Light the way

TOGY talks to

Michael FRASER
Managing Director
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THE OIL & GAS YEAR: *Can you trace AGL Energy's origins from the company that supplied gas for the first public lighting in Sydney in 1841?*

MICHAEL FRASER: Originally known as The Australian Gas Light Company, AGL was the second company listed on the Australian Stock Exchange. We started out as a manufacturer of gas from coal and we did that for the best part of 150 years. We then converted Sydney to natural gas. Then, with the deregulation of energy markets and the privatisation of the electricity industry in Australia, we became a multi-utility company. We owned both gas and electricity network companies and high-pressure pipeline businesses, as well as retail. We were originally involved in the upstream oil and gas business back in the late 1980s and early 1990s. We sold out of it and then invested in electricity. In October 2006, we demerged our network businesses out of what is today AGL Energy, which is the country's largest gas and electricity retailer and has the largest privately owned and operated suite of renewable energy assets. We have a fairly wide range of interests in what we describe as the upstream sector including, coal seam gas and power generation across the whole range – hydroelectricity, wind, gas and coal.

TOGY: *What is the extent of your supply network and where are your primary markets?*

MF: We have approximately 3 million customer accounts. We used to have interests in Western Australia but now our prime markets are Queensland, New South Wales, Victoria and South Australia. We have the largest contracted portfolio of gas in the country with long-term contracts that run out as far as 2028. A couple of large contracts will fall away going into 2017 and we have been looking at the overall supply-demand balance. We do not need additional gas in the short term. As a company, we are positioning ourselves for the longer term and looking at a balance between what gas is available here in Australia and what gas may end up in export markets. Our long-term objective is to have a 50/50 supply where we are contracting half from third parties to supply our customer base and half from our own equity gas investments.

TOGY: *Do you foresee your outlook on domestic gas prices changing as LNG from coal seam gas projects becomes a reality and East Australia gas is subject to international pricing?*

MF: It is very interesting. Everybody has a view on gas prices. We are in a couple of formal arbitration processes at the moment and we've just renegotiated some of our contracts. My view over the next four to five years is that the gas price won't really go anywhere in a hurry. When you look at the supply and demand balance, the international linkage between the region's gas resources and the LNG market will probably create an uplift in prices over the longer term. The proposed Emissions Trading Scheme would also create increased demand for gas-fired generation, will put pressure on the supply side and lift up prices. But the mandatory renewable target for Australia's retail companies will push back the need for base load gas generation. So the real question you have to ask is how much of this gas sitting on the East Coast is going to find its way into an LNG market. I think the jury is still out.

TOGY: *What is the status of your coal seam gas investment in the Galilee Basin, how do you plan to commercialise this asset?*

MF: It is early days for us in the Galilee Basin, and for the moment we are trying to get through the approvals in relation to what we should do with the water from those wells. The whole coal seam gas industry is facing that issue at the moment. Once we have that cleared, we will get on with the exploration programme and then ultimately, depending on the size of the resource that we find there, we will make a decision on how it is commercialised. That decision will be based on

Australia's largest gas and electricity retailer has assumed a leadership role through a robust portfolio of coal seam gas interests and the country's largest suite of renewable energy assets. AGL Energy was Australia's first company to trade carbon, which could prove a strategic advantage as the country prepares to introduce its first Emissions Trading Scheme. ■

AGL's Torrens Island power station uses natural gas to produce 1,280 MW of electricity

what provides us the highest return on our investment, which could be gas into our domestic base, it could be power generation or it could probably be into some of these LNG projects – it really just depends.

TOGY: *AGL Energy was the first Australian company to join the Chicago Climate Exchange. Why do you place such emissions restrictions on yourself when you are not obligated?*

MF: Because I think you have to be very forward looking as to what is happening, and Australia is not unique. Whilst Prime Minister Kevin Rudd would argue that we are trying to be at the forefront of environmental reform, the reality is that the whole world is already looking at the climate change issue, which means emissions trading, energy efficiency and renewables. To us, it is quite clear this that is where the world is going. We want to be out there to understand how those markets are operating elsewhere in the world and be able to apply that to the Australian market. We were the first Australian company to trade carbon, which will apply when the government introduces its new scheme. We have two core products in our portfolio: gas and electricity. Five or six years from now, carbon will also be one of the key products that we are trading.

TOGY: *Approximately 40 percent of your power generation portfolio is from renewables. How do you stimulate interest from international investors in AGL Energy's assets?*

MF: It is interesting because the structure of the Australian scheme is very different than that of Europe, which has feed-in tariffs. In Europe, if you have a renewable project, you can go and develop that project, hook it into the transmission system and get paid for the electricity you produce. There is a subsidy effectively built into these feed-in tariffs. The way the scheme operates in Australia is that retailers have to purchase renewables certificates and surrender them to the federal government. Under that system, electricity retailers play an absolutely key role because they make a decision either to write a cheque to underwrite other people's projects that they have developed or they can go and develop their own. That is an interesting dynamic for international investors because they have to be prepared to make very substantial investments without the benefit of a long-term contract. They do not have any certainty beyond 2030, when the scheme is supposed to run out. International investors have to be prepared to take the merchant risk.

TOGY: *What are the opportunities for solar power in Australia and how do they compare with other renewables you are already investing in?*

MF: They are coming into the mix of technologies that can and are being implemented to satisfy the federal government's mandatory renewable targets. We are currently constructing a 140-MW hydro plant in Victoria that will be commissioned at the end of 2009. That is the largest hydro project built in more than two decades in mainland Australia. Wind power is also on firm economic ground. There are a lot of small-scale photovoltaic solar installations with feed-in tariffs on domestic rooftops. It does not actually make a lot of economic sense, but the government's policy is encouraging solar panels through multiple levels of subsidy. The federal government has also just recently announced budget funding for some large-scale solar thermal projects, so it is effectively going to try and force the investment. But as things stand right now, the costs of solar energy are well above what other renewable technologies offer.

TOGY: *In the next five years, what kind of balance will you try to strike between renewables and traditional hydrocarbons?*

MF: At the end of the day, there is no shortage of opportunities for us. The reality for us is to get the government and regulatory policy settings right to encourage investment. The next issue will be how we fund all the growth that lies ahead of us in the next decade. In the whole renewables arena, about A$25 billion-35 billion ($20 billion-28 billion) needs to be invested across the sector between now and 2020 to satisfy the government's policy targets. That is a significant opportunity, and a challenge. In addition, there will be huge demand for conventional gas-fired generation, particularly peaking gas plants. The potential privatisation of the New South Wales government's energy retail businesses should create a lot of opportunity.

TOGY: *Do you foresee expanding your customer base outside of Australia?*

MF: We sold out our interest in Papua New Guinea in 2008 and we also sold our interests in Chile. We have so many opportunities sitting right here in this country that it would not make sense for us to look offshore. In Australia, we are fortunate to have a range of competitive advantages that position us very well for the future. ■