Kleiner, Gennady

From: John Phillips <John.Phillips@blueenergy.com.au>
Sent: Thursday, 2 July 2015 4:32 PM
To: Gas Inquiry
Subject: Submission Re: Coast Gas Inquiry

Attention: Jeremy Jose

Dear Sir,

Public Submission to the ACCC East Coast Gas Inquiry by Blue Energy Limited on 2 July 2015

Blue Energy makes the following submission to the above inquiry. It makes no claim to confidentiality of any part of this submission.

Issues Paper Question 3: Factors Significantly Restricting or Limiting the Ability or Incentive for Gas Producers to Explore and Develop New Gas Reserves.

It needs to be understood that exploration for gas (or hydrocarbons in general) is different to gas production activities.

New gas reserves can be found in:

1. frontier areas;
2. existing hydrocarbon producing geological basins; or
3. from within existing known accumulations.

The geological risk profiles for each of these activities is distinctly different and can attract a different kind of proponent (company).

This use of the word “risk” is specific and entails geological risk or, put another way, the chance of successfully finding gas which can be economically extracted and brought to market (it is not designed to indicate any level of environmental risk).

Factors restricting exploration are as follows:

1. ***The lack of meaningful exploration acreage released to industry for exploration by the State jurisdictions.*** The States are the owners of the subsurface mineral and hydrocarbon resources of the nation. Explorers and producers are but contractors to the States to explore for, discover, develop and produce hydrocarbons, and from which royalties flow back to the States in a success case.
2. ***The time it takes to be awarded acreage from gazettal to first on ground activity.*** This is a government run process of identifying suitable acreage for gazettal, the gazettal process, seeking interested bids and evaluating the bids, then nominating the successful bidder.
3. ***Access to land for exploration has now become extremely time consuming.*** Native Title negotiations in the oil and gas space are not streamlined - and until a Native Title Agreement is reached, exploration permits cannot be awarded (in Queensland). Negotiations with landholders for access can be extremely drawn out with compensation expectations for exploration activities being skewed heavily by community expectations generated from production activities in the producing basins.
4. ***Community concerns about exploration activities***. These are by default low impact, but have been inflated by anti-fossil fuel activist groups.
5. ***The ability to quickly move from exploration tenure to production tenure (thus allowing gas production) once a gas discovery is made.*** Largely this process is bogged down in unnecessary bureaucratic regulation, a lot of which is environmental and might also be duplicated on a federal level. There is a pre-disposition of some regulators to stop activities rather than to

facilitate exploration and discovery. A fear also exists in some bureaucrats of making a "wrong decision" – so instead of making a decision they just don't make a decision – a double jeopardy . Bureaucrats are unnerved by FOI requests by green activists.

6. ***See-sawing regulatory and political support for the onshore oil and gas industry.*** Each time a new government is elected there is now a high risk that previous environmental and tenure regulations will be changed. This 3-4 year political cycle means there is no longer any certainty (except possibly in the Northern SA region of the Cooper Basin) for industry as to the rules governing its activities. This limits investors' willingness to seed capital to explorers in this environment. Yet industry is expected to attract risk capital from investors to undertake a low chance of successful exploration – with no real certainty of the ability to develop a successful discovery.

   Examples are fracture stimulation bans/enquiries (Vic/ NSW), tenure buy backs (NSW), lack of law enforcement to protect industry undertaking lawful activity (for example unlawful protests interfering with Metgasco's activities in NSW) and effective control of oil and gas activities ceded to State environmental regulators (Metgasco has spent $120 million of shareholder funds and now have no real prospect of going into production because of a lack of political leadership in NSW).

7. ***Access to capital for explorers***. This has two aspects:
   a. **Frontier exploration is generally undertaken by small exploration companies** (who have the geological talent to develop concepts for gas accumulation discovery in areas where others may have failed previously, or because no one else had thought of previously exploring in these areas). These small companies however need to access capital markets to undertake the on-ground work. This introduces the risk of failure concept. Large companies are generally risk averse (by comparison to the small companies), and so shy away from unproven areas (that is, frontier areas). Larger companies are much more likely therefore to undertake exploration in the proven areas – either around existing accumulations or along trends in producing basins.

      Exploration is a high risk business (ie low chance of discovery) with the chance of success between 10-30%. The high cost of exploration in remote areas – in part caused by over regulation of low impact exploration activities, means that access to capital is a key risk for pure explorers. Also, in low oil price environments, the larger producing companies focus on revenue generating activities and cut costs in areas of non-revenue generating activities – exploration. It is only the small pure explorers whose whole existence is geared toward finding gas, who continue to endeavor to explore in hard times. Exploration needs to be encouraged

   b. **Capital markets are volatile – and volatility engenders risk aversion.** The number of successful capital raisings in Australia over the past two years by small explorers has been very low. The result of this is the number of small explorers with sufficient capital to continue operating is dropping alarmingly quarter by quarter (BDO produces a report that tracks these statistics). We are witnessing the rapid destruction of the small Australian exploration company in both oil and gas, and minerals. Small explorers need more incentives to remain viable –less regulation of on ground activity, better fiscal incentives to explore, and for discoveries that might be made, royalty holidays. An example is the UK North Sea changes to tax rates.

Issues Paper paragraph 41: Companies With Little Expertise or Financial Backing.

There is a tendency to categorise small entrepreneurial explorers as having no expertise or financial backing – or worse, to refer to them as "cowboys". It has been all too easy to lay blame for minor environmental incidents or landholder discontent at the feet of those innovative companies that have discovered a resource contrary to previously held geological interpretations. Small entrepreneurial explorers will take

geological and financial risk to discover the next swathe of oil and gas accumulations. Exploration is about testing the unknown – there are no guarantees about the outcomes.

The lifecycle of onshore resource projects in the onshore oil and gas space is often as follows.

1. A small company (often unlisted, and often with minimal shareholders and shareholder funds) has a novel geological interpretation about an area and why it might contain hydrocarbons.
2. It applies for acreage (and despite the disincentives inherent in the bidding process) is successful.
3. It devises a work program to test its theory – and thus develops a budget for what it might cost to undertake the test (but not to develop it).
4. It then seeks seed capital – or seeks to list on the stock market to attract a broader range of investors to fund the idea.
5. Assuming it successfully raises the money – it shoots seismic, (possibly) selects a drilling location and spends $2-3 million to drill a well. Shale gas is much more expensive.
6. If the well indicates there is a gas accumulation the company's share price and market cap will increase. This may allow it to take on debt to develop the field
7. Often however, the original company dilutes its exposure to the project by "farming down" to a bigger company – that is, the bigger company's entry has been de-risked by the smaller company's activity and success
8. Ultimately the project may become too expensive for the small company to continue and it sells out to the bigger players (for example, Arrow to Shell and Petrochina; Pure Energy and Sunshine Gas to QG;, QGC to BG; BG to Shell!, etc).

The length of time to do this necessary work has been extended. It has to be recognised that the complexity and prescriptive nature of the oil and gas regulatory system has increased markedly since the mid 2000's as a result the influence of environmental and landholder groups – and in turn, their influence on the politics of gas development. The requirements of regulators to approve on ground activity had become so onerous that is has not been possible in Blue Energy's experience to conduct on ground activity within the first two years of Queensland tenure (out of a 4 year work program). Such delays effectively should have triggered a force majeure event for most explorers under their tenure work program conditions with the Queensland Government, but the Government took the view they did not. This was manifestly unfair to the exploration sector and it effectively shut down exploration in Queensland up until 2013-14 (as evidenced by the pure exploration well count for the period 2009-2013-4 – GSQ data). Explorers in Queensland were subject to environmental regulations that had been derived and developed for LNG producers on Curtis Island (and the associated upstream gas developments). That is, the explorers were being regulated in their on-ground activity as if they were drilling an equivalent number of wells (in the thousands) as the LNG Projects. This hiatus in exploration activity will have, and is having (compounded by poor access to capital and low oil prices), the effect of placing a five year hiatus on new gas discoveries. This will flow through into supply side issues for domestic gas users and future royalty streams for the States.

Issues Paper Question 21 – Key Factors Affecting Gas Price in Eastern Australia

These are:

1. Insufficient supply of gas not linked to export LNG projects;
2. Potential choice of gas producers to supply the international market at world gas price;
3. Expectation of domestic gas users that gas prices should remain at historic lows; and
4. The actual (high) cost of exploration, development, production (including regulatory compliance, community and environmental issues) and transportation of gas. There is no longer any A$3.00/gj gas left.

Issue Paper Question 46 – 15 year no coverage determinations

This is clearly not conducive to efficiently exploiting the country's gas resources, and is contrary to the desired open access principles for pipeline infrastructure. In addition, the 15 year no coverage determination on the QGC pipeline to Curtis Island was made when the pipeline was owned by QGC et al. It has now been sold to APA and therefore in theory should not be dedicated to QGC gas alone. Similar arguments could yet be made for the GLNG pipeline to Curtis Island.

A further example of where such a determination would be detrimental to efficient gas exploitation and delivery to market is the Bowen Basin. Presently there is no pipeline connection between the Bowen Basin and the southern markets, yet an abundant gas resource is being delineated by several proponents. Arrow Energy is currently in a front end engineering design study to decide on the construction of a pipeline from Moranbah to Gladstone – a link to the southern market. Should this pipeline receive final investment decision, and should Arrow apply for a no coverage ruling, it will lock out significant third party gas from the southern domestic market.

In general the Company is concerned at the limited number of pipeline operators on the east coast and the lack of competition to deliver low transportation tariffs to producers.

I am happy to discuss, or expand upon any aspect of this submission with officers of the ACCC, should that be required.

Regards,

JOHN PHILLIPS
CEO & MD
t 07 3270 8800
f 07 3270 8899
e john.phillips@blueenergy.com.au
Level 3, 410 Queen Street,
Brisbane QLD 4000.
PO Box 10261 Adelaide Street,
Brisbane QLD 4000.

blueenergy.com.au

Fine Print
This email and any attachment(s) is intended only for use by the addressee(s) and may contain information which is confidential, copyright and/or the subject of legal privilege. If you are not the intended recipient of this communication, any disclosure, distribution or use of the information is prohibited and may be unlawful. Please delete and destroy all copies and contact the sender immediately. We do not represent, warrant and/or guarantee, except as required at law, that the integrity of this communication has been maintained nor that the communication is free of errors, viruses, interception or interference.