



**Gas Marketing &
Commercialization**

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25th June 2010

Timothy Hughes, Principal Research Officer
Legislative Assembly Committee Office
Level 1, 11 Harvest Terrace
West Perth WA 6005

Dear Mr Hughes,

Economics and Industry Standing Committee's Inquiry into Domestic Gas Prices

I am the Sales Representative for the Gorgon Domgas Project.

As the Sales Representative, I would like to lodge the attached public submission in respect of the above inquiry.

My contact details are:

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Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Sorensen'.

Chris Sorensen
Gorgon Domgas Marketing
Sales Representative

Marketed by **Chevron (TAPL)**
as Sales Representative for the
Gorgon Project domestic gas sellers



GORGON SUBMISSION TO THE ECONOMICS AND INDUSTRY STANDING COMMITTEE – INQUIRY INTO DOMESTIC GAS PRICES

Introduction

1. The Gorgon Gas Project is an unincorporated joint venture (**Gorgon Project**) between a number of companies, including companies within the Chevron, Shell and ExxonMobil group (**Gorgon Sellers**).¹ It is a major new greenfields gas development in Western Australia, and is the largest resources project in Australia to date. The domestic gas (**domgas**) component of the Gorgon Project will, when full capacity is reached, supply an additional 300 terajoules per day (**TJ/day**) of domgas to the Western Australian market.
2. The Gorgon Sellers welcome the opportunity to provide a submission to the Economics and Industry Standing Committee's 'Inquiry into Domestic Gas Prices', in order to:
 - (a) explain what factors the Gorgon Sellers consider drive domgas wholesale prices in Western Australia;
 - (b) clarify why certain comparisons raised in the Inquiry's terms of reference are not relevant to assessing domgas wholesale prices in Western Australia; and
 - (c) offer their insights, as future domgas suppliers, on what changes to the industry would be capable of delivering material benefits to the Western Australian domgas market.

Overview of the Gorgon Project²

3. The Gorgon Project involves the development of a number of gas fields located between 130km and 200km off the northwest coast of Western Australia. These fields have an estimated total recoverable resource in excess of 40 trillion cubic feet of natural gas.
4. The Gorgon Project involves the development of both offshore and onshore infrastructure to recover and transport gas from the fields to Barrow Island for processing into liquefied natural gas (**LNG**) for export, and dry natural gas of pipeline quality for delivery to customers in Western Australia i.e. domgas.
5. The Gorgon Project joint venture participants entered into an agreement with the State of Western Australia³ under which they have agreed, among other things, to an obligation to reserve a certain amount of natural gas, develop a domgas plant capable

¹ Tokyo Gas Gorgon Pty Ltd, Osaka Gas Gorgon Pty Ltd and Chubu Electric Power Gorgon Pty Ltd hold equity interests in the Gorgon Project.

² For further information, see section 2 of the submission in support of the Gorgon authorisation application, available on the ACCC website at:

<http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D09+50029.pdf&trimFileTitle=D09+50029.pdf&trimFileFromVersionId=901112> (**First Gorgon ACCC submission**).

³ The Gorgon Gas Processing and Infrastructure Project Agreement dated 9 September 2003.

of delivering up to 300 TJ/day, and undertake marketing of such domgas (**State Agreement**).

6. In addition to bringing a major new source of domgas to Western Australia, the Gorgon Project will also deliver substantial economic and employment benefits to the State.⁴

Domgas prices in Western Australia

7. The most significant drivers for wholesale prices for domgas in Western Australia are the levels of supply and demand, and the costs involved in supply.
8. In terms of supply, Concept Economics prepared a report for the Gorgon Sellers which provided an overview of, among other things, historic and future pricing trends in Western Australian wholesale domgas.⁵ In this report, Concept Economics relevantly found that:
- the Western Australian domgas market has historically been oversupplied;
 - however, as at 2008 (when the report was prepared), existing producers had fully contracted their developed reserves and in the medium to longer term there is a growing demand for new and replacement contracts. This trend has been compounded by instances of supply shortfalls;
 - the historical availability of excess domgas sold at low prices and the absence of a transparent price signal had acted as a disincentive in relation to the development of new gas fields;
 - as a result, the wholesale price for domgas has increased above historic levels.⁶
9. Two producers currently account for approximately 96% of the total supply of domgas to Western Australia. These are:
- the NWS Venture, operated by Woodside Petroleum, which supplies approximately 63% of domgas to Western Australia; and
 - the Harriet and John Brookes joint ventures, both operated by Apache Energy, which supply approximately 33% of Western Australia's domgas.
10. By the time the Gorgon Sellers anticipate supplying domgas to Western Australia pursuant to their State Agreement obligations (2015), however, industry forecasts suggest that there will be at least six significant joint venture projects supplying domgas into Western Australia.⁷

⁴ These benefits are detailed in a report prepared for the Gorgon Sellers by ACILTasman, *Gorgon domgas marketing: Assessment of the economic value of delays in achieving full capacity*, July 2009. Available on the ACCC website at: <http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D09+83592.pdf&trimFileTitle=D09+83592.pdf&trimFileFromVersionId=901112>

⁵ Concept Economics Report, *Marketing of Natural Gas in the Western Australian Domestic Gas Market*, 1 December 2008. Available on the ACCC website at: <http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D09+50033.pdf&trimFileTitle=D09+50033.pdf&trimFileFromVersionId=901112> (**Concept Economics Report**).

⁶ Concept Economics Report, pp.9-11.

⁷ For further details, see [7.20]-[7.22] of the First Gorgon ACCC submission.

11. The addition of the very significant new source of domgas supply in Western Australia by the Gorgon Project has been facilitated by the recent authorisation granted by the Australian Competition and Consumer Commission (**ACCC**) to the Gorgon Sellers to engage in the joint marketing of domgas.⁸
12. Notably, in its authorisation determination the ACCC found that 'the price of domgas in WA is likely to be more significantly influenced by the overall volume of gas supply rather than whether that gas is jointly or separately marketed'.⁹ The ACCC also found that joint marketing by the Gorgon Sellers 'is likely to deliver a public benefit by facilitating a greater amount of domgas supplied from the Gorgon project'.¹⁰ Indeed, the ACCC observed that joint marketing by the Gorgon Sellers was unlikely to lead to higher prices, and may in fact lead to lower prices, compared to separate marketing.¹¹
13. Accordingly, given the current structure of the Western Australian market means separate marketing of domgas is not feasible, joint marketing has served to facilitate new projects being commissioned and this increased supply, which the ACCC recognises is the most likely way of encouraging competition and lower prices.
14. In terms of levels of demand, three main industries drive demand for domgas in Western Australia: manufacturing (processing/conversion of raw materials), mining (extraction of minerals/ore) and power generation.
15. Domgas consumption is dominated by a small number of very large customers, with the six largest customers estimated to account for over 90% of WA domgas consumption. Supply to these customers is contract-based, with customers securing supply under long-term arrangements. This customer profile means that there is a 'lumpy' demand profile in which there are limited time-windows in which suppliers are able to secure large customer contracts.¹²
16. In terms of the cost of supply, in the experience of the Gorgon Project the supply of domgas to the Western Australian market involves substantial costs relating to the domgas plant, pipeline and associated upstream and gas processing infrastructure. These costs have increased significantly since the development of the Gorgon Project was initiated, and the State Agreement signed in 2003.
17. The very high costs involved in developing the Gorgon Project reflect a number of inherent complexities, including:
 - the gas fields being deepwater fields;

⁸ ACCC, *Determination in respect of applications for authorisation lodged by Chevron, Mobil and Shell in respect of the joint marketing and sale of natural gas from the Gorgon Project for supply in Western Australia*, Authorisation no. A91139, A91140, A91160 and A91161, 5 November 2009 (**ACCC Final Determination**). Available on the ACCC website at: <http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D09+180600.pdf&trimFileTitle=D09+180600.pdf&trimFileFromVersionId=901112>

⁹ ACCC Final Determination, at [7.144].

¹⁰ ACCC Final Determination, at [7.144].

¹¹ ACCC Final Determination, at [7.161].

¹² For further details, see [7.23] – [7.29] of the First Gorgon ACCC submission.

- the high CO₂ content and other impurities in the hydrocarbons in the Gorgon field, which will be extracted at the main processing facility and reinjected underground (into a saltwater aquifer) in what will be the biggest geosequestration project in the world to date;
 - the development of the gas processing facility on Barrow Island pursuant to extremely strict environmental conditions given the designation of Barrow Island as a 'Class A' nature reserve;¹³ and
 - the construction of undersea pipelines from the gas fields to Barrow Island, and from Barrow Island to the mainland.
18. The Gorgon Sellers note that their experience is consistent with the findings regarding expected cost trends in the Concept Economics Report. The Concept Economics Report found that, in recent years, exploration and development costs have increased dramatically and they are expected to remain high, noting in particular:
- infrastructure pricing trends;
 - environmental compliance costs;
 - cost increases resulting from new natural gas supplies having to be produced from fields that are located further offshore.¹⁴
19. These factors - of historically low prices for domgas and excess capacity acting to limit new sources of supply (but with a number of new sources expected to come online from 2011), concentrated and lumpy demand, and increased costs of supply – are the key drivers of wholesale domgas prices in Western Australia. The Gorgon Sellers therefore submit that these are the factors which the Inquiry should be focused upon in order to assess Western Australian domgas prices.

Comparisons with other markets

20. In order to assess the competitive impact of joint marketing by the Gorgon Project in its recent authorisation determination, the ACCC noted that the first step was to 'consider the relevant market affected by that conduct.'¹⁵ The ACCC decided that the relevant market was 'the wholesale supply of domgas in WA or the south west region of the State.'¹⁶
21. In confining the product and geographic dimension of the relevant market in this way, the ACCC observed that:

¹³ Barrow Island is reserved under the *Conservation and Land Management Act 1984* (WA) as a Class A nature reserve for the purposes of 'Conservation of Flora and Fauna'.

¹⁴ See Concept Economics Report, at [2.4.2]

¹⁵ ACCC Final Determination, at [7.3].

¹⁶ ACCC Final Determination, at [7.10].

...there are currently no pipelines enabling domgas supply either to or from the Eastern States. In addition, there exists no facilities in WA that would enable the importation of LNG that could then be subsequently regasified for supply in WA.¹⁷

22. Accordingly the ACCC - an independent, specialist competition body with decades of detailed industry information and expertise at its disposal - determined that in order to assess the impact of joint marketing by the Gorgon Project on competition, including prices, it should confine its focus to the wholesale supply of domgas in Western Australia.
23. The Gorgon Sellers submit that the Inquiry should similarly focus upon domgas in Western Australia, as looking to other markets with different products and/or geographic boundaries (which will have different levels of supply and demand and costs of supply) will be of no relevance to assessing Western Australian domgas prices.
24. While the Gorgon Sellers' preference is to separately market domgas (as noted in their submissions to the ACCC), the decision to jointly market domgas while separately marketing LNG from the Gorgon Project reflects that different markets have significantly different characteristics which limit the relevance of comparisons. Most significantly, in contrast to the domgas market in Western Australia, the global LNG market has a large and diverse mix of suppliers and customers around the world, and involves a material number of short term and spot sales for LNG which provide transparency for demand and pricing and lead to a greater ability to settle imbalances.

Measures that could be implemented to reduce the price of gas in Western Australia

25. The ACCC's recent authorisation of joint marketing of domgas by the Gorgon Project has facilitated the addition of a major new source of domgas for Western Australia, with the ACCC recognising that in light of the current structure of the Western Australian domgas market, it is the introduction of additional sources of supply which will produce the greatest benefits for competition, rather than the manner in which domgas is marketed.¹⁸
26. Further, as noted above, when the Gorgon Project is expected to commence domgas supply, it is estimated that there will be six significant joint venture projects supplying domgas into Western Australia. This is a substantial increase to the historical supply position in Western Australia, where there were only two sources for the vast majority of domgas supply.
27. The Gorgon Sellers consider that increased intervention aimed at reserving more gas to the Western Australian domgas market is unwarranted. Further, intervention of this nature does risk dampening investment in Western Australian gas projects, ultimately leading to less gas being available for Western Australian consumers and industry, with flow on effects for domgas prices.
28. The Gorgon Sellers consider that any initiatives to reduce the price of domgas in Western Australia should be focused upon increasing supply, including by way of the

¹⁷ ACCC Final Determination, at [7.6].

¹⁸ ACCC Final Determination, at [7.160].

development of market features that facilitate gas supply. This would include developments leading to increased access to flexible gas transportation and investment in increased storage capacity. Notably, the Gorgon Sellers support the development of a Gas Bulletin Board and the Gas Statement of Opportunities for Western Australia as recommended by the Gas Supply and Emergency Management Committee Report to Government of September 2009,¹⁹ albeit noting that these initiatives alone are insufficient to significantly alter the market.

29. Initiatives designed to develop market features that facilitate gas supply would benefit all industry participants – producers, transporters, and large and small Western Australian domgas customers alike.

Chris Sorenson
CHRIS D. SORENSON
MARKETING MANAGER

¹⁹ Available online at: <http://www.energy.wa.gov.au/cproot/1574/2/GSEMC%20Report%20to%20Government.pdf>