

FINKEL REVIEW: GAS COULD BE THE TRANSITION FUEL IN THE MOVE TOWARDS A LOW EMISSION ENERGY MARKET

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Legal Briefings - By **Belinda Fan and Robert Merrick**

The Finkel Review confirms that gas could, and should, play a role in electricity generation in a low emission market. The report warned that tighter supply availability and higher gas prices may still stifle the role of gas-powered generation.

THE ROLE OF GAS-FIRED GENERATION IN THE NEM

The Finkel Review (the **Review**) examines the challenges faced by the National Electricity Market (**NEM**) and provides a wide ranging set of recommendations to overcome such challenges. It recommends a Clean Energy Target (**CET**) as well as a series of recommendations on ensuring reliability and security of the NEM. For a concise summary of the proposed CET and these other recommendations, refer to our previous articles.¹

The Finkel Review also devotes substantial attention to the role of gas as part of energy security. This, in itself, is significant. Gas powered generation comprised only 8 per cent of NEM in 2016.² However, gas security and the role of gas in power generation has been the focus of much media and government attention in recent months.

Several reflections in the Review are worth highlighting:

- There is an increasing interdependency between gas and electricity markets in supply

and price. As coal fire generators retire, gas-fired generators are likely to set the marginal cost of generation within the NEM, which will flow through as higher retail electricity prices.

- In the short to medium term, the NEM is likely to require higher levels of flexible gas-fired generation to maintain security and reliability. Gas-fired generation will be relied on to balance against intermittent renewables as some ageing coal-fired generators retire. In this regard, predictions of short term shortfall in supply for gas-fired generators are of concern.
- AEMO's Energy Supply Outlook (June 2017) indicates that supply and demand for gas fired generation remains finely balanced for 2017-18 but there is a possibility of shortfall of 17PJ (approximately 9% of demand).³
- The current market conditions are not conducive to gas-fired generators behaving as the bulwark for NEM's reliability and security. The Review cites the stark submission from AER that *"given the prevailing gas prices, most existing gas-fired generators cannot economically provide dispatchable power at current wholesale electricity prices. Alternatively, gas-fired generators run less often and seek to capture periodic price spikes."*
- In the long term, the role of gas-fired generators will depend on whether the higher gas prices and tighter supply availability will ease. The Review suggests that new technologies such as battery storage systems and pumped hydro technology may be more cost-effective in providing security and reliability in the NEM.
- Finally, while the Review is careful to recommend the CET as a technology neutral mechanism, the modelling used by the Review indicates that, in the long run, gas's role as a transition fuel may be minimal in a market which incorporates CET. In a CET scenario, the modelling showed gas-fired generation will reduce from the current 8% of total NEM generation to 5% in 2030 and 3% in 2050. In this scenario, the reduction in coal-fired generators appears to be mostly replaced by wind and solar generators.
- The Review's modelling assumes an emissions reduction target of 28% on 2005 levels by 2030. Presumably, gas' actual role in this transition would depend on the target set by the government (if CET is to be adopted).

GAS MARKET RECOMMENDATIONS

The Finkel Review recommends the following measures to ensure gas continues to play a role in electricity generation:

- **Improved efficiency of the gas market** – The Review supports the current COAG

Energy Council's reform measures to improve efficiency in gas supply and transportation markets, such as a new information disclosure and commercial arbitration framework for uncovered pipelines.

- **Improved technical efficiency** – The Review suggested that replacement of inefficient gas turbines with modern turbines may improve fuel costs and reduce emissions. A CET may implicitly encourage investments in upgrading existing gas-fired generators.

- **Ensure long term gas supply certainty**

- AEMO should have better industry data to better plan its response to shortage in the NEM. Gas-fired generators should provide AEMO with information on fuel resource adequacy and fuel supply contracts. Major gas producers and consumers should provide a rolling monthly forecast.
- AEMO should be given the power to direct the market during peak demand period, including a last resort power to procure or enter into commercial arrangements to have gas-fired generators available to maintain reliability of electricity supply in emergency situations.
- Gas industry performance data should be transparent, clear and accessible to the public. The COAG Energy Council should bring together relevant regulatory and scientific data on gas in an informative and easily accessible format to the public, this includes seismic activity, fracking fluid composition, aquifer purity and fugitive emissions.
- The Review urges the governments to avoid blanket restrictions and bans on gas projects and instead adopt evidence based regulatory regimes to manage the risk of individual gas projects on a case-by-case basis.
- Governments should produce an outline as to how they will ensure that landholders receive fair compensation for gas exploration and development.

IMPLICATIONS

- The Finkel Review recognises that, in the short to medium term, gas-fired generation

plays an important role in ensuring NEM's reliability and security, but the current market conditions (particularly the high gas price and tight supply) are not conducive to this role.

- The Finkel Review broadly supports the Australian government's recently proposed measures to address tightness in the east coast gas market, including certain interventionist measures to ensure supply reliability during peak demand or emergency scenarios. This will likely provide the additional impetus for the implementation of measures such as the Australian Domestic Gas Security Mechanism which gives the government powers to impose export controls on LNG projects when there is likely to be a shortfall in the domestic gas market. The Prime Minister announced on the 21 June 2017 that this mechanism will be put in place by 1 July 2017 and could potentially restrict gas export from 1 January 2018.
- The Review echoes the gas industry's calls for governments to adopt evidence based regulatory regimes to manage gas projects' risks, and avoid blanket restrictions and bans on gas projects. This is a view shared by the Commonwealth government, but ultimately the state and territory governments are the decision makers in respect of regulation of onshore gas.
- The Review seems to be ambivalent about the long term role of gas-fired generation in the NEM. It notes that even with the benefit of gas market reforms, domestic gas prices are likely to remain higher than historical levels in real terms. Therefore, other measures such as improving efficiency of gas-fired generation will be required to ensure gas can continue to play a role in electricity generation.
- The Coalition announced on the 21 June 2017 that the joint party room has agreed to endorse all of the Review's recommendations except the recommendation of a CET.⁴ Thus gas industry participants should expect the recommendations of the Review stated in this article to be progressed and have governmental support. Gas industry participants should begin to prepare for the additional disclosure obligations regarding fuel resource adequacy and gas industry performance data.
- At the same announcement, the Prime Minister flagged his intention to ask AEMO to advise on how to ensure adequate dispatchable power could be made available. Commentators suggest this foreshadows the introduction of a reverse auction in respect of dispatchable power which is removed from the NEM when, for example, coal-fired generators exit. Given the gas market issues identified in the Review, gas-fired generators' bids into such auction is unlikely to lower wholesale electricity price. However, such auction may encourage more innovative collaboration between gas-fired generators and variable renewable generators (wind and solar) to develop cost-effective and reliable blended fuel offerings.

ENDNOTES

1. [‘Finkel on the future: Australia to renew its energy policy and recharge investment with a Clean Energy Target’](#), 9 June 2017; [‘The Finkel Review: Beyond the Clean Energy Target’](#), 16 June 2017.
2. AER, State of the Energy Market, May 2017,
3. AEMO, Energy Supply Outlook, June 2017.
4. [Media Statement](#), Tuesday 20 June.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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