ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO DOMESTIC GAS PRICES

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
WEDNESDAY, 15 SEPTEMBER 2010

SESSION TWO

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 10.28 am

PETERSEN, MR TONY
Chairman, DomGas Alliance, examined:

GOH, MR GAVIN
Executive Director, DomGas Alliance, examined:

The CHAIRMAN: Thank you for your appearance here today. We met before and you gave a briefing earlier. This committee hearing is a proceeding of the 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 number of procedural questions that I need to ask. Have you read the "Details of Witness" form?

The Witnesses: Yes.

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

The Witnesses: Yes.

The CHAIRMAN: Did you receive and read an 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: The committee has received your submission and the appendices, which are quite extensive. Thank you very much for those. Do you wish to propose any amendments to your submission?

Mr Petersen: No, we do not.

The CHAIRMAN: Before we ask questions, do you want to make an opening statement or otherwise?

Mr Petersen: Yes, I have a small opening statement.

The CHAIRMAN: Okay, please proceed.

Mr Petersen: Thank you very much for the opportunity to address the committee. My name is Tony Petersen, and this is Gavin Goh. The DomGas Alliance is the state's peak energy user group. We represent gas users, infrastructure investors and prospective domestic gas producers. Alliance members also supply gas and electricity to over 200 000 small businesses and two million Western Australians. Domestic gas security is one of the biggest challenges facing the state today. Affordable gas is vital for jobs, infrastructure, investment and growth of the state's economy, especially manufacturing and resource processing industries.

It has a direct impact on small business and households through gas and electricity prices. Twenty-five years ago the state government and Alcoa took a strategic decision to underpin the development of the North West Shelf project and the LNG industry. This was through long-term take-or-pay contracts and the construction of the Dampier to Bunbury natural gas pipeline. This resulted in major payment obligations that almost bankrupted the state. By the mid-1990s, the state had paid over $300 million for gas that it had not received. Development of the gas industry was therefore only possible with significant financial support from the state, the commonwealth and the gas users. Without this support, there would have been no project and no LNG industry as we know it today.

Today, after 25 years, we have a situation where the state with Australia's biggest gas market and largest reserves has Australia's worst gas shortage and prices that are up to three times that in Victoria. This situation is caused by two factors—the absence of competition and the lack of access to gas reserves. First, the Western Australian gas market is the most uncompetitive in the country. It is basically a duopoly market where just two producer groups control close to 100 per cent of the market. The ACCC has repeatedly intervened in the market to protect individual sellers from competition. This has resulted in sellers having immense market power, which is reflected in gas prices. Sellers are able to choose their marketing windows to ensure that new supplies do not compete with each other for customers. Secondly, offshore gas fields can be warehoused for long periods without any competition or public transparency. Federal government policy is currently prioritising LNG over domestic supply for Western Australia. Some fields have been warehoused for as long as 30 years.

The DomGas Alliance believes the solutions are straightforward and already available to government. First, the reservation policy must be applied unequivocally. Domestic supply obligations must be made unconditional and not be subject to a commerciality escape clause. Second, the retention lease process must be transparent, must foster competition and must aim to stop producers warehousing gas. Finally, joint selling must end in five years' time to ensure that there are more sellers in the market to compete with each other, just as they do in New Zealand, the European Union and most other places in the world. These and other initiatives are discussed in the Alliance’s submission.

I would now like to supply some factual information. First, there appears to be no available evidence that Western Australia’s high gas prices are justified by increasing costs to producers. According to Woodside's 2009 company results presentation, gas lifting costs—the cost of extracting gas and delivering it to the processing plants—rose from 31c in 2005 to 55c in 2009. Over the same period, gas prices for new contracts in WA have risen from around $2.50 per gigajoule to around eight dollars per gigajoule. Secondly, there is no international price for gas. Gas prices vary considerably between countries. Most energy producing countries have gas prices that are now substantially lower than in Western Australia. Even in gas-poor China, industrial users can pay as low as $4.50 per gigajoule for domestic gas.

Western Australia has a natural endowment in energy. These resources belong to all Western Australians and the DomGas Alliance is a strong supporter of gas developments in the state, including export projects. Affordable domestic energy must be a competitive advantage for this state. There can be no justification for the Western Australian community paying export prices, or LNG netback prices, for our own energy resources; instead, the domestic price should reflect the cost of delivery into the processing plants. Thank you.

The CHAIRMAN: Thank you very much. I guess the starting point is that you have mentioned both in the briefing and in your various submissions, and we have received from others, about policy instruments you suggest about tightening up retention leases—both duration and justification—and also joint selling. Those are largely in leases offshore. I guess this is the question: what can the state do about those two issues?

Mr Petersen: In terms of joint selling?

The CHAIRMAN: Both retention leases and joint selling.

Mr Petersen: Okay. I believe that the state can certainly support the move away from the joint seller. That opportunity is certainly going to be available in about five years' time.

The CHAIRMAN: Five years for which project—the North West Shelf?

Mr Petersen: Yes, that is right.

The CHAIRMAN: And the Gorgon is being deliberated by the ACCC now or has the ACCC given a decision on the Gorgon joint seller?

Mr Petersen: They have.

The CHAIRMAN: So there is no window to review that?

Mr Petersen: Not currently.

The CHAIRMAN: Could you create a window to review that?

Mr Petersen: Yes, I imagine that avenue is available.

The CHAIRMAN: Is it in the case of Gorgon that there is joint selling in our domestic market but not joint selling on the export market; that is, do partners of Gorgon sell their gas oversees separately?

Mr Petersen: Yes, they do.

The CHAIRMAN: So when the North West Shelf was set up there was an agreement, I think on all sides, that they would jointly sell the gas offshore, at that time to Japan, for countervailing monopoly reasons, I think it was, as a justification—single buyers, collective buyers and Japan utilities, and then the joint seller from here. Obviously the Gorgon people have decided that is not necessary for offshore export of LNG. What is the justification of the Gorgon people for joint selling domestically whilst they are not joint selling offshore?

Mr Petersen: The information provided through the ACCC determinations—I guess it is probably a better question to ask the Gorgon joint-venture people—

The CHAIRMAN: But you would have had debates with them through the ACCC?

Mr Petersen: Yes, through the determination process. They believe that there is a risk in selling to the WA market and they need to be protected from that risk.

The CHAIRMAN: What risk?

Mr Petersen: That is a good question.

The CHAIRMAN: Would that be volume, price or what? You are arguing for the same volume to be sold but by two different parties. You can negotiate —

Mr Petersen: Individually, yes.

Mr Goh: Certainly, for Gorgon with domestic supply you are looking at perhaps five or maybe 10 per cent of overall production and maybe it is decided it takes capital investment costs, but the argument that the proponents put to ACCC and which the ACCC accepted was that unless they could sell jointly domestically, that would impact on the overall project investment. That was the initial argument. Then that subsequently became that it would impact on domestic supply volumes, because of the additional costs of maintaining separate selling arrangements. We made a very strong case to the ACCC in terms of the lack of logic and in fact a lack of evidence around this, but ultimately we were not successful.

Mr W.J. JOHNSTON: I have tried to write down the words you used, and if I have got them wrong I apologise for that. But in respect of the cost for the domestic sale of gas, it should be the cost of delivering into the processing plant. As I understand, that is basically the same words that the Premier used in his speech in the United States. Could you explain the difference between that price and the LNG netback price please?

[10.40 am]

Mr Petersen: The LNG netback price assumes investment in LNG projects. I guess there are a few different ways of calculating the LNG netback but you basically look at the investment in the project and then determine what is the price that is required to maintain the same level of return on investment.

Mr Goh: I guess the LNG netback is the downwards calculation.

Mr Petersen: Correct.

Mr Goh: So, it becomes: what is the price of energy for people in China, Japan and Korea? What are they prepared to pay for energy? Then you subtract processing costs, transport costs, rectification costs. By accepting the LNG netback, you are basically locking in the state to effectively what people in China, Japan and Korea are prepared to pay for gas.

The CHAIRMAN: But that is not completely right. Many of these offshore projects would not exist without LNG.

Mr Petersen: Yes.

The CHAIRMAN: So you have to include a disproportionate share of your exploration and development costs because if you do not do that, the projects do not exist, at least offshore projects.

Mr Goh: We would certainly accept that. I guess what the Premier's formulation is about and what we have agreed with the state is the price of gas into the processing plant. Sure, you add a processing cost and produce the same data to a fair rate of return. But it is an upwards calculation as opposed to a downwards calculation.

The CHAIRMAN: Yes. So you take the gas, let us say, to Karratha.

Mr Goh: Yes.

The CHAIRMAN: Then one can go offshore and you can give them netback LNG. If the other one goes through a domestic processing plant, you have to subtract both that and the pipeline cost, depending where you are.

Mr Petersen: Yes.

The CHAIRMAN: So your essential argument is that the domestic price of gas should not relate to world parity prices, whatever that may be. Is that what your argument is?

Mr Petersen: Correct.

Mr Goh: Yes, plus I think ultimately it comes down to: do we as a state want a competitive advantage in energy or do we not?

The CHAIRMAN: One would look at the state's perspective as you have choices; right? Onshore gas, you have no choice except small fields. Let us look at the LNG, once they have an option for LNG. The other ones are completely different. You have the choice of hitting the LNG industry or you have a choice of selling gas domestically. LNG provides a lot of benefits. The Gorgon project provides a lot of benefit to the state and to the nation without question—royalties, economic activity, developments and growth. Then you are also consuming gas domestically, which provides to many of your members obvious benefits; okay? So, why should we as a state have a policy that we are going to administratively differentiate the price between offshore and domestic? Why? Show me why it is preferable, argue why it is preferable, to have cheaper prices, regulatory cheaper prices, for domestic, as opposed to LNG, recognising LNG does provide benefits to the economy.

Mr Petersen: We do not believe it is an "either or". It is not a choice of it is either LNG or it is —

The CHAIRMAN: At the margin you are saying it is. You are not going to get those big scale ones for domestic gas without LNG. It is not "either or".

Mr Petersen: Yes.

The CHAIRMAN: Okay, we recognise that. But what you are saying at the margin, what you are essentially saying is that international netback prices they can get for LNG in the Asian energy–poor areas, which they are, should not have any bearing on the prices of gas from those LNG projects domestically.

Mr Petersen: We do not believe that the state should be paying the international price for gas.

The CHAIRMAN: The state?

Mr Petersen: Domestic gas consumers and users.

The CHAIRMAN: What price should it be?

Mr Petersen: I think we have just elucidated that it should reflect the price for delivery into the processing plant.

The CHAIRMAN: It means it is priced zero before it gets into the processing plant?

Mr Petersen: No, it will not be zero.

The CHAIRMAN: What would it be? I mean, again, these projects do not exist without LNG; okay?

Mr Petersen: Sure.

The CHAIRMAN: There is a conjoined function to it; okay?

Mr Petersen: Sure.

The CHAIRMAN: So, what would it be? Is it just cost-recovery plus?

Mr Petersen: Would it be reflective of lifting costs perhaps?

The CHAIRMAN: That is a marginal variable cost.

Mr Petersen: Yes.

The CHAIRMAN: We have heard evidence that those marginal costs are rising, too. The price that you referred to as 55c is an average cost, as I understand it, not a marginal. So, we need some kind of argument or direction. What do you think that price would be? I mean, you are the major consumers. You have come up with this price calculation or method. What would it be? What are you arguing the price should be from the North West Shelf? Forget LNG, which is what you are saying. What is the price you think should be sold to the domestic market?

Mr Petersen: I think that is a question not to ask of us, because we do not have the costs information that a producer would have.

The CHAIRMAN: But you are a major purchaser of this gas.

Mr Petersen: Indeed.

The CHAIRMAN: Have you never done the calculation?

Mr Goh: We just do not have that degree of information available. I mean, we can say what the price should not be. It is harder for us to calculate what the actual price should be. I guess if you look back in terms of what policy purchase device is being found to push, over the last few years we have steered away from what prices should be. Our line has always been the prices would be set according to the market so long as it is competitive. We do not have a competitive market.

The CHAIRMAN: We had a policy on oil and gas years ago, I think in the 1980s sometimes, when we went to world parity prices for oil. We have done it on almost all industries that we decided, because we were a major resource exporter. And for a variety of other reasons we tried to limit tariff barriers and protective barriers, and we go to what the market determined to some extent were offshore prices. Again, this argument relates only to LNG domestic non-exportable fields—a different question altogether.

Mr Goh: Yes.

The CHAIRMAN: And we need some kind of guidance about what that would be. Is it 50 per cent of the latest contract price? We need some guidance. We are going to have a hard time collecting it. We are not an expert body. We need people such as yourselves to provide us some kind of indication what that is or what it would be.

Mr Goh: And the reality is we will be plucking the numbers out of the air if we went down the path of —

The CHAIRMAN: Better that you pluck than us!

Mr Goh: Yes.

Mr Petersen: Or perhaps the producers could.

The CHAIRMAN: This committee is taking on an issue about: what is the price of LNG? As you said, there is no single price.

Mr Petersen: Correct.

The CHAIRMAN: And shifting the investments offshore between LNG and domestic is very difficult. So, we need people, experts, to provide us estimates of demand and consumption and expenses and calculate the prices if we are going to make what is an accurate view on this.

Mr Petersen: Perhaps the question is, I mean for us, we have seen prices go from around the $2.50 mark to $8 and upwards of $8. We have not seen any justification—perhaps there is. We have not seen the evidence of that; we do not believe there is. We believe it is a competition issue.

The CHAIRMAN: Those marginal sales were from Apache; $2.50 was the North West Shelf mainly, and the take-or-pay contract which drove the state along for 25 years. The marginal sales were from other fields, often offshore fields. The North West Shelf has entered into additional contracts over take or pay.

Mr Petersen: There were some other longer term contracts drawn up; Apache–Santos out at the Donnybrook's field, for example, in 2005.

The CHAIRMAN: Yes, but those are not LNG projects.

Mr Petersen: No.

Mr Goh: No, but there is the recent North West Shelf conflict and redetermination with Alinta. It was a fairly sizeable contract. There is not much by way of public information. All we know is terms of the media reporting.

The CHAIRMAN: Yes, we will get to some of those initiatives about clarity and transparency and whatnot, which we discussed. But, I think I urge you to provide some kind of guidance of where your recommendations on pricing formula will take us, just for indication. Also, I mean some of those recent prices are not from LNG. So, LNG netback to those providers of gas is not relevant. It is not an option they have, but they are providing higher prices. That is where the higher prices, I understand, are coming from: non–LNG producers.

[10.50 am]

Mr Goh: But it is all flowing from a single market. Now, when you have a market that is undersupplied with no competition, it is a duopoly market; effectively, the prices are being set off each other.

The CHAIRMAN: Yes. Another issue that people have argued is that "price is cost to you but an incentive to explorers". One of the problems of not having a large number of non-LNG suppliers is that the price has been at $2.50, which is very low, for a long time and has been set by the DomGas LNG contract. Although price was initially very high—when the contract was first set in the 1980s—over time, relative to world prices, it has declined. Consequently, there has been no price incentive for people to go out to explore and to bring on smaller onshore/offshore fields. Therefore, if we set, through calculation or otherwise, a domestic market price that is the inadequate relative to cost an incentive needed, we could be stuck in a mess. It would result in less exploration than would be otherwise optimal in a domestic market. If there were onshore gas discoveries that could supply the domestic market—because they have no alternative—we might, through price regulation, be cutting off a large supply source. It is a little Ockham's Razor issue—this fine line that you are arguing for. Your members have as strong an incentive as anybody to make sure that there is an adequate supply of gas to market.

Mr Petersen: Absolutely—and from a diverse range of supply. We are very supportive of initiatives to promote —

The CHAIRMAN: Yes; many of them are doing it themselves.

Mr Petersen: Exactly.

The CHAIRMAN: Yes.

Mr Petersen: And there might be opportunities in shale gas, for example.

The CHAIRMAN: Yes, or in conventional gas. I think one of your members, Alcoa, is in a joint-venture—yes.

Mr Petersen: Indeed.

Mr W.J. JOHNSTON: What do you say to somebody who says that the DomGas Alliance is arguing for an energy price that is below the world price, but exporting its output into a world market in which it receives world prices for its exports?

Mr Petersen: We would say, "Does this state have a competitive advantage in energy or does it not?" The state certainly has a competitive advantage in minerals; does it have a competitive advantage in energy to process these minerals? We believe it should.

The CHAIRMAN: Why?

Mr Petersen: Because the energy is here and available to us.

The CHAIRMAN: We have a transport advantage; that is, China would have to use gas from the North West Shelf and therefore have to pay transport costs, handling costs and distribution costs that we would not necessarily have to pay.

Mr Petersen: Agreed. However, having the mineral resources here and having the energy available to us, it would seem that WA should take advantage of this.

The CHAIRMAN: At the cost of making a quid from exporting high-value peaking fuel in the form of LNG?

Mr Petersen: It does not have to be a trade-off, as far as we see it. There are plenty of examples in the world in which that is not the case.

The CHAIRMAN: I think, from the evidence we have heard, that the Holy Grail, if it exists, is in fact onshore or smaller offshore fields of gas that would have no option but to sell to the domestic market. It might require different infrastructure and whatnot, but your partners are definitely focused on and aware of this. Do you think that that should be a priority focus of the government initiatives to spur exploration in those types of fields? If you have a view, what would it be about the prospects of that?

Mr Petersen: I guess that we were optimistic that some of the closer inshore fields, some of the smaller fields that were not suited to LNG on their own, would become available to domestic gas;

however, it seems that recently, through the retention lease policy arrangements, a lot have ended up being aggregated into LNG projects. We find that disappointing and do not see the value in waiting for year 15 or 25 of an LNG project when the gas can be made available on the domestic market now. And we believe that the lack of transparency in this whole process has not helped.

Mr M.P. MURRAY: In your opening remarks you commented that WA gas was three times, I think you said, more expensive than Victorian gas. Is that due to subsidies or pegged prices? What is the reason other than the competitive market? There must be a competitive market on the east coast. What do you believe is the reason for the difference in the price from one side of Australia to the other?

Mr Petersen: We believe it is the lack of competition in the market. The east coast market is much more competitive with a lot more buyers and sellers and a lot more producers. That market is more transparent; that is, gas prices are available. We believe that to be the key difference; that is, in the competitive structure there are a lot more buyers and sellers in the market over east and a lot more transparency about prices.

The CHAIRMAN: Of course, right now it does not have competition from offshore LNG.

Mr Petersen: Yes.

The CHAIRMAN: They are working up to that.

Mr Petersen: That is right. And the Queensland government decided to allocate certain reserves for domestic supply.

The CHAIRMAN: You raised the issue of smaller fields being accumulated or aggregated into the LNG market. In past years, those fields would have been developed separately, under a different ownership structure. In your view, are they being able to warehouse those fields for significant periods of time—in excess of what is needed for LNG projects—through the retention leases?

Mr Petersen: Yes.

The CHAIRMAN: Are they being purchased—discovered—by firms other than the joint-venture partners? Are the joint-venture partners purchasing discovered fields or making the discoveries?

Mr Goh: Most of these fields have been around for a very long time. An example of that is the West Tryal Rocks field. There is a lot of discussion about how feasible it is to develop the fuel. The challenge is that a number of the prospective producers have in the past put up their hands to have a go at the field and have been knocked back.

The CHAIRMAN: Who knocked them back?

Mr Goh: It would be the joint authority.

The CHAIRMAN: Who discovered the field?

Mr Petersen: Thirty years ago? I am not sure.

Mr Goh: I am not sure. Certainly, Chevron is the holder of the field now. It is all about regulatory pressure—you either develop the field if it is feasible or drop the field. We do not have that regulatory pressure in Australia at present. The federal government has been going through a very long process of reviewing the retention lease arrangements and in 2007 a joint state working group recommended that these retention leases have to be stringently applied to promote domestic supply. That is the background. Today, we have a federal policy that effectively says if the resource can be developed as part of an LNG project for 15, 20 or 25 years, that takes precedence over domestic supply.

The CHAIRMAN: Is there an explicit policy statement to that effect?

Mr Goh: There is no explicit policy statement because, in our view, it is not permitted under legislation. However, Minister Ferguson has certainly made a number of comments along the lines of prioritising the “bigger project” and when we see fields like West Tryal continue to be rolled over despite potential interest, all we can do is simply make our assessment accordingly.

[11.00 am]

The CHAIRMAN: Is the problem with the retention lease the methodology used—that is, you have to make some decision? Is it because of the issue about the profitability, and is it being rigorously and objectively assessed for justification for obtaining those retention leases?

Mr Petersen: We do not know. The issue is transparency. These reports are not published; they are not available.

The CHAIRMAN: They are provided to the relevant commonwealth department.

Mr Goh: The other issue is the fact that the existing leaseholder deems something is uneconomic for its cost structure does not mean a smaller, more nimble company is not able to make it economic to develop.

The CHAIRMAN: So this decision is not contestable or transparent to other parties?

Mr Goh: That is correct.

The CHAIRMAN: What about at the state level? What is the methodology? Is it similar? We do not have LNG projects, so it is probably not as important, but is the methodology similar at the state level to that of the commonwealth level for adjudicating retention lease decisions?

Mr Petersen: Yes, essentially.

The CHAIRMAN: Essentially the same thing? Is there not work program bidding for retention leases where they have to do some drilling and activities to retain the lease?

Mr Petersen: Work programs are a requirement for all leases.

The CHAIRMAN: So they have to spend some money to keep it going—to retain?

Mr Petersen: Yes. They have to put in a work program that says they will spend some money.

The CHAIRMAN: Yes. You raised some issues about transparency and we have heard them from other people. We did a tour of the eastern states and are now the full bottle on that, I hope. In Queensland there is a gas commissioner. They had an issue about their reservation policy and they decided not to do it in this flux period and leave it up to an annual review or something of the new gas commissioner who looks at the market; that is one initiative. The second one is the bulletin board, which at least allows people to know which transactions have been taken. Then there is the short-term gas market, which was opened up while we were over there. It has excited the regulators immensely. Could you comment on these types of policies, or anything else that you would suggest for increasing the knowledge and transparency of the gas market?

Mr Petersen: We think all those are very positive. The gas statement of opportunities, the bulletin board; we think they are all very positive and we know that the Office of Energy here is looking at ways of implementing those sooner rather than later, so we certainly welcome all of those to make the market more transparent.

The CHAIRMAN: All those. Anything else that you could suggest?

Mr Petersen: Rigorous application of the reservation policy.

The CHAIRMAN: Yes.

Mr M.P. MURRAY: In your view, which way do you think the world markets are headed? Is it flattening out because we have other projects coming on stream, possibly on the east coast, in Western Australia and the Middle East? Do you think the world market will flatten or continue to rise?

Mr Petersen: That is the better minds than mine, Mick!

Mr M.P. MURRAY: Sure, but a rough guesstimate? It is important to the whole picture for gas.

Mr Goh: For every report we see that says it is doomsday for LNG, there is another that says it is not, so we find it really hard to assess how the world is going in terms of the LNG market. We have looked at this state's domestic gas market, in terms of the supply and demand developments. What we can say is that there is a significant shortage that is happening now and will continue until 2020 and beyond.

The CHAIRMAN: Why do your members not put more money into exploration of prospective onshore fields?

Mr Petersen: Some of our members are.

The CHAIRMAN: We have heard that, particularly for shale gas and other areas, it is very prospective. You guys have a large interest in finding gas; you are the major users and transporters. There are people doing that, I understand, from reading the paper and whatnot. As an alliance, have you thought about putting money into exploration for these gas fields?

Mr Petersen: Not as an alliance, but certainly our individual members are, that is for sure. Alcoa is certainly putting in significant exploration expenditure, particularly around the Perth basin.

The CHAIRMAN: One of the major suppliers of gas historically has been the North West Shelf partners. The DomGas contract supplies about 60 per cent of the gas on the market. That contract, as I understand it, starts approaching renewal in 2014. That would leave a huge gap in the market if it were exhausted. Do you have any comments on that?

Mr Petersen: That is part of the projections for some of the recent projections by both the Department of Mines and Petroleum and the work that the alliance has done. We are certainly trying to look at what happens with those contracts.

The CHAIRMAN: Yes. What would be your recommendation on that one particularly, since it has been the basis for the industry and consumption for a long time?

Mr Petersen: Our understanding is that as long as there is demand, and we believe there is a significantly unmet demand here in Western Australia, that the supply will be met. We believe that the powers exist in the North West Shelf Agreement Act for government to review the supply of gas under that sort of contract, so we would hope that that would continue.

Mr Goh: Certainly the state agreement actually contains a clause that allows the state to prioritise domestic supply of LNG. We believe that long-term LNG contracts are now being rolled over and negotiated, and it is important, given how critical the supply is to the state, that the states does step in and ensure the future needs of the state are met before any of these LNG contracts can be rolled over.

The CHAIRMAN: As I understand it, we cannot really officially renegotiate until the quantity of contract gas is approached, so it is about 2014. The contract says the North West Shelf partners will supply to the domestic market a certain quantum of gas, and as we approach that, there is the right to negotiate.

Mr Goh: There is actually two separate—I guess you could describe—domestic reservation commitments under this state agreement. The first is the set volume that has been set aside, and we understand that volume would be met by the producers. The second is the residual obligation that allows the state to prioritise domestic supply need over LNG contracts, before the contracts are rolled over.

The CHAIRMAN: Even if they are rolled over before the —

Mr Goh: That is right. Clause 46 of the state agreement applies to rolling over contracts between 2010 and 2025. There is a powerful mechanism available to the state to ensure that local needs are met.

The CHAIRMAN: As we discussed earlier, Western Australian industry has been based on relatively competitively priced gas. We met some people in the eastern states who undertook an inquiry in 2002 into the Australian energy market. At that time, they said that Western Australia was viewed as the epitome of what the rest of the country should be doing, with large volumes of cheap gas being heavily used and reticulated through the industry. At that time the eastern states was seen as a massive policy vacuum basket case. Now there has been a total switch; the market in the eastern states has new reserves, new pipelines, it is competitive and it is pretty good. We know, hopefully, where we should go. It is not easy to get towards that. Besides those joint markets, how can we inject an ensured multiplicity of suppliers, multiplicity of pipelines—that is what they have in the eastern states—and multiplicity of competition in the downstream market? Again, the downstream market is heavily dominated by a few major consumers.

[11.10 am]

If you look at the eastern states and you say that that is the benchmark, clearly it is the performance of that industry that is the benchmark. Could you give us an idea on how and whether we can evolve towards that?

Mr Petersen: From the state’s perspective, we are going to see a lot of significant users soon with larger demands, such as the magnetite miners, for example. Every magnetite miner needs about 150 megawatts of power. Whether that involves more of the same in terms of gas reticulation or whether there are economic opportunities for other new pipelines remains to be seen. Perhaps there is a case for linking the two pipelines, for example. From looking at the upstream and production side, we would welcome anything that supports more competition and more producers and gas sellers in the market place. We would hope that the joint marketing lasts for only another five years. We would hope also that there are opportunities for retention leases to be made available so that people can get access to those reserves and bring them onto the domestic market, and perhaps a shared infrastructure arrangement can be looked at as well. Most joint venture partners think of the legal issues, but maybe we need to think through that and say that if it is possible in other parts of the world, it should be able to happen here.

Mr W.J. JOHNSTON: I will just follow up on that thought. The pipelines from Pilbara to Perth and from Pilbara to Kalgoorlie are both regulated infrastructure. Do you think there is an argument for the regulation of the gas processing facilities as infrastructure in the same way that there is a debate about the train lines in the iron ore industry; that is, the LNG plant and domestic gas plant is infrastructure and should be separated from the gas producers? Do you have any comments to make about that?

Mr Petersen: Bill, there are probably a whole range of issues that could be followed up, and that is certainly one of them. We have looked at developed, mature fields and operations such as at Scandinavia and the Gulf of Mexico where there is a lot of shared infrastructure. Some of the level of regulatory oversight differs, but a range of issues can be talked about.

The CHAIRMAN: They did that with gas gathering in the 1980s with the Bond and Harriet fields. That was actually induced by government policy and it was like herding cats that do not like each other. Do you see any scope for that?

Mr Petersen: I suppose our concern with the gas aggregation philosophy is that —

The CHAIRMAN: Yes, areas where you see that there is scope for cooperation to ultimately have a joint onshore gas facility.

Mr Petersen: Provided that it does not end up being the same arrangement that we have now, which is a dominant joint selling arrangement. We would rather see more players than fewer players. It might then have some advantages. Our natural view to gas aggregation is that it will lump together two big dominant players in the market.

The CHAIRMAN: I go back to the history of the gas industry in Western Australia. The gas used in Western Australia is based on the gas brought from the North West Shelf. We use a lot of gas in this state; more than any other state. In the eastern states they use only 15 per cent gas and 85 per cent is coal and alternative energy. We have a heavy dependence on gas. The price for gas in WA has been relatively low compared with the other states and relative to what it costs now. Do you think it is therefore inevitable, whether you take LNG netback or a price by a formula that you are advocating, that we will see a higher gas price in the future and therefore adjustments from your customers?

Mr Petersen: That is crystal-gazing. Every time someone tries to state what the oil price will be next year, it turns out to be totally different.

The CHAIRMAN: Let me put it this way. It was $2.50 sometime ago and it is now $8. Do you expect the price to be closer to $2.50 or $8, according to your methodology?

Mr Petersen: We believe, looking at our supply and demand forecasts and the forecasts from the Department of Mines and Petroleum, that there will be significant unmet demand. We would see that as a natural drive for the price to go even higher, unless significant changes occur to what is currently happening. We believe that the best opportunity is the unequivocal application of the reservation policy.

The CHAIRMAN: The Department of Mines and Petroleum had a couple of forecasts. One was exceedingly low and was driven by the fall off of the North West Shelf DomGas and some assumptions about the post-2014 contract. There is no doubt that the gaps were huge. It also had some upper forecasts, depending on the Pluto, Gorgon and Browse Basin projects and others, which were more or less meeting demand at the upper end of the scale. They also had this issue of non-LNG supplies, which is a big issue. What sticks in my mind is that what happened in the eastern states, which our terms of reference bind us to look at, is they had a price incentive. The Queensland government said that you have to use 13 per cent of gas for electricity generation. That was done to promote a pipeline from New Guinea but there was an incentive and so people went out and drilled and used unconventional technology and wallah. They have large amounts of coal seam methane and a very vibrant and competitive gas market. That was because of the pricing, or demand signal. If we suppress that by having artificially low prices, we could cut off the exploration of onshore fields that would be targeted for the domestic market. We would be locking ourselves into a regulatory means of forcing gas onto the market rather than allowing the market to go out and discover new quantities and therefore giving us a lot more of a market for both export and domestic users. That is the quandary we have. That is why I am trying to get some kind of price mechanism from you. Would there still be an incentive, under your system, for people to drill in the Perth and Canning Basins for conventional and unconventional gas? Some of your people know it very well because they are doing it under the current regime.

Mr Petersen: Indeed, and they are after diversity of supply.

The CHAIRMAN: That is another point.

Mr Goh: It would be ideal to have unconventional gas, but at the end of the day, you do have 80 trillion cubic feet of gas readily available offshore. That is where the focus should be. Everything helps, and some of our members are actively in the unconventional gas field. I think that even the Department of Mines and Petroleum's projections less optimistic projections are talking about maybe five or seven trillion cubic feet of gas. Certainly, that is 10 per cent of what we already have offshore.

The CHAIRMAN: A small percentage is offshore. Most of that, no matter what we do, will go on LNG.

Mr Goh: Not necessarily. If we have an effective reservation policy, that gives us certainty that 15 per cent comes onshore. That is the mechanism that we can use.

The CHAIRMAN: No matter what we do, even if we apply rigorously a 15 per cent policy, most of the gas—the reserves—will go offshore.

Mr Goh: Certainly, but at least —

The CHAIRMAN: Especially if we have your policy of a differential price.

Mr Goh: We are reluctant to get in the space of the government setting a regulatory price.

The CHAIRMAN: No, your differential price. You are basically saying that you have a reservation of 15 per cent; that is, 15 per cent of the field has to go onshore.

Mr Goh: That is right.

The CHAIRMAN: The pricing should not relate to netback LNG but should relate in some way to the cost of providing it onshore.

[11.20 am]

Mr Goh: Certainly, that is what we would like to see, but as for government actually setting that price —

The CHAIRMAN: Of course, that is why we are here. I am just trying to explore your recommendations and to get to the point that if we did that, you could easily, dependent on how your costs add up—particularly in the North West Shelf, where that capital was sunk a long time ago; it is mostly written down—come up with a very low price, $2.50 or $3. At $3, the information that I think is available on unconventional and onshore gas, all the drilling rigs, the few that are there now—were there actually 90 drilling—would go.

Mr Goh: I think no-one is advocating, certainly not our membership, about a return to $2.50 or $3 gas; that is not realistic. I guess what we have always been keen to do is have certainty of supply through the reservation policy. If you have 15 per cent being delivered, the market will set the price. Of course, if you had a competitive market without joint selling, but we have lost that fight for another five years. So I think that, compared to what the state can do, there are certainly strands that we can bring together and within five years, hopefully, all of these things will amount where we can get more effective and competitive in a certain market, certainly different to what we have today.

Mr Petersen: We would argue that if the LNG partners knew that they had this obligation for supply, they would then go and do what they do best and let their marketing people come to the best commercial arrangement for that gas.

The CHAIRMAN: It is the same thing that they would do with a royalty arrangement. But are you proposing to revise the reservation, back cast it; that is, to tell Gorgon—I think they have done it. As I understand it, there has been an agreement on reservation with the Gorgon joint venture partner and that applies to 15 per cent, with some flexibility —

Mr Petersen: We have only seen what we have seen publicly, which works out to be about five per cent and there are some now and some later.

The CHAIRMAN: Are you arguing to back cast that?

Mr Petersen: No. I think we have an aversion to that sort of policy.

The CHAIRMAN: Of course you would.

Mr Goh: There is a separate issue there relating to Gorgon—with Chevron's analysis of all these new field discoveries. Now, the original Gorgon reservation policy was to set a volume, which, under the existing resources, comes out to five per cent. Now, when multiple fields and discoveries are being, I guess, folded into Gorgon, we would like to see a 15 per cent reservation policy applied to these new fields in the same way in which they should be applied to other new projects.

Mr W.J. JOHNSTON: I am interested to know whether you could provide us with a list of projects that are possible for the state of Western Australia with what they would need as a gas price to make the projects fly. Often there is discussion of what possible industrial development, mineral processing developments, are around for Western Australia. It would be interesting to know what projects there are about and what their gas price sensitivity looks like for us.

Mr Petersen: We certainly do not have that information off the top of our heads.

Mr Goh: It is a challenging issue, Bill, because you are not going to find many companies publicly saying at what price their project goes under.

Mr W.J. JOHNSTON: Even if you cannot provide that information, at least provide the possible demand. You have your demand curve on page 20 of your report, which, obviously, I am not dismissing, but I was just referring to your report. What makes up that demand curve that you are projecting for the future?

Mr Goh: We certainly engaged an expert to put together a report on the future of supply and demand. We can provide that to the committee. It does provide, I guess, a list of indicative projects. The assumption that the report makes is that those projects would go ahead if they can get gas that is affordable to those projects, so that report does not actually try to drill down in terms of price. That is the assumption that was made.

The CHAIRMAN I have a couple of issues. One is that your major policy recommendation is that it is a joint market. There are a couple of aspects to that. One of the questions is: if you allowed competition between those parties, how much competition would there be? Do you have proof that the gas producers are working together in that marketing—that is, they are colluding in the joint market and working together to jointly market and sell the gas on the domestic market?

Mr Petersen: We just see the evidence, which is the joint marketing approach.

The CHAIRMAN: Another one is: in your submission to the ACCC, you argue that the continuation of joint selling out of the North West Shelf project will cost Western Australia current consumers $2 billion.

Mr Petersen: Correct.

The CHAIRMAN: Can you explain how that number is derived?

Mr Goh: That number is calculated based on the historical prices of between $2.50 and $3 gas, and if you are shifting to this new paradigm of $8 gas. I guess it is a back of the envelope calculation but it does make sense in terms of moving from a $1.5 billion market to a $2.5 or $3.5 billion market.

The CHAIRMAN: So the implicit assumption is that the joint marketing is totally responsible for the rise from $2.50 or $3 to $8?

Mr Goh: We cannot see how joint marketing would have any other effect.

The CHAIRMAN: It would arguably have a diminishing effect on competition, but that calculation means that the total rise is because of that lack of competition. There was not competition with $2.50 or $3; that was a contract price. The price moved up to $8, even though it was to a large extent, from non-LNG sources of supply.

Mr Goh: I think a big chunk of that would be the North West Shelf determination.

The CHAIRMAN: But your calculation assumes the total increase is due to a lack of —

Mr Petersen: Correct.

Mr W.J. JOHNSTON: What do you think of the idea of adding in 500 or 750 extra megawatts of coal-fired power and back out gas to make it available for other uses? I am not even the member for Collie–Preston! Do you have any comment about that?

The CHAIRMAN: You did see mixed smiles!

Mr M.P. MURRAY: I am grooming him!

Mr W.J. JOHNSTON: Not very well!

Mr Petersen: I think that the Department of Mines and Petroleum agrees with you that the inevitable outcome of the energy gap, as they are calling it, will be an increase in coal supply of power.

Mr W.J. JOHNSTON: You are the DomGas Alliance: does it cause you any offence, because it seems like a sensible option? What is your position on that?

Mr Petersen: From our perspective, we know that there is a high concentration of gas-fired power in the state compared with anywhere else in Australia at the moment. We think that there is obviously a benefit in having more gas-fired power for a whole range of reasons. But if the current market determination is that there is a mixture of coal and gas going forward, provided there are some opportunities for our members, then that is what it is going to be. Would it be better, effectively, if it were all gas? That would suit our members. Is that 100 per cent realistic? Not in the current climate.

Mr Goh: The other factor to consider is what would be the impact of a future carbon tax or carbon cost? If we go from the situation where we are winding down a lot of our gas and energy-based economy and shifting it to coal, does that potentially expose the state to higher carbon costs in the future?

The CHAIRMAN: I am not sure whether you would commit to this, but if you could give some thought to some numbers on your pricing arrangement; that is, how you think the domestic gas should be priced and give us some kind of ballpark figure to work from. We are out there grasping at LNG prices and they are all over the place; it depends on the latest contract and what you report. There is no doubt about trends, we have evidence on the domestic gas price rise, but we need to have some benchmark. We are not a forecasting group; we rely on information provided by submissions.

Mr Petersen: We will certainly consult our members, so, hopefully, we can get back to you and we can provide that economic forecast.

The CHAIRMAN: It would be nice if you could have a supplement about your members' thinking about the prospectivity of onshore gas or their own activities in exploration, so that we can see what major users are also thinking about in terms of looking for gas outside the LNG regions.

Mr Petersen: Absolutely; our members are very keen and they are exploring. It is all about diversity of supply. We would not be doing it if there was long-term confidence in the supply arrangement, but at the moment there is a very high risk; therefore, diversity of supply is paramount.

The CHAIRMAN: So what you are saying is that they probably would not be doing that if in fact there was a large amount of gas coming down from the LNG projects?

Mr Petersen: I would suspect that ex-Varanus most people would have gone off and done this anyway.

The CHAIRMAN: Okay. I just have a closing statement. Thanks for your evidence today. A transcript of this hearing will be forwarded to you for minor corrections. Please make these corrections and return the transcript within 10 days. If we do not get it in 10 days, we assume it is okay. You cannot change the sense of your evidence, but if you want to provide additional information, please provide it in a submission either with the transcript or we will accept late submissions. Thank you very much.

Hearing concluded at 11.31 am