ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO DOMESTIC GAS PRICES

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 13 SEPTEMBER 2010

SESSION ONE

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 12.34 pm

NOLAN, MS ANNE LESLEY
Director General, Department of State Development,
examined:

CUSWORTH, MS NICOLA CLAIRE
Deputy Director General, Department of State Development,
examined:

GARDNER, MS JENNESS
Manager, Strategic Policy, Department of State Development,
examined:

The CHAIRMAN: Thank for coming to the hearing today. Before we begin, I need to read out a formal statement. I think you have heard it before. This committee hearing is a proceeding of Parliament and warrants the same respect that proceedings in 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 a contempt of Parliament. Before we commence, there are a few procedural questions that I need to ask you. Have you completed the “Details of Witness” form?

The Witnesses: Yes.

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

The Witnesses: Yes.

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

The Witnesses: Yes.

The CHAIRMAN: Do you have any questions relating to your appearance here today?

The Witnesses: No.

The CHAIRMAN: Would you place state your full name, your address and the capacity in which you appear before the committee?

Thank you. The committee has received your submission, and thank you for it. Do you wish to propose any amendments to your submission at this time?

Ms Nolan: No.

The CHAIRMAN: Before we ask you questions, do you wish to make an opening statement or make any additions to your submission?

Ms Nolan: No. We are looking forward to answering your questions.

The CHAIRMAN: Okay. As you well, know, because Nicky at least has given some earlier briefings to the committee, the driver of this inquiry is the concern that after decades of low-priced available gas, and the economy and the business sector and consumers depending on that gas and consuming it in large volume, there are concerns right now and into the future about shortages of supply and therefore higher prices for gas. Is that a prognosis that you have?

Ms Nolan: I will start and then hand over to Nicky. One thing we know about the future is that we will never be able to predict it in terms of demand and supply, whether that be for gas or any other commodity. In terms of looking forward, as you have said, the past is not necessary a predictor of the future there either. We have seen only one large LNG project dominate Western Australia, and that was obviously the North West Shelf joint venture project. That had a particular set of requirements associated with domestic gas. In particular, that was a project that went ahead because of domestic gas and LNG being produced together. Looking forward, we see a different scenario potentially developing in terms of an array of projects that are on the horizon. We have all seen the enormous interest in reserves off the Carnarvon basin in particular, but also more recently an interest in the Browse Basin. Those projects—there is a raft of them—provide the potential supply scenarios for domestic gas, as well as domestic gas options such as the Apache project, which is purely a domestic gas project, and other onshore developments that could potentially be domestic gas-oriented as well. So there is a range of scenarios on the supply side. On the demand side, there is similarly a range of scenarios. With regard to whether there is a going to be a shortage of supply, that is one of those things where in reality it always boils down to price in terms of what the demand for gas will be, because it will be largely a function of price and other attributes of that gas supply. Similarly, with regard to what will be the supply, well, it is going to depend on what is commercially viable in the main. So that is the general scenario that we are operating under. Does that mean that prices will rise and we will have a shortage? We may in fact see an alternative scenario of a number of projects coming on stream with LNG that provide domestic gas options that are very viable, and that could see an increase in supply, which we have not seen in the last couple of years. So I think there is a range of potential outcomes into the immediate term. Nicky may want to add to that.

Ms Cusworth: Yes. The previous advice that we gave you did include some charts of potential supply and demand scenarios. I think that those are useful exercises, and they give us an idea of how the future might look. But, as Anne has said, depending on which projects do and do not proceed, the real future is going to be different from those projections. Also, those projections were done independently of price, and obviously price is going to be a very important determinant of where demand and supply actually eventuate. The reality is that there are many different and almost equally plausible scenarios, some of which would say that there will be quite a large increase in supply, some of which would say that supply will be relatively limited, some of which would say that there will be a very large increase in demand, and some of which would say that it will be perhaps a bit more modest. That is not to in any way denigrate the modelling that you have seen. I think that was a very useful exercise. But I would not take that as gospel truth as to how the future might unfold.

The CHAIRMAN: Just judging from what you have provided earlier and what others have provided, and looking at the market, there is a great deal of uncertainty in the market as to supply in particular and also, of course, price. We have heard evidence of rising cost curves, particularly offshore. The committee did a tour of the eastern states the week before last. In Queensland in particular it was rather remarkable how the market has changed there. One of the key issues was that there are multiple providers, multiple users and multiple routes for the pipelines. So they have a viable market there, with competition in all segments of it. We do not have that here, obviously. Is that a policy focus for DSD in the strategic energy initiative?

[12.40 pm]

Ms Nolan: First of all, I want to make one comment on the Queensland environment that is obviously also particularly relevant, and that is technological change—actually being able to produce coal seam methane, coal seam gas, as alternative supplies that have traditionally not been viable. So you can see quite significant changes, and Queensland is a really great example, as is the US, where we also have unconventional gas. That is completely changing the scenario.

That is another reason why our demand and supply forecasts will inevitably be wrong. If we had a situation where we have multiple providers, multiple demand sources and some transparency, we would normally call that a market, and they would be the normal sorts of situations where you would aspire to see a commodity being exported in an open, transparent market arrangement. Tradition and the nature of the projects in Western Australia have seen the North West Shelf example and even Varanus Island being two sources of gas, but we have not had the multiplicity of supplies and we have not seen the transparency. They have been based on long-term contracts—10, 15, 20-year contracts—with the conditions being held confidential. That has been the characteristic of our market, or scenario, rather than, I guess, a market in the traditional sense.

In terms of policies that would encourage an open and transparent market, I think we are looking to the medium to long term to see that evolve. With the number of projects coming on stream, we are hopeful that we will see increased sources of supply. I think they will be a very important aspect going forward in terms of the development of a true market scenario. Into that environment, we can see a scenario, where, obviously, joint marketing of gas is one of the issues with domestic gas we have seen in the past and we will see into the future. One of the things the ACCC has obviously considered is whether there is in fact a viable market, and they have come to their conclusion that joint marketing would not inhibit the development of a market, or it is premature to call it a market, probably more realistically. So the question is: how do you get the fundamentals to actually give rise over a period of time to a more realistic market scenario?

Ms Cusworth: Again, and specifically with regard to the SEI, I think that is one of the issues that they are looking at. The reality is, as Anne has said, that we have had a market that has been characterised by very few buyers, very few sellers and relatively infrequent contracts, so it just does not look like a fully competitive market, and we are a long way away from that in WA. One thing that the SEI could be trying to do is to look at making things a bit more market-like, so proposals like the gas statement of opportunity, which might be encouraging conversations between buyers and sellers and identifying where potential demand might be, could be helpful steps in that direction, but we are a long, long way from the multiple buyers and sellers and outlets that you observed in Queensland.

The CHAIRMAN: The change happened in Queensland very, very quickly.

Ms Cusworth: Yes.

The CHAIRMAN: How much of the total gas supply medium term is derived from LNG projects or projects that are focused primarily on LNG?

Ms Cusworth: From memory, about 70 per cent.

The CHAIRMAN: The DomGas contract with the North West Shelf venture is a dominant supplier, of course.

Ms Cusworth: Yes.

The CHAIRMAN: That contract runs up in 2014, or starts to run up in 2014. Is it going to be rolled over or renewed?

Ms Cusworth: We will have to have a conversation with them about that. They have an existing plant, which is written down, so I would be surprised if they were not to be using that, but the question will become then the economics of progressively extracting gas from a mature field and how the balance of domestic versus international supply will work for the company. We are not expecting that supply will dry up from there, but we have not had a detailed conversation yet.

The CHAIRMAN: When does that start taking place?

Ms Nolan: I was just going to make the comment that there is a specific requirement under the state agreement act for that discussion to actually occur. We have not commenced that discussion as yet.

The CHAIRMAN: It is 2014 when it starts running up. I am not sure, but that is what I have been told.

Ms Cusworth: It uses a volumetric obligation, so the timing will depend on how quickly they are currently supplying gas.

The CHAIRMAN: They have an aggregate supply?

Ms Cusworth: Yes; so it is not a percentage and it is not a date cut-off; it is when they supply a particular volume.

The CHAIRMAN: Because that would leave a huge gap in the market potentially that you would have to find from some other source.

Ms Nolan: Potentially, but, again, that is one potential outcome, whereas we would see a range of other outcomes being equally, if not more, plausible in terms of their desire to see ongoing utilisation of that domestic gas plant that they actually have in place.

The CHAIRMAN: In terms of other sources, could you run through some of the potential sources in the medium and long term, and what expectations can you put on them as a source for domestic gas?

Ms Nolan: I will start off, and we will probably do a bit of a tag-team effort here on this one. Obviously, the next plant that will come into production is the Gorgon project, which has, I think, a—I have not got the actual maths written in front of me, but it is 175 or 150 terajoules per day in the first stage, 2015, or when the third train comes on stream, whichever is the sooner.

Ms Gardner: Two hundred and seventy-five.

Ms Nolan: It is 275; okay. So the Gorgon project is by far the first cab off the rank, and they have already gone out to expressions of interest in the purchase of gas. That is a conversation that we have had with Chevron as to what interest they have had from that. They have been fairly constrained by confidentiality requirements in terms of how much information they have revealed regarding that. But I think one of the comments we can make is that the range of price that people will pay for that gas goes from a very low number to a more reasonably commercial number. So that is another comment that we would make here: that sometimes demand can be inflated by perhaps some projects that require very cheap gas, such as fertiliser plants, urea plants and the like.

The next project that we see as potentially providing domestic gas would be the Pluto project. Its train 1 is coming into production early 2011. A conversation and discussion with government still is to occur regarding what the timing of their obligation will be and when that will kick in, but that would be the next sort of cab off the rank there. The next one after that is probably the Wheatstone Chevron project. Again, we are in the process of conversation with them at the moment regarding what their potential domestic gas obligations are in the context of the state's gas reservation policy.

Ms Cusworth: And in addition to the LNG projects that Anne has talked about, there is Macedon and Devil Creek, which are focused primarily just on domestic gas.

The CHAIRMAN: Has the Macedon one let domestic contracts yet?

Ms Nolan: I do not think they have let the contracts. The actual final investment decision is due, I think, in October this year.

The CHAIRMAN: Devil Creek has got the official go-ahead.

Ms Nolan: Devil Creek is under construction.

The CHAIRMAN: Where did CITIC Pacific get their gas from?

Ms Cusworth: Devil Creek.

The CHAIRMAN: What about onshore?

Ms Nolan: Mines and Petroleum are far better placed to actually give you a really good rundown on where the potential sources of exploration are, but, obviously, in the north, in particular, where we have seen in the Kimberley that there has been quite a bit of exploration for gas, and that has been relatively successful, as well as in the Perth basin. But as far as I am aware one obviously has an infrastructure issue associated with it as to how you actually get it to a market. And in the Perth basin I think some of the finds are encouraging but not yet commercial.

[12.50 pm]

The CHAIRMAN: Is that a priority of onshore gas? Is that a development priority of the department?

Ms Nolan: It is certainly a priority of the government. In terms of where it would see one of the options for increasing the supply of gas is obviously to see an onshore development of a domestic gas facility which does not really have the export potential of some of our offshore deeper finds. So the Department of Mines and Petroleum runs an exploration incentive program, and that is very much designed to encourage investment in alternative sources of onshore gas. We would also see technology as being one of the factors that will break through there in terms of tight gas and in terms of horizontal drilling techniques being applied. In the turning point we may find our supply scenario could change, perhaps not as drastically as Queensland's but certainly there is potential for upside there as well.

The CHAIRMAN: Any questions?

Mr J.E. McGRATH: Just one on that subject. On page 2 of your submission you talk about the percentage of total production that went to export LNG and the percentage that went to natural gas domestic supply. You mentioned a figure of 70 per cent, I think, LNG a while ago; was that all from the joint ventures at Woodside? Can you just say where that figure was taken from? The 70 per cent and then the 65.7, is that total gas produced; and if so, what about the joint venture at the North West Shelf? Of the gas that they have produced, how much has gone offshore and how much has been sold into the domestic market?

Ms Cusworth: Sorry, do you mean historically or —

Mr J.E. McGRATH: Historically, because there was a domestic component when the joint venture was established and the field was explored. Historically, how much of that gas has come in and gone off as LNG and how much has been provided to the domestic market?

Ms Cusworth: We do not know the answer to that off the top of our head, but we will get back to you with some numbers.

The CHAIRMAN: So, over the life of the project how much was exported and how much was consumed locally?

Mr J.E. McGRATH: Yes.

Ms Cusworth: We will get back to you on that.

Mr W.J. JOHNSTON: Is there currently in the department any discussion with potential large gas users to be established in Western Australia?

Ms Nolan: Large gas users?

Mr W.J. JOHNSTON: Users like Burrup Fertilisers.

Ms Nolan: There are always a number of project proponents who come and see us with some really great ideas and great project proposals. And, you know, you can be standing at a conference and somebody comes up to you with a great idea and they can say, "If you can get me gas at $1 a gigajoule, I'll build a fertiliser plant." And you sort of take that, you know, in the context of a cup of coffee as an interesting conversation. But if you are asking more realistically what are the projects that require gas, they can be a number of sources. You can use gas as a feedstock and hence the fertiliser-types of projects. We see projects that use a lot of electricity or energy in general, and there we see the magnetite projects in terms of iron ore; or even going that step further if you were to see steel production by a steel plant, it is very much an intensive use of electricity; and similarly where we see alumina and expansion of alumina processing. So, obviously, the price of electricity or the price of energy is an important input to those projects. We believe the first lot is largely a feed stock, which I think would truly require some very competitive gas prices, or alternative sources of supply. The ones in the middle will very much depend on the nature of world markets. We have obviously seen some delays in the expansion of alumina plants in Western Australia, and that has not all been driven by the price of energy. But obviously energy is a very large input into those decision-making processes; as is the world markets for alumina and other alternative sources of supply and what the security of supply is. So, yes, we do have conversations of that ilk on a relatively regular basis. And then if we look at the next array of projects such as some of the magnetite projects in the Mid West where we will see they will need some fairly sizeable electricity supplies to actually take that process to an export phase of iron ore. And we already saw with the Sino example at Cape Lambert; they required a very large cogeneration mine cycle plant that was gas to be very energy efficient, and they had a source of gas. So, obviously, we would also see some requirements for gas potentially in the Mid West as well to actually drive their electricity demands and their energy demands. But again it would depend on what the price of that gas is and how it feeds into the overall structure of the market for iron ore, what the price for iron ore is, what the diversity of supply needs are from the Chinese or Indians, or whoever it may be, and what the alternative cost of energy is with a raft of coal and other options available to it. So, gas is not the only source of energy for those types of projects.

Mr W.J. JOHNSTON: Sure, and if I can just ask a follow-up question: in that first category there is currently nobody that is seriously in discussions with the state government, like Burrup Fertilisers or the Burrup Fertilisers expansion?

Ms Nolan: There is always conversation and they are at different stages of maturity, would be my best comment.

Mr W.J. JOHNSTON: And would any of these projects be able to fly at $8 a gigajoule?

Ms Nolan: It is a big call for me to make a statement to that effect, but I think it would be a reasonable expectation to say that if gas is your feedstock, at $8 a gigajoule, you might find alternative options in the world.

Mr W.J. JOHNSTON: Somewhere else that is selling it for $4?

The CHAIRMAN: Burrup, is that contract up for renewal, do you know?

Ms Nolan: I honestly do not know. I understood it was quite a long-term contract.

The CHAIRMAN: Okay. I do not know.

Mr M.P. MURRAY: Having seen some graphic footage just before the weekend of a gas pipline blowing up, what storage capacity do we have at the moment and what is envisaged for the future or do we have any projects as such?

Ms Nolan: That is a really good question to ask the Office of Energy, who I know are providing evidence to you later in this month!

The CHAIRMAN: That is a very quick handball!

Ms Nolan: We have a fairly limited supply of gas storage in Western Australia. It has not been a feature of our market. There is actually storage availability in line pack in terms of the Dampier to Bunbury natural gas pipeline. There is actually quite a deal of gas stored within that pipeline. But, conversely, we also are aware of—for the life of me I cannot think, is it Mondarra?

Ms Cusworth: Yes.

Ms Nolan: There is some gas storage there and we have also got obviously issues. We do not have extensive gas storage in Western Australia because of the cost.

Mr J.E. McGRATH: Just on another subject, the Pilbara Cities project and the government's plans for development in the north, do you see gas playing a role in that if we are going to build a new city at Karratha and expansions in Port Hedland and Kununurra and those places, or do you think the gas market is going to be more down in the South West?

Ms Nolan: For a start, gas from the concept of LNG is going to have a very large impact on shaping the development of Karratha in particular. So, how big Karratha grows and what is in Karratha will be impacted by all the development opportunities in terms of gas and iron ore. In terms of actual usage of gas in Karratha and the associated industrial areas, again, it will come down to what is feasible in a world market. Because if you are going to have an industrial process of some sort that uses gas, it is going to depend on what your competitiveness is in the rest of the world. But if you are asking about do I see gas as being the source of electricity generation for domestic consumption, I think that is obviously one of the areas where you would need to look to. There is already an increased use of gas in the Pilbara, as I understand it, particularly in Karratha for generation with some new generation capacity in Karratha, and one would anticipate that you would see more electricity generated by gas in that area. But, in terms of the specifics regarding that, I think it is too early to say.

[1.00 pm]

Mrs L.M. HARVEY: Switching across to the submission that DSD made to the ACCC regarding the joint marketing arrangements for North West Shelf, there was a comment in there that the current process is for acreage management and retention leases—that might be more important in promoting competition. I would be interested if you could expand on what role you see in the management of acreage and retention leases in looking after our domestic gas supply.

Ms Cusworth: Not much at a state government level, because most of the gas is in commonwealth waters; unfortunately, we do not have a massive mount of leverage over that process.

The CHAIRMAN: Does the government have a position on it, even if it is outside our domain?

Ms Cusworth: No, there has not been a position, and we have not approached the commonwealth, as far as I am aware—certainly not from our agency—on those issues It was really more a part of a free-flowing conversation about the kinds of things that might, in principle, be able to stimulate a more competitive gas market. Because it is primarily beyond our jurisdiction —

Ms Nolan: The state provides input to the commonwealth Department of Resources, Energy and Tourism in terms of its retention policies, but that is not through the Department of State Development; the Department of Mines and Petroleum provides technical input in terms of a retention policy there.

Mrs L.M. HARVEY: Taking that one step further then with some of the potential onshore gas reserves we may have with tight gas and some coal seam, perhaps, has there been any development done on the potential for some kinds of changes to policies on retention leases with those onshore reserves that we would have control over?

Ms Cusworth: Not that I am aware of, but, as Anne has said, the Department of Mines and Petroleum would probably have carriage of that.

The CHAIRMAN: One of the issues is: how are prices formed in this market? It is a strange market in that there is a great deal of competition, as we know. For us, trying to get a grasp of what the international pricing outlook is, as you indicated, there is a lot of flux in the market. When we had our trip east, I think most people said there is still a great deal of flux, particularly with shale gas and a large number of LNG projects being proposed. Nonetheless, what is your view on one of the issues: is our market going to settle down into world parity pricing as some sort of net back LNG price for domestic gas? Is that your view?

Ms Cusworth: I do not think we have a view on price.

Ms Nolan: We do not have a price view going forward.

Mr W.J. JOHNSTON: If you do not have a price view, that is clearly a major issue in the industrial development of the state. Where do potential industrial partners of the state get their cues for future energy costs from?

Ms Nolan: I think the first question is supply and who are the potential suppliers, and through conversations with suppliers.

Mr W.J. JOHNSTON: Do you not see it as a role?

Ms Nolan: It is a very difficult role for a state government agency to actually be involved in a price conversation. They tend to be very commercial; these are very large companies that tend to have very strong confidentiality restraints surrounding their conversations on such sensitive issues. It is sort of like trying to predict the exchange rate. If you are in a state government department, it is just not the appropriate thing to do.

Mr J.E. McGRATH: Page 6 refers to the 15 per cent reservation of LNG for domestic use. Is Woodside's Pluto the only development that has had the 15 per cent applied to it so far? And you talk about there being a negotiation between Woodside and the state on an appropriate test for commercial viability, because, according to your advice to us, if it is not commercially viable, they will not be required to supply domestic gas. I guess the question is: when will that negotiation take place; and, apart from Woodside, what other explorers have already had the 15 per cent reservation applied to them?

Ms Nolan: I have some preliminary comments: the North West Shelf joint venture is the only exporter of LNG from Western Australia, so that is the only project that this policy has, in the past, applied to. That is the only plant we have had. There is also an agreement with Woodside, which is the sole owner of the Pluto project, that when it did the phase 1, train 1 of Pluto that there would be five-year holiday, for want of a better word—delay—in when it would be required to produce domestic gas. It is now time, and, just prior to the establishment of the Pluto project going on stream in early 2011, it will become an appropriate timing to have conversation about when we would see domestic gas from the Pluto project. Those conversations are at the very earliest of days.

Mr J.E. McGRATH: Further to that question, Mr Chairman: if Woodside can demonstrate that it is not commercially viable to sell gas to the domestic market, what happens then?

Ms Nolan: I will augment my earlier answer to the question by saying that of course we have had the conversation with the Gorgon project, which is coming on stream in 2015. That was for a specific quantity of gas—not 15 per cent as a percentage. In terms of commerciality, the gas reservation policy is based on a concept of that being a commercially viable project. At the moment, conversation is around a whole raft of issues, but one of those would be the commercial viability of the project.

Mr J.E. McGRATH: I guess the point I am making is—as a layman might ask—is: what would happen if the demand for LNG around the world became so intense and fierce that these companies that have the gas might say, "I'm sorry; it's not commercially viable for us to sell it on the domestic market when we can get so much more offshore." Could that be an argument, or is there another factor in that commerciality, as you have explained it?

Ms Nolan: Obviously, the price is one of the determinants of whether it would be commercially viable, so it is going to depend on the demand for that gas and what people are prepared to pay as to whether it would impact on the commerciality. At this stage, one of the surrounding policy issues on the domestic gas policy is whether it is a commercially viable investment.

Mr J.E. McGRATH: Are you saying that if the state can get the buyers, domestically, of the gas, it will not be a problem? If people are prepared to pay the price, that will not be a problem. If Western

Australian companies, or whatever, are prepared to pay the same price that these companies can get offshore around the world, will that not be an issue?

Ms Nolan: We would certainly hope not, no.

The CHAIRMAN: Just on the Gorgon project —

Ms Cusworth: I think what you are driving at is—we have not settled on exactly what the definition of commercial viability is. I think what you are driving at is: is it an equivalent price to what can be gained overseas, or whether or not there is some other benchmark.

Mr J.E. McGRATH: Yes.

Ms Cusworth: The short answer is that we have not yet had that negotiation.

Mr J.E. McGRATH: Not wanting to dwell on it. I am saying that if a company said, “Sorry, it’s not commercially viable for us to do it”, for which they might have all sorts of reasons, and they might say, “It’s easier for us to just send it straight offshore.” I do not know. But I am saying that there could be something in there in that negotiation that might cause a problem. Are you saying that you have yet to work through that?

[1.10 pm]

Ms Nolan: I do not think that was the answer to that question. Is there something else other than price that would inhibit the investment?

Mr J.E. McGRATH: Yes.

Ms Nolan: We would certainly want to hear about what that was to see whether there was anything government could do about that or whether the buyers would. If there was a commercially viable investment and the companies did not want to participate in it, that would certainly be a topic of great interest to us all.

The CHAIRMAN: Just to clarify: the Gorgon project is scheduled to start delivering domestic gas under its contract in 2015. Is there any scope for putting that off, or is that still up to negotiation? Was that a firm commitment?

Ms Nolan: My understanding is that part of the investment decision taken by Chevron last year was to go ahead with the production of both LNG and domestic gas. Those conversations are on —

The CHAIRMAN: Are they starting to let contracts now?

Ms Nolan: My understanding is that they went out for an expression of interest, and I think some of those contracts may have even been let.

The CHAIRMAN: That is at 275 terajoules?

Ms Nolan: Yes.

Mr W.J. JOHNSTON: I am just referring to the chart on page 8. I understand it was prepared by the DMP and not by DSD. There is quite a large variation between the low and high supply scenario. Am I right in saying that one of the reasons for the low supply scenario is effectively a reduction in supply via the North West Shelf joint venture into the domestic market to feed the five LNG trains?

Ms Nolan: That is when the contracts are in place?

Mr W.J. JOHNSTON: Yes.

Ms Nolan: At the moment, roll-off is an accurate description of that.

Ms Cusworth: Not that gas will disappear but —

Mr W.J. JOHNSTON: As I understand it, the fields that supply the North West Shelf joint venture, I am not saying they have run out, but their production peaks over the next four to five years; is that right?

Ms Cusworth: My understanding is they are hitting maturity but the company is also looking at options to increase the yield out of those reserves. There are types of investment that can continue to maintain supply but it becomes a question of whether that is economically viable.

Mr W.J. JOHNSTON: Five LNG trains is a big slab of equipment. I imagine they would want to get full value out of those. That is a world scale LNG precinct.

Ms Nolan: And of course the joint ventures are investing an awful lot, in the vicinity of $5 billion as we speak, to work to increase pressure and gas availability into those plants.

The CHAIRMAN: They are also doing some expansion or updates of their offshore rigs.

Ms Nolan: Exactly—to try to maintain the pressure and the flow.

The CHAIRMAN: Just looking at that facility, there is a huge sunk asset there that will have to look for more gas going into the future to keep it going. You could see them doing all sorts of things, maybe tolling other gas, maybe acquiring adjacent fields and what-not. That project will have pressures to extend its life 20 to 25 years to acquire more gas in the basin?

Ms Nolan: That would be commercially obvious.

The CHAIRMAN: That is how you would see it happening?

Ms Nolan: Yes.

Mr W.J. JOHNSTON: As a public servant.

Ms Nolan: If I was in their shoes, that is what I would do, yes!

The CHAIRMAN: That is the logical steps. One of the issues they will look at is sopping up smaller fields. There are too many big ones sitting out there. They would have tapped those. One of the avenues to get gas onshore is not only onshore gas, which others have talked to us about, but also trying to get some of the smaller fields, like Apache has focused on, to bring in domestic gas. Given the declining reserves in the North West Shelf, can you see it acting as an accumulator of small fields to keep its facilities going—therefore acquiring perhaps more for export as opposed to strictly for domestic?

Ms Nolan: That is one scenario. I guess the other comment I make is that the next conversation–discussion that is held with the North West Shelf joint venturers regarding their domestic gas obligations would be telling in that respect. Post-2014–2016 there is the requirement under the state agreement act to have a further discussion once the first quantity of domestic gas is produced.

The CHAIRMAN: When do you think those discussions will start?

Ms Nolan: There is no formal timetable for those discussions. It will obviously commence some time before then. We are in 2010 now.

Mr J.E. McGRATH: Getting back to the original agreement, we were talking about 15 per cent. Was it 15 per cent that was imposed at the initial obligation on the North West Shelf? Was it 15 per cent or was it just in terajoules that worked out at about 15 per cent?

Ms Cusworth: It was volumetric initially. The 15 per cent is a recent interpretation. When the 15 per cent figure was included in that document, it was based on a rough estimate of how much of known reserves at the time would be needed to supply what was expected to be domestic demand. It was done on that basis rather than replicating what had been done in any previous agreement.

Mr J.E. McGRATH: Do you think, though, that estimation might have changed since then?

Ms Cusworth: Yes; it probably would have.

Mr J.E. McGRATH: Has the demand gone up?

Ms Cusworth: Demand may have gone up. The amount of gas available will also have gone up. We have not actually redone that calculation. It was only ever an approximation. One of the reasons the policy talked about having case-by-case flexibility was that you have to be sensible about matching supply to demand. If we have a massive amount of LNG going out, then perhaps you would not want 15 per cent of that, particularly in the early years, all coming into the domestic market. If you like, it is a stretched target which was just approximating what was believed at the time to be approximately what would be needed.

The CHAIRMAN: In your submission, did you give a thorough discussion as to your understanding of what this reservation policy is?

Ms Cusworth: We did give a summary of the background.

The CHAIRMAN: It would be very interesting to know what the dimensions of flexibility are. Some of the issues you just raised are —

Ms Cusworth: I do not think there is anything hard and fast by definition because it is intended to be flexible. There are no hard and fast guidelines about what flexibility might mean. The other issue of course is that each project is very different in terms of its economics, in terms of its location and in terms of its reserves. Again the government was keen not to be too prescriptive in having a single model —

The CHAIRMAN: Basically you took a project-by-project negotiation —

Ms Cusworth: The phrase is actually "case-by-case" in the policy. There is a considerable degree of flexibility which is to allow for unforeseeable characteristics of the project in the market.

Mr W.J. JOHNSTON: I refer to the chart set out on page 3, table 2, headed "Current and future LNG gas projects in Western Australia". If you could just add effectively an extra column telling us what the domestic gas obligation is for each project, that would be really helpful to me and other members of the committee.

Ms Cusworth: Yes.

Mr J.E. McGRATH: Are you aware that in Queensland a gas commissioner has been appointed to monitor supply and demand? They do not have a fixed reservation policy. They felt the best way was to monitor it. If the commissioner sees it going one way or the other, they can recommend to the government that some action be taken. Are you aware that that happens over there?

Ms Nolan: In that vaguer terminology, yes. We are aware also of the origins: an alternative gas reservation policy was a requirement for a certain percentage of electricity generated to be generated by gas; they took a different direction.

[1.20 pm]

Mr M.P. MURRAY: Just on the gas grid, what is your view on the expansion of that grid, and if there is, what extra volumes will be needed, especially looking further south? Do you see that as viable into the future? I am not talking about 20 years away.

Ms Nolan: The gas pipeline industry is a well-established industry in Australia. It is also a very well regulated industry that has a good track record of seeing investment just in time to provide the gas required. Because of the nature of the regulation, you do not tend to see pipelines built with a lot of excess capacity but rather that the capacity can be relatively easily increased on an incremental basis. We have seen the development on the Dampier to Bunbury pipeline of increased compression over time and then ultimately looping, and I think we have provided information that suggests that with the Dampier to Bunbury pipeline and when the current staging of looping is completed, we will see 80 per cent of that pipeline effectively being reproduced. So you will have two pipelines for 80 per cent of the DBNGP. In terms of whether that is a constraint on the development of the gas market, I think that pipeline industry is there to support the market and it is relatively mature in many ways—the investment decision to invest in pipelines, that is, not that we have an extensive network per se, but we do have good investment in pipelines.

Mr M.P. MURRAY: So it is your view, then, that there will not be any major expansion of that pipeline further south?

Ms Nolan: Sorry; that is not what I said. What I am saying is —

Mr M.P. MURRAY: No, you are not saying much at all, to be quite honest.

Ms Nolan: Okay. If there is a demand for gas, I think the pipeline will come, effectively.

Mr J.E. McGRATH: You are talking about Albany.

Mr M.P. MURRAY: The obvious one is Albany that has been talked about.

Ms Nolan: It was an election commitment of the state government when it came to power that it would look at the expansion of the Dampier to Bunbury pipeline to Albany. As we are all aware, that has been looked at a number of times on and off. The question becomes what the demand is for gas along that route, as well as what in fact the route would be. There is an interagency committee that has been established to look at some of those foundation questions that we would need to answer before you would expand the Dampier to Bunbury pipeline to Albany. It may not meet the regulatory test on an initial cut—that is, it might not be commercial—so that is why the government would potentially become involved in that investment decision.

Mr W.J. JOHNSTON: Could I ask, not on the Dampier to Bunbury pipeline, we have had people tell us—whether it is true or not I do not know—that there are mine projects relatively close to the Goldfields transmission line that cannot get gas and are using diesel. Does the DSD have any views or comments about that?

Ms Nolan: I have not actually heard that myself so I cannot comment.

The CHAIRMAN: There is a firm, which I have read about in the paper, called Karoon, which went from nowhere to about $7 on the stock market. Where are they located, do you know?

Ms Nolan: In the Browse Basin, adjacent to almost near the Prelude field—right up there.

The CHAIRMAN: So they will be included in this thing called the Browse LNG precinct.

Ms Nolan: Potentially, if they were to go onshore.

The CHAIRMAN: The Browse LNG includes more than just, of course, Woodside, so it includes a number of investors in potential projects in that area.

Ms Nolan: What the state is effectively doing is being a proponent for the Browse precinct itself, which is an LNG precinct. It must have been last year that the state put out an expression of interest to those companies that would like to be involved in being a foundation proponent. Alternatively, if they did not wish to be a foundation proponent, but had an interest in being kept informed and potentially being a proponent—that is, an investor in that precinct into the future. The development is of a nature that would enable at least two LNG plants to be developed there.

The CHAIRMAN: Are you talking about plants or trains?

Ms Nolan: There are at least two companies—two JVs effectively—could have their LNG facilities, and in effect the number of trains could be considerably more than two, and it could be up to five. I will pass on the number, but it is a number that is quite large. Woodside expressed interest in being a foundation proponent, and that is the company that the state is negotiating with for the first lease agreement, if that comes to pass.

Mr W.J. JOHNSTON: Can I just ask a question on that? What is the expected capital investment by the state in the development of the precinct?

Ms Nolan: I do not know the answer to that. It is largely a precinct that would be funded by the foundation proponent, particularly for dredging the shipping channels, the port facilities and the like. Those facilities would ultimately be transferred to the state, and future users of the common-user infrastructure would be required to pay commensurate capital investment and/or usage fees over time.

Mr W.J. JOHNSTON: So they are not expected to have to build a hospital or schools?

Ms Nolan: In terms of broader social consequence, one thing the state has done is undertake a comprehensive strategic environmental assessment that included social impact. One of the things that we have looked at is what the impact would be on Broome and other communities. In terms of what that impact is, we have not seen that translate into an impact on capital investment. It is premature at this stage, if there is any impact.

The CHAIRMAN: One of the issues that have come up, particularly in the east, is all these LNG plants being proposed in the world market—I think there are four in Queensland—each proposing two to three trains, which is a lot of gas out of Australia. Then there is other gas around the world. Then you have shale gas in the US, which has seen the market go from $14 to $4. So you have a huge supply of gas worldwide. These are not all interacting markets but they potentially could be.

Ms Nolan: Yes, potentially.

The CHAIRMAN: Are you concerned at all about softening the LNG market in terms of price and projects?

Ms Nolan: In terms of a monitoring brief, we frequently look at the raft of projects on a worldwide scale that are out there and what is potentially happening. In particular, we look at projects that could be targeting some of the traditional export markets of Western Australia—China, potentially India, Korea, Japan—which is where we would see most of our market develop. We are quite fortunate in terms of our location being in that zone where the sailing time is probably seven to 10 days, which is probably about half of what it used to be to travel from Qatar, so that actually provides us with some competitive advantage. Offsetting that is, say, Qatar is nowhere near as expensive in the capital investment sense as developing in Western Australia. So we need to be internationally competitive, and that is probably the major issue that we look at in terms of, not the competitiveness, but what are the raft of projects, where are they and what is demand looking like, and just a general monitoring brief. We obviously hear feedback from the companies themselves as well. You are entirely correct in saying that the world market has changed for both structural and cyclical reasons over the last couple of years. The global financial downturn did see demand of energy fall for the first time in the world, and that was quite unusual. The second thing was the ability to take advantage of the non-conventional gas in the US, and where it sees that gas that may have been exported to the US displaced to is very much an interesting proposition. But if you do a world demand forecast, as against a world supply forecast, then again they tend to be built up on a project-by-project basis for supply and demand and you do not see that price interaction. So that is where we do not yet know—just as we do not know locally for a domestic price of gas—the international price of our LNG, and whether that will continue to be linked to oil price; they are very much interesting questions for the future.

The CHAIRMAN: There is a huge growth in demand for electricity up in the Pilbara—2 000 megawatts, I have read, on the Horizon Energy forecast. Almost all of it is going to be gas, and most of that is base-load. Are there thoughts to put in an alternative source of electricity up there?

Ms Nolan: They are not conversations we have been involved in. It does not come into our bailiwick; that would be more the Office of Energy. The only area that we have seen is potential project proponents talk to us about alternatives, such as solar energy, biofuels and those sorts of issues. We tend to see it at the other end of what the alternatives are as well.

The CHAIRMAN: Do you have any issue that you want to raise that we have not touched on?

The Witnesses: No.

The CHAIRMAN: Thank you for the evidence today. A transcript of this hearing will be forwarded to you for correction of minor errors. Please make these corrections and return them within 10 working days of the date of the covering letter. If the transcript is not returned within that period, it will be deemed to be correct. New material cannot be introduced via these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on a particular point, please include a separate submission for the committee's consideration when you return your transcript.

Hearing concluded at 1.30 pm