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4 April 2003

Dr. Ken Michael AM
Western Australian Independent Gas Pipelines Access Regulator
Office of Gas Access Regulation
Level 6, Governor Stirling Tower
197 St. George's Terrace
PERTH WA 6000

Dear Dr. Michael

**Demise of Gas to Liquids Projects and Resource Based Project Risk**

I write to draw your attention to, and comment on, an article appearing in "The West Australian" newspaper on Friday 14 March 2003 (copy attached) which reports that Methanex, a major producer of methanol, has abandoned plans to construct and operate a world scale methanol production facility on the Burrup Peninsula, in the state's Pilbara.

In isolation, this decision has negligible immediate and direct impact on the Goldfields Gas Pipeline, or any other natural gas transmission pipeline.

However, the article continues, to raise broader issues. It states (emphasis added by GGT):

> The news [that Methanex's proposed project is "no longer financially viable"] comes just five months after another American company, Syntroleum Corporation, walked away from its $1 billion Sweetwater gas-to-liquids proposal because it could not raise the money.
>
> Of the six major WA resource development projects on the drawing board six months ago, just one - Burrup Fertilisers - has ***claimed*** to have cleared all the hurdles. But Burrup Fertilisers is ***yet to announce a starting date*** for construction on its $630 million liquid ammonia project.

> Another three projects, worth $3 billion, have been proposed for the Burrup, near Karratha, but of these only London-based GTL Resources is believed to be close to getting the financing needed to build its gas-to-liquids project.

These wider issues warrant consideration in turn.

## Reserves and Determinants of Success

The natural gas reserves of the Carnarvon Basin, on which potential future gas to liquids projects would depend, are in excess of 60 trillion cubic feet, making the Carnarvon Basin one of the world's major natural gas resource provinces.

Thus, the failure of the Methanex and Syntroleum projects to materialise cannot be attributed to lack of feedstock reserves.

In fact, a large proportion of the Carnarvon Basin natural gas reserves are in a dormant state - identified but unexploited.

The greater Gorgon natural gas reserves remain undeveloped more than 20 years after their discovery, despite considerable expenditure by the project's participant companies over the last 13 years to progress their development.

Correspondingly, Western Australia also holds abundant reserves of metallic ores, including iron and nickel. The bulk of the state's nickel resources occur in the form of lateritic ores.

However, the mere existence of such resources does not in any way guarantee that they can be economically exploited.

The majority of proposed direct reduced iron and lateritic nickel projects in Western Australia have failed to materialise. Of the minority which have reached the point of physical completion and subsequent commercial operation, the majority have failed (some more spectacularly than others). These facts exemplify that extraction and processing technology, extraction and processing economics, commodity prices, and the ability to attract investment capital overshadow availability of relevant ore as determinants of project success or failure.

Here, "success" constitutes a project first 'getting off the drawing board' (i.e. achieving physical completion) and then subsequently achieving safe, profitable, and long lived operation.

## Reporting, Optimism and Risk

The actual demise of the Methanex and Syntroleum projects and the probable demise of at least two of the remaining four projects subsequently identified in the "West Australian" article under discussion highlights the sharp contrast between

actual outcomes and the manner in which these, and other, gas to liquids projects have been reported in the past.

The March - May 2002 edition of "Prospect" (published by the then Department of Mineral and Petroleum Resources) offered the following comment at page 5 (emphasis added by GGT):

> The Western Australian Government's vision of a world scale gas processing precinct on the Burrup Peninsula near Karratha ***is about to materialise.***
>
> ***Land has been allocated*** for no fewer than six gas-to-liquids (GTL) projects, worth a total of $6.1 billion, on Australia's most strategic strip of industrial land. Several other big projects are also slated for development in the same area.

GGT considers that such land allocation by the State Government indicates that the latter considered all six projects to have 'firm' status.

Examination of the map contained in the "West Australian" article indicates that the gas to liquids project under consideration by Sasol Chevron is not included in the six already mentioned. This reflects earlier statements made in an article appearing in the March - May 2002 edition of "Prospect" (at page 8). The relevant "Prospect" article identifies the Sasol Chevron project as "world class" and views the prospect of its future development as "encouraging".

The Sasol Chevron project, if it proceeds, would produce 'environmentally friendly' synthetic diesel.

It is apparent that the enthusiasm and optimism expressed in "Prospect" less than 12 months ago have been dispelled, to be replaced by more sober commercial reality.

The failure of <u>all seven</u> proposed gas to liquids projects to materialise despite various gestation periods is both a tangible manifestation and yardstick of the concept of risk, which may be thought of as the probability of occurrence of outcomes which do not constitute "success" in the broader sense as discussed above.

It is apparent that:

- all seven of these high profile resource based projects have yet to achieve 'maturity',
- it is likely that the majority of these projects will not materialise;
- it is virtually certain that at least two of these seven projects will never materialise in their proposed form.

These observations serve to illustrate:

1) the volatility and uncertainty inherent in all resource based projects;

2) the fact that many of the resource based projects which are proposed and publicised subsequently fail to materialise;

3) the typically over-optimistic nature of the reporting of large, sought-after projects in the trade press and wider media.

In short, there are many more proposed and promoted projects than operational and successful projects.

This leads to consideration of the reporting of large projects which are attractive to the State of Western Australia because of their potential to generate employment, stimulate the state's economy, and realise considerable royalty revenue.

It is both inevitable and necessary that the proponents of (unrealised) resource projects are optimistic about their own projects. However, in some circumstances such expressions of optimism reflecting intent may become confused with firm commitments to action.

Cases in point are certain reports regarding the (previously) proposed expansion of the Murrin Murrin nickel and cobalt project, operated by Anaconda Nickel Ltd. ("Anaconda"), and supplied with natural gas via the Goldfields Gas Pipeline.

In March 2000, Anaconda made the following statements in a public submission made to you regarding the Goldfields Gas Pipeline Access Arrangement (emphasis added by GGT):

> In a letter [to GGT] dated 13 September 1999 (attached, Appendix One) it [i.e. Anaconda Nickel Ltd.] outlined potential volumes of some ***200 TJ/day***, and increase of approximately 220% of the pipelines existing committed throughput.
>
> Whilst it is yet to be confirmed whether the Anaconda Projects will proceed, Anaconda has ***committed funds in the tens of millions*** to Feasibility Studies on its Stage Two expansion and Mt. Margaret Projects. It is working towards a construction commencement date of ***January 7th 2001*** for the Mt. Margaret Project which will require approximately 60 TJ/day of gas.

The December 2001 - February 2002 edition of "Prospect" listed the proposed Murrin Murrin expansion (from 'as built' capacity of 45,000 tonnes of nickel per annum to 115,000 tonnes per annum) as a "committed" project.

You are aware that soon after, Anaconda announced it had scrapped all its expansion and future development plans.

The Anaconda internet website (*www.anaconda.com.au*) contained, as at 20 March 2003, the transcript of an interview with Mr. Peter Johnston, Anaconda's Chief Executive Officer. This interview was broadcast by Channel 9 as part of its "Business Sunday" television programme on 9 March 2003. In it, Mr. Johnston stated (emphasis added by GGT):

> The company [i.e. Anaconda] has ***performed very poorly*** for shareholders over a ***long period of time***. Last year of course we went into ***default on our loans*** and we had to ***restructure the entire debt position*** of the company to survive. It has taken us twelve months to do that, we think it was a very successful restructure and we now ***paid out our creditors and bondholders*** last week and we raised enough capital and we recapitalised the company so at least now the a) the shareholders have a future, and b) ***if the plant performs*** we will be able to return some dividends in the future too for the long suffering shareholders.

GGT understands (from a variety of press reports) that bondholders were repaid approximately 26 cents in the dollar. This inability to meet obligations resulted in bondholders losing around 800 million Australian dollars, or a large part of the initial construction cost of the Murrin Murrin project.

It is apparent that the discontinuity between reported intent as articulated by Anaconda and "Prospect" and the realised outcomes as articulated by Mr. Johnston is considerable.

As discussed above, the failure by Anaconda to realise its stated plans for expansion is a concrete manifestation of one aspect of the risk of the Murrin Murrin project.

The loss suffered by Anaconda bondholders is a concrete manifestation of another aspect of the project's risk.

Resource Projects, the Goldfields Gas Pipeline, and Risk

As identified above, natural gas processing projects of the type discussed above are not directly related to natural gas transportation. However, the examples provided by the unrealised gas to liquids projects identified above provide further indication that any project which is based on resource extraction is subject to a number of inhibiting factors, any one of which may result in the project's failure to materialise.

While metals mining and natural gas to liquids conversion are quite different industries in terms of end products and technologies, they share a number of common characteristics.

These include:

- the extraction of raw materials from the earth's crust;
- the production of commodities, whose prices vary considerably and unpredictably;
- the requirement for large, risky, capital expenditures;
- the fact that assets are immobile, and hence all expenditures are sunk costs.

Thus, lessons learned from the varying failures of gas to liquids projects in Western Australia are generally applicable to resource projects, including (but not limited to) metals mining.

Approximately 99 percent of the natural gas transported by the Goldfields Gas Pipeline is utilised by the metals mining industry.

The risks of potential future projects not materialising and existing projects defaulting on contractual obligations reflect directly on the Goldfields Gas Pipeline.

It can be seen that the combined extent of these risks is considerable.

I request that you give due consideration to the issues discussed above when formulating your revised Draft Decision for the Goldfields Gas Pipeline Access Arrangement.

Please do not hesitate to contact me if you wish to discuss these, or any other, issues further.

Yours sincerely

**David A King**
**General Manager**

The West Australian

# BUSINESS



Edited by PAUL ARMSTRONG

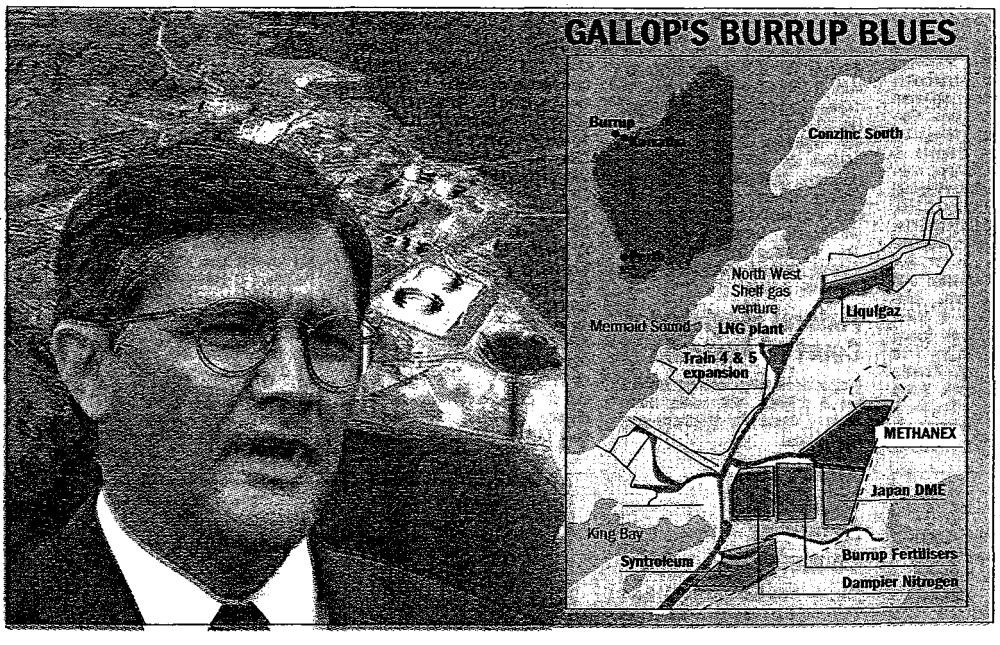
| SHARES | | |
|---|---|---|
| S&P ASX 200 | 2700.4 | ▼ 18.0 |
| Gold Price | 342.90 | ▼ 6.97 |
| All Ordinaries | 2673.3 | ▼ 13.8 |

| MONEY | | |
|---|---|---|
| $A/US | 59.21 | ▼ 1.21 |
| $A/Yen | 69.88 | ▼ 1.03 |
| $A/Stg | 36.90 | ▼ 0.70 |

## Fears Shelf boom may be over before it begins

# Methanex dumps $2b Burrup plan

**By Michael Weir**




THE Gallop Government's vision of a development boom on the Burrup Peninsula has been dealt another blow with US company Methanex scrapping plans for a $2 billion methanol project.

Methanex confirmed yesterday the project was no longer financially viable because of a blow-out in capital costs and rises in the value of the Australian and euro currencies against the US dollar.

The news comes just five months after another American company, Syntroleum Corporation, walked away from its $1 billion Sweetwater gas-to-liquids proposal because it could not raise the money.

Of the six major WA resource development projects on the drawing board six months ago, just one — Burrup Fertilisers — has claimed to have cleared all the hurdles. But Burrup Fertilisers is yet to announce a starting date for construction on its $630 million liquid ammonia project.

Another three projects, worth $3 billion, have been proposed for the Burrup, near Karratha, but of these only London-based GTL Resources is believed to be close to getting the financing needed to build its gas-to-liquids project.

Premier Geoff Gallop and State Development Minister Clive Brown have been quick to seize the political mileage associated with the multi-billion-dollar proposals for the Burrup.

But news of Methanex's withdrawal will add to the growing pressure on the Government, which is already under attack from the business community over its industrial relations policies.

Importantly for other project hopefuls, the go-ahead for Burrup Fertiliser has triggered a $134 million promise by the State Government to build common-user infrastructure on the Burrup, such as roads, power, water and port access.

But construction of the infrastructure will not start until Burrup Fertilisers begins building its plant.

Methanex senior vice-president Asia Pacific Bruce Aitken said the plans for a two million tonnes-a-year methanol project had been put on hold, but there was still a chance a smaller scale plant could be built. Methanol, which is made using huge quantities of natural gas, is used as an industrial chemical.

Mr Aitken said the strengthening Australian dollar had added $US50 million ($84.5 million) to capital costs in the past two months.

"We just want to pause for a breath, decide if there is a different approach that represents a smaller project or a little less capital," he said.

Mr Aitken said the company had been using an Australian dollar exchange rate of US55¢ in its economic modelling, compared with yesterday's price of more than US59¢.

He said Methanex was committed to developing a project on the Burrup but there was a risk the company would have to look elsewhere.

"We've spent $55 million getting to where we are so we have a real commitment to find a successful way of getting to an end point," he said.

The company retained its ultimate vision of developing a production hub, capable of producing 4mt a year of methanol, to satisfy the company's Asian customer base, Mr Aitken said.

Mr Brown said the Government had been engaged in high-level discussions with Methanex. "The Government has been working closely with Methanex over the past two years to bring the project to fruition and it is the Government's understanding that WA remains the preferred location for this investment," he said.