ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO DOMESTIC GAS PRICES

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 25 OCTOBER 2010

SESSION FOUR

Members

Dr M.D. Nahan (Chairman)
Mr W.J. Johnston (Deputy Chairman)
Mr M.P. Murray
Mrs L.M. Harvey
Mr J.E. McGrath

Hearing commenced at 1.48 pm

LEWIS, MR STEVEN
General Manager, Western Australia, APA Group, examined:

TASNADY, MS SUZY
Regulatory Manager, APA Group, examined:

The CHAIRMAN Thank you for your appearance here today. This committee hearing is a proceeding of Parliament and warrants the same respect that the proceedings of the house itself demand. Even though you are not required to give evidence on oath, any deliberate misleading of the committee may be regarded as contempt of Parliament. In the lead up to today's hearing you indicated to the secretary that you would request restrictions to some of your questions that may be posed by the committee. In accordance with this request, we will close the latter part of the hearings to the public to discuss these questions and how you can answer them. For now there are a couple of procedural questions. Have you completed the "Details of Witness" form?

Mr Lewis: Yes.

The CHAIRMAN Do you understand the notes at the bottom of the form?

Mr Lewis: Yes.

The CHAIRMAN Did you receive and read the information for witnesses briefing sheet regarding giving evidence before a Parliamentary committee?

Mr Lewis: Yes.

The CHAIRMAN Do have any questions relating to your appearance before the committee?

Mr Lewis: No.

The CHAIRMAN Could you just describe your business in Western Australia.

Mr Lewis: We operate four gas pipelines and one gas storage facility. The four pipelines are the Goldfields gas transmission pipeline, that is a covered pipeline; we also operate the Telfer pipeline, the Mid West pipeline and the Parmelia pipeline and the Mondarra gas storage facility, which has a very limited capacity of sixty terajoules a day injection and 15 terajoules a day withdrawal.

The CHAIRMAN The Telfer, one by the name, just means that it goes to the Telfer gold project?

Mr Lewis: That is right, from Port Hedland to Telfer. It also supplies the Nifty Birla copper project.

The CHAIRMAN Is that a regulated pipeline?

Mr Lewis: No.

The CHAIRMAN And the storage facility, is that on-market?

Mr Lewis: It is at capacity at the moment in terms of contractual arrangements. As I said it has got a limited size and the customers are Verve, Synergy, Alcoa, Alinta and one or two smaller other players.

The CHAIRMAN Do you operate storage capacity interstate?

Mr Lewis: We do; we operate the LNG facility at Dandenong, which is a liquid storage facility that supplies the market during peak times.

The CHAIRMAN Where do you get the LNG from?

Mr Lewis: We liquefy the gas into LNG.

The CHAIRMAN So it is a liquefaction plant rather than a storage plant?

Mr Lewis: Yes. We take small amounts of gas in over non-peak times, liquefy it on site and store it as liquid in tanks and then supply it back into the market at peak time at much higher rates.

The CHAIRMAN Do you see a scope or need for doing that in Western Australia?

Mr Lewis: Not at present. I do see a need for a gas storage facility, but with gas in its current gas form rather than LNG. So an expanded form of what we currently operate. We are currently in commercial negotiations to launch a major expansion, hopefully in 2013—up to 150 terajoules withdrawal and 75 terajoules injection.

The CHAIRMAN How much would that meet of domestic demand—southern demand?

Mr Lewis: Southern demand: it would meet probably 15 to 20 per cent of that demand on any given day, but most importantly it would meet all of the requirements for electricity generation and gas supply to the Perth market. Some of the industrial users such as Alcoa make their own arrangements, as they have done before for things like diesel, but that size of facility is ideally placed to basically keep the lights on in Perth for months and keep gas supply up in winter.

The CHAIRMAN And to mitigate the risk of something similar to the Varanus explosion?

Mr Lewis: Correct. To that end we flew the Minister for Energy to the site not last Friday, but the Friday before, with two of our key customers to give him a good understanding of where the facility is at. We have a drilling rig on site at the moment; we are drilling the second of two production wells. That is necessary to prove up the capability of the facility, which then underpins the tariff structure with customers, and if we can agree to that, then we are into investment and development of the facility.

[1.54 pm]

The CHAIRMAN Is that facility regulated in any way?

Mr Lewis: No.

Mr W.J. JOHNSTON: You said it is currently at capacity. How much gas is in there and if you did the expansion, how much would you have?

Mr Lewis: It currently has a working capacity of about three petajoules, which is 3 000 terajoules. After expansion it will have a working capacity of about 12 petajoules, so 12 000 terajoules.

The CHAIRMAN Your storage facility, like Victoria, will serve a number of purposes—peak shaving?

Mr Lewis: Yes.

The CHAIRMAN Emergency?

Mr Lewis: Yes.

The CHAIRMAN Also, perhaps, emergency not just for the supply of gas, but also utilising that adjacent pipeline. It can use both pipelines, can it not?

Mr Lewis: That is right. The technical specifications would have us connecting into both the Parmelia and the Dampier to Bunbury pipelines. Currently we flow gas from the Dampier to Bunbury pipeline into the storage facility and down the Parmelia pipeline only. When we interconnect, we will be able to go down the Dampier–Bunbury, into storage, back out to the Dampier–Bunbury or down the Parmelia pipeline.

The CHAIRMAN What is the capacity of the Parmelia pipeline?

Mr Lewis: Currently, its capacity is 65 terajoules a day.

Ms Tasnady: It is expandable up to about 120.

The CHAIRMAN Okay. It is a very old pipeline, is it not?

Ms Tasnady: It was built in 1971.

The CHAIRMAN Do you see any other capacity or need for additional storage facilities besides the one you are building now?

Mr Lewis: I think it is a case—to use the mobile phone analogy—that we do not actually have storage on a large scale in Western Australia, but I think once we do and people see the benefit of it, we will see a lot of expansion. There is the ability to either drill more wells into the facility to provide more production capability, or there is a capability to tie in adjacent depleted fields to, basically, supply a bigger storage tank.

I think the other benefit of a storage facility—you named two: one is peak shaving and another is security of supply. A third is basically the more efficient use of our gas transmission and production capability. If you are an upstream producer, you like to produce at steady rates and if you are a pipeliner, you like to transport at steady rates, but, of course, the market goes up and down not only during the day, but also in seasons. Upstream storage allows you to build gas production and transmission capabilities for steady streams of gas and downstream you expand your pipeline to carry that maximum day of the year. At the moment you have got 1 600 kilometres of pipeline that can carry the maximum amount required during the year. It is a strategic, but also economically efficient, way of organising gas transportation systems.

Mr W.J. JOHNSTON: There is no storage capacity, but does that same issue apply to the Goldfields pipeline?

Mr Lewis: Yes. The Goldfields is slightly different because it mostly services industrial load, which is pretty much fixed. Your mine is operating 24 hours a day, so you do not have the same seasonal or daily variation as you do in the Perth market, which does vary a fair bit.

The CHAIRMAN One of the benefits would be that you could capture some of the value that is offered for the suppliers for flexibility now they are entering into contracts with buyers who are willing to pay quite a bit for some flexibility. You can capture some of that storage by taking take-or-pay and then onselling it to other ones with some flexibility.

Mr Lewis: That is correct. As a consequence, the gas suppliers’ overall costs should come down.

The CHAIRMAN We hear a bit about unconventional gas sources and that some of those, I think, are in the area that your storage facility would be. More importantly, if this was to come on, the big issue would be access to the market and access to pipelines. Do you see that as an issue?

The CHAIRMAN Yes, it is an issue. The ERA is currently going through an access arrangement round with the DBP. It called for submissions earlier in the year. The DBP have promoted one set of access arrangements and, I think, pretty much every major player in the market has asked for something different. We certainly would like to see access arrangements into the DBP that provide for part haul and back-haul services, and much more flexibility than what is offered under a standard T1 service from the North West Shelf down to Perth. We need Mondarra to be recognised as a formal access point into the DBP so the customers can then contract using that access.

The CHAIRMAN Is that not the case?

Mr Lewis: We understand our customers have bilateral contracts with the DBP, which do not specify Mondarra as an access point. They can specify it as a delivery point because we are obviously flowing in, but they do not specify it as access coming back out. We would need to have those arrangements in place in order to make the facility workable.

The CHAIRMAN Would APA be willing to build a parallel, competitive pipeline to the domgas pipeline?

[2.00 pm]

Mr Lewis: We already have one; the Parmelia pipeline.

The CHAIRMAN I know you do—but all the way?

Mr Lewis: All the way north? I just do not see the need for it. I do not see the market for it. If the Dampier to Bunbury pipeline is operating efficiently, we are injecting only 75 terajoules a day. I just would not see the market for an additional pipeline to sit alongside it.

Mr J.E. McGRATH: I want to clarify something about the gas storage facility at Mondarra. The domestic market gas suppliers, that is, Verve and Synergy, buy the gas and have an arrangement with you to store it for them. Is that how it operates?

Mr Lewis: Correct. So we think there is a market to expand that 10 times on the back of Varanus.

Mr J.E. McGRATH: Yes. So what happens there would have no bearing on people exploring other gas fields because the operation of the storage facility is basically underpinned by the companies that distribute the gas.

Mr Lewis: Correct, yes. I cannot go into this because of commercial-in-confidence, but I have had two expressions of interest from upstream companies that would like to use storage. Both of those companies are operating gas fields that are yet to produce, but they need to go through a commissioning phase. So before they are ready to flip the switch and start charging their customers, they have to commission and put gas through and the gas has to go somewhere. They are expressing an interest in putting it in storage. It is just another benefit of a big soak that can take the additional gas that the market cannot take.

The CHAIRMAN You would look at the overall market for your product, which is basic transport and storage.

Mr Lewis: Yes.

The CHAIRMAN Do you see any challenges going forward, for instance the shift to more gas and backing up intermittent load or intermittent supply?

Mr Lewis: The major challenges we see at the moment are—if we reduce the benefits of gas storage to two things—firstly, meeting the seasonal requirements of your market, and, secondly, having security of supply. The biggest commercial challenge that we see at the moment is that our customers are unable to recover the value of security of supply in their tariffs; so we want customers to take storage contracts. Clearly, there is a storage benefit for security of supply, but how do they recover that cost from their customers—particularly if they are supplying gas into regulated markets in which the tariffs are set? That is one challenge that we see. The other —

The CHAIRMAN Let us be a bit more clear about that one. In regulated markets, there is a process that in fact takes into consideration cost and whatnot.

Mr Lewis: Yes.

The CHAIRMAN Right now, with the introduction of storage, that has not yet been built into the cost structure.

Mr Lewis: Correct.

The CHAIRMAN Okay.

Mr Lewis: So last year we had the Gas Supply and Emergency Management Committee and there were two major conclusions from that. One was that the ideal option to mitigate supply seemed to be gas storage and dual fuelling of most of Verve's capacity. And then it went further, saying that if people have to put in place additional investment—for example, Verve has to dual fuel or people have to buy storage contracts—how do they recover that from the market? The Office of Energy has been tasked with coming up with a mechanism and I understand that a discussion paper is due out soon. That is fine, but these things move very slowly and we really want to get this project built and into the market in 2013. To the extent that we cannot get binding commitments because people are waiting for other things, puts the whole project back. That is probably the major risk that I see.

The other one that we have struggled with a little bit—I am sure you have heard this in buckets from the upstream—is that although Perth is a big market, it is a lumpy market; five major customers take 80 per cent of the gas and that pretty much narrows my customer base for the selling of storage services. I pretty much have to get all of those people aligned in order to underwrite the project. Whereas if you are in eastern states, where you have many retailers and lots more customers, you do not need everybody at the same time in order to get a decision made. That is a real challenge as well.

The CHAIRMAN Yeah; I mean one of the real challenges of the gas market is that they are few in number in all parts of the market structure—from producers to pipe liners to users.

Mr Lewis: That is right.

The CHAIRMAN So one of the challenges is how you get more diversity of numbers on each side—all sides.

Mr Lewis: We can go back to the point you raised about the advantages in the take-or-pay issue. One of the issues that retailers have selling into the WA market is that they have to take long-term take-or-pay contracts upstream and they have to take long-term take-or-pay contracts in pipelines, but they are competing for market. They are competing with each other and the market is only a certain size. Again, gas storage would enable another one or two retailers to come in; yes, they have to buy their upstream contract for gas at fixed take-or-pay, and potentially the bit of pipe from upstream to Mondarra is fixed. But then they are constantly supplied and they just take out what they need. So they are not faced with a big bill at the end of the year if they have not taken all the gas that they are required to take under the contract. It is up to them to manage that portfolio. That supply liquidity is really what is needed to drive more competition in the retail market. And that competition in the retail market ends up bringing down the price.

The CHAIRMAN Yeah. Are you thinking about any other investments in Western Australia?

Mr Lewis: We are thinking about extensions to the Goldfields pipeline, but that is a little problematic given—am I allowed to talk about the most recent decision?

Ms Tasnady: It is public knowledge.

Mr Lewis: It is public knowledge. So the ERA in its most recent access arrangements for the Goldfield pipeline came out with a decision about—expansions policy?

Ms Tasnady: Expansions policy.

Mr Lewis: Yes; so that means that whenever we expand the pipeline beyond a certain point, some of the tariffs paid by existing customers automatically reduce. On the one hand, we are trying to expand our pipeline to capture additional revenues, but every time we do that, revenues from existing customers go down; that is actually a disincentive to expand and is one issue that we are managing at the moment.

Mr J.E. McGRATH: On that, why do you think that decision was made?

Mr Lewis: I will ask my expert here.

Ms Tasnady: I think it was a policy decision that a regulated pipeline should remain regulated in all circumstances. That is a view that has been put forward.

Mr J.E. McGRATH: Therefore, because you are expanding the pipeline to supply other customers, in doing so you then have to make the pipeline available at a cheaper price to existing customers.

Mr Lewis: Yes. I mean, fundamentally the tariffs for a regulated pipeline are set by the regulator who gives you what is considered a fair rate of return on your capital. Therefore, if you invest additional capital and you get additional revenue, and because that incremental capital brings down your overall cost of capital, the overall tariff you charge your regulated customers comes down. It is a bit of a quirk and, yes, there are ongoing discussions and we are in the process of appealing that decision.

Mr W.J. JOHNSTON: That would also stop you doing a loss leader on an expansion. Even if you made the decision to invest your own capital in providing what is effectively a subsidy for other users, because that was in your long-term strategic interest, you would not be allowed to do that.

Mr Lewis: We would be "disincentivised" from doing that.

We are trying to get the Mid West pipeline back up and running. The customer for that was in administration for quite some time and a new joint venturer has just purchased that company.

The CHAIRMAN Okay.

Mr Lewis: We do see a future for the Parmelia pipeline to be expanded. We are also looking at the opportunity to build a new pipeline in the Pilbara area, which is an area not currently serviced. That is in the very early stages of consideration, given the iron ore price and the number of mines to get away there.

The CHAIRMAN We have heard stories about some miners having difficulty getting access to gas coming down the Goldfields pipeline. I will not mention names, but have you heard about that?

Mr Lewis: Yes. We have heard that you can get gas, but at a pretty high price when compared with historical gas prices. Putting that aside, the major issue seems to be the term for which you can buy the gas. When we expand a pipeline, typically we will provide a tariff to a customer that is based on a 15-year capture of that capital, over time. Customers cannot seem to get 15-year gas contracts, so they cannot back-to-back the risk of a tariff from us on a gas transportation agreement, which amortises over 15 years, and a gas supplier which underpins it. They do not want to be caught short halfway through that term with a gas transportation agreement and no supply.

[2.10 pm]

The CHAIRMAN But you can adjust your terms of the length of the contract.

Mr Lewis: Yes, we can shorten the contract. That ends up just then putting up the tariff significantly, and then when you add the gas price to a significant increase in tariff, suddenly we are not competitive and usually a customer goes to diesel-fired power.

The CHAIRMAN Do you see the need for an aggregator of gas, at least in the SWIS, or the alternative to Alinta—I guess an access aggregator in some way?

Mr Lewis: Generally, we think that more competition is good, so to the extent that another retailer comes in and competes with Alinta, as Synergy does in some areas of gas sales, that is a positive thing.

Mr W.J. JOHNSTON: Can I just ask a question? You have this admirable investment in gas storage, which is perhaps going to give us some capacity to go for quite a period of time—80 or 90 days, it would seem—providing those generators with gas. If you had an outage on the pipeline, as opposed to what happened at Varanus where it was the production facility that had the problem, how long would you expect that a pipeline might be out of action?

Mr Lewis: From the outages that I have seen we have had, I mean, it is a matter of hours. We have depots all around the state. We can get to any of the compressor stations within a matter of hours, and usually it is just something faulty that is fixed and off we go. We have not had a catastrophic failure, if that is what you mean.

Ms Tasnady: Are you meaning on the Parmelia or the Dampier to Bunbury pipeline?

Mr W.J. JOHNSTON: Obviously, most people would think about the Dampier to Bunbury. I know that is not your pipeline, but just in terms of your expertise on dealing with pipelines. You saw in San Francisco recently a catastrophic failure. If you had catastrophic failure, with your knowledge of the industry, how long would you expect something like that would take to get back online?

Ms Tasnady: Are you thinking that the Dampier to Bunbury pipeline, for instance, would be out of action south of Mondarra or north of Mondarra?

Mr W.J. JOHNSTON: North of Mondarra.

Ms Tasnady: The capacity of the DBP is 600 terajoules, so that would require considerable amounts to meet, but given that what we are talking about would be the domestic load, obviously the high-end industrials would have to go onto their own alternative supplies.

Mr W.J. JOHNSTON: Let us move away from the DBP—whatever they call it—to your Goldfields pipeline. If you had a catastrophic failure of the Goldfields pipeline, how many days would you expect it to take to get back online?

Ms Tasnady: It is a small number of days because of the availability of spare pipe and things happening on the pipeline are much easier to fix than a whole treatment facility, like Varanus Island. Even if we had an entire compressor station that failed, there would be mechanisms to be able to circumvent that. There would be a reduced capacity but not total.

Mr W.J. JOHNSTON: So, effectively—I am not trying to put words into your mouth but this is my understanding of what you are saying—that even with a catastrophic failure of one of these major pipelines, you are talking about maybe a week and you are not talking about one month or two months to get back online?

Mr Lewis: Correct, yes.

[The committee took evidence in camera]