



15 July 2008

Mr Lyndon Rowe  
Economic Regulation Authority  
Level 6 Governor Stirling Tower  
197 St Georges Terrace  
PERTH WA 6000

Dear Mr Rowe

## **ANNUAL WHOLESALE ELECTRICITY MARKET REPORT**

Thank you for the opportunity to comment on the Authority's discussion paper: "Annual Wholesale Electricity Market Report to the Minister for Energy".

The DomGas Alliance was formed in 2006 and includes current and prospective gas users and gas infrastructure investors. Alliance members represent the majority of Western Australia's domestic gas consumption and gas transmission capacity, including smaller industrial and household users of gas.

The Alliance works closely with the Western Australian and Federal Governments to promote increased competition and supply of gas for manufacturers and consumers. The Alliance will limit its comments on Discussion Points 1 and 2 of the discussion paper – the impact of fuel supply, fuel constraints and fuel prices on the market.

### **WA's gas dependent economy**

As the Authority is aware, Western Australia is the most energy and gas-dependent economy in Australia. Natural gas supplies half of WA's primary energy requirements. Natural gas also fuels 60% of the State's electricity generation. Access to natural gas is critical for the State's manufacturing, processing and mining industries, which support thousands of jobs.

WA's demand for gas continues to grow rapidly. A 2007 study conducted for the Alliance by Economics Consulting Services concluded that Western Australia will require around 900 TJ/day of gas in the next 6 years to meet new and replacement demand, including 650 TJ/d of new gas. This is equivalent to the total size of the existing market for gas.

The study identified at least \$23 billion in projects are currently seeking gas for expansion or new developments. These comprise eight iron ore and nine other developments including alumina, nickel, molybdenum, vanadium, gold and ammonia projects. Failure to secure competitive gas supply could see the loss of 17 large projects involving over 15,000 potential construction jobs, 5000 permanent operating jobs and \$9 billion in annual economic output.

Since 2007 however, expectations of future gas demand have further increased, including with respect to potential development in the Mid-west. The Alliance has engaged Economics Consulting Services to complete an updated study of future gas demand. The Alliance will be pleased to provide the study to the Authority once completed.

### **Western Australia's domestic gas crisis**

Setting aside the impact of the current gas supply emergency precipitated by the fire at Apache Energy's processing plant, Western Australia is currently experiencing a gas supply shortage. Current and prospective gas users are unable to secure long term gas supplies in substantial quantity. The price of such short term gas that is available has risen dramatically. The Authority would be aware that wholesale gas prices have almost tripled over the past 12-18 months with prices reported for recent gas sales now almost three times Eastern States prices on a delivered basis.

At the same time, oil and gas producers continue to expand exports of Australia's clean energy reserves. Despite holding just over 2 per cent of world natural gas reserves, Australia aspires to be an "LNG superpower" and the world's second largest exporter. Government and industry are targeting 50 million tonnes of LNG exports by 2015. As a result, local WA manufacturers have experienced increased competition from the energy hungry industries in China, India and Japan, leading to escalating prices and supply shortages.

### **Rising gas prices are having a significant impact on WA industry**

Rising gas prices are having a significant impact on WA industry particularly in the energy, mineral processing and manufacturing industries. Businesses are already facing significant pressures from escalating labour and material costs, a rising Australian dollar, high interest rates and overseas competition.

Rising gas prices also undermine industry's ability to meet national greenhouse targets by raising the cost of clean energy. At current price levels in Western Australia, natural gas is no longer competitive with coal for base-load power generation and resource processing. A number of WA resource and energy projects have been forced to resort to coal-fired energy. Industry therefore face higher cost impacts from an emissions trading scheme with the removal of clean natural gas from the competitive fuel mix.

## **A competitive wholesale electricity market depends on fuel competition between gas and coal**

Given natural gas fuels 60% of the State's electricity generation, a competitive wholesale electricity market depends on competitive gas supply. It also depends on fuel competition between gas and coal. At current price levels in Western Australia, natural gas is no longer competitive with coal for base-load power generation.

Rising gas prices will also lead to higher coal prices. Historically, gas and coal have a direct price relationship with coal prices closely shadowing gas prices. Rising gas prices will create upward pressure on coal prices, leading to higher overall fuel costs for power generation, and higher energy and electricity costs for WA industry and households.

## **Measures to promote greater competition and diversity in gas supply**

Given Western Australia's dependence on natural gas, it is critical that the State has a competitive domestic gas market. The current Apache Energy crisis also reinforces the need for greater competition and diversity in gas supply.

The Alliance supports a range of policy responses to promote competition, diversity and opportunity in gas supply, including:

- Strengthening the Retention Lease system to ensure that gas fields that can supply the domestic market are developed and to ensure producers do not withhold supply. Introduce greater transparency in the process to promote opportunity and third party participation.
- Removing anti-competitive selling arrangements whereby major gas producers currently sell jointly as a cartel to local customers.
- Establishing a national energy security strategy, underpinned by a domestic reservation policy, to ensure competitive long term supply.
- Ensuring domestic supply obligations are met.
- Ensuring the original intent of the North West Shelf State Agreement is met in relation to new LNG export developments.
- Facilitating common user gas supply infrastructure to reduce project costs and promote development.
- Reviewing tax and royalty arrangements to ensure they promote domestic gas exploration and development.

- Encouraging and supporting the development of “tight gas” fields.
- Facilitating and expediting approvals processes for gas exploration and development.
- Eliminating unnecessary government imposts that act as a disincentive to gas exploration and development.
- Ensuring that the Federal Government’s trade negotiations support, or at the very least not undermine, Australia’s long term energy security.

The Alliance is pleased to provide additional discussion on these policy responses (**Attachment**).

Given the importance of natural gas, it is critical that Western Australia’s regulatory arrangements promote competition and diversity of supply for industry and households.

Yours sincerely

Gavin Goh  
Executive Officer

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All correspondence to:  
C/- Dampier Bunbury Pipeline Level 6, 12-14 The Esplanade, Perth WA 6000  
Postal Address - PO Box Z5267 St Georges Terrace Perth WA 6831  
Telephone: +61 8 9223 4300 Facsimile: +61 8 9223 4301

## **ATTACHMENT: POLICY RESPONSES TO PROMOTE COMPETITION AND DIVERSITY OF GAS SUPPLY**

### **More stringent review of retention leases**

53% of WA's gas reserves are currently held under Retention Leases on the basis that they are uneconomic to develop. Further reserves are held in Exploration Licences which are close to expiry and are due to be converted to either Production Licences or Retention Leases

The Alliance supports more stringent government assessment of Retention Leases to ensure that they are not used by producers to withhold domestic gas supplies. The Commonwealth – State Joint Working Group on gas supply recommended more stringent assessment, and this has been supported by the Federal Resources and Energy Minister. A review is also underway on how the policy might be applied in the future, including ways to improve transparency in the Retention Lease process, and to ensure that commerciality tests are stringently applied. A copy of the Alliance's submission is **attached**.

The Alliance believes that in the first instance, reserves held under Retention Leases should be assessed to determine whether they are capable of supplying the domestic market on a commercial basis. The Alliance also supports amendment of the administrative guidelines or legislation to further reinforce this expectation.

The Alliance supports greater transparency and disclosure in the retention lease process. There is currently no gazetting system which would make public the substance of a retention lease application, nor is there a formal procedure for third parties to participate. This provides for an asymmetry of information that exclusively benefits existing lease holders.

Greater transparency and disclosure will improve the underlying basis of decisions, encourage third party participation, subject application claims to greater scrutiny, strengthen the application of the commerciality test and promote opportunity and field development.

### **Remove anti-competitive joint selling arrangements**

The North West Shelf Joint Venture producers – which supply almost 70% of the domestic market - currently sell gas to domestic customers through a joint selling entity North West Shelf Gas. This arrangement forces gas consumers to deal with a single entity rather than with individual Joint Venturers. This significantly reduces the number of sellers and, as a result, competition in the domestic market. Gas consumers are prevented by the Trade Practices Act from buying jointly.

The impact of joint selling is further exacerbated by the concentration in gas supply. Two operating entities (North West Shelf and Apache) supply close to 100% of the domestic market and control the developed fields that currently service the WA domestic market. The participants in the North West Shelf Gas Joint Venture hold the vast majority of undeveloped reserves in the Carnarvon Basin. The Synergies Economic Consulting Report recommended removing the joint selling arrangement to promote competition and supply in the domestic gas market.

The Alliance has written to the ACCC calling for a review of the joint selling arrangement. The matter is currently being investigated by the ACCC. In the absence of any authorisation, joint selling appears to be in breach of section 45 of the Trade Practices Act which prohibits arrangements which substantially lessen competition. The Alliance is also concerned about joint selling becoming standing practice in other gas developments. Producers should not maintain selling arrangements that would have or be likely to have the effect of substantially lessening competition.

#### **Review tax and royalty arrangements to promote domestic gas development**

The Alliance supports a review of existing taxation and royalty arrangements to provide financial incentives for domestic gas developments. Under the Petroleum Resource Rent Tax (PRRT) which applies to Commonwealth waters, exploration expenditure in areas designated as frontier between 2004 and 2008 are eligible for a 150% uplift. Similar incentives should be considered to encourage inshore and onshore domestic gas developments.

The Alliance also supports mechanisms such as Flow Through Shares and any other arrangements which would lead to increased exploration in the inshore and onshore areas where fields amenable to development for the domestic market are most likely to be discovered.

#### **Promote common user midstream infrastructure**

Third party participation in – and multiple use of - midstream gas supply and processing infrastructure has the potential to facilitate new domestic gas developments by lowering investment barriers and costs.

The Alliance engaged energy consulting firm Wood McKenzie to conduct an analysis of opportunities for common use mid-stream gas gathering and processing facilities. The report concluded that there were significant benefits including lower barriers to entry, a more economically efficient use of capital leading to lower gas supply chain costs and increased transparency in the costs of supply. A copy of the report and the Alliance position paper is **attached**.

Government can facilitate discussions between relevant stakeholders, and by improving transparency and disclosure in the retention lease system. An effective gas reservation policy would also ensure that any consolidation between domestic gas and LNG projects still delivers domestic gas supply.

### **Promote development of onshore tight gas**

WA potentially has 9-12 Tcf of 'tight gas' resources in the Perth Basin, located close to existing gas pipeline infrastructure. Tight gas currently accounts for around 30% of total gas production in the United States.

The State Government is examining opportunities to facilitate tight gas development, including by meeting current technology barriers. Alcoa and Latent Petroleum have recently partnered to evaluate and develop WA's first tight gas field – the Warro gas field. The Alliance supports these efforts and the need for the Commonwealth and State to explore financial incentives for tight gas development.

### **Ensure the original intent of the North West Shelf State Agreement is met with new LNG export developments**

The North West Shelf State Agreement, originally due to expire in 2010, was extended in 1984 to 2025. The gas reservation commitments under the original agreement have been met by the North West Shelf Gas producers.

Since the initial State Agreement was negotiated in 1979 however, LNG exports from the NWSGJV will have increased by over 150% from the originally envisaged 6.5 million tonnes per annum, with further expansions foreshadowed. By comparison, supply to the domestic market by the NWSGJV has increased only marginally. Domestic users are unable to secure new gas supplies and prices have risen threefold.

Given the State's dependence on the NWSGJV for almost 70% of its domestic gas, and the fact that the JV parties continue to hold the bulk of the State's gas reserves, it is critical that continued expansion of LNG exports be matched by increased commitments to the domestic market.

It is important that the original intention of the Agreement – that of placing priority on the availability of gas to the WA domestic market – be maintained in the ongoing administration of the Agreement. The need for LNG contract extensions – and new developments such as LNG Train 6 mooted by Woodside - may provide the State with the opportunity to pursue further domestic gas supply commitments.

## **Domestic gas reservation and a national energy security policy**

Claims by producers and government that Australia has abundant reserves of gas are misleading. For an energy intensive economy, Australia holds just over 2% of the world's natural gas resources, yet aspires to be the world's second largest exporter of LNG.

Current estimates of gas reserves considerably overstate availability by failing to take into account: the practical viability of resources, the rapid expansion of LNG export production, or the contracting out of available resources under long term LNG contracts.

WA's 130 Tcf of estimated gas resources refers to resources with only a minimum 50% probability of recovery. Only 17% of WA's resources relate to developed fields. The bulk of resources are currently located deep offshore and have gas quality issues. There is no certainty that it would be economic to develop gas from remote reserves for the domestic market. If government and producer export targets of 50-60 million tonnes per annum of LNG are reached, the total existing resources of the Carnarvon Basin will be fully committed by 2015-2020. Once committed to long term LNG contracts, gas is unavailable to meet current and emerging needs of the local economy.

The Alliance believes that in the face of this, some form of reservations policy is necessary to secure long term domestic gas supply. The Alliance, therefore, supports the efforts of the WA government in this regard. The Alliance also supports the development of a unified State/Commonwealth position on reservations and a national energy security strategy to ensure competitive long term supply.

A report by Curtin University found that governments around the world are acting to ensure long term domestic gas security. Other countries with significant gas reserves are introducing policies to ensure that their domestic requirements are adequately provided for. The report also found that over 90 per cent of world gas reserves are directly or indirectly controlled by national oil companies. Only 8 per cent of world reserves are subject to full access by international oil companies – Australia represents a quarter of these reserves.

### **Facilitate and expedite approvals**

The current approvals process and stringent demands placed on developments create significant barriers to entry for new players and serve to protect larger incumbent producers.

While efforts have been made in this area, there are opportunities for further streamlining of State and Federal approvals processes for new projects. The Alliance supports a review of existing approvals processes to identify opportunities for further streamlining.



### **Eliminate unnecessary government imposts**

The promotion of a competitive gas market requires the elimination of unnecessary costs throughout the gas supply chain.

The Alliance encourages both State and Federal governments to examine the impact of all policies and regulations impacting on the gas supply chain, with a view to reducing unnecessary costs and inefficiencies.

### **Ensure the Federal Government's trade negotiations support, or at the very least not undermine, Australia's energy security**

The Alliance is concerned that the Federal Government is currently contemplating treaty commitments which would underpin Japan and China's energy supply requirements.

Such commitments could limit the ability of State and Federal governments to ensure Australia's energy security. They could also create unsustainable expectations on the part of trading partners, with consequential impacts on the administration of Australia's resource, energy and investment regimes. It is critical that Australia's Free Trade Agreement negotiations support and not undermine Australia's energy security.

## The DomGas Alliance

The DomGas Alliance was formed in 2006 in response to serious concerns about the continued availability and competitiveness of gas supply to the WA domestic market. The Alliance includes current and prospective gas users and gas infrastructure investors.

Members include: Alcoa of Australia, AlintaAGL, Synergy, Dampier Bunbury Pipeline, ERM Power/New Gen Power, Newmont Australia, Fortescue Metals Group, Windimurra Vanadium and Horizon Power.

Alliance members represent the majority of the State's domestic gas consumption and gas transmission capacity, including smaller industrial and household users of gas. The Alliance also represents a significant proportion of prospective demand for additional gas supplies.

