Response to Australian Competition and Consumer Commission East Coast Gas Inquiry Issues Paper

Cooper Energy and the East Coast Gas Market

Cooper Energy is an ASX-listed oil and gas company that is engaged in:

- developing new gas supply projects;
- marketing gas directly to eastern Australian gas users; and
- exploration for new gas reserves for supply to the eastern Australian market.

Cooper Energy, for its part, considers its position offers perspectives relevant to the deliberations of the ACCC on this matter:

1. as a gas supplier actively engaged in negotiations with eastern Australian gas users to supply gas directly (ie as distinct from joint venture marketing).
2. as an independent new entrant not engaged in existing arrangements.
3. as an organisation which recognised opportunity in the eastern Australian gas market several years ago and which has reorientated its corporate strategy, and undertaken a substantial and ongoing capital investment to build a business offering a new source of supply to eastern Australian gas users.

The Company has chosen to address those questions from the Issues Paper relevant to its activities and interests. Cooper Energy is willing to participate in further discussion should the Commission consider it appropriate.

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Introduction

Cooper Energy is an Adelaide based ASX-listed exploration and production company.

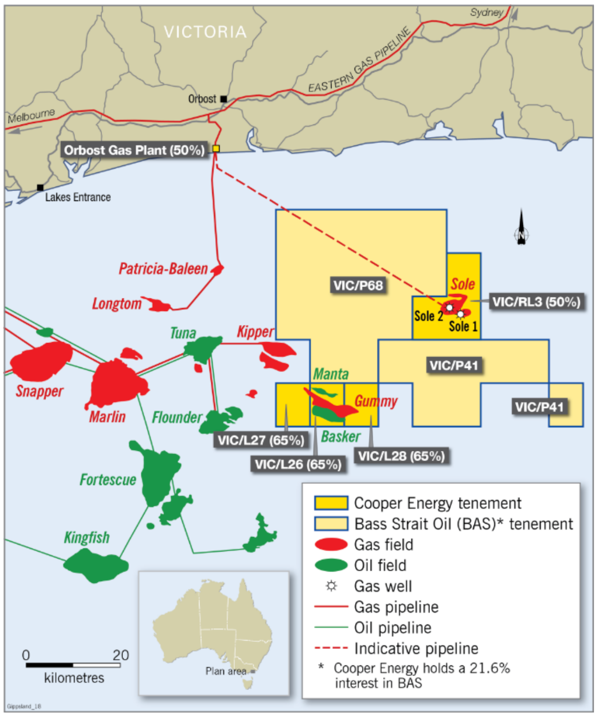
The Company is the fifth largest onshore oil producer in Australia and has annual production of around 0.5 million barrels from the Cooper Basin and Indonesia.

Whilst Cooper Energy currently generates 100% of its revenue from oil production, this is expected to change within three to four years due to gas projects and interests currently at different stages of maturity within the Company's portfolio. These assets have the capacity to see Cooper Energy selling 12 PJ per annum of gas to eastern Australia in 2019 and 25 – 30 PJ per annum by 2022. These figures represent Cooper Energy's forecast equity share supply from existing resources and do not include additional production that would arise from exploration and acquisition that is contemplated.

The company's gas resources and interests include (refer accompanying maps):

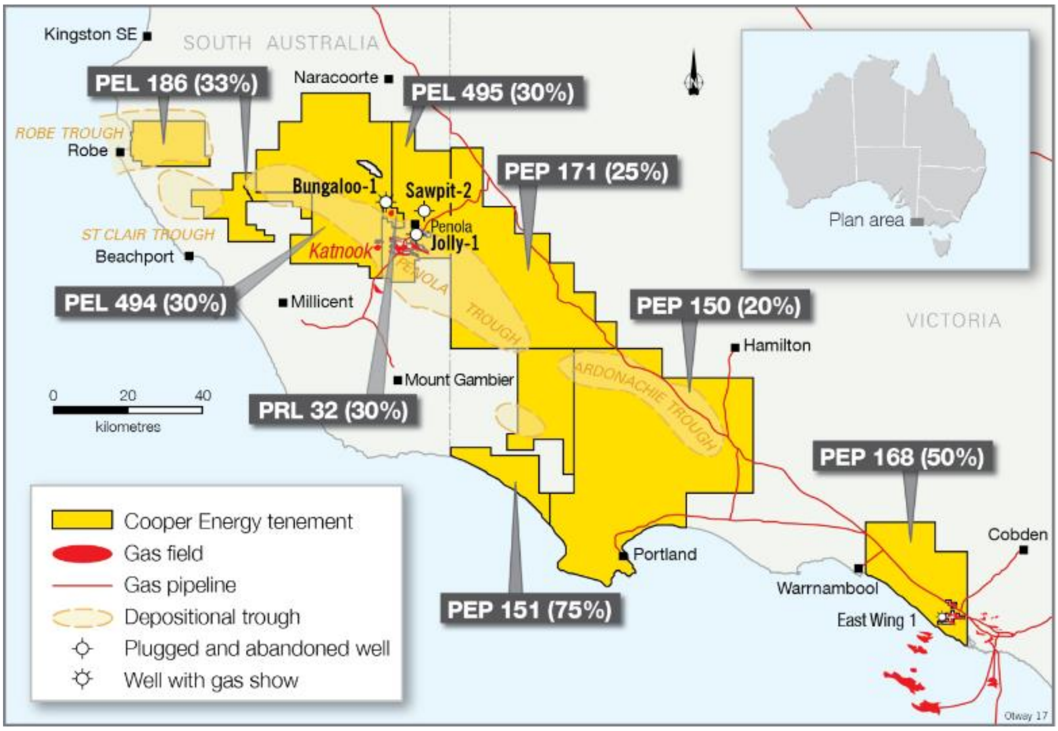
1) a 50% interest in VIC RL/3 in the offshore Gippsland Basin, which contains the Sole gas field. Sole, which is assessed to contain 2C Contingent Resources of 211 PJ, is currently undergoing Front End Engineering and Design (FEED) for development to supply gas from January 2019 onwards. Project output will be finalised in the FEED process, with the current expectation being that Sole will provide eastern Australia with approximately 25 PJ per annum (100% JV basis) over 8 years.

2) a 50% interest in the Orbost (Patricia-Baleen) gas plant, located onshore Victoria. This plant processed gas from the Gippsland Basin gas fields, Patricia-Baleen and Longtom until recently for supply to eastern Australia through the Eastern Gas Pipeline (EGP). The plant is currently in care and maintenance and is expected to resume operation as a hub for offshore Gippsland Basin gas fields (such as the Sole and Manta gas fields) to access the EGP.



3) a 65% interest and the role of Operator in VIC RL/26, RL/27 and RL/28 in the offshore Gippsland Basin, which contains the Basker Manta Gummy (BMG) gas and liquids resource. BMG is assessed to contain Contingent Gas Resources of 119 PJ and is currently the subject of a Business Case Study for development to supply gas to eastern Australia.

4) Approximately 10,200 square km of acreage in 8 permits in the onshore Otway Basin in South Australia and Victoria, acquired to explore for gas that may be economically developed to supply eastern Australia.



In 2014 Cooper Energy participated in the drilling of two exploration wells by the PEL 495 and RL32 Joint Ventures in South Australia which identified the presence of gas in deep conventional reservoirs, as well as confirming the potential for shale gas in the Casterton Formation. The identification of deep conventional gas resources in the Otway Basin is particularly encouraging given the proximity to pipeline and plant infrastructure and access to eastern Australia gas users. This approach is consistent with Cooper Energy's strategy of securing cost-competitive gas resources to bring to market in a timely manner. The company intends to conduct follow-up exploration to test the potential of its Otway Basin acreage to yield commercial gas reserves for sale to eastern Australian gas users.

Strategic rationale and confidence in market operation

Cooper Energy began building its gas portfolio in April 2012 after the Board of Directors implemented a report prepared by the Company's current Managing Director that recognised the opportunity in the supply of gas to eastern Australia from 2016 onwards. Since that time, the Company has been building its interest, relationships and internal resources for the clear purpose of offering gas users an additional source of supply from a multi-basin gas portfolio. Cooper Energy expects further additions to its portfolio as it 'rounds out' the spread of interests.

This strategy has been implemented on the understanding that the eastern Australia gas market will continue to operate on normal commercial terms where gas supply and prices are set by commercial negotiation.

The development of the three Gladstone-based LNG projects generates significant national and local economic benefits in particular ongoing significant employment and state and federal government royalties and income taxes - which otherwise would not have been possible without the link to international LNG prices for these projects. The development, commitment and supply of gas from lower cost sources are then naturally followed by the development and supply from higher cost sources. The Cooper Energy strategy recognised these 2 issues and the encouragement this give to new gas resources. These new gas resources will often have been uneconomic under the lower prices that prevailed when supply from existing contracts aligned with non-LNG demand.

An increase in upstream gas price is therefore not symptomatic of insufficient gas for domestic use in an undersupplied market; rather the increase in prices is what is required to bring new and competing gas supply to market.

Cooper Energy took the view that market forces would be allowed to operate, and thus encourage prices that enable new sources of supply. This in turn would enable competitive forces to determine which sources of gas supply would be successful in "winning" the new contracts required post-2016.

In support of this strategy, Cooper Energy analysed, and sought positions in, gas projects it considered most favorably placed in terms of 'lowest cost' and 'speed to market'. The Company's investment and position in the Gippsland and Otway Basins are the outworkings of this strategy and the Company's confidence that the market will recognise those who can commercialise new gas supply where this will be required.

The Sole gas field is a good illustration of this approach. Development of the Sole gas field is currently subject to Front End Engineering and Design, in preparation for the Final Investment Decision (FID) on a project that is planned to bring new gas supply from early 2019. This project was uneconomic at previous gas prices. However, market conditions are now supportive of project development and Cooper Energy believes the field will be able to deliver a new gas source to users at prices in line with industry forecasts and for an appropriate return to the developer. The project will not proceed without a critical mass of gas being sold in advance of FID and this will require sales contracts to be won with gas buyers who are presently being supplied from other sources.

Cooper Energy is presently engaged in pursuing the development of new gas resources and gas supply agreements. Key to this is developing an acceptable overall return whilst also delivering a good outcome for the communities with which we work and gas customers. This context forms the basis of the Company's response to the questions posed by the ACCC in its discussion paper.

Current market behaviors…. is there a problem?

As a general observation the Company notes that it considers the behavior of market participants in the current market to be consistent with what would be expected of the market situation:

- new sources of supply are being pursued by the likes of Cooper Energy, Central Petroleum, Strike Energy, Drillsearch and Beach Energy that previously would have been considered uneconomic.

- it is anticipated that the existing suppliers will be pricing their product in accordance with their fiduciary and commercial obligations, as is to be expected in a market environment.

- commercial agreements are being written as buyers move to secure supply, and in some instances buyers are taking positions and making investments further upstream to assist their access to the flow of gas from new sources.

- gas buyers may be faced with an increase in their gas purchase costs brought by the increasing supply costs and market changes, and understandably do not want energy costs to increase.

Provided market forces can be allowed to operate, balance can occur as prices encourage the commitment of investment funds and that enables new and competing sources of supply.

Submission content and commercial confidence

For commercial confidentiality reasons Cooper Energy will not, and does not, address the specifics of any individual negotiation in its response to the Discussion Paper's questions. This submission reflects general observations and insight acquired by the Company in its role as an independent gas supplier and upstream gas explorer and project developer.

Responses to Discussion Paper Questions relevant to Cooper Energy

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.

There are no significant restrictions on Cooper Energy pursuing its strategy of exploring and developing gas resources in eastern Australia at present. However, Cooper Energy has not sought to expand or manage significant exploration activities onshore NSW or Victoria given the well-known uncertainties and restrictions in those jurisdictions. Cooper Energy is focusing its attention offshore and in South Australia where the jurisdictions are currently more supportive of gas exploration and development.

Higher existing and prospective ex field gas prices encourage increased exploration and development capital. Cooper Energy takes the view that allowing prices to be determined through agreement between buyers and producers will result in prices that encourage supply from both existing and potential new sources where required.

The moratoria on onshore exploration and fracture stimulation that apply in Victoria and New South Wales have effectively halted gas exploration and development activity in these regions and therefore the identification of new gas resources which could broaden supply and increase competition at a time when new supplies are sought.

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

The current permit management processes are appropriate to ensure all participants have relevant skills and experience within their organizations to undertake these activities.

13. Are there any other regulatory barriers which create significant difficulties in accessing new gas reserves?

As outlined in response to question 3 above, Cooper Energy has not sought to expand or manage significant exploration activities onshore NSW or Victoria given the well-known uncertainties and restrictions in those jurisdictions. Cooper Energy is focusing its attention offshore and in South Australia where the jurisdictions are currently more supportive of gas exploration and development.

Cooper Energy does consider that some prospectivity does exist in the onshore basins in both NSW and Victoria.

14. *Is the cost of building new processing facilities or the ability to access existing facilities a significant barrier for prospective entrants? If so, explain how and give examples of where this has occurred*.

The cost of constructing processing facilities is mainly an issue for very small discoveries. Cooper Energy does consider it prudent to minimise the number of facilities built from an economic and environmental perspective. It is for this reason that Cooper Energy plans to upgrade the existing Orbost (Patricia-Baleen) gas plant for Sole gas rather than construct a new plant. Significant modifications will be required for the Orbost plant to process the different gas composition found in fields such as Sole. Cooper Energy will also actively encourage processing of third party gas at Orbost based on commercial tariffs in the future.

15. Do owners of processing facilities have an incentive to provide third party access to spare processing capacity? Explain why or why not.

Cooper Energy believes that processing facility owners do have an incentive to provide third party access to spare processing capacity as long as “spare” means unwanted capacity in the medium to long term, as opposed to temporarily or short term idle capacity that the owner(s) has plans to use in the future.

An example is the Orbost gas plant. The plant was originally constructed to process gas from the Patricia – Baleen gas field which has since ceased production. The plant was subsequently upgraded by Santos in 2008 to process gas from the Longtom gas field owned by Nexus Energy. Cooper Energy recently purchased 50% of the plant with the dual objective of firstly processing gas from the Sole gas field, and secondly, toll processing gas from other nearby gas fields. The plant was modified in 2009 primarily to remove the condensate from the Longtom gas. Gas from Sole contains only minor quantities of condensate but does contain H_2S so further modifications are required.

16. 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?

The key factors for Cooper Energy in determining its pricing requirements for the Sole development include:

- estimated development costs. This includes:
  - offshore field and pipeline costs
  - Orbost plant modifications
  - offshore surveys
  - engineering, procurement and management costs
- regulatory and stakeholder management
- expected return on investment, both by shareholders and financiers
- estimated operating costs for the life of the field
- tax payable including PRRT
- production and sales profile.

Typically, the pre-production capital cost component is the largest contributor to total project cost and pricing requirements. Some offshore capital costs are currently lower than in the last few years because of the reduced project development activity that has followed lower oil prices. Cooper Energy will monitor to see if these lower costs are maintained through to the expected development timeframes for the Cooper Energy projects. A large proportion of the capital costs are denominated in US$ and therefore any recent lower US$ costs are partly offset by the lower A$/US$ exchange rate.

Cooper Energy is also conscious of impact on end users of gas pricing and is therefore striving to achieve lowest costs possible.

To date Cooper Energy has held many discussions with a range of gas buyers. Based on these discussions we are in optimistic of contracting for sale our share of gas production prior to making a final investment decision in 2016.

17. In what way do non-price terms and conditions influence the negotiations for the price for gas or vice versa? Which non-price terms and conditions have the biggest effect on price negotiations?

In addition to project cost (discussed in answer to question 16 above) contract term does have an impact on project economics and therefore also price – particularly for gas supply from new projects. There does now seem to be a general preference for contracts of approximately 3 years duration for larger users which does increase the price required to support new gas projects.

55-58. Questions on storage.

Gas storage, whether it is in an underground storage facility or within a pipeline, is used by industry participants to manage peaks and troughs in gas supply and demand. Cooper Energy believes, on the basis of our recent discussions with gas transportation and storage providers, that adequate storage is available and is accessible to third parties on reasonable terms.

The current design for the Sole Project assumes that the field and plant have limited capacity to provide swing. As such, end users will need to access their swing requirements from storage or other suppliers. This has not been raised as a particular concern in our discussions with buyers.