wholesale gas price pressures and appliance cost trends are influential factors, there is evidence to indicate significant amenity and financial benefits to individual consumers remaining on gas, significant environmental benefits in the carbon emission abatement contribution of gas, and advantages to Australia's energy system in the complementary roles of diverse fuels.

ENA considers the experience of gas consumption in Western Australia following the wholesale gas price inflation after the 2008 Varanus incident, which cut off 30 per cent of the state's domestic gas supply, is indicative of the ability of customers to respond quickly to price impacts and the perception of price impacts. In the aftermath of the event supplies to mines and industry in the Pilbara region fell by 45 per cent. Industry responded by switching to alternatives such as diesel generation – which cost around 10 times as much as gas at the time. This incident gives an, albeit brief, window into the vulnerability of gas to be substituted by other fuels – even those that are more expensive.

Question 9: Do exploration title regimes and their administration facilitate behaviours that limit competition through denying new entrants? If so, explain how.

ENA is unaware of information which demonstrates evidence of undesirable tenure or resource 'hoarding' behaviour in order to exert market power or avoid a competitive supply response. However, the timely economic development of upstream supplies is clearly important to ensure an efficient market response to balance supply and demand. In response to a call from the DomGas Alliance in a submission to the Eastern Australian Domestic Gas Market Study, the Productivity Commission stated that *(t)here is insufficient evidence available to the Commission to determine whether gas producers are restricting the quantity of gas available by hoarding reserves*⁹.

ENA suggests however that an examination of administration of land tenure management and its contribution to the efficient development of upstream gas supply markets is required. In examining the issue of retention of leases, the Productivity Commission noted the example provided by Western Australia where, in 2011, the Economics and Industry Standing Committee concluded that: *the*

⁷ Page 13, ENA Gas Network Study, Core Energy 2014.

⁸ Page 45, Eastern Australian Domestic Gas Market Study, Department of Industry and the Bureau of Resources and Energy Economics, 2014

⁹ Page 60, Examining Barriers to More Efficient Gas Markets Productivity Commission, 2015

processes for the application and renewal of retention leases were lacking in rigour and enabled (but did not necessarily result in) the warehousing of gas reserves by incumbent producers.

The ACCC may wish to evaluate the extent to which State and Territory governments have actively administered relevant tenure regimes to require relinquishment of undeveloped tenure on an appropriate basis. Some stakeholders have argued previously that administrative discretion is often, or normally, exercised to roll over tenure entitlements in the absence of development. By way of example, in May 2014, the Queensland Government introduced changes to extend the term of all current Authority to Prospect exploration work programs from four to six years, with the associated relinquishment of 33 per cent of the tenure also deferred to the end of the extended 6 year period.¹⁰ There may be demonstrable benefits to upstream supply efficiency in relaxing relinquishment requirements on gas explorers and producers – for instance, to the extent it encourages new entrants and thereby increases competition. More typically, active tenure management is regarded as an important discipline to encourage workable competition in wholesale gas supply markets.

Question 11: Are there any other regulatory barriers which create significant difficulties in accessing new gas reserves?

ENA considers that two factors are critical to the development of new sources of gas supply. Firstly capacity by government and project proponents to address community concerns regarding the development of natural gas reserves and secondly removing unnecessary restrictions or duplication in approval processes for exploration, development, production, transmission and distribution without compromising evidence-based environmental regulation.

Whilst exploration for further gas resources will not alleviate rising wholesale gas prices in the near future, the promise of further gas supply may act to lower prices in the wholesale domestic market – especially if there are concerns around the ability of current LNG trains to provide sufficient supply to meet international contractual arrangements. The proliferation of regulatory barriers was noted in the Victorian Government Gas Market Taskforce, Final Report and recommendations which stated that:

There are over fifty pieces of Victorian legislation, regulations, policies and administrative arrangements relevant to adopting leading practices for coal seam gas operations. The complexity in regulatory arrangements creates uncertainty in the regulatory environment and adds to the cost for industry. The diversity of the legislation as well as the number of agencies involved creates uncertainty, delays and confusion. Without compromising environmental or safety standards, the Victorian Government should take action to improve certainty, consistency and reduce regulatory costs.

The NSW government has announced a six-month freeze on processing new applications for coal-seam gas and increased CSG exploration licences by \$49,000 and banned CSG exploration activity in a number of areas:

- a 2 kilometre buffer around existing residential areas;
- Equine Critical Industry Clusters (CIC) which are important for horse breeding and training;
- Viticulture Critical Industry Clusters (CIC) which are important for grape cultivation and the viticultural hospitality industries;
- Biophysical Strategic Agricultural Land (BSAL) which are areas capable of sustaining high levels of productivity; and
- Conservation Zones

However the environmental issues that fostered community concern and lead in part to the creation of these areas can be mitigated as suggested by 18 measures in the National Harmonised Regulatory Framework for Natural Gas from Coal Seams. The Productivity Commission's economic modelling

¹⁰ Queensland Government Press Release. Petroleum and gas sector to benefit from new reforms 14 May 2015

suggests that the minimum economic welfare cost of NSW and Victorian State Government moratoria is \$164 million¹¹. ENA acknowledges and welcomes the NSW gas plan to implement all recommendations of the 2014 NSW Chief Scientist's Coal Seam Gas Review.

Question 21: What are the key factors currently affecting the price of gas in Eastern Australia? Are current prices expected to be transitory or likely to be sustained? What information is most important to informing your view?

As discussed in ENA's response to question 8, the gas price for 3.9 million smaller users of gas is affected by a number of issues including the wholesale price and the distribution networks response to rising wholesale gas prices. The CORE study released by ENA in 2014 suggested that the *...price of gas relative to alternative energy sources will be a major driver of future gas demand within the Gas Network sector, over the next 2-5 years*¹²

Recent announcements such as those by Jemena¹³ indicate that the potential for other components of the retail gas cost, including network charges, to mitigate wholesale gas price pressure. These changes however, do not receive as much media attention as the increase in wholesale gas prices. It is likely for instance that retail gas customers are not aware that a headline announcing wholesale gas prices to triple may only impact about 20% of their current gas bill, and that the decreases in gas network prices over the same period are likely to more than offset these wholesale price increases, a situation reflected in IPART's recent NSW regulated retail gas price determination for customers on AGL's regulated prices.¹⁴

The CORE report also noted that *...gas is an energy source of choice which will be substituted for an alternative energy source if consumers observe a shift in the cost/benefit relationship...* and that such a shift *...has been most pronounced in WA where marginal prices have doubled over the last five years.*

The evidence from WA indicates that these shifts are likely to be sustained with gas residential and commercial gas use potentially moving away from the mainstream to a more 'boutique' product for specific uses. Such a move would create a downward demand spiral where price increases reduce demand, resulting in further price increases.

Whilst the ACCC's question may be focussed on the provision of information to larger buyers, the CORE report indicated that information and clarity around Government energy policy was critical to the provision of gas at reasonable prices to customer. The CORE report cited several market distorting policy measures such as the Small-scale Renewable Energy Scheme (SRES) that materially disadvantage gas relative to alternatives favoured by energy policies that focussed on specific technologies.

ENA suggests that improved transparency in supply markets would increase confidence to investors and markets and remove some of the cause for alarm in the media around increasing wholesale prices. Governments could also be more transparent in the application of controls on supply. The removal of moratoria and the reduction in the number of reviews of the sector would also act to remove much of the concern in markets. Finally the application of technology neutral greenhouse gas and energy efficiency programs and incentives would provide transparent information to those markets trying to predict and understand the impacts and forces acting on gas prices in eastern Australia.

Question 38: Are gas trading markets in Eastern Australia sufficiently well developed to enable the separate marketing of gas by producers in joint ventures? If not, what would the preconditions be for removing joint marketing?

As noted by the ACCC's Issues Paper, the Victorian Government's Gas Market Taskforce suggested that whilst joint marketing arrangements were useful in reducing risks when the Gippsland Basin dominated Australia's oil in the 1960s and 1970s, the practice of joint marketing is now potentially acting to reduce

¹¹ Page 210, Appendix C, Examining Barriers to More Efficient Gas Markets Productivity Commission, 2015

¹² Page 13, ENA Gas Network Study, Core Energy 2014.

¹³ Jemena proposes lower network charges to keep gas competitive in NSW, Jemena, 2015.

¹⁴ Regulated gas prices to fall for most customers, Independent Pricing and Regulatory Tribunal, 2015.

competition. The ENA supports the removal of conditions that can distort markets and reduce the potential for effective market operation. While there is limited use of joint marketing, ENA considers it appropriate for the ACCC to assess the extent to which joint marketing remains relevant in the Australian market context, and to outline a pathway to the cessation of joint marketing without introducing sovereign risk to incumbents.

ENA's position:

ENA recommends that:

1. Governments encourage increased transparency in wholesale gas markets;
2. Governments, in particular State Governments, apply measures to increase the transparency in their application of controls on supply, especially in relation to land tenure allocation;
3. Measures such as the National Harmonised Regulatory Framework for Natural Gas from Coal Seams, the Multiple Land Use Framework and evidenced based environmental policies are applied to reduce community concerns around exploration for further reserves of gas;
4. State moratoria on exploration are removed or not extended; and
5. Technology neutral greenhouse gas and energy efficiency programs and incentives are developed rather than technologically specific responses to these issues.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'John Bradley', is positioned below the 'Yours sincerely,' text.

John Bradley
Chief Executive Officer