Richard McIndoe, Managing Director, EnergyAustralia
Speech to CEDA, Melbourne
"Gas market reform is critical to meeting Australia's gas needs."

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Check against delivery

Acknowledgements

Thank you Matthew (Warren) for your kind words of introduction.

I'd like to acknowledge the first-rate work the Energy Supply Association of Australia undertakes in developing and advocating for key policy issues across the sector.

Thank you also to CEDA – and to State Director Peter FitzGerald here today – for the opportunity to deliver today's Keynote Address, at the third and final event in CEDA's Victorian Energy Series.

EnergyAustralia supports this series because we believe it is critical to the nation's energy security and economy that we examine the big policy issues our sector confronts.

Today's topic is a case in point: how can we best harness the potential of unconventional energy – particularly coal seam gas – and how we can do so in a way that builds a secure and predictable gas supply, and provides the market and the community with greater transparency.

Introduction

This evening, my executive team and I will spend the night sleeping rough. We'll join other business leaders in Melbourne and around the country for the St Vincent de Paul's annual CEO Sleep Out.

It's a terrific initiative to raise the profile of and money to address the issue of homelessness. It's an event that needs no further purpose. But I will ascribe one today.

The latest forecast for Melbourne is for an overnight low of four degrees. Not that I'm constantly checking my weather app.

Contemplating a cold, harsh night without creature comforts has led me to consider what might happen if we get wrong the major policy decisions that will shape our gas market into the future.

What's at stake is access to a key fuel for our lives: a fuel that powers industry, supports jobs, warms our homes, heats our showers and is used to cook our meals. And how we can support access based on a market where buyers know they are not paying more than their neighbours, their competitors or overseas markets.

Energy reform in Australia has come a long way since change was envisaged in the early 1990's.

But we have reached a critical point in the gas market and our gas supply. LNG exports will quadruple the demand for Australian gas over the next five years.

We have two choices:

- We can turn our back on the rest of the world and let our local market draw in on itself. Regulating against safe and sensible development, reserving gas, destroying investor confidence and gas sector innovation and efficiency. All of this will ultimately deliver a supply crunch and a significant challenge for policymakers;

- Or, we can build a regime that opens Australia to the world; that encourages investment; that opens new sources of gas and provides transparency for market players and consumers alike.

Central to opening up Australia to the world will be transitioning our market from its current state.

From balancing hubs dominated by opaque long-term contracts, to a market as deep, liquid and transparent as our electricity market: a market that provides clear signals on the price of gas today, tomorrow, in one year and in three years' time; and a sector based on a regulatory environment that is stable and predictable.

I believe this will encourage exploration and development of gas for future demand, as well as pipeline and storage investments that will facilitate gas flows and meet peak demands.

History is littered with examples of jurisdictions that have sought to hoard their resources and shut out the rest of the world or have imposed unnecessary restrictions and regulations that have destroyed otherwise viable industries.

From various European countries seeking to control the spice trade of the 18th century, to the 1980s oil gluts that made some otherwise profitable operations uneconomic.

Similarly, history provides many lessons about industry incumbents who unsuccessfully sought to only look after their own short-term interests, rather than shouldering some of the hard work of reform to build better ways for the future.

My message is clear today: we will face some cold, harsh challenges if we do not drive reform towards greater transparency and liquidity.

Scenario One
Consider this. It's 2017 – not that far away.

Demand for gas in Asia continues to grow as a result of urbanisation and concerns about pollution.

In Gladstone in Queensland, the LNG industry is reaching peak production as it delivers on long-term export contracts into Asian markets.

The LNG export price links domestic gas prices to the rest of the world. The LNG industry is drawing from the Cooper Basin, and east coast gas production has now quadrupled – with all of this growth for export.

New South Wales continues to use about 20 per cent of the nation's gas, but no new gas production is being developed. A restrictive and inconsistent regulatory regime in New South Wales has prevented industry from developing new coal seam gas production.

These issues are putting additional upward pressure on domestic gas prices on the east coast and opaque long-term contracts continue to dominate the market.

Rising gas prices are making the generation of electricity from gas uneconomic compared to coal – resulting in the prospect of stranding some of the industry's most efficient and modern power generation assets, like our combined cycle gas power station at Tallawarra.

So, it's 2017 and entities are seeking to negotiate new long term gas contracts:

- They're likely to be competing against LNG producers needing to top up their production to meet export contracts. Given the tens of billions of dollars they have invested, they simply have no other option.

- Export-linked prices are exerting upward pressure on domestic prices.

- A supply crunch is looming, driven by export demand and failure to develop new production.

Buyers – energy retailers, households, industry – have no way of knowing whether they are paying more for gas than their competitors, their neighbours or overseas markets.

Without gas price transparency, Australian industries and businesses cannot fully know if their business is competitive today, let alone understand what sort of future return they will receive for potential investments.

This is not good enough for our customers – industry, business and households. We firmly believe our customers should be empowered with knowledge, so they have the power in their hands to make informed decisions about the future.

Lessons from Around the World

It comes as no surprise that Australia is not the first jurisdiction in the world to face the task of reforming its gas market to provide greater transparency and predictability.

A common desire for increased transparency and liquidity has emerged globally.

Key markets are at different stages of transformation. The United States and the United Kingdom are the most advanced, with open and transparent markets.

In the US, national reforms have diminished the role of long-term contracts in gas markets.

Legislation has driven the development of actively traded hubs which underpin short-term and futures markets for gas, and contracting that references these open markets.

Reform has supported increased competition. It has also provided clear signals to investors.

Has this worked? The evidence is in. The US is transforming itself from a major importer, to leading unconventional gas development through investor confidence driving its shale gas industry.

The UK's open market emerged from legislation to break the dominance of British Gas, unbundle transmission and establish a virtual trading hub to underpin short-term prices and provide a basis for longer-term contracts.

The International Energy Agency, in the 2012 World Energy Outlook, has forecast continued growth in gas demand between now and 2035, driven by China, India and the Middle East.

In China, the clear majority of this demand is forecast to be met through LNG imports.

China is making clear that open markets are best positioned to take advantage of this demand.

In its recent China Energy Outlook 2012, China's National Development and Reform Commission called on foreign energy producers to "abandon energy nationalism, to expand and attract investment, and to adopt advanced exploitation technologies".

Scenario Two
Let's return to 2017 in Australia.

What if we were able to heed the lessons from the rest of the world? What could the East Coast gas market look like?

LNG exports are worth as much as $50 billion to the national economy.

The step-change in gas demand is re-shaping the industry.

The structures that served us to this point no longer suffice in a market that has grown dramatically and has opened to the world.

The design of a new market must provide certainty for investment and innovation to meet future demand and it must give confidence to consumers that they are not paying more than a neighbour, a competitor or an overseas market.

When it comes to principles for a future gas market, we don't have to look much further than our electricity market.

We can see the benefits of a market that provides clear price signals for today, tomorrow, in one year and in three years' time, so consumers can know what their costs are today, and what they are likely to be in the future.

We need a gas market design founded on key features:

1. Enabling guaranteed access to gas by those who value it the most and supporting production by those who can deliver it in the cheapest way.

2. A more liquid and transparent market for capacity, which encourages more efficient pipeline use and more transparent signals about market demand for investment.

3. The role of long term gas and pipeline contracts is diminished. They can still play a role, but are referenced against open and transparent markets.

With confidence and signals gained from a deep, liquid and transparent gas market, investors can commit the significant capital and highly specialised machinery, like drilling rigs, to support new gas production and exploration. Commitments may still be in the form of contracts, but referenced against a transparent price for gas.

These projects must include new coal seam gas production in New South Wales, where a more stable and predictable regulatory environment would support much-needed development and would bolster the sector's efforts to build the social licence for the technology.

This will result in the LNG industry's draw on the Cooper basin not delivering the supply crunch that would have happened without new gas production.

Conclusion
Right now, multiple jurisdictions, departments, agencies, associations and others are undertaking a range of reviews on gas – looking at gas commodity and transport markets, future supply and demand, and potential paths for reform.

East coast gas markets have undergone significant transformation over the past 20 years, since the 1991 Industry Commission report on Energy Generation and Distribution

Victoria's Wholesale Gas Market emerged from National Competition Policy reform agenda between 1995 and 1999. And the Ministerial Council on Energy has led reform since 2004.

But these advances have not yet delivered national, long term transparent gas pricing and liquid markets.

In Australia, the energy value chain – retail, production, transmission – is held by just a few. The size of our market, particularly the number of players, places a massive premium on transparency.

By 2017, we will undergo a step-change in the Australian gas sector, with LNG exports quadrupling demand and linking domestic prices to the rest of the world.

The gas market structures that have underpinned the industry in the past simply are not up to the challenges of the future.

I firmly believe that delivering deep, liquid and transparent markets for gas is a nation-building reform that will help us build a gas sector for the future.

For the sector, transparency will provide new signals for where and when to invest in production, transmission and storage. This must be backed up by a regulatory regime that is stable and supports – not restricts – sensible development of new gas production.

Investment in new production is critical if we are to avoid a supply crunch and unnecessarily high prices into the future.

Liquidity will transform the market by providing a visible and tradeable price for gas today, tomorrow, in a year’s time and in three years’ time.

And consumers will have in their hands the information to know they are not paying more for gas than their neighbours, their competitors or overseas markets.

They’re empowered with the knowledge they’re getting access to gas at a competitive price.