



17 July 2008

Commissioner Philip Weickhardt
Productivity Commission
Locked Bag 2
Collins Street East
Melbourne VIC 8003

Dear Commissioner

Thank you for the opportunity to comment on the Commission's Review of Regulatory Burden on the Upstream Petroleum Sector.

The DomGas Alliance is pleased to provide a submission to the review and urges the Commission to examine the importance of domestic gas supply for Australian industry, and to examine the impact of regulatory arrangements affecting competition and supply for domestic users.

The DomGas Alliance

The DomGas Alliance was formed in 2006 in response to serious gas supply shortages 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 State and Federal Governments to promote competition and supply of gas for industry and households in Western Australia.

The importance of downstream gas supply

Western Australia is heavily dependent on domestic gas to supply energy, support essential services, fuel industry and supply households. The State is the most gas-dependent economy in Australia with natural gas supplying 51% of the State's primary energy and 60% of electricity generation. As demonstrated by the current Apache Energy emergency, industry is critically dependent on competitively priced gas to sustain operations and to compete in international markets.

The State's demand for gas continues to grow. A 2007 study 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 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, expectations of future gas demand have further increased, including in relation to potential development in the State's Mid-west. The Alliance has engaged Economics Consulting Services to complete an updated study of future gas demand, which we will be pleased to provide the Commission once completed.

Western Australia's gas supply shortage

Putting aside the current emergency, Western Australia has been experiencing a serious gas supply shortage since at least 2006. 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. 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 LNG. Despite holding just over 2% of world natural gas reserves, Australia aspires to be an "LNG superpower" and the world's second largest exporter, with government and industry targeting 50 million tonnes of LNG exports by 2015. As a result, local manufacturers have experienced increased competition for scarce energy resources from China, India and Japan, leading to escalating prices and supply shortages for domestic industry.

Rising gas prices are impacting industry competitiveness

The domestic gas shortage and rising gas prices are having a direct impact on WA industry through higher energy costs. This is eroding international competitiveness at a time when industry is already facing significant pressures from escalating labour and material costs, a rising Australian dollar, high interest rates and increased overseas competition.

The experience in Western Australia has consequences for the international competitiveness of industry in the Eastern States, particularly in the manufacturing, automotive and processing industries. Escalating gas prices in Western Australia reflect a long term strategy of oil and gas producers to increase prices to a notional “international” price based on LNG or international oil prices. This is despite there being no world price for gas with gas prices varying significantly between different countries and regions, and being tightly controlled in many countries, including China.

The development of LNG projects in the Eastern States and LNG pricing for domestic gas will therefore lead to dramatic price increases for manufacturers and industry - by over 300 per cent. This was recognised by a recent report by Commonwealth / State officials which warned:

“The effects of price competition are already being felt in Western Australia. Gas prices in WA have increased to around double the prices in the Eastern market, where exports of gas are not presently viable.”¹

“The announcement of two potential LNG terminals using CSM [coal seam methane] has the potential to impact on both supply and price in the Eastern gas market.”²

A recent presentation by Origin Energy considered that access to international LNG markets is likely to result in significant increases in gas prices.³ The National Generators Forum have also warned that LNG export developments in Gladstone, Queensland, could potentially double the price of gas in the eastern states from the current \$3.50 per gigajoule: “We are worried that prices on the eastern seaboard will mirror the far higher export price, as is the case with domestic gas prices in WA, where an LNG export industry already exists.”⁴

The Alliance understands that oil and gas producers in the Eastern States have also acted to withhold supply. For instance, the *Sydney Morning Herald* recently reported on Queensland Gas’ proposed LNG project at Gladstone and that the company was limiting supply to domestic users to obtain higher LNG prices in the future. This included by shutting down new wells that might otherwise supply Australian industry.⁵

¹ Joint Working Group Report on Natural Gas Supply, p.16.

² Joint Working Group Report on Natural Gas Supply, p.9.

³ Origin Energy, presentation at Macquarie Conference, May 2008.

⁴ ‘Gas price under pressure’, *The Australian*, 1 July 2008.

⁵ ‘Queensland Gas looks to high-value LNG’, *Sydney Morning Herald*, 6 March 2008, available at: <http://business.smh.com.au/queensland-gas-looks-to-highvalue-lng/20080305-1x7t.html?skin=text-only>

Emerging issues – national emissions trading scheme

The Commission's Issues Paper identifies carbon sequestration and an emissions trading scheme as "emerging areas of regulation that have the potential to cause additional burdens on the upstream petroleum sector". There are also significant impacts for downstream industry.

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.

By increasing the cost of clean energy, rising gas prices undermine industry's ability to meet national greenhouse targets and dramatically increase the cost of any emissions trading scheme.

Removing gas from a competitive fuel mix will also lead to higher overall energy costs. Coal prices traditionally shadow gas prices. Rising gas prices will therefore result in higher coal prices - and higher fuel costs for power generation, and electricity costs for industry and households.

The impact of regulatory arrangements on competition and diversity of domestic gas supply

Given the importance of gas supply for industry competitiveness, it is critical that regulatory arrangements promote competition and diversity of supply for downstream industry.

It is the Alliance's view that current regulatory arrangements operate to discourage competition and diversity of supply. In particular, there is a need for State and Federal governments to reform regulatory arrangements to:

- Strengthen the Retention Lease system to ensure that gas fields that can supply the domestic market are developed and that producers do not withhold supply. Greater transparency in the process is also needed to promote opportunity and third party participation.
- Remove anti-competitive selling arrangements whereby major gas producers currently sell jointly as a cartel to local customers.
- Establish a national energy security strategy, underpinned by a domestic reservation policy, to ensure competitive long term supply.
- Ensure domestic supply obligations are met.
- Ensure the original intent of the North West Shelf State Agreement is met in relation to new LNG export developments.

- Facilitate common user gas supply infrastructure to reduce project costs and promote development.
- Review tax and royalty arrangements to promote domestic gas exploration and development.
- Encourage and support the development of “tight gas” fields.
- Facilitate and expedite approvals processes for gas exploration and development.
- Eliminate unnecessary government imposts that act as a disincentive to gas exploration and development.
- Ensure that the Federal Government’s trade negotiations support, or at the very least not undermine, Australia’s long term energy security.

These issues fall within the Commission inquiry’s broad terms of reference to “assess the impact of the current regulatory framework on the international competitiveness and economic performance of Australia’s petroleum sector *and on the performance of the economy as a whole*”. The Alliance is pleased to provide additional information on these regulatory recommendations (**Attachment**).

Given the importance of gas supply for industry competitiveness, the Alliance urges the Commission to examine the impact of current regulatory arrangements on competition and diversity of supply for downstream industry as part of its inquiry.

The Alliance also urges the Commission to undertake a broader inquiry into the importance of domestic gas supply and energy security for Australian industry competitiveness.

Yours sincerely

Gavin Goh
Executive Officer

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

Attachments:

- A. Regulatory Responses to Promote Competition and Diversity of Gas Supply
- B. DomGas Alliance submission to the Department of Resources, Energy and Tourism inquiry into the Retention Lease framework
- C. Report by Wood Mackenzie on common-use mid-stream infrastructure and Alliance policy paper
- D. Report by Synergies Economic Consulting on 'WA Gas Supply & Demand: The Need for Policy Intervention'

ATTACHMENT: REGULATORY RESPONSES TO PROMOTE COMPETITION AND DIVERSITY OF GAS SUPPLY

More stringent review of retention leases

Section 38B of the *Petroleum (Submerged Lands) Act 1967 (Cth)* provides for the grant of a Retention Lease over petroleum discoveries. This applies where a petroleum discovery proves to be currently non-commercial but has the potential to become commercial within 15 years.

The initial term of a Retention Lease is five years. This may be renewed provides it still meets the required uncommerciality criteria. A Retention Lease must be converted to a Production Licence when a reserve is commercial. Retention Leases are administered by the Joint Authority comprising both the Commonwealth and the State.

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 and 45A of the *Trade Practices Act 1974* 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.

The Alliance is currently completing a detailed review of tax and royalty arrangements with the view to recommending measures to encourage gas exploration and development for the domestic market. The Alliance will be pleased to provide a copy of the review to the Commission once completed.

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.

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. A copy of the Wood McKenzie report and Alliance policy paper is **attached**.

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 is scheduled in the *North West Shelf Gas Development (Woodside) Act 1977*. The Agreement was originally due to expire in 2010, but 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 incorrect. 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% of world gas reserves are directly or indirectly controlled by national oil companies. Only 8% 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 – and their implications for domestic law - 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.





30 April 2008

Mr John Hartwell
Head of Resources Division
Department of Resources, Energy and Tourism
GPO Box 9839
CANBERRA ACT 2601

Dear Mr Hartwell

Thank you for your letter of 25 March 2008 concerning the Retention Lease policy review. The Alliance supports improving the Retention Lease process to ensure greater openness and transparency, and that commerciality tests are stringently applied.

Domestic supply commerciality should be the first test

The Alliance acknowledges the important role of the Retention Lease process in facilitating exploration, investment and development of Australia's gas resources. However, the process also plays an important role in meeting broader national interest objectives – in particular, ensuring the energy security needs of the Australian economy are met.

The Alliance believes that Retention Leases are currently being used by producers to withhold gas supplies from the domestic market. This is contrary to the object of the legislation which does not allow producers to park reserves or to develop in sequence reserves most profitable for LNG export.

The Alliance supports more stringent Government application of the Retention Lease process to ensure it is not used by producers to withhold gas that could be used to supply the domestic market.

Recommendations

- 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.

Improving transparency and third party participation

The current process provides little transparency or openness. There is no gazettal system which would make public the substance of a Retention Lease application, the stage in the process that a particular application is at, or the reasons or basis for the Designated Authority's decision. The current process therefore provides an asymmetry of information that limits participation of other interested stakeholders.

This contrasts to existing State and Commonwealth environmental approval processes for development projects. These processes provide for transparency and significant opportunity for stakeholder input.

Greater transparency and disclosure will:

- 1) improve the underlying basis of Retention Lease decisions;
- 2) encourage third party participation;
- 3) subject applicant claims and assumptions to greater scrutiny and contestability;
- 4) strengthen the application of the commerciality test; and
- 5) promote opportunity and field development.

Recommendations

- A public, on-line registry of State and Commonwealth retention leases should be established.
- The registry should provide clear indication on the current status of a particular Retention Lease application, the step in the process, etc; as well as identify Retention Leases coming up for review.
- There needs to be a public announcement when the Designated Authority begins its process of review.
- The general parameters or assumptions used by the Designated Authority to test "commerciality" should be publicly disclosed. This could be achieved by publishing an assumptions or data book identifying key factors such as prices, local demand, rate of return, expectations on CAPEX / OPEX, etc.
- Expert reports commissioned by the Designated Authority into matters such as market conditions, construction costs, etc, should be published.
- The Government's Joint Technical Report should be published.

- There should be a review period allowing third parties to submit information in relation to the assessment parameters used by the Designated Authority, the assumptions and development concepts being advanced by the proponent, or to reinforce or challenge the Designated Authority's draft decision.
- Opportunity should be provided to third parties to have input into the establishment of conditions for the grant or renewal of Retention Leases.
- The reasons and substance of the Designated Authority's decision should be published.

Independent review

The robustness of Retention Lease decisions can be improved by providing for independent peer review or third party assessment of the Government's Joint Technical Report. This will also promote confidence and transparency in the process.

Recommendation

- There should be an independent peer review or third party assessment to review and validate the Joint Technical Report, and to test the assumptions and conclusions made.

Managing commercial confidentiality concerns

The Alliance recognises that lease holders may raise commercial information and confidentiality concerns. Such concerns should be manageable and, in any event, should not override the objects of the Retention Lease system.

The closed nature of the Retention Lease process contrasts sharply with the process employed for environmental approvals. Existing State and Commonwealth environmental approvals processes for project developments for example require project proponents to publicly disclose a great deal of detailed information, much of which could be described as "commercially-sensitive". This includes information on:

- the proposed development concept and production levels;
- required infrastructure modifications or proposed new infrastructure;
- equipment components and process modifications;
- requirements for services and utilities, including water and energy;
- construction and operational workforce;
- expected emissions and other environmental impacts; and
- proposed environmental management plans.

Timeliness of proposed changes

The Alliance urges that any proposed changes to strengthen and improve the Retention Lease process should be implemented in the most expeditious manner. Where changes can be effectively achieved through existing arrangements or administrative guidelines, this should be preferred to legislative amendments; however, legislative amendments should also be pursued where appropriate, to further strengthen and reinforce policy changes.

The Alliance will continue to work closely with Government to ensure that Retention Lease arrangements facilitate investment and development of Australia's gas resources, while ensuring the energy security needs of the Australian economy are met.

Yours sincerely

Stuart Hohnen
Chairman, DomGas Alliance

CC:

Mr Drew Clark, Head of Energy and Environment Division, Department of Resources, Energy and Tourism

Mr Stuart Smith, A/Director General, Department of Industry and Resources

Mr Bill Tinapple, Director Petroleum & Royalties Division, Department of Industry and Resources

Mr Jason Banks, Coordinator of Energy, Office of Energy