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The Gas Industry's Powerplay

By Mike Seccombe

Lindsay Partridge, the managing director of building products and property development company Brickworks, is a man to whom the Liberal Party listens. At least on some issues.

Back in March 2011, when the Labor government planned to put a price on carbon, Partridge emailed Liberal Party fundraiser Paul Nicolaou: "Tell Tony to stick to his guns on no carbon tax."

We know, because it came out in evidence to Independent Commission Against Corruption a couple of years ago, that Nicolaou passed the message on in an email to Abbott's chief of staff, Peta Credlin. He described Partridge as "a very good supporter of the Party" – and he was. In 2010-11 Brickworks gave $384,000 to the Liberal Party. During the next two years, it gave more than another $300,000. Labor got nothing.

Credlin replied to Nicolaou seeking more detail. Brickworks' concerns would make "a great line" for a parliamentary question, she thought. Subsequently, Brickworks was conscripted into the fight against carbon pricing. Brickworks sites became the backdrop for a hard hat- and fluoro vest-clad Abbott as he went about his scare campaign. The political right and their friends in the media hung on every Partridge whinge.

Oddly, though, while the Coalition was eager to hear and co-opt Partridge's concerns about the tax on fossil fuels, it has been less receptive to his complaints about the fossil fuel industry – specifically the cartel of Australian gas companies that is screwing his company.

Partridge tells *The Saturday Paper* that he's expressed his concerns to government for five years, pushing the notion that a share of Australia's vast reserves of natural gas should be held for domestic use.

But no one listened. Now Brickworks is looking at shifting its manufacturing overseas.

"Our situation is similar to most manufacturers," Partridge says. "It's very hard to find gas supply and very expensive if you do find it. And if you don't sign the contract straight away, you lose it."

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The company signed a gas supply contract for 2019 a couple of weeks ago. The price was up 76 per cent.

“It’s having a massive impact on our cost of production – a $10 million hit in 2018 and a $20 million hit in 2019,” Partridge says

“Last year we made $75 million out of building products, so $20 million represents 25 or 30 per cent of earnings.

“We already import some product from overseas, so expanding our imports would not be that difficult for us.”

It’s unfortunate, he says, but reality has to be faced. “And the reality is now that there will be less electricity. There will be blackouts in Sydney over the next couple of years and gas shortages.”

But why would anyone believe the dire predictions of Lindsay Partridge? This is the man who once said of Labor’s carbon price scheme: “The end result will be an exodus of manufacturing industries and investment offshore, jobs will be lost … and there will be no change to carbon emissions.”

Wrong, wrong and wrong.

This time, however, a lot of other people are singing the same song as Partridge. People without ideological, commercial or political axes to grind, such as the Australian Energy Market Operator, which reported a couple of weeks ago that widespread power shortages loomed over the next few years, first in New South Wales and South Australia, then in Victoria and then in Queensland.

There are others such as Credit Suisse, whose energy market analysts warned last week that unless more gas was supplied to Australia’s domestic market we would “watch manufacturing in Australia rapidly disappear”.

There is the Australian Competition and Consumer Commission, whose report last April into Australia’s east coast gas market noted an “unprecedented” conjunction of high prices, limited volumes and restrictive terms and conditions, pointing to an uncertain and expensive energy future.

Indeed, a whole lot of people have been trying to get government to take the issue seriously for a long time, much like Partridge. And, until recently, they had found government unresponsive.

Then, suddenly, the government discovered a crisis. Prime Minister Malcolm Turnbull declared it so.

“Today, I’m taking national leadership to resolve this gas crisis,” he boasted on March 15.

He went into a meeting with the leaders of the gas cartel, who, after a stern talking to, assured him they would not let the lights go out. The details of exactly how they

would do that and how much they would charge for it were missing. But Turnbull came out and declared the problem fixed.

If only that were true. The reality is that this is a problem many years in the making, and it will take many years to fix. And fixing it is going to cost someone – the gas companies, consumers or government, or all three to some degree – tens of billions of dollars.

“This,” as one energy market analyst put it, “is a clusterfuck of epic proportions.”

The elements of the predicament are these: corporate greed, lack of market transparency and government oversight, and the vagaries of globalisation.

Tony Wood, energy program director for the Grattan Institute, gives a potted history of how we got to this point.

“For a long time the Australian east coast market was very insular, there was no export market and gas was cheap,” he says. “Prices were stable and relatively low, at $3 to $4 a gigajoule [GJ] for decades.”

But in the 1990s, when people began to become concerned about climate change, some companies saw potential for gas in electricity generation, because it produced less carbon dioxide per unit of power produced than coal.

Quite a few gas generators were built around the country, Wood says, which increased demand somewhat.

Around the world, the same realisation dawned, which increased global demand. At the same time, there were technological advances that increased the supply of gas.

“In the late ’90s, gas took off because of developments in technology – three-dimensional seismic [surveying]; horizontal drilling, meaning you could drill into a coal or shale seam for a long way; and fracking, which enabled you to get gas out of coal and shale structures,” Wood says.

“Before that, everyone knew there was lots of gas in Australia, particularly in the coal seams in Queensland, but it was too expensive to get it out.”

And so grew the new gas industry, known as “unconventional” gas extraction. Instead of drilling large wells into large pockets of gas, which flowed under its own pressure, miners began drilling large numbers of smaller holes and squeezing the gas out. The practice is highly contentious. Opponents fear contamination of groundwater and the greater potential for leaks.

Asia was industrialising, prices were moving up. The time seemed ripe for the formerly insular, stable east coast gas industry to boom and enter the international market.

Then on March 3, 2011, a tsunami hit Japan. Overnight 27 per cent of Japan’s power production was wiped out. Demand and prices went through the roof. Japan takes more than a third of global gas imports.

As always happens in the mining industry, the high demand led to massive investment. Three consortiums, led by Santos, Origin Energy and Shell, set about building massive gas liquefaction plants on the central Queensland coast to supply

the Asian market and Japan in particular. They began drilling vast numbers of new wells to feed these plants.

“The gas price was then $15 to $20 a GJ,” Wood says. “Oil was then above $100 a barrel. The Australian companies signed long-term contracts on an oil-linked price.

“But by 2014-15-16, as these plants are coming online, the world is awash with gas and the oil price has collapsed to $50 or $60 and life for Origin and Santos became very difficult. Their share prices collapsed and have never recovered.”

Origin’s share price peaked just weeks after the tsunami at $18; this week, it was about $6.58. Santos peaked at $22 a share nine years ago. This week, they were trading around $3.60.

The timing of the LNG expansion was spectacularly bad. As *The Australian Financial Review* noted in December 2015: “Conceived in boom times, Queensland’s $80 billion natural gas export industry has been born in something scarily close to a bust.”

The write-downs of the value of the new assets began almost immediately.

Bruce Robertson, a gas specialist with the Institute for Energy Economics and Financial Analysis, takes up the story.

“So we’ve ended up with these three plants in Gladstone that are the highest cost plants on the globe,” he tells *The Saturday Paper*.

“What that means when we go into a downturn, as we have now – the contract price has fallen from roughly $US16 a gigajoule to $8 – they’re running at below the cost of production.”

Which is sad for them, but also sad for the country as whole, because they still have those long-term contracts to fulfil. And so they are sucking gas out of the domestic market to fill them.

“The east coast domestic market including South Australia, Victoria, Queensland and NSW is about 600 petajoules, which compares with about 1200 that they are shipping off overseas. The market is roughly one-third domestic, two-thirds export,” Robertson says.

“The plants are losing money in the export business. And they have to make money somewhere.”

Robertson reckons the gas suppliers are making that money by gouging Australian gas consumers.

“The constant narrative from the industry is that we are not paying international prices and that we should pay export parity,” he says. “Fair enough. Pick a market that we export to. We should be paying that price, less the costs of liquefying and transporting the gas.

“At present, gas from Gladstone is exported to Japan and the landed price is $A10.41. And at the moment, according to the ACCC and the Australian Industry Group, the price being offered to businesses here is $20.

“Or compare the price on the Henry Hub market – the benchmark market in the US – which is around $A3.38 a GJ. So we’ve got Japan on $10.41, the US on $3.38, and we are on $20. It’s a totally unacceptable situation. It’s going to send businesses broke. It’s feeding into electricity prices, which affects the whole economy.

“What we have here is an industry holding Australia to ransom. It’s using this leverage to try to open up new coal seam gas fields.”

And their leverage is working for them, too. Turnbull, eager to deflect blame, has taken to attacking the states for having listened to public opinion and imposing moratoriums on new fracking.

But the problem here, says Robertson, is not lack of gas: it’s lack of domestic supply. Where is the logic in responding to a global glut of gas by producing more gas? And even if we did, how much would that help?

He points to Santos’s controversial proposal to open up a new field near Narrabri in NSW.

“The wellhead cost according to the Australian Energy Market Operator would be $7.25, more than twice the price you can buy gas at in the US,” he says.

The situation we find ourselves in would be funny if it weren’t so serious. And there is no better indication of that than the recent suggestion by AGL that it is considering spending $300 million on an LNG import terminal.

The idea that Australia, which is soon to be the world’s largest exporter of gas, could have to import it for the domestic market is ludicrous, Robertson says. “This would be like building an oil import terminal in Saudi Arabia.”

To be fair to the Turnbull government, this problem is not of their making. Those export contracts and the vast expansion of the gas industry occurred long before they took office. The deals were done when the responsible federal minister was Labor’s Martin Ferguson, who, on leaving politics, slipped straight into highly paid work with the fossil fuel industry.

It’s also fair, though, to note that before the last federal election Labor announced that it would impose a national interest test on new gas developments if elected, with the aim of protecting domestic supplies. The Coalition and Martin Ferguson both savaged the idea.

And the government continued to savage the idea of a national interest test or a gas reservation policy right up to the point where Malcolm Turnbull threatened the big gas companies at last week’s crisis meeting.

Not that earlier intervention would have helped, boom mentalities being what they are. “My suspicion,” Tony Wood says, “is that if back in 2004-6 we had applied some kind of national interest test we would have concluded developing the facilities was in the national interest.”

Exactly how events play out from here is anyone’s guess. One thing appears certain, though: even if Turnbull’s strongarming of the industry succeeds in preventing price gouging and keeps the lights on over the next few years, gas will never be cheap again in Australia.

“The test I would apply would be export parity pricing,” Wood says. “I don’t think it will ever be $3 or $4 again. But it could be $6 to $8. And, logically, if the playing field is level for price, then Australian manufacturers should be able to compete.”

Whether the companies that bet tens of billions of dollars on LNG exports can compete is another question.

Ultimately, the laws of supply and demand will prevail. Globally, gas is in oversupply and demand is falling. The future is renewable energy, managed through better grids and storage, as Turnbull acknowledged last week when he announced the major expansion of the Snowy Mountains Hydro scheme.

And the future may be closer than many think. Research released last week by Professor Andrew Blakers, director of the Australian National University’s Centre for Sustainable Energy Systems, and his team concluded that by 2020 – just three years from now – wind and solar photovoltaic, supported by pumped hydro storage and linked by high-voltage interconnectors, will be “decisively cheaper than new coal or gas”.

And thereafter, there was simply no future for fossil fuels.

Blakers says Australia’s electricity market “could reach 100 per cent renewable electricity with high reliability and at zero net cost within a decade”.

No wonder the gas companies are gouging while they can. As to Partridge and his company, Brickworks: they no longer make political donations.

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