

INTRODUCTION

The Energy Users Association of Australia (EUAA) is the peak national body representing major Australian electricity and gas users. Our membership covers a broad cross-section of the Australian economy including significant retail, mining, manufacturing, materials and food processing industries.

The EUAA is a strong advocate for energy users and firmly believes that the primary objective of energy markets should be to serve the long-term interests of the consumer as stated in the NEO and NGO. There can be no doubt that energy users, both large and small, are experiencing unprecedented increases in both electricity and gas costs while there are potentially significant risks to both the availability and reliability of energy for some consumers. This situation is clearly at odds with both the NGO and NEO.

Over the last 10 years Australia has given up its comparative advantage in competitively priced, highly reliable energy that has underpinned significant industrial development and employment for many decades. It is inconceivable to think that a country with resources that are the envy of the world cannot deliver competitively priced energy to its own population.

If allowed to continue on this trajectory this comparative advantage will be permanently lost and along with it, a majority of energy intensive industry including many industrial, food processing and manufacturing.

Information asymmetry is a major hurdle faced by industrial gas customers as they seek to negotiate affordable gas supply. Therefore, the EUAA welcomes the ACCC moves towards greater transparency in all parts of the gas supply chain. In the case of reserves, the lack of publicly available and clearly understood reserves numbers is another part of the information asymmetry that our members confront as they seek to negotiate their gas supply agreements.

This submission focuses on the issues discussed in Section 3 of the consultation paper associated with reserves estimation, particularly the gas price assumptions to be used in the estimation and associated disclosure requirements.

We strongly agree with the ACCC's objectives of improved information transparency to facilitate better policy making and reduce the large the information (and hence negotiation) asymmetry long faced by our members in negotiating gas contracts.

We are happy for this submission to be published on the ACCC's website.

Andrew Richards
CEO
16 March 2019

ANSWERS TO SPECIFIC QUESTIONS

29. Do you agree that producers should be required to estimate their reserves on the basis of forecast economic conditions? If not, please explain why.

Yes. Users are interested in getting as clear a possible understanding of their ability to contract for gas in the future.

30. Do you think that:

(a) Producers should be responsible for determining the forecast gas prices they will assume when estimating uncontracted reserves and required to disclose these assumptions (i.e. Option 2)?

i. If so, please explain why.

ii. If not, please explain why.

(b) Producers should be required to use a mandated common gas price assumption when estimating uncontracted reserves (i.e. Option 1)?

i. If so, please explain why and set out:

a. the benefits you think this would provide over the producer-determined assumptions?

b. how you think the forecast common gas price assumption should be determined?

ii. If not, please explain why.

(c) Producers should be responsible for determining the forecast gas prices they will assume when estimating uncontracted reserves and not required to disclose their assumptions (i.e. Option 3)?

i. If so, please explain why and set out how do you think this option would address the concerns outlined in section 3.1?

ii. If not, please explain why.

We agree with Option 2 as the preferred option.

We agree with the ACCC's analysis of the difficulties with Option 1 given the lack of a widely accepted external reference price in Australia, unlike the US where the SEC uses Option 1.

While we agree with the points made in Box 3.2 on the problems with using LNG netback as that price, we comment below on whether the current market conditions may lead producers to choose an LNG netback related price in applying option 2.

We agree with the ACCC's view on Option 3 that it does not provide the information this disclosure framework is designed to achieve. Successive ACCC gas reports in recent years have highlighted the lack of transparency that prevents an efficient market operating. Users need to have a clear understanding of the assumptions used in reserves data to help reverse the current information asymmetry.

31. If Option 2 is implemented, do you think that the disclosure requirements in section 3.6 will impose sufficient discipline on producers, or do you think the gas price assumptions used by producers should be required to satisfy a test that would be overseen by the AER? If you think the gas price assumptions should be subject to a test, please set out:

(a) what form you think the test should take and if the test should apply to the gas price assumptions or the method used to determine the gas price assumptions

(b) how you think the test should be enforced by the AER (for example, should the AER have the power to require producers to re-estimate their reserves using an alternative price assumption).

The gas prices proposed by producer should be subject to a “reasonableness” test, similar to the approach employed by the Canadian Securities Administrators. As the ACCC notes, there are similar precedents already in the National Gas Rules so applying the test in this case is should not be regarded as an onerous requirement for producers.

32. Do you agree that the gas price assumptions underpinning contracted reserves should be based on the prices specified in the relevant GSAs? If not, please explain why.

Yes, we agree with the ACCC’s proposed approach.

33. Do you agree with the ACCC’s proposal to allow producers to account for the operation of:
(a) price escalation mechanisms when determining the prices to apply under the relevant GSAs over the forecast period? If not, please explain why.
(b) contract extension provisions if the GSAs are likely to be extended and the prices (or pricing mechanisms) to apply in this period have already been determined? If not, please explain why.

In principal, yes. However, what is not clear is how this calculation would be undertaken for GSAs that have an LNG netback linked component. In this case we would expect the producer to provide the justification for their forecast LNG netback prices for the full five-year period.

34. Do you agree that producers should be required to disclose the following information when reporting their reserves estimates?
(a) The gas price range within which there would be no material change in the 2P reserves estimates, which is to be reported at a basin level for each of the following five years and generally for subsequent periods (with the range to be based on the price assumptions used to estimate uncontracted reserves).
(b) The sensitivity of the 2P reserves estimates to a +/-10% change in the gas price range reported under (a).
(c) A description of the method used to determine the gas price assumptions and any other assumptions that have been made when determining the price range.
(d) An explanation of any changes that have been made to the gas price assumptions from the previous year and why the changes were made.
If not, please explain why.

We agree with the proposed information to be disclosed.

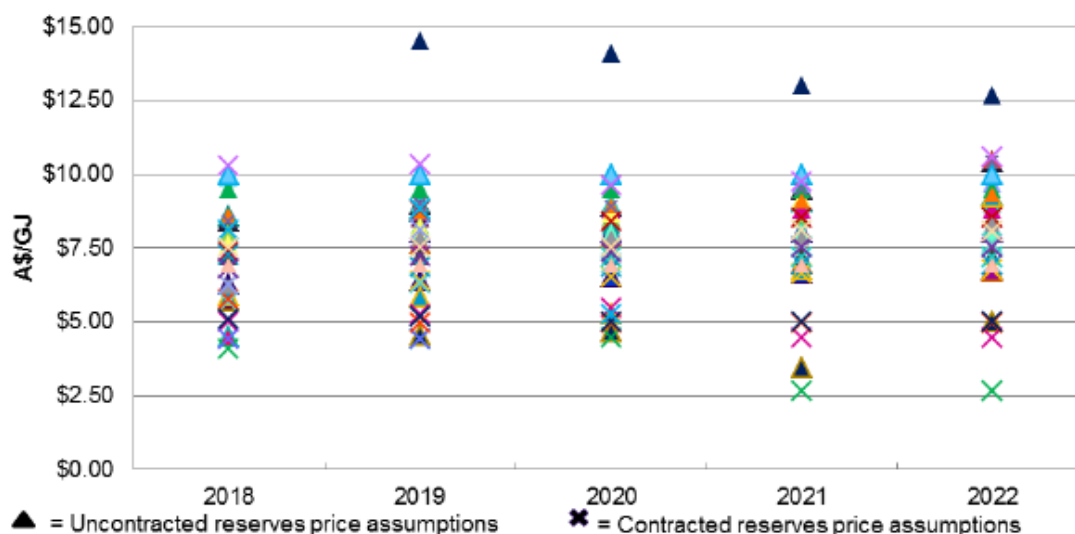
Given the objective to:

“...provide any useful insights into the sensitivity of the reserve estimates to price assumptions.”
 (pp37-8)

we wonder if simply the range \pm a materiality threshold will give all the information that is necessary for a fully transparent market.

At a more fundamental level we wonder if the gas price range is going to be much different from the producer’s estimate of LNG netback adjusted for transport costs to their particular basin. We would suggest that while there was a large range of gas price assumptions used by producers in the uncontracted data reported in the ACCC’s December 2018 report,

Chart 3.1: Gas price assumptions underpinning producers' reserve estimates



Source: ACCC, *Gas inquiry 2017-2020 interim report*, December 2018, p. 49.

this may change when producers have to publicly reveal their price assumptions.

The ACCC description of the process (p.25):

“... reserves are defined by the PRMS as those quantities of gas that are ‘commercially recoverable’ and the producer has demonstrated a ‘firm intention to proceed with the development’. The assessment of whether quantities are commercially recoverable requires a range of assumptions to be made about forecast conditions. Assumptions must, for example, be made about the costs that are expected to be incurred in bringing the gas to market, the prices that are expected to be received from the sale of the gas and the taxes and/or royalties that are expected to be paid.

suggests we might expect a range of prices reflecting reasonable costs and required margin to be reported and where, for example, the Core Energy forward and life cycle cost estimates¹ might offer some guidance to consumers negotiating for supply.

However, we would argue that while this might be the case in an efficiently functioning market, the east coast gas market is a long way from that. In the current market conditions, we would expect price assumptions to be based on some measure of opportunity cost i.e. LNG netback adjusted for transport costs in the particular basin. In the ACCC terminology – somewhere between the buyer and the seller alternative. This is irrespective of whether the reserves can actually be exported.

This suggests that the price will be adjusted over time driven by the oil price and the LNG market expectations. It also suggests that domestic economic conditions are less relevant to determining the price. Even if the RBA forecasts the country to go into a recession at some time over the five-year forecast period, a strong oil and LNG market may mean there is no downward adjustment in the assumed gas price for reserves calculation. In the absence of any explicit policy to ensure domestic supply is available at a particular price (the ADGSM only regulates volume, not price), producers may simply continue to value reserves at the LNG netback.

¹ See ACCC “Gas Inquiry 2017-19 - Interim Report” December 2018 p. 62-3
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For producers with an LNG option, a forecast of a domestic recession may not change their price assumption as they will, in the absence of some form of domestic reservation, simply re-direct volume to the export market given their excess capacity at Gladstone. Producers in the southern States without that LNG option may simply decide to leave the gas in the ground. The recent Energy Quest forecasts of falling reserves in the southern States², driven by a combination of producer revisions, the failure of some exploration efforts and the moratoriums and restrictions on new developments, my lead producers to conclude that may will be enough buyers for a dwindling reserves base at an LNG netback price. Why would producers put in a lower price, even if it is “economic” to sell it at that price when they can ration their remaining reserves to those customers that can afford to pay the higher LNG netback related price?

We cannot understand why a producer would publish any price other than LNG netback:

- Consumers would be immediately be knocking on their door saying “I want to buy some of your \$5/GJ gas”
- Shareholders would be knocking on management’s door saying “Why are you selling this \$5/GJ gas so cheaply?”

35. Do you agree with the proposal to require producers to report the gas price range:

(a) for each year over a five-year period and generally thereafter? If not, please explain why.

(b) for uncontracted reserves only? If not, please explain why.

(c) at a basin level? If not, please explain why.

We agree with the provision of information annually for a five-year period and then generally thereafter. It should only apply to uncontracted reserves and at a basin level.

36. If producers are required to report the gas price range within which there would be no material change in 2P reserves, what materiality threshold do you think should be adopted for this purpose and why?

We would support a “no material change” measure of 5% consistent to increase the usefulness of the information provided.

37. Do you agree that the threshold for measuring the sensitivity of the reserves estimates should be 10%? If not, please explain why and what alternative threshold you think should be applied.

We support the proposed $\pm 10\%$ sensitivity range.

38. Is there any other information that you think should be disclosed about the gas price assumptions? If so, please explain what the information is and why it is required to meet the objectives set out in section 1.

There are no additional measures we would suggest at the moment. We would propose that the ACCC review the operation of the reserves reporting after it has been in place for say one year to see if it still fit for purpose to meet the objectives in Section 1.

39. What incremental costs do producers expect to incur in complying with the proposed reporting requirements set out in sections 3.4-3.6?

² See Angela Macdonald-Smith “A third of Qld’s LNG industry at risk of closure by 2025:report” 21st February 2019 <https://www.afr.com/business/energy/gas/onethird-of-qlds-lng-industry-at-risk-of-closure-by-2025-report-20190220-h1bhdd>

We do not see significant compliance costs given reserves estimation will build on, rather than replace current processes e.g. based on forecast economic conditions.

40. Do you think there are any refinements that could be made to the proposed reporting requirements in sections 3.4-3.6 to further reduce compliance costs or the regulatory burden, whilst also ensuring they are fit for purpose and achieves the objectives set out in section 1?

No.