ECONOMICS AND INDUSTRY STANDING COMMITTEE

THE COMPILATION OF THE GAS STATEMENT OF OPPORTUNITIES FOR WESTERN AUSTRALIA

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
WEDNESDAY, 24 AUGUST 2016

Members

Mr I.C. Blayney (Chair)
Mr F.M. Logan (Deputy Chair)
Mr P.C. Tinley
Mr J. Norberger
Mr T.K. Waldron

Hearing commenced at 10.30 am

Mr MATTHEW JUSTIN BROWN
Executive Director, DomGas Alliance, examined:

Mr TIMOTHY LANGMEAD
Director, External Relations, Fortescue Metals Group Ltd, examined:

The CHAIR: On behalf of the Economics and Industry Standing Committee, I would like to thank you for your appearance before us today. The purpose of this hearing is to assist the committee in gathering information in relation to the compilation of the gas statement of opportunities for Western Australia. At this stage I would like to introduce myself and the other members of the committee present today. I am Ian Blayney, the chair. With me is the deputy chair, Fran Logan; Jan Norberger; and Terry Waldron. The Economics and Industry Standing Committee is a committee of the Legislative Assembly of the Parliament of Western Australia. This hearing is a formal procedure of the Parliament and therefore commands the same respect as given to the proceedings in the house itself. Even though the committee is not asking witnesses to provide evidence on oath or affirmation, it is important that you understand that any deliberate misleading of the committee may be regarded as a contempt of Parliament. This is a public hearing and Hansard is making a transcript of the proceedings for the public record. If you refer to any documents during your evidence, it would assist Hansard if you could provide the full title for the record.

Before we proceed to the inquiry-specific questions we have for you today, I need to ask you the following. Have you completed the "Details of Witness" form?

The Witnesses: Yes.

The CHAIR: Do you understand the notes at the bottom of the form about giving evidence to a parliamentary committee?

The Witnesses: Yes.

The CHAIR: Did you receive and read the information for witnesses sheet provided with the "Details of Witness" form today?

The Witnesses: Yes.

The CHAIR: Thank you for appearing today. We have some questions to ask you but before we get to them would you like to make a brief opening statement?

Mr Brown: Thank you, Mr Chair. The DomGas Alliance represents major users of gas in Western Australia—companies that provide thousands of jobs, help generate economic growth and support regional development in our state. The alliance welcomes the opportunity to address the committee and thanks the committee for its longstanding interest in issues relating to the production and supply of gas in Western Australia. Our state's economy is heavily reliant on natural gas as an energy source. Perhaps even more importantly, the future growth of our state's economy, the diversification of our industry and the creation of jobs in the post–mining boom era are all dependent on our ability to secure a fair share of our natural gas resources for the domestic market. In short, there can be no jobs and growth without a reliable and affordable energy source.

In its 2011 inquiry into domestic gas prices, this committee considered a number of measures that could assist in improving the transparency of the domestic gas market in Western Australia. The committee concluded that —

> The establishment of a Gas Market Bulletin Board and Gas Statement of Opportunities (GSOO) is likely to enhance the efficient operation of the Western Australian wholesale gas market.

The committee also urged the government of the day to expedite the introduction of these tools. The first gas statement of opportunities, or GSOO, was published in July 2013 with the most recent version being published in November 2015. The DomGas Alliance has challenged the conclusions of the various GSOOs and remains concerned that the latest GSOO does not reflect what is happening in the market. We have also taken note of public statements by respected market analysts Wood Mackenzie in relation to the outlook for domestic gas supply. While the latest GSOO predicts that supply will be between 10 and 45 per cent above demand over the forecast period, Wood Mackenzie has estimated a dramatic domestic gas shortfall of around 150 terajoules a day from 2022. The Wood Mackenzie assessment first became public in December last year, prompting the alliance to write to the committee on this issue. Earlier this month Wood Mackenzie restated its assessment in response to the announcement of a spot gas purchasing agreement between Synergy and Woodside. The Wood Mackenzie spokesman said —

> “We’re not changing our base case forecast, which is still that there is going to be a supply–demand gap from the early to mid-2020s.

Therefore there is a serious discrepancy between the official GSOO outlook and the views being put forward by independent market analysts. As the DomGas Alliance noted in our correspondence to the committee earlier this year, the clear danger here is that if the government is making energy policy decisions based on the GSOO outlook, there is a serious possibility it will be making the wrong decisions. The consequences of this for domestic industry in Western Australia are potentially disastrous. I would note that there are already some signs of complacency in some sections of the government in relation to domestic gas supply and that complacency could be attributed to the overly optimistic outlook of the GSOO. In its deliberations on this issue, the DomGas Alliance would ask that the committee is mindful of the purpose of setting up the GSOO process in the first place. The Gas Services Information Act 2012 specifically states that —

> The objectives of the GBB —

The gas bulletin board —

> and GSOO are to promote the long term interests of consumers of natural gas …

It is highly questionable that the GSOO in its current form provides a discernible benefit for consumers of natural gas. To the contrary, if the GSOO is overstating the supply outlook, it is doing a disservice to gas consumers and the state.

Our correspondence to the committee sought to raise three key areas of concern for consideration: what are the powers available to the IMO in compiling the GSOO; how have these powers been exercised to date and have they been exercised effectively, particularly in relation to gathering data from producers; and are any additional powers required to ensure a more accurate picture of future supply?

Can I preface our comments today by saying that this request to the committee and our views on this matter are not intended to reflect negatively on the former IMO, AEMO or any individual public servant. It would appear to us that the Gas Services Information Regulations and rules provide sufficient scope to AEMO, or previously the IMO, to secure the information it requires to compile the GSOO. The regulations provide AEMO with the power to derive information required for the GSOO while also placing an obligation on participants to provide the information requested. Penalties can be enforced for noncompliance. Questions must therefore be raised about the effectiveness of the way the powers have been used to date and if further powers are required.

There are a number of concerns or question marks over the contents of the GSOO from our perspective. These include the forecasted price expectations and whether they reflect what the market is experiencing. We have no visibility on how these estimates are arrived at. Second is the usefulness of reporting nominal production capacity and the prominence in which it is reported and the potential for this reporting to provide a false expectation that excess capacity can translate into excess supply. Third is the use of the method of “willingness to supply” at various price points for assessing future supply and whether this provides a misleading level of assurance, particularly when some LNG producers have clearly noted they will not accept anything below LNG netback for their product. Under domestic gas reservation agreements, producers have an obligation to market, not an obligation to supply. Fourth is at what level the data and information provided by producers is signed off at. Fifth is whether or how data and estimates provided by producers are tested by AEMO—for example, by examination of forward production plans, including field development plans lodged with NOPSEMA that contain detailed data on field depletion and development resource scheduling. Finally, how the domestic obligations of newer projects such as Pluto will be taken into account and at what price points.

In summary, the DomGas Alliance is supportive of measures that can help improve the transparency and efficiency of the domestic gas market. The GSOO needs to be a robust and credible document. We must therefore be confident that the processes that produce the GSOO are robust and credible. We have serious concerns that the GSOO in its current form is not really providing any greater transparency around future supply and, even more worryingly, may be fuelling a false sense of complacency amongst policymakers in the state.

Sorry, that was a little bit long. Can I add too that Mr Dominic Rodwell from CITIC Pacific is a late apology, regrettably.

The CHAIR: Tim, do you have comments as well?

[10.40 am]

Mr Langmead: Thank you, Mr Chairman. No, I simply echo and endorse Matt’s comments and, if I may, I could just give a quick summary of Fortescue’s interest in this issue in that we are a very large energy user—in fact, we consider ourselves to be in the energy business; we are just short of energy and we need to procure it. We are looking at an annual energy bill of around half a billion dollars just in the operations of our mines, our railway and our port. That is probably double when you consider the use of bunker oils in the shipping fleet, which, again, we do not own that fleet—we certainly do pay for the energy cost in that fleet. So, we certainly consider ourselves to be in the energy business.

We are a company that is a relatively new entry into the WA business community if you consider that we only started shipping iron ore in 2008. We now employ directly and through contractors about 9 000 Western Australians and of that about 1 100 Aboriginal people. We spend about $3.5 billion to $4 billion a year at current operational status in the Western Australian economy. So about 97 per cent of our expenditure is Australian domiciled expenditure and, in addition, we contribute about $813 million a year in state and federal taxation. Our direct PAYG withholding from our employees is another $166 million on top of that. Included in that $800-odd million figure is about $454 million in just state royalties alone. So as a company we are certainly contributing—and these are FY 16 figures.

Just in summary, we are very much in the energy business. It is critical to us to continue to put downward pressure on our costs as a business. We see the energy space as really important to doing that, but it is also part of our approach to our environmental responsibilities. So just to give you an example, the ability to displace the use of diesel at the Solomon mine for stationary power generation for the first full year in FY 16; that saved about 102 million litres of diesel consumption, which, when we used gas instead of diesel, represented a total carbon abatement of about 35 000 tonnes of CO_2 equivalent. The use of gas in our fuel mix is something that we aspire to increase and we certainly share and endorse the views of the DomGas Alliance in terms of the utility of the report, the GSOO, as it currently stands.

Mr F.M. LOGAN: Thanks, Tim and Matt. Can I just kick it off with maybe a very simple question first of all: what is the current market price for gas, so my colleagues here have got some understanding of what the price is today?

Mr Brown: I do not know that we have got a great deal of transparency around —

Mr Langmead: Look, it depends if you are talking about a spot price today—and I have not checked the spot price today—but just to give you an idea, I guess what we are looking for is more longer term contract gas.

Mr F.M. LOGAN: Tim, what could you contract gas at? Let us just say if you were to step into the marketplace, what could you contract gas at now?

Mr Langmead: You certainly cannot contract gas at the spot. I mean, the spot sales have been around $3. I am not sure what it is today, but, let us say, between $3 and $4 is potentially where the spot price has been. But you certainly cannot contract gas for that. I guess from a commercial prospective, we are not particularly keen to disclose our contract pricing, but I guess I could say that we would be looking at—there is rapid escalation over the forward curve, if you like. If you are looking at contracting gas for five years, then you are looking at a starting price in the first year of, say, at least a 50 to 70 per cent premium to current spot prices and then you are looking at very aggressive increases in those prices over the forward years. They are certainly greater than CPI in the initial years and then they may come back to CPI.

Mr J. NORBERGER: Tim, how do those prices relate to the LNG netback cost? Are they at, below, higher?

Mr Langmead: We do not have any —

Mr J. NORBERGER: You do not have to give me a figure but, you know —

Mr Langmead: I am not sure we have any transparency as to what is the LNG netback price. I mean, from time to time various people have talked publicly about their LNG netback price, but my understanding is that it is a bit like a C1 cost in mining; it is a moveable thing. I do not think we have any transparency as to what the moving LNG netback price might be. So, I do not think that is something that we can speculate on. Matt might have further —

Mr Brown: The GSOO has a chart in its appendices which has the LNG netback price as of August last year as being around $10. We have been pretty constant around that. The GSOO's predictions going forward have it at around $10 and rising.

Mr J. NORBERGER: It is an interesting point that you raise, Matt. You made mention that the current regulations or requirements on the producers means that they have to market the gas, but they do not have to sell—or supply, I should say. Assuming the netback cost was $10—because in that same statement you said that the producers have generally said that they have no interest in selling at below netback—why would they be selling it on the spot market even for $4 now or $5 now if in theory they could be liquefying it and getting a higher price? Having said that, why would they even market it for $4?

Mr Brown: A good question. In terms of the public comments, Woodside is on the record, publicly, as saying from their domestic gas obligation that they would expect LNG netback and nothing short of it. Now, the international prices have been coming down, but we do note that as recently as two or three weeks back articles saying that the Woodside Pluto project was being operated above its template capacity or nameplate capacity. So, quite clearly, they have still got a strong market internationally. Now, I think what the GSOO picks up on is when they are assessing supply, they make the assumption that producers will not supply in below LNG netback. I think what, potentially, history shows—certainly, this committee looked at it in 2011—is that there have been occasions where gas has been offered above LNG netback prices.

So I think we have got a situation where—and this is a point of view as opposed to an empirical fact—but the impression of our members is that the major LNG producers have little interest in supplying the domestic market. We are, for want of a better term, a nuisance that they have to put up with. I think Mr Waldron's parliamentary colleague Mr Grylls has focused his mind on this issue recently in terms of the point you raise—the domestic gas agreements between the state. First, there is not a lot of visibility around them apart from the Barrow Island Act; second, there are plenty of outs for the producers in terms of they are required to diligently market it, and your interpretation of "diligently market" and their interpretation and our interpretation may be completely different. If they cannot market it in, then they can seek an exemption—or if they cannot get the price that they want, they can seek an exemption and off it goes. I think Mr Grylls is turning his mind then to, well, how do we resolve that situation. We have certainly been supportive of his efforts to find a resolution there.

[10.50 am]

The CHAIR: Can I just follow that up a bit. Are you saying that they, if it is 15 per cent—is it not—the North West Shelf requirement is 15 per cent?

Mr Brown: The policy states that new LNG projects are required to make available 15 per cent, and then it says that they have to diligently market.

The CHAIR: It is not like there is a block of 15 per cent of their production that has to be put into the domestic market.

Mr J. NORBERGER: It just has to be made available.

The CHAIR: And yet they grizzle about it so diligently.

Mr Langmead: Can I just make it comment, Mr Chair, in relation to this netback pricing issue. When you look at the domestic gas market, it is quite complex in terms of the players. You have players who are not in the LNG business, who are solely focused on the provision of domestic gas. In our view, the focus on LNG netback pricing is a bit dangerous, in that it does focus on a notional cost of production that is imposed on that market by a different industry—an LNG industry, not a domestic gas industry. When you do the analysis of suppliers like, say the Devil Creek gas plant or the Macedon gas plant, they are 100 per cent domestic gas projects and they have no capacity to supply LNG. They are not interested in LNG. They got into this business because it was an attractive business to them to supply domestic gas. Obviously, we do not know their businesses, but from understanding the capital that has been deployed and from understanding a range of other factors, it is possible to do some modelling. Deloitte previously did some modelling for Fortescue on these questions and effectively they established that Devil Creek was the highest marginal cost domestic gas producer. If you were to instead of focusing on LNG netback pricing you were to focus on a cost curve, similar to how we look at the iron ore business, and you looked at where is the cost of production, on that curve the highest marginal cost producer will be the producer that effectively goes out of business first if demand falls below where they sit on the production axis.

Mr J. NORBERGER: You said that is Devil Creek?

Mr Langmead: That is Devil Creek. It is not the North West Shelf. It is not other suppliers. It is Devil Creek. That is looking at it from a cost-plus-12-per-cent-IRR basis. That is not even looking at it from the basis of what their breakeven is before they go out the business—which is what we commonly do in the iron ore interest—that is looking at it from the perspective of what is a reasonable return on business suffice to keep them in business. The 12 per cent IRR is a figure that the COAG ministerial council sets as being an economic test for retention leases.

Mr J. NORBERGER: Tim, does that not then make the argument that if you buy gas from an LNG producer at LNG netback, you are still getting a good price, because if you were getting it from Devil Creek, in theory, from a dedicated domestic gas provider, you would be paying more?

Mr Langmead: Our view is because they are the highest marginal cost producer—this Deloitte report is two years old—the cost of production should have decreased, because bear in mind that they are using their own energy to produce this energy, and the cost of that energy has declined. Their highest cost is going to be energy as much as ours is. They were at $A7.20 per gigajoule on the Deloitte report, which we made public, and so they should set the market, not the LNG netback price was the contention that effectively Deloitte was making. Now, we just do not see that happening. If it was a competitive market with truly abundant and competitive supply, then that project would be effectively the highest marginal cost producer that sets a price, not this $10 LNG netback price, which is a construct.

Mr F.M. LOGAN: Tim, you know historically that that construct came about as a result of opportunities that were grabbed during and after the Varanus Island issue—that is how it came about.

Mr J. NORBERGER: One of the key arguments—sorry, I thought you were finished; my apologies.

Mr F.M. LOGAN: The point I am making is that in one of your statements in the paper is a reference back to the North West Shelf consortium, who, as we know, used to market their gas conjointly, has now after much complaint by various agencies and governments from around the country, decided to market it themselves. Has that provided more availability of gas? Has it changed the attitude of the upstream international majors about their sort of driving-it-back pricing? Or is it that despite the fact that they have said that they are going to make themselves available to market gas individually, nothing has actually changed?

Mr Brown: I will let Tim answer for FMG, but certainly the feedback other members of the alliance is that it was expected—I think it has been predicted in the GSOO—that it would generate a lot more competition, but that has not really been seen yet. To put it in the words of one of our members, "They're hardly beating our doors down to offer us gas."

Mr Langmead: I would not add to that much, other than to say that there has been quite a lag between that decision and this actually taking effect. I guess when there have been internal processes involving the partners having to come to various agreements between themselves as to how they would act that has taken up a significant amount of time. I would suggest that we may only just be at the point now where they are actually giving effect to that. The one observation that I would make is that we do not see that as necessarily increasing the supply. It is a positive in the sense that some of those individual entities do appear to take a different attitude to the marketing effort.

Mr F.M. LOGAN: I do apologise, because I have to go. One of the concerns that certainly I have, and I know it is shared with my colleagues, is that as a result of our investigations, not only into looking at domestic gas, but also the FLNG inquiries, which looked at the overall oil and gas industry in Western Australia, whilst GSOO looked at demand and supply for availability of gas in the domestic market, and AEMO does the same in the eastern states—that is not to say they have got it well and truly right, because if you look at the situation in the eastern states, as I said, it is an absolute disaster; particularly, going forward, it is a real disaster for New South Wales and Victoria—the concern we have as legislators, whether in government or possibly in government, is that if for example FMG was to reach agreement with a Chinese company to move beyond mining of iron ore to then go into processing and steel production, that is a large volume of gas and GSOO, or even AEMO, cannot predict that, and we would not expect them to want to predict that, but they are not flexible enough to be able to allow the nation state or that state to say, "We have a massive opportunity for major employment in the north west and growth of domestic industry, but we can't get hold of energy at all." They cannot get the volumes of energy that they need and it is not flexible enough for us to be able to demand it. Would you see that as a critical issue? It is a sovereign issue for Western Australia and Australia, and these market structures do not provide the flexibility for state or national governments to be able to respond.

[11.00 am]

Mr Brown: I will let Tim answer for himself. But the first point you made about New South Wales and Victoria being a mess—we tend to overlook the fact that Queensland is not much better for domestic gas. Despite thousands of stakeholder agreements and thousands of wells drilled, the domestic industry in Queensland is facing closure because the gas is being sucked out through LNG. I do not know that you can really blame AEMO for that situation, but certainly back in 2013 or 2014, AEMO on the east coast actually did compile a report and it did point to demand destruction, particularly in Queensland. Sorry, it was the April 2015 report. They pointed to fact that the supply–demand gap would not be as great. That was supposedly good news, but when you read into the detail, the supply–demand gap was not going to be so great because industry was closing down because they could not afford the gas. To take that into a Western Australian context, one of the weaknesses we see in the GSOO is that it does not look at demand destruction. You are talking about new business opportunities; we are talking about existing industry. The way I read the GSOO and the way it is presented is that gas prices will continue to rise and supply will come in because of those gas prices and demand will stay solid and also rise slowly. There has to come a point, particularly with some of our members, whereby if a gas price hits a certain point, do they continue their operations? Now, there is nothing in this GSOO which would say to government, "Hey, look, we've got a looming crisis. If gas prices keep hitting these price points, X number of companies maybe gone, X numbers of jobs may be gone." That then allows government to make decisions about whether the market is operating in an efficient way to deliver what the community wants from its gas resources.

Mr F.M. LOGAN: And that is on existing industry; that is not taking into account—the point I am making is that the opportunities should be available.

Mr J. NORBERGER: It is a complicated issue and we are not trying to oversimplify it. We have just said that basically the dedicated gas producers are able to produce gas profitably at a 12 per cent internal rate of return at below the netback price, yet the Queensland example is basically saying that industries are going out of business because they cannot afford the gas that is being offered to them. Why are we not seeing dedicated gas producers entering the market? Market forces would dictate that there is a massive profit that they could have, because they are capable of undercutting the LNG producers at a good profit. Market forces would dictate that there is an opportunity and they would pop up. Is the fact that we are forcing—well, we are not in Queensland, but part of the argument from industry sometimes is because we are forcing a fixed amount of the supply onto the market here, it actually acts as a disincentive for companies to come along and set up dedicated domestic gas operations.

Mr Brown: I always challenge that point when it is put forward by some domestically focused operators. I know Santos has made that argument in the past. Yes, we have a domestic gas reservation policy and it requires 15 per cent of that gas to be marketed into the market, but we have Woodside and others saying that they are not going to accept the low LNG netback. If you are a domestically focused producer and you are willing to compete on price and you are willing to come in at LNG netback, you should be able to sell your gas. This notion that we cannot invest because we do not know what Woodside is going to do—Woodside has said on the public record, they have told their shareholders, "We will not sell below LNG netback. We are not interested in the domestic market."

Mr J. NORBERGER: Why are not they coming? It is not a trick question.

Mr Langmead: Can I add to that? I guess that comes to the nub of exactly what the committee is examining in my view, which is this statement of opportunities, at present, contains very little opportunity in it; in fact, that is a bit of a misnomer. At the moment, we would see it as a very rosy outlook, which, as Matt has pointed out, is completely out of step with some very credible analysis and credible recent analysis by Wood Mackenzie. That does two things, in my view. It creates complacency on the one hand, but on the other hand it says to those other businesses and their financiers, “Well, why would we finance you into this business when the IMO or the AEMO says it is going to be oversupplied?”

Mr J. NORBERGER: The issue is, I suppose—and I have learnt something new today—I actually thought they were forced to supply. If that was the case, I think the GSOO’s report on supply is almost completely unnecessary, because it is not actually supply; it is a report on the ability to market. You said that they could be price makers, not price takers, so they could say however many gigajoules are marketed. If they said, “We won’t sell it for less than $100 a gigajoule” or whatever it is, you will not sell a single molecule, because no-one is going to take it. I agree with you; that counterargument makes no sense to Santos. It should not matter how much these companies are forced to market. If we know they are not going to sell at anything less than netback or thereabouts, if I was a Santos, in theory, I would still feel comfortable, “Look, no, I can make a decent return and even maybe a little bit more above it.” I am not saying that is your fault; it is just perplexing to me that we seem to have that disconnect in the supply.

Mr T.K. WALDRON: You have expressed your concern about the GSOOs prepared so far and that they do not accurately represent what has happened in the market. You mentioned the Wood Mackenzie report. Were there other reasons that you arrived at that? How did you actually arrive at that decision that it is not represented properly? Have you expressed those concerns, who have you expressed those concerns to and what have you got back from expressing those concerns?

Mr Brown: Broadly speaking, our members are trying to contract gas all the time, so when they see a report like the GSOO and it says, “Well, there is heaps of gas out there”—I make it very clear I am not a spokesman for Alcoa, but let us take Alcoa as a hypothetical example. If they are having trouble securing long-term gas for their plant and then suddenly a government report lands and an analyst in New York is saying to Alcoa’s parent company, “Well, look there’s plenty of gas in Western Australia”, there is a disconnect between what Alcoa is seeing when they go and have the discussions and what the GSOO is saying. It might be because people have misinterpreted the obligation to market as being an obligation to supply. It might be that the analysts in that particular case are saying, “Well, look, the market is awash with gas; it should be relatively cheap.” If the market was awash with gas, you would expect prices to come down, but that is not the experience that our members have had. Look, we have raised with, formerly, the IMO, and there is also a consultative board —

Mr T.K. WALDRON: Have they come back to you?

Mr Brown: My previous discussions with the IMO have not secured a great deal of joy. I would acknowledge—and it is remiss of me to not have done it in the opening statement—AEMO took over the function of the IMO at the end of last year. To its credit, AEMO have set up a stakeholder consultative forum, which will then lead into the next preparation of the GSOO. Whether that will materially affect it or not, they should be given some credit for reaching out.

Mr T.K. WALDRON: Are you saying that could address some of those issues?

Mr Brown: It is a forum that to this point in time is largely dominated by the producer side of the equation, but I do not want the inference to be that AEMO are just not listening. We have concerns with this. They clearly stand by their document. I did put that question to them in one of the earlier consultations: do you actually have confidence in this? They still think that it is a robust and credible document. My query, particularly given why we raise this with the committee, is Wood Mackenzie are used throughout the industry. They are actually used by IMO and AEMO, so they are a credible source; you cannot knock them. They have come out and said that there will be a 10 to 15 per cent supply–demand gap by 2022, at the same time that AEMO’s document is saying we will be swimming in gas. My question on that would be: why have AEMO not sat down with Wood Mackenzie and said, “Well, guys, how have we come up with this discrepancy?”

[11.10 am]

Mr T.K. WALDRON: And that has not happened; they have not done that?

Mr Brown: To my knowledge, no, it has not. I am sure you will be talking to AEMO and you will be able to ask them. This statement has been on the public record for nine months. I would have thought the first port of call would be saying, “This is a serious discrepancy. Have we got it wrong? Have you got it wrong? Are you measuring different things?”

Mr T.K. WALDRON: Just really briefly, Mr Chair, when you were saying that if government takes decisions on what the GSOOs are saying, there could be some serious consequences, what were you talking about there? I know that is “could be”, so I am not going to hold you to it.

Mr Brown: Again, this is a personal observation in, obviously, my role as the executive director. I have found that, in dealing with government, government is supportive of the domestic gas reservation, which Mr Logan was dealing with. It was a Labor-introduced policy.

The CHAIR: You have got Mr Tinley here.

Mr Brown: Mr Tinley is here; I am sorry.

Mr P.C. TINLEY: I am concerned that you do not naturally find me in that!

Mr Brown: Now you have made me lose my train of thought!

Mr T.K. WALDRON: You talked about consequences.

Mr Brown: Government has a good attitude towards the broader problem, but I have sensed over the last 12 to 18 months, particularly since the new agreement for the North West Shelf was signed, which we have to acknowledge is a significant drop in the level of supply that will be coming from that, there is an air of complacency within sections of the bureaucracy and parts of the government —

Mr T.K. WALDRON: Because of the GSOO?

Mr Brown: We have got this GSOO report. The market is going to be 40 per cent oversupply. There is a whole range of other issues we need to deal with and we are going to focus our effort here.

The CHAIR: To get it in *Hansard*, I will say that Mr Tinley has joined us.

Mr J. NORBERGER: Let us assume that Wood Mackenzie’s projections are correct and let us say that the next GSOO were to reflect that and we suddenly find ourselves in a position where we are predicting an undersupply—I think 2020 to 2022 or that period. In one part, you would be happy because the report is now reflecting what you believe the reality to be. The other part, of course, is then we have still got the issue that if that is the case, we have got an impending undersupply. What is DomGas’s view of what the solution to that would be?

Mr Brown: The first step is to get your data and your information to be robust and credible, and, as I said, we have some concerns around the way the document is put together and the result it comes up with. If we have got a shortage appearing in 2022, then it allows government to make some decisions around how to deal with that, and that may be around re-looking at the domestic gas reservation policy and saying, “Is it meeting the requirements?” It may be that government then sits down and says, “Well, we’ve done as much as we can on domestic gas reservation. Maybe it’s time to start thinking about moving beyond that. What can we do to further encourage domestically focused producers to come into the market? Is there something that is actually preventing them from doing so? What can we do as a government? Are there incentives? Is there red tape that we can clear there?" But to have a document that says, "Look, there's no problem", to us, is not sustainable and it is not going to lead to good policy.

Mr Langmead: I have nothing to add to that.

Mr P.C. TINLEY: At the risk of potentially repeating something, the Treasurer has already identified in the first GSOO statement the wild nature of the assumptions of that first one last year.

Mr Brown: July 2013 was the first one.

Mr P.C. TINLEY: Yes, that is right. My concern is there is something fundamentally awry here, as you have identified. People are not operating on the same assumptions. Let us face it: the majority of this is informed by the assumptions that you accept or you reject. What representations with the minister have you had and are you confident that you are going to get a remedy for it?

Mr Brown: In terms of the compilation of the document, the first one was July 2013. There have now been four GSOOs and, hopefully, one of the things that this committee can do is look at the process which delivers this. The first GSOO is going to be a best guess, if you like. They are going to be learning as they go along. The second one you would like to think would be closer to the mark. The third and fourth should have a system down pat. Now, it is important to understand what that system is. We could be wrong, but our sense is that there is a "Let's sit down with producers and let's have a discussion about what they are prepared to bring into the market and at what levels." The question we would have is: after four GSOOs, surely there must be some sort of more rigorous, robust process which sets down perhaps at a set time each year a list of questions—a database, if you like—that gathers the information from the producers and then can be tracked year after year. The regulations give AEMO significant powers to ask producers whatever AEMO wants to ask to get the information. It does say that they have to put it in writing and that if it is in writing, they can specify a date. Anecdotally, we have had it put to us that producers sometimes will provide the absolute bare minimum, that they will be pedantic about the information that they provide, that potentially when, previously, IMO, but I suppose now AEMO, have sought clarification, at times the time line has not allowed for that clarification to be received and included and that potentially information has not been received in a timely manner. I have had a look through the GSOO reports. I have never seen anything which actually lists that these companies were requested information and we sought clarification but it was not provided at the time. There is no tracking as to whether producers are complying. To my view, there is no tracking as to whether producers are complying. So question 1 is: are you getting the right information in a timely manner? Question 2 is: does the process allow for that information to be tested?

Mr P.C. TINLEY: I suppose the corollary to that is: is it comparable year on year? If you are not doing the same measurement in the same year in the same time frame with the same inputs and the same assumptions, you are always going to get a distortion.

Mr Brown: The information that you are seeking from the producers should not really change in terms of what you are asking them.

Mr P.C. TINLEY: Yes, but are you seeking it from all the producers at the same time and at the same point in the cycle or different producers at different points?

Mr Brown: You are doing a yearly report and you are seeking information from the market.

Mr T.K. WALDRON: Do they need more powers to get that information?

Mr Brown: Perhaps that is a question for them. I am not a lawyer and I do not think Tim is either, but I have read the regs and I have read the rules. They can pretty much ask for whatever they want. The producers cannot rely on commercial-in-confidence to deny the information. There is an obligation put on AEMO, as the compiler of the report, to reasonably protect confidential information, but they can ask and they should be able to receive it. If the request is in writing, it is enforceable. AEMO can specify what data it wants and by what date it wants it; and, if it is not provided, then they have options to —

Mr T.K. WALDRON: So they have got the power now, but they might not be using that.

Mr Brown: Yes. That is certainly one thing. To give you a quick example, for the Pluto gas project there is a domestic gas agreement which is a confidential exchange of letters between government and Woodside. We know broadly what the terms of it are because Woodside have acknowledged publicly and the Premier, I think, has put it on the record in the Parliament. The domestic gas obligation for Pluto kicks in five years after its first LNG shipment, which would be next year, or after 30 million tonnes of LNG export, which, according to their production —

[11.20 am]

The CHAIR: Is that whichever comes first?

Mr Brown: Well, according to the public statements by Woodside, it is whichever comes first. According to the correspondence we have had from the Premier that "whichever comes first" is not specified. We have actually got some correspondence in with the Premier at the moment seeking a bit of clarity around that. But, even if it is the latter, the 30 million tonnes, that should be maybe 2018 or 2019 at the latest. Clearly, that should be part of this. Now, IMO or EMO have got the power to say to Woodside, "When do you see your obligation beginning, and how much are you going to be supplying then?" My point is I do not think the question has been asked, because the latest GSOO just says "We have not been able to get information." Hang on, "The IMO has not received further advice on the timing of any domestic gas supply from Pluto LNG." You think, "Well, why not?" You have got all this power under the rules and regulations, surely, if the question has been asked —

The CHAIR: Do you think the rules are adequate?

Mr Brown: Look, my reading of them, yes, they are adequate. The question that I raise is —

Mr P.C. TINLEY: Are they being used?

Mr Brown: — are they being effectively —

The CHAIR: If you saw it as inaccurate, you would say it is because they are not using the rules that area available to them.

Mr Brown: I think the question is: are they effectively using it? Again, we do not sit in on those discussions, but the sense we have is that it is: sit around the table, let us have a discussion with Woodside or with Chevron and let us have a discussion about what has happened. Now, there may be levels that underpin that, but I think we need to understand how are they gathering the information? Are they getting it in a timely manner? If they are not getting it in a timely manner, why is it not being acknowledged in the report, even as a disclaimer to say, "Look, company X was not able to provide the information by a particular date."

The CHAIR: Are there any of the rules that you would like to see amended?

Mr Brown: The rules that relate to the GSOO, I do not think—this is my reading—I did not think needed to be looked at because I thought, and I still do, they provide adequate powers. I mean, the rules quite clearly specify the function of AEMO to gather the information. The rules talk about what the GSOO must contain. One suggestion in terms of the contents of the GSOO, it does say in the rules under section 104 it must contain information about demand for natural gas. Whether we need some clarity around that to talk about some of the things we talked about in terms of demand destruction or demand opportunities at various price points, that may be a useful thing. But in terms of giving AEMO the powers to actually compile the report, I cannot see that there is anything further that they would need.

Mr J. NORBERGER: I have two quick questions. I had better do the official one that the chairman wants me to ask, first, otherwise I will be in trouble. Is there any information that is not currently in the GSOO that the DomGas Alliance believes should be included; and, if so, what other information do you believe should be included and how would it be obtained?

Mr Brown: I think we have just mentioned a couple in terms of demand destruction. As I said, AEMO on the east coast for the eastern and south eastern market—what was that date? April 2015—were able to produce a report which clearly identified that, particularly in Queensland, industry closure would result in a drop in demand, and that industry-put closure was predicted on the basis of higher gas prices. I think it would be useful for the Parliament, as policy makers, to have that sort of information.

Mr Langmead: Can I just add to that as well? The other aspect of that is the unmet latent demand, so that is something that is not transparently dealt with. It is possible to understand in any given year what the total use of diesel fuel is in the Western Australian economy for stationary power generation. These are figures collected by the federal government by the Australian Bureau of Agricultural and Resource Economics and Sciences. From that, you are able to make some assumptions about what is latent demand, effectively, for fuel switching. If you look at our case, clearly it is preferable to be generating stationary power using gas, because it is more cost effective and it is better from an environmental point of view. When Deloitte had a look at this for us, they took a conservative view that if you assume only 10 per cent of that latent demand switches each year, it would result in an annual compounding increase in demand for domestic natural gas of 7.4 per cent. Now, that blows out of the water any projection of future gas supply, and that is not any new jobs; that is just satisfying latent demand and replacing imported diesel.

Mr P.C. TINLEY: But, Tim, that, to me, is an interesting contention. There are two parts to it. That is, therefore, assumption based; the assumption has to be supported by some form of evidence that that conversion from diesel to gas, for example, is real. So, you can assume 10 per cent, you can assume 50 per cent or five per cent conversion, but the evidence is around how much has that actually occurred. But, then, the second point of that for me is if in making that assumption you also have to make a statement or commentary the opportunity cost or that as an incentive for people to convert that discussion on power generation. So, how much of the GSOO or the process, probably more generally, is of itself constraining people or enterprises moving to a better form of fuel?

Mr Langmead: Yes, it is interesting. At the moment, based on the most recent GSOO, you would think that you should see a massive increase in fuel switching. Now, it is not occurring, and why not?

Mr P.C. TINLEY: They do not believe it.

Mr Langmead: Is the gas there, or is it not? They do talk about field switching; they do make some assumptions. They assume a very low rate or none in the current market.

Mr Brown: Could I just add one other thing, which I think would be useful to re-include in the GSOO. Earlier versions of the GSOO included a list of potential projects, which could be gas users. Now, that subsequently dropped out of more recent versions. I think the reason given is that the companies do not like their names listed there if their projects are not ready to go.

Mr P.C. TINLEY: But then you could aggregate that, could you not?

Mr Brown: I would not even think you would have to aggregate it. I think it would be useful for the Parliament and the policy makers to have a list of potential projects which could be going ahead in Western Australia if gas was there and —

Mr J. NORBERGER: But the danger with that, Matt, is that once you start including assumptions on demand, you also need to include assumptions on supply. So, then, you could say that there are all these projects, all these gas fields, that could be developed. And then you are kind of going from a document that is trying to be quite, you know, focused on realties.

Mr Brown: Just to clarify, IMO and EMO have a process where, I think, in the latest one there were 65 potential projects and I think they only included five, so they have got a process of weeding out which they think are the most likely to go ahead. What I am saying is not include it in the demand assumption or the demand modelling, but just to say: well, look, here are all of these projects which potentially could be using gas into the future. That then gives the Parliament or the community an idea that if we use our gas resources wisely, how many of these projects could be coming on stream?

Mr T.K. WALDRON: In compiling GSOO, if they were using commercially and sensitive data from suppliers and users that would create, I think, some anxiety amongst those parties. Are you confident that if that info was included could that be included without prejudicing the suppliers and gas users and their commercial arrangements? If they had the information, would that give them the ability to put out better GSOOs, if you like?

[11.30 am]

Mr Brown: Again, my reading of the rules and regulations is that they can ask for anything they want. The companies under, I think, regulation 13 cannot say, "No, this is confidential, we can't do it."

Mr T.K. WALDRON: But if that happened would it purchase anything?

Mr Brown: They provide it to AEMO and AEMO has a responsibility under the act to make reasonable measures to stop the unauthorised release of that information. They would be aggregating, they would not be saying in their report, "Woodside are going to be charging this much." They would aggregate it.

Mr T.K. WALDRON: I see. But they can use that information without —

Mr Brown: Yes.

Mr T.K. WALDRON: And you think that they can do that now if they wanted to?

Mr Brown: I am sure that is what they would say their current report uses. They would not split out a Woodside or a Shell or a Chevron. They would —

Mr J. NORBERGER: In some way we are getting to the original legislation. My understanding is, as the name implies, that it gets reservations, reserving it for the market, but it does not imply a requirement for a particular price point. We are always heading to that point where it would seem that the desire of the domestic gas community would be that the price is also somehow influenced, because we are saying that we do not know how much they are selling it for. At the end of the day, I agree that there is a bit of a grey area around—what was the term? Was it prudent efforts or diligent efforts or whatever it is to market? But I agree that the data should be reasonably easy to produce. It is a percentage value of their output. They can show, "Look, we have gone and made this available for whatever portal it is, but you know what, the price that we want to sell it at is X, Y, Z." Part of your argument was that they should not be selling it that high. Does the domestic gas user want, first, a fixed supply or a minimum guaranteed supply, which is a gas reservation, but also then to start dictating price?

Mr Brown: I think that our preferred option would be to have the market sorted out. I think most of the companies in the alliance would say if there is a way of avoiding government intervention in the market, then that is the option you take. However, we are faced with a situation where the hands-off approach quite clearly is not working. I think one of the points that Mr Grylls made is that the community actually thinks that this gas is coming into the state, and it is not. I think the community is going to be a little bit put off by the fact that Western Australian gas is not being used to fuel Western Australian industry. At a philosophical level, the Western Australian community needs to make a decision about what it wants from its gas resources. The Australian people own the gas resource. Do we want simply to suck it out of the ground and export it as quickly as we can? If that is what we want and you ask the question, “Is the market working?”, well, yes, the market is working. If the community says, “We’d like to use some of this to build local industry and diversify our industrial base and develop regional communities and create jobs”, then ask the question, “Is the market working?”, well, no, the market is not working because the gas is not coming in and it is not coming in at a price.

Mr J. NORBERGER: It is not coming in at a price that the market would like. I do not think anyone has actually ever said that the companies are not meeting their obligations in making the gas available. I have not heard any accusation that anyone is in breach of not marketing the gas that they are supposed to make available. What we are saying is that not everyone is willing to pay the price that they want to sell it at. You are saying that with certain industries, if we are going to see that diversification, it will only happen if that gas is sold at a discount rate, which then leads to the philosophical argument of whether we should pause and take that next step. Not only do we want you to make 15 per cent available but you do not have the choice of marketing it. You will make it available. It will be sold one way or the other, which of course would instantly—and you could even say it would be a half of this. You could potentially do all of that, but that is a significant policy shift from where we are at at the moment.

Mr Brown: I see your point. About one-third of the world’s gas is sold at regulated prices. Regulated prices are not unusual in the gas industry. In terms of wanting the gas to come in at a price that can be afforded, I think this is where the GSOO can play a role in identifying at what point do we start seeing demand destruction, because then the community can focus its mind on, “Do we want to take that next step?” or “Well, this gas needs to come into the market regardless.” It has never been the DomGas Alliance’s first point of attack, if you like, that prices should be regulated. We have always wanted the market sorted out and producers to do the right thing. I think some of the work that FMG had done with Deloitte also indicated that, and we are mindful of the fact that having that LNG domestic link can create some problems. There is nothing we would like more than to move beyond that, but the domestic reservation has to stay as our safety net until a better opportunity comes up.

Mr P.C. TINLEY: I will just follow on from that, because this is the nub of the issue, really. If there is market failure, even though it has got its own structured, and some would say confected market, for better or worse, regulations frame this market. That is not unusual. Governments frame markets every day of the week. The extent to which they participate in the market by interventions or various other levers varies. The fundamental point you are saying is that if the market cannot sort it out, the government needs to fix the price. The ERA does that to a large extent on tier 3 rail, for example. My question is: have you looked at some of these things? If it did go to that sort of point, how do you see it expressing itself? Is it in an ERA model where we put a ceiling and a floor, or what would that look like?

Mr Brown: We have not gone down that path at this stage in terms of doing detailed work. Certainly from Mr Grylls’ public comments, it seems to be an area that he is thinking about. He has spoken with us broadly about it. Without giving away anything in confidence, he put a range of options on the table to us and I think our members are in the process of going back to their various organisations and running it past them so that we can then come to which parts are we prepared to support and which parts we cannot support. To me, that is the next step. The purpose of this inquiry, I hope, is to get the information that says to us, “Look, by 2022 if Wood Mackenzie is right, we have got a problem and now’s the time to be doing something about it.” When Labor introduced the policy in 2006, it was not there to fix the 2006 problem; it was there to fix the problem into the future. In that policy they actually said, “The problems we are facing here are going to emerge on the east coast eventually. The east coast did not listen and, as Mr Logan said earlier, they are now in a complete mess. Unless we have got the quality information, there is no need for government to act at all. With this report, the Premier, the Treasurer and the Leader of the Opposition can sit down and say, “There’s no need for us to even talk about this. There’s 40 per cent oversupply of gas. Why are we even wasting our time on it?” That is what we have got to get to the nub of: why?

Mr P.C. TINLEY: So here is the problem. One of the problems here is that the GSOO is inaccurate. It has been not a contributor to a positive policy outcome.

Mr Brown: That is our view.

Mr P.C. TINLEY: So if that is the case, there is something around, as we have talked about here, that the GSOO is not delivering for us in terms of a position from which we can at least start looking at the signals we might send to the market as a government. Would you say that there are not enough consequences for the inaccuracies of the contributions of producing, particularly to the GSOO, to ensure that they enforce the philosophy that underpins it?

Mr Brown: To be honest, I do not know the answer to that question. I think that is something you will have to direct to AEMO. It is important to understand the process, though. If it is collegial—let us have a chat and let us have a sit down and discuss what you think—and the rules and potential penalties are not enforced, then, clearly, I think we have a problem. After four GSOOs, we should have a pretty robust price point.

Mr P.C. TINLEY: It has not worked.

[11.40 am]

Mr J. NORBERGER: The more fundamental question is: if the GSOO is inaccurate, what is the source of that inaccuracy? By that I mean, the GSOO derives its information literally from the horse’s mouth; that is, there is no middleman; it is the producers providing the information. Now, we do not necessarily know where Wood Mackenzie, in this example, gets its information from. They may not have that firsthand information, so they may actually be the ones that are looking at other sources or what is publicly available—assumptions, forecasting, different—do you know what I mean? Because, if we are saying the GSOO is inaccurate, and there is only one source of that information—that is, from the producers—are we saying that the producers are deliberately misleading government, which is a fairly strong accusation?

Mr Brown: I think it would be a fair question to ask, but again I would come back to: What are the processes around it? Is the right information being given? As I said, to me, it strikes me as odd that someone could produce a gas statement of opportunities and have Wood Mackenzie, who the IMO and AEMO use, come out and publicly question it. As far as I am aware, there has been no interaction between the two to resolve—well, maybe Wood Mackenzie are assessing it on a different basis. Maybe GSOO does have better access to information, but the discrepancy is such, it is not a small margin.

Mr P.C. TINLEY: It is not a statistical anomaly.

Mr Langmead: Can I just make one point? It goes back two questions ago to your point about pricing and pricing aspiration. The point I would make is you have currently got a situation where the people with market power in this market are the producers and the producers have set their aspiration for pricing at LNG netback pricing. That is an arbitrary construct that bears no relationship to the actual economics of supplying domestic gas. The highest marginal cost producer of domestic gas—we would contest and supported by work from Deloitte—is at a very much lower point than the LNG netback construct, so who has the market power and who is setting the price? They are relevant considerations. Our view is that what we would like to see is a truly competitive market where the price is set by the market. Here you have a market where the price is being set by producers.

Mr J. NORBERGER: But, Tim, just because someone asks a price does not mean that is what they get. As to what was suggested, are you saying you want the market to determine the price? The market is determining the price at the moment. We ascertained early on that we do not always have the visibility around that, but obviously gas molecules are being sold, contracted either spot or long term. Whether it is at the LNG netback or not, you indicated sometimes it is possible they might even be going for higher, which means that the supply or the demand is such that someone is willing to pay higher than netback. It is no different if I want to sell my house and it is worth half a million and I ask a million, you could turn around and say, “How dare Jan ask a million.” I could ask for whatever I want. Will I get it, I suppose is the point. Otherwise, if anything, you are suggesting there is an oversupply; that is, that they can get away with asking however much they want. You know what I mean? I do not know; I am just trying to say that just because they are asking for the netback price —

Mr Brown: But they have the option. Woodside or Chevron or whoever, the LNG producer has the option. If I ask you for LNG netback and you say no, I then go to the government and say, “If I can’t sell it here, I am going to sell it somewhere else.” The gas is not going to go —

Mr P.C. TINLEY: Let us be clear: the cost of LNG, achieving LNG netback, the cost to the producer is different than the cost of supplying domgas. I am talking about the actual production costs that achieve LNG netback. Am I right?

The CHAIR: It is cheaper to produce one than the other.

Mr P.C. TINLEY: It is cheaper to produce domgas than it is LNG.

Mr Brown: LNG netback strips out the cost of transportation and the freezing.

Mr J. NORBERGER: But they are still sourcing gas potentially from fields that you would not otherwise have developed if you knew that your only market would have been domestic gas. They are going out into deep ocean, this, that and the other, and so they are having all those additional costs, as opposed to, say, Devil Creek, which is a land-based conventional extraction.

Mr Langmead: It is not land-based.

Mr J. NORBERGER: Sorry, yes you are right.

The CHAIR: I am going to have to draw it to a close. I think we could go on all day with this; it is so interesting. I would like to thank you for your evidence before the committee today. A transcript of this hearing will be forwarded to you for correction of minor errors. Any such corrections must be made and the transcript returned within 10 days from the date of the letter attached to the transcript. If the transcript is not returned within this period, it will be deemed to be correct. New material cannot be added via these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on particular points, please include a supplementary submission for the committee’s consideration when you return your corrected transcript of evidence. There may be some questions that occur to us, is it okay if we just write to you with those questions?

Mr Brown: Certainly.

The CHAIR: With that, I thank you very much for your time with us today.

Hearing concluded at 11.45 am

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