Tenure Matters

A column by Sue Slater, Senior Advisor Petroleum, RLMS

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Welcome back. So, unless you have had your head in the sand for the past few weeks, you will be well aware that we have a "gas crisis". Apparently this was news to some, even though the issue have been brewing for a long time. There are many reasons for the current state of affairs. These include the lack of a unified energy strategy across jurisdictions; a failure of gas-users to contract supply; the apparently inexorable increase in regulation and compliance for no added benefit (only increased cost and delay); the advent of moratoriums and bans on gas exploration in several jurisdictions; and untenable delays in granting acreage and other approvals in jurisdictions where there is no ban. Add to that the failure to collaborate on significant infrastructure developments for the LNG projects. This has added substantial cost to CSG-LNG projects, and resulted in a very large and hungry beast to feed, which is seen by many domestic users as the primary reason they have a gas supply problem.

Prior to the advent of the CSG-LNG projects, gas users on the eastern seaboard had enjoyed low gas prices for a long time. These prices increasingly did not represent the true cost of getting the gas out of the ground, and producers looked, not unreasonably, to increase the return on their exploration dollars and secure long-term contracts. The lure of LNG was too much to resist, linked to oil prices which were then high. Fast-forward a few years, with oil prices low, capital costs that ballooned, and increasing compliance and regulatory costs, and you might wonder on the outcome – but these are the vagaries of the market place.

Meanwhile domestic gas users held on to their belief that there would be surplus uncontracted gas available and prices would not significantly rise! Back in 2007, prices received for pipeline quality gas delivered to a transmission pipeline ranged from $2.40 and $3.50 per GJ, and spot sales in the order of $4-5 per GJ. In 2008, the lower end had disappeared, with pipeline quality gas ranging from $3.05 to $3.50 per GJ, and the spot market in the range of $5-6 per GJ. By 2009-2010, the price ranged between $4.00 and $4.10 per GJ[1]. Hindsight is, of course, a wonderful thing, but where was the critical analysis of the risks of not having a contracted gas supply by businesses that depend on gas?

[1] Figures from Eastern Australia Upstream Gas Report, prepared by RLMS; (Dec. 2007; January to June 2008; July 09-Jun10)

The graph below shows the alarming decline in drilling due 2010, and the increase in both industrial and residential gas prices over the same period.

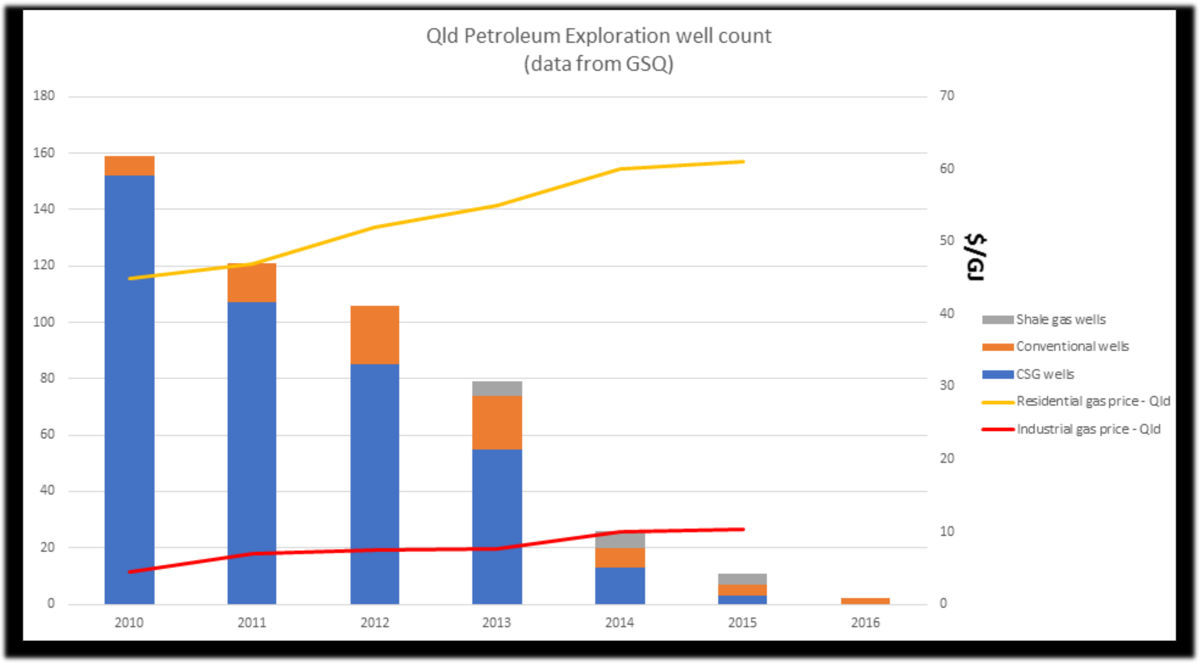


Figure 1 Queensland drilling and gas prices[2]

This situation has been a long time in the making, and cannot be fixed in the short-term. For domestic gas users without a contract, or whose contract will shortly expire; the availability of new gas to the market is going to be constrained. The confluence of several events has contributed to the situation, including, but perhaps not limited to:

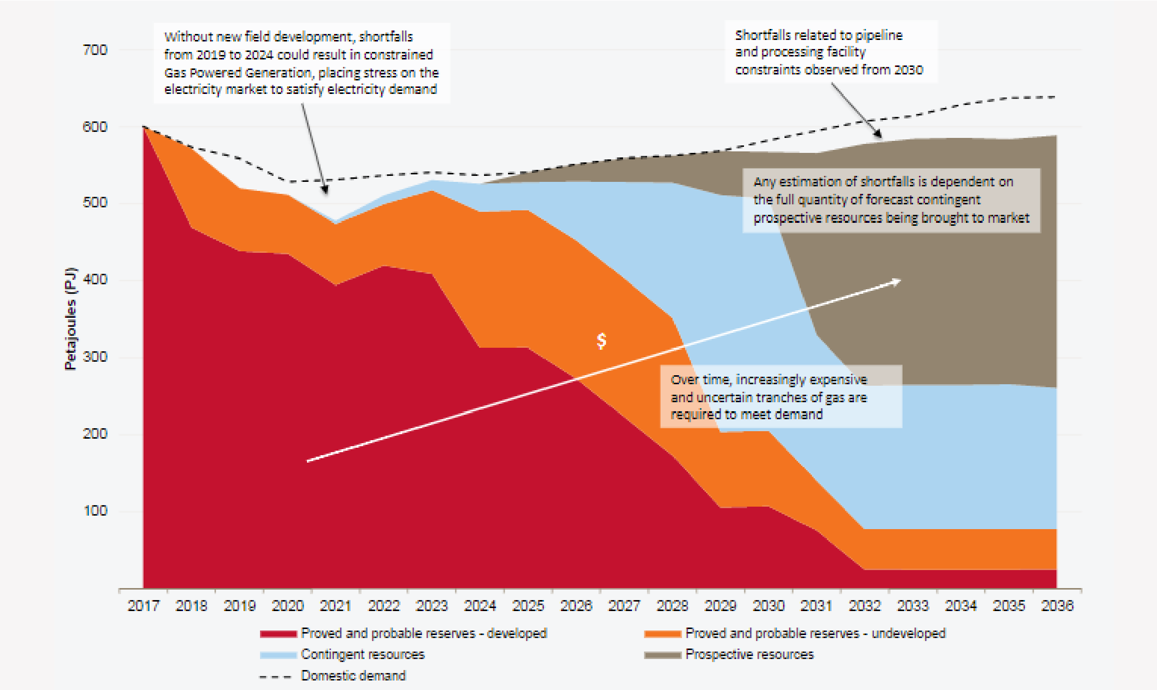
- a precipitous fall in oil price (now somewhat recovered to WTI Crude 47.83 at time of writing);
- the loss of access to capital or an unwillingness to commit capital; and
- an ever-changing regulatory environment that has seen moratoriums, bans, increased regulatory requirements, increased timeframes and increased compliance costs.

The Australian Energy Market Operator (AMEO) released its 2017 Gas Statement of Opportunities on March 9[3] which predicts a shortfall of gas-powered electricity generation (GPG) that would impact New South Wales, Victoria and South Australia by the 2018-2019 summer. The statement assesses the adequacy of gas infrastructure, reserves and resources to meet demand in eastern and south-eastern Australia to 2036. Not surprisingly, AEMO conclude that additional production will be required to meet the needs of GPG, residential, commercial and industrial gas users. The statement prompted a flurry of political activity, with the Prime Minister calling an urgent meeting of gas producers in its wake. Interestingly there are two key shortfalls identified, the earliest from 2019 resulting in constrained GPG if new field development does not occur; and later from 2030, shortfalls related to pipeline and processing facility constraints.

[2] Graph courtesy of John Phillips, Blue Energy Pty Ltd. Sources GSQ and Oakley Greenwood

[3] https://www.aemo.com.au/Media-Centre/2017-Gas-Statement-of-Opportunities-released

Figure 2 Eastern and south-eastern Australia domestic gas production (excluding LNG) 2017-2036[4]



Of course gas supplies will not be helped by the fact that several states have some form of moratorium or ban on either gas production and/or fraccing. Victoria has passed legislation to permanently ban onshore unconventional gas exploration, and extend the moratorium on conventional onshore gas exploration to June 30 2020. A moratorium, and yet another enquiry, on fraccing in the Northern Territory was announced in September 2016.

In South Australia the results of Round 1 of the PACE (Plan for Accelerating Exploration) Gas grant program were announced on 17 March together with the Round 2 release[5]. It must be demonstrated how the project will increase the gas available for South Australian gas users. The projects from Round 1 are:

- Senex-Santos Cooper Basin pipeline project;
- Beach Energy Otway Basin conventional reservoir exploration project;
- Santos Cooper Basin re-fracture stimulation project;
- Santos Cooper Basin underbalance drilling project; and
- the first phase of the Strike Energy Cooper Basin deep coal project.

Round 2 proposals for PACE funding close on 6 October 2017. This program was highlighted as part of South Australia's package of measures to address concerns about its energy security following its energy supply events of 2016.

Meanwhile in Western Australia, 6 blocks released in the Canning Basin and 8 blocks in the Officer Basin on 13 September 2016 with a closing date of 9 March 2017 failed to attract an application. The promised ban on hydraulic fracturing in the south-west of the State by the WA Labour Party, if it should win the State election held on 11 March, must have given at least some explorers reasons to consider whether to lodge a bid. Despite the fact that the blocks released were located far away

4 Source: AMEO https://www.aemo.com.au/Media-Centre/Media-Statement---Gas-development-required-to-meet-future-energy-demand
5 http://petroleum.statedevelopment.sa.gov.au/latest_updates/pace_gas

from the south-west of the State where such a ban would apply; the prospect of regulatory creep is not an insignificant issue, and one industry has seen before. The current economic, regulatory and social environment just does not seem to foster confidence within the industry.

Similarly the Commonwealth offshore acreage release of 12 work program areas attracted only one application and 11 of those blocks were re-released with a closing date of 23 March. The successful bid has now been issued as WA-527-P to 3D Oil.

So, despite a great deal of focus on making land available for exploration in various reports and enquiries, this alone cannot address or explain our exploration woes. Why is this so? There needs to be some critical evaluation of why areas fail to attract any interest: either:

- the acreage is less attractive; and/or
- the conditions attached to its grant too restrictive or difficult; and/or
- there is a lack of confidence in the stability of the regulatory and policy framework required to deliver long-term projects like exploration and hopefully, subsequent development.

Exploring for gas is a risky and expensive exercise, and the costs continue to skyrocket. Partly this can be attributed to the fact that we are now looking for gas in harder to find places – the easy targets have been found; but partly this is because the cost of compliance has increased to a huge extent. Increased compensation expectations also add to those costs. Gas explorers want to explore – but they can only bear so much. When they do find something they need to be able to recoup those costs by monetising their asset. This can be achieved by moving to a production tenure and becoming a producer of gas; or perhaps more simply, by selling the acreage. Tenure Matters has previously addressed the difficulty of bridging the gap between exploration/appraisal and production[6] and if anything the hurdle has got higher to jump in the meantime.

Back in January 2016[7] I took a look at the state of exploration in Queensland. The total area made available (both in terms of number and sub-blocks) since the land release system was introduced by the 2004 Act, has been very low since 2012 and the ATP areas offered were comparatively small. Unconventional petroleum resources will always struggle with economics when the areas made available are very small, unless several areas can be amalgamated, or relinquishments waived or delayed. I discussed the perilous state of exploration in Queensland during 2016 in the December 2016 issue of Tenure Matters[8]. But to recap briefly only two conventional petroleum exploration wells and no CSG exploration wells were drilled. Only three new ATPs were granted.

On the plus side in Queensland, three Potential Commercial Area applications, lodged in 2012 over ATP 771, were granted in February this year for 15 years. These form part of Senex Energy's Western Gas Project.

Then there is the release of PLR2016/17-1-C covering an area of 58km^2 or 19 sub-blocks, in the Surat Basin. The call for tenders opened on 10 February 2017, and will close on 20 April 2017. This block will have domestic gas supply conditions, and is the first time the Queensland Government has

[6] See Tenure Matters No. 17 https://www.rlms.com.au/wp-content/uploads/2015/08/13-Tenure-Matters_No17_July.pdf
[7] See Tenure Matters No 23 https://www.rlms.com.au/wp-content/uploads/2016/04/22-January-16-Tenure-Matters_No23.pdf
[8] See Tenure Matters No 31 https://www.rlms.com.au/wp-content/uploads/2016/12/32-Dec-16-Tenure-Matters_No31.pdf

utilised the provisions of sections 175A to 175I of the *Petroleum & Gas (Production & Safety) Act 2004*[9].

Time will tell how successful this process is and whether future similar land releases are made; but some of the government's expectations seem as if they would be difficult to achieve. This includes providing proof of lodgement to the Department of Environment and Heritage Protection (DEHP) of a site specific environmental authority (EA) application within 15 business days of being notified as the preferred tenderer. I can only assume that they are blissfully unaware of the complexity and detail required in a site specific EA. Then, before any activity can occur on the granted PL, DEHP requires a Plan of Operations to be lodged. Another, not inconsequential, plan required to be prepared and approved by a department other than DNRM. Given that there are no wells currently drilled in the area, two years from grant to get to production may be optimistic.

Meanwhile on 23 March 2017, Gas Vision 2050[10] was released. This was developed by Australia's peak gas industry bodies (includes Energy Networks Australia, APPEA, APGA, Gas Energy Australia and Gas Appliance Manufacturers Association of Australia). Whilst there does not seem to be anything fundamentally new in this document, it does demonstrate the importance of gas in our energy supply mix, and why it will remain important into the future. However, a vision requires action in order for that vision to be realised, and there are no action plans here[11]. The Queensland *Gas Supply and Demand Action Plan* has not yet been released.

I am happy to hear suggestions about topics you would like covered. Feel free to email me at sue.slater@rlms.com.au with the subject heading Tenure Matters.

In the meantime, remember "Tenures make the Project; the Project doesn't make the Tenures".

RLMS covers the project spectrum from planning through to State and Federal government approvals, including land access, compensation, environmental impact statements and work schedules for clients ranging from entrepreneurs to major corporations, from start-ups to government agencies, and state significant projects such as Queensland's LNG giants. Contact RLMS at:

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[9] See Tenure Matters no. 32 https://www.rlms.com.au/wp-content/uploads/2017/04/33-JanFeb-17-Tenure-Matters_No32.pdf
[10] http://apo.org.au/node/74764
[11] See Tenure Matters No. 30 https://www.rlms.com.au/wp-content/uploads/2016/11/31-Nov-16-Tenure-Matters_No30.pdf for previous discussion on this topic as well as Tenure Matters No. 18 https://www.rlms.com.au/wp-content/uploads/2015/09/15-August-15-Tenure-Matters_No18.pdf