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**Public Submission to ACCC East Coast Gas Inquiry**

Santos welcomes the opportunity to comment on the Australian Competition and Consumer Commission (**ACCC**) East Coast Gas Inquiry – Issues Paper.

Santos is one of Australia's largest domestic gas producers, with more than 60 years of responsible gas exploration and production across the nation, supplying natural gas to all mainland Australian states and territories, ethane to Sydney, Liquefied Natural Gas (**LNG**) for export and oil and other liquids to domestic and international customers.

The Cooper Basin oil and gas field in north-eastern South Australia and south-western Queensland, which Santos and its joint venture partners discovered and developed, is one of Australia's largest onshore resources projects. More than $8 billion has been invested to date in the Cooper Basin.

As a leader in the Australian natural gas industry, Santos has almost 20 years of Coal Seam Gas (**CSG**) operations in Queensland. Santos has also been involved in CSG exploration in north-western NSW since 2008, and is the only company with significant CSG interests in both Queensland and NSW.

In this submission, Santos provides brief comments on the following matters:

- Changes affecting the domestic gas industry
- Access to new gas resources
- Access to processing facilities
- Negotiation of new supply agreements
- Rising domestic gas prices
- Availability of information and trading liquidity

Several of the issues highlighted below have been discussed to varying degrees in earlier submissions by Santos to the Commonwealth Government's Energy White Paper – Green Paper, and to the Australian Energy Market's East Coast Wholesale Gas Market and Pipeline Frameworks review, Issues paper and Draft stage 1 report.

## Changes affecting the domestic gas industry

The supply of natural gas in Eastern Australia is undergoing a transformation process. That process involves the Eastern Australian gas market adjusting from being isolated and purely a domestic focussed market to a market that is open to the opportunity to export value-added gas to markets in Asia, as well as supplying domestic users. These are not mutually exclusive scenarios.

Although this transformational change has been accompanied by changes to market structure and rising domestic gas prices (from a number of factors), these changes are reflective of an evolving and functioning market with buyers and sellers continuing to transact. In particular, prior to the first LNG facility in Gladstone, Queensland, receiving final investment approval:

- Domestic gas prices in Eastern Australia were low relative to global prices.

- Conventional gas reserves in Eastern Australia were declining, exacerbated by the increasing costs of production.

- This decline in conventional reserves was the catalyst that brought about an increase in the value and price of Eastern Australian gas and, in turn, prompted gas producers to risk capital in exploring for unconventional gas, predominantly CSG in Qld.

- The sheer scale of the CSG discoveries in Qld facilitated feasible opportunities to build LNG production facilities that could export gas to overseas customers from Eastern Australia. With the advent of construction of LNG facilities, demand for Eastern Australian gas expanded to include substantial international demand. This higher demand has prompted further increases in domestic gas prices at this point in the cycle of an evolving market.

These developments appear to reflect the economics of supply and demand working – and that natural gas in Eastern Australia is moving to those who value it most which, in turn, has driven investment and brought-on more supply. This additional supply also benefits the Eastern Australian domestic market.

It is also important to recognise that, despite the developments in recent years and some media commentary to the contrary, gas sales agreements for domestic gas users have continued to be negotiated and signed, and those agreements represent substantial volumes of gas.

## Access to new gas resources

Although natural gas projects are inherently risky in terms of the large capital outlays required and the long lead times, investing in new or expanded gas supply remains commercially feasible. There are numerous market participants like Santos who accept and manage these risks and invest in new gas projects, provided that it is economically viable and the relevant regulatory framework is appropriate and sufficiently certain.

In order for market participants to confidently invest in new gas projects, and attract the necessary joint venture partners that are typical of the industry, it is essential that there is a consistent, stable and predictable regulatory framework. Without that, and particularly when there is market intervention, the perceived investment attractiveness of new and expanded gas projects can be seriously undermined.

Santos considers that regulatory uncertainty at the State level in some Australian jurisdictions has contributed to decisions by some natural gas companies to seek projects outside the Eastern Australian gas market, offshore and/or overseas. This has impacted Santos as well as other project proponents across Eastern Australia. As an example, political, regulatory and some community uncertainty around Santos's Narrabri Gas Project in NSW has stalled its development, undermined investor confidence, and significantly delayed much needed new gas supply that would have benefited domestic business and household gas users. Importantly, Opposition parties can contribute to political and investment uncertainty just as much as the government of the day.

Accordingly, the development of new gas resources in Eastern Australia requires consistent and settled regulatory frameworks. In particular, the gas industry needs coordinated and streamlined regulations that strike the appropriate ongoing balance between development, environmental protection and community safety.

## Access to processing facilities

The Moomba Processing Plant owned by the South Australia Cooper Basin (**SACB**) joint venture is not an impediment to bringing on supply from the Cooper Basin, or from even further afield, as has been suggested in the Issues Paper.

The SACB has a substantial economic incentive to enable as much gas as possible, including third party gas, to be processed through the Moomba Processing Plant, given it is a high fixed-cost facility that currently has surplus processing capacity. Accordingly, the SACB parties welcome and respond constructively to approaches for production processing. It is therefore not surprising that the SACB parties have, for over a decade, facilitated processing at Moomba, and export via Port Bonython, of non-SACB crude oil and natural gas liquids.

In addition, the SACB aims to incentivise parties to utilise the Moomba Processing Plant for third party gas processing, thereby enabling non-SACB parties to deliver processed gas to market. Santos, as the Operator of the Moomba Processing Plant, has discussed access to gas processing at Moomba with a number of parties (with a view to access commencing as early as this calendar year).

Santos, as operator, welcomes bona fide requests for third party processing at Moomba.

## Negotiation of new supply agreements

Santos is willing to supply gas to domestic customers when it has available, uncontracted gas and available transport capacity. Santos is actively negotiating gas sales agreements with large industrial customers, and has quoted more than 10 potential gas sales agreements to domestic customers in the past 12 months alone.

It is also important to recognise that the developments in the marketplace over recent years have contributed to changes in some of the non-price terms that appear in gas supply agreements.

For example, the length of gas supply agreements has become shorter in recent years. This is a response to demand uncertainty and suits both customers and producers. That is, shorter terms are the negotiated outcome of bilateral contracts that allocate risks between the parties. In particular, shorter terms assist both buyers and sellers to manage their risk associated with a gas market undergoing a process of transformation.

## Rising domestic gas prices

Rising domestic gas prices in recent years do not appear to be caused by any lack of domestic competition. On the contrary, it is likely they are the result of increased exploration, development and production costs for natural gas as well as additional competition among customers for the gas.

The cost of producing natural gas has been impacted by gas resources that are more difficult to extract for geological reasons, dry gas (which has no associated liquid hydrocarbons to supplement the revenue stream), more expensive labour and contracting services and increased regulatory imposts and longer approval timeframes.

In terms of **production costs**, over the last decade the finding and development costs for the petroleum industry have increased six-fold[1]. And, in the three years to 2013, total Australian finding and development costs averaged $4.16/GJ, which was 2.7 times the average for the three years to 2007.[2] These rising costs are partly explained by the fact that unconventional gas production involves significantly higher capital expenditure than that of conventional off-shore wells, given that CSG requires multiple wells to be drilled in order to access equivalent volumes of gas.

In terms of the impact of **LNG demand**, the opening-up of gas export markets from Eastern Australia has significantly increased the pool of buyers for the Eastern Australian gas. Previously, competition from buyers was minimal. Domestic customers now compete with these new export markets, just as buyers would for any other commodity product such wool, grain or coal. This has had the effect of diminishing the relative bargaining power of domestic buyers, who now compete against overseas buyers willing to pay more than the historic domestic gas price.

Santos considers that gas supply in Eastern Australia is moving through a cycle similar to that seen in commodity markets when they are opened up to overseas buyers.

[1] *Oil and Gas Industry Cost Trends*, EnergyQuest, 1 November 2014 p.6 http://www.appea.com.au/wp-content/uploads/2014/11/APPEA-Cost-Report_Final.pdf
[2] Ibid at p.7

## Availability of information and trading liquidity

Santos does not consider there is any real information asymmetry between gas producers and gas users. In particular:

- There is detailed information regarding all areas of gas demand and supply currently in the public domain, although not necessarily in a central location. Equity investment analysts, market commentators and energy procurement advisors utilise this information to construct sophisticated market and models, based only on this publicly available data.

- Although gas producers have information regarding their own gas sales agreements, Santos does not have any additional knowledge regarding the terms of bilateral contracts between Santos's competitors and their customers.

Steps have also been taken to improve the level of information flow regarding the supply of gas. The ongoing COAG Gas Market Vision and Development plan contains pivotal tools in this respect. There are currently major work streams that cover all aspects of the Eastern Australian gas market. However, it is important that industry and State and Federal Governments co-ordinate their approach in this regard, so as to minimise the burden to all market participants while ensuring that all areas of industry and Government are focusing on the priority areas.

There are also currently multiple reference prices in the Eastern Australian gas market. For example, the Sydney, Brisbane and Adelaide Short Term Trading Markets (**STTMs**), the Victorian Declared Wholesale Gas Market (**DWGM**), and the Wallumbilla Gas Supply Hub (**GSH**), which have a daily spot price where gas can be traded. However, it is acknowledged that none of these markets has become a true reference point for Eastern Australia.

Santos considers that the Wallumbilla GSH is the most appropriate site for a reference price, due to its proximity to the Cooper Basin and the Queensland coal seam gas fields. This location is utilised by a number of gas shippers sourcing gas from a number of different fields. We also note that there is work currently underway on the development of a Moomba Hub.

It should also be noted that the current level of price information appears to be flowing through to the market. As an example, Victorian gas prices have fallen substantially for contract periods in 2016-17, with multiple suppliers and buyers in active negotiation to secure contracts for this period. Like most markets, information is more accessible for near dated supply versus long dated supply, but suppliers and buyers are still negotiating, and are able to receive price discovery that is sufficient for making contracting decisions. These are the conditions that reflect the dynamics of the underlying market - a market that is working

The current Australian Energy Market Commission (**AEMC**) Eastern Australia wholesale gas markets and pipeline frameworks review is looking holistically at the Eastern Australian gas market structure, with the mandate to provide recommendations to COAG regarding structural impediments to establishing a reference price, and the forward price that can be traded from it. Santos believes the AEMC review is the most appropriate vehicle for assessing and recommending any market structure changes in this regard, and for setting out a roadmap for the continued development of the wholesale gas market.