

31 August 2015

The Hon David Davis MLC
Chair, Inquiry into Unconventional Gas in Victoria
Environment and Planning Committee
Parliament House
MELBOURNE VIC 3000

Dear Mr Davis

RE: QUESTION ON NOTICE: APPEARANCE BY THE AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION ASSOCIATION (APPEA): 22 JULY 2015 HEARING

I refer to one of the questions taken on notice at APPEA's 22 July 2015 appearance before the Environment and Planning Committee's *Inquiry into Unconventional Gas in Victoria*.

At the hearing, APPEA was asked to take on notice a response to the findings of the Melbourne Energy Institute (MEI) in their report, *Switching off gas – An examination of declining gas demand in Eastern Australia*, which was made available to the media on 25 August 2015 and released publicly on 26 August 2015.

APPEA is pleased to provide the following comments on the report.

The report, funded by The Australia Institute and an undisclosed group of Victorian farmers, examines a scenario where demand falls to a level such that no new gas developments are required.

Like any modelling exercise, the MEI results are driven by the assumptions. In this case, the report examines a scenario where gas demand is significantly lower than any other scenario previously examined, for example, by the Australian Energy Market Operator (AEMO), which has a comprehensive demand and supply forecasting/modelling approach in place, in their December 2014 *National Gas Forecasting Report* and April 2015 *Gas Statement of Opportunities*. Figure A, from page 4 of the report, illustrates the very large gap between their scenario and even the AEMO 'low' scenario:

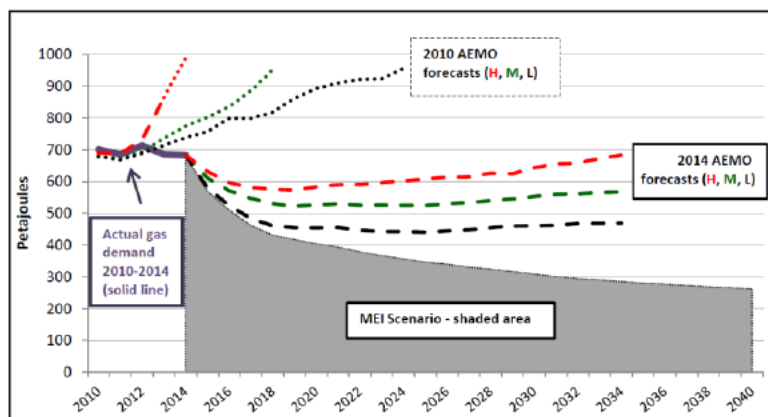


Figure A: Gas demand in eastern Australia – actual demand and scenarios of future demand.

This lower demand is driven by a number of factors, all of which are essentially assumptions used to prepare the particular scenario. That is not unusual (most modelling exercises are based on alternative scenarios (base case/alternative)) but it is important to understand that these are scenarios driven by assumptions, not reality. That is, the results answer a “what happens if this happens?” question rather than a “how likely is this to happen?” question. This is important context for the Committee when considering the results.

In this case, the scenario chosen is one that considers the demand reductions required to keep daily peak winter demand below the level that requires new pipelines and gas fields. Having chosen that scenario the model appears to back-calculate the demand reductions required. The plausibility of these reductions are not considered in any rigorous way. The authors do not suggest that this is probable, only that it is possible.

In this case, the falling demand scenario is driven by a range of mutually reinforcing assumptions (alternative assumptions are considered in the brackets). These assumptions include:

- Wholesale gas prices in eastern Australia will increase at an unprecedented pace – doubling and even tripling. Rising gas prices will dampen domestic gas demand across eastern Australia (as was noted in APPEA’s submission and at our hearing allowing supply to respond in Victoria and other jurisdictions in eastern Australia to these rising prices may dampen this outcome, as may the influence of falling oil prices on gas prices. Most of the existing modelling may not fully consider these influences).
- Carbon price repeal (assumes no alternative that places downward pressure on more carbon intensive energy sources and that the repeal is permanent).
- Ongoing energy efficiency schemes (assumes they drive down gas demand significantly).
- The growth of renewable energy (which seems to particularly assume there will be a change of Government at the Federal level and the new Government’s policy approach will drive down gas demand), energy storage and electricity demand management practice (that reduce gas demand for power generation (significantly)).
- Environmental conservation efforts (assumes such efforts reduce gas demand).
- Warmer winter temperatures (assumes this happens and that existing relationships between gas demand and temperature hold).
- Technological advances (assumes these act to reduce demand for gas).
- The falling costs of alternatives to gas (this is one of the key points in the report and assumes that (i.) such falls are achieved, and that (ii.) they are falls relative to the cost of gas (that is, gas does not or cannot match those falls with falls of its own (through, for example, technology, falling wholesale prices or falling gas network charges)).

In other words, these are all assumptions that drive gas demand in one direction (down) and they are all assumptions that have alternatives (highlighted above).

Also as noted above, the results also contrast with the efforts of every other gas market analyst, most notably the AEMO forecasts, which are the subject of a large-scale, rigorous and extensively scrutinised process each year. It is not at all clear that the MEI scenario should be viewed as superior or more likely.

While the report highlights very significant fuel switching and efficiency opportunities to drive the results, it is not clear that these are probable outcomes. For example, the opportunities for switching from gas to any other fuel (including electricity) at the commercial and industrial level can

be limited (because of the heat rates required and the lack of other suitable fuels). While there are some opportunities to improve the efficiency of gas use (that is, upgrades to boilers), APPEA members who also have gas retailing interests have advised there has not been significant interest from their customers to follow these up.

The report also highlights demand contractions (particularly for large industrial companies) as a result of the closure of manufacturing plants in response to rising gas prices. APPEA questions whether this should be regarded as an appropriate outcome. All of the submissions from manufacturing interests in Victoria have called for increases in gas supply to Victorian manufacturing interests.

More appropriately, the MEI scenario should be viewed as a “low, low demand scenario” at the edge of (or beyond) what is possible (and only if all of the assumptions set out above hold true), with other scenarios (such as AEMO’s) viewed as more “mid-case” scenarios.

In any event, as APPEA highlighted at its appearance, allowing the energy market (including gas) to respond efficiently is the best way to react to any of these possibilities. If the gas market is allowed to operate freely then it can respond to all the demand and supply signals it receives.

If the MEI scenario comes to pass then the market can react through little or no new investment. If this scenario does not come to pass and additional investment, including in developing gas onshore in Victoria, is required, then the market can react and that can be allowed to happen.

A scenario (or a reality) where regulatory restrictions, such a moratorium, prevent the development of further supply, if that supply is required, is not the right outcome.

I hope these comments assist the Committee in its deliberations. If you have any further questions or wish to discuss these comments further, please do not hesitate to contact me on 0 [REDACTED]

Yours sincerely



Paul Fennelly
Chief Operating Office – Eastern Australia