DOMGAS ALLIANCE

MEETING DOMESTIC GAS OBLIGATIONS:
DISCUSSION PAPER

1 June 2011

Overview

Domestic gas reservation remains the single most effective policy available to the State to promote supply and competition in the WA domestic gas market.

A strong, transparent mechanism to implement the domestic gas reservation policy will balance the needs of producers to cover their costs and deliver an acceptable return to their shareholders, and the needs of gas and electricity users to manage their energy costs at a level which allows them to compete in their markets and support the state economy.

The 2006 policy commits the State to reserving a minimum of 15 trillion cubic feet (Tcf) – equivalent to 15 per cent of the State's existing and potential LNG project reserves.[1] Realistic growth projections indicated that up to 32 Tcf of gas should be reserved to meet the State's long term requirements.[2]

Key elements

To meet this minimum requirement, a 15 per cent commitment needs to be applied on **all existing and potential gas reserves**.

This must include the remaining reserves from the North West Shelf Project, the expanded reserves supporting the Gorgon, Wheatstone and Scarborough projects in the Carnarvon Basin, and the discoveries in the Browse Basin including Icthys, Prelude, and BCT.

It should also apply to annual LNG production. This would avoid potential difficulties with comparing or trading gas of different specification or heating value given LNG is a standard product (15 per cent of 1 mtpa LNG is equivalent to 7.2 bcf of domestic gas).

[1] Department of Premier and Cabinet, *WA Government Policy on Securing Domestic Gas Supplies*, October 2006.
[2] Department of Premier and Cabinet, *WA Government Policy on Securing Domestic Gas Supplies*, October 2006.

The commitment should be made unconditional and enforced as part of producers' licence to operate in Western Australia.

Producers should however be given sufficient flexibility in how they would meet their domestic supply obligations, such as by meeting commitments from outside a specific project or field.

Gas swaps and trading arrangements

Any trading arrangement should support the following principles:

- It should ensure timely monetisation and supply – it should not allow producers to indefinitely delay domgas supply through commitment shifting;

- It should be a transparent mechanism; and

- It should deliver the same volume of gas.

The following elements could be incorporated into a trading arrangement.

Obligation should attach to the company, not the Joint Venture

This would allow individual companies to swap and trade commitments both within the company (from outside the project) or with third parties. It should also lead to the most economic development option being chosen, for example by swapping the 15% reservation on remote fields for gas closer to existing domestic gas infrastructure and markets.

Given the level of concentration in the resource owners in the upstream market across different projects, it would be practical for individual companies to trade within themselves or between themselves.

There are sufficient gas reserves in the Carnarvon Basin from existing projects to offset obligations from, for example, Browse or Prelude. A 15% domestic commitment on Browse, equating to just over 5 Tcf, could for example be supplied from the expanded Gorgon Project (50 Tcf).

Obligation should apply to existing and expanded LNG production

The 15% obligation should apply to both existing reserves and prospective acreage. This would ensure that the overall 15% commitment is maintained as new discoveries are made, or original estimates are revised (up or down) and new fields are added to an existing LNG project.

The Gorgon Project reserves have significantly expanded from the original 40 Tcf to now 50Tcf with no increase in the original domestic supply commitment. It would also further promote exploration and development of smaller offshore gas fields and onshore unconventional gas.

Banking arrangements

Where it can be objectively determined (by the ERA or the IMO) that domestic demand is not sufficient to meet delivery of the full 15% production commitment, any surplus could be “banked” for future delivery.

This supply must be delivered within, for instance, 5 years, or at the very least when domestic demand is sufficient to meet supply volumes.

The Gas Statement of Opportunities would provide a useful tool in managing and assessing trading or banking proposals.

“Offset arrangements”

Additional flexibility might be accorded to producers through “offset” arrangements, i.e. investment dollars offsetting the absolute requirement to produce gas volumes. The aim remains to support the sustainability and growth in the domestic gas market. These could include:

- Investing in new domestic gas (unconventional, shale or tight gas) developments in Western Australia;
- Investing in domgas-targeted exploration;
- Investing in new gas storage infrastructure; and
- Providing third party access to gas gathering and processing infrastructure;

The value of the proposed offsets would need to be compared to the value of the domgas that would otherwise be supplied to the market under the reservation commitment. This needs to recognise that the State may be foregoing the immediate benefits of domestic supply for a longer term and potentially uncertain benefit (such as domgas exploration or shale gas development).

Strong enforcement penalties

Strong enforcement penalties should be applied to enforce domestic gas supply obligations. These could be incorporated as part of a project State Agreement or through other export licensing / land access arrangements.

Chart: Meeting domestic gas obligations