DomGas Alliance

Date 30 August 2013

The Principal Research Officer
Economics and Industry Standing Committee
The Parliament of Western Australia
Parliament House
Perth, WA 6000

To The Committee,

Submission by The DomGas Alliance to the Economics and Industry Standing Committee inquiry into the economic implications of floating liquefied natural gas operations

DomGas Alliance is pleased to provide this submission to the Economics and Industry Standing Committee's inquiry on the economic implications of floating liquefied natural gas (FLNG) operations. The Alliance strongly believes producers moving towards FLNG rather than on-shore processing will have a severe and detrimental impact on the Western Australian economy and on industries that rely on affordable and stable gas supplies.

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The DomGas Alliance was formed in 2006 to respond to consumer concerns about domestic natural gas supplies and pricing. The Alliance aims to promote security, affordability and diversity of gas supply for industry and households in Western Australia. The members of the DomGas Alliance purchase around80% of the gas produced for domestic use in WA. Our members include Alcoa of Australia Limited, Alinta Energy, Dampier to Bunbury Natural Gas Pipeline (DBP), Gold Fields Australia Pty Ltd, Horizon Power and Newmont Mining.

While the Committee's inquiry covers the impact of floating liquefied natural gas (FLNG) operations on a number of sectors, this submission provides the Alliance's view on the specific term of reference regarding the likely effect on domestic gas supply and industrial gas users. (For the purpose of this submission the use of the term domestic gas by the Alliance refers to the industrial use of natural gas)

Domestic gas supply in Western Australia

In considering the ramifications of FLNG it is first important to understand the current state of play for domestic gas users in Western Australia.

Natural gas accounts for half of Western Australia's energy supply and 60% of electricity generation. A wide variety of Western Australian industry is critically dependent on competitively priced gas supply to sustain operations and compete in international markets. However, despite Australia's (and particularly Western Australia's) massive gas resources this competitive advantage is being eroded as potential supplies are preferentially directed towards LNG export.

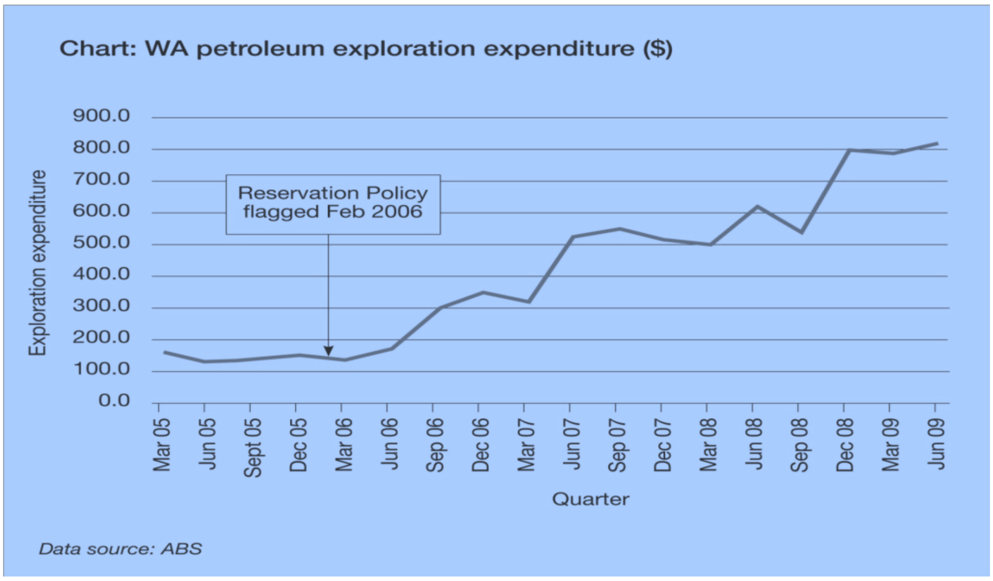
Even without FLNG operations, the medium to longer term domestic gas market in Western Australia is delicately poised with significant supply shortfalls likely in future years. This is despite the Western Australia market having the benefit of a nominal 15% domestic reservation policy.

The Western Australian market currently consumes around 1000 terajoules per day (TJ/d) of domestic gas. While almost 60% of this need is supplied by the North West Shelf (NWS) the supply from this project is expected to fall sharply during this decade, before ending in 2020 when long term domestic supply contracts expire.

Well before this date the Alliance believes that Western Australia will need to find ~700Tj/d in new domestic gas supply to replace the NWS project and to meet the estimated modest annual consumption growth of 2.5% per annum. The question this poses is simple – where is the gas going to come from to fill the gap? Unfortunately the answer is far more complex and concerning. Currently the Gorgon and Wheatstone projects are understood to be the only near to medium term developments which have uncontracted offshore gas. Even with these projects delivering some gas into the domestic market, it is likely supply will not meet demand. The consequence of which will be a slow-down in State growth, the real likelihood that local industry will continue to pay some of the highest prices for gas in Australia, amongst the highest prices of any gas exporting country in the world, and the possibility of supply shortfalls – all this without taking into account the lost opportunity to boost domestic supply due to the pursuit of FLNG.

There is already clear evidence that rising domestic gas prices and uncertainty of long term gas contracts are impacting Australian industry and eroding international competitiveness of Australian industry. This also has a dampening impact on growth by reducing the attractiveness for new projects and investment opportunities. For example, recently Incitec Pivot chose to invest $US850 million ($940 million) in a new ammonia plant in the United States instead of Australia, citing access to a reasonably priced supply of natural gas as one of the key reasons it shelved plans for an Australian facility.

Despite the domestic gas supply outlook in Australia, major gas producers and their representative body, the Australian Petroleum Production and Exploration Association (APPEA) have maintained that domestic gas reservation is a threat to international competitiveness and has the potential to make projects uneconomic. This flawed argument is not supported by the data. The graph below shows that investment has continued to grow with recent projects such as Wheatstone, Gorgon and Pluto in an environment where the domestic obligations were well known and no doubt factored into the decision making process.



Despite the protestations it is clear that producers are being asked to put domestic gas into the Western Australian market only when commercial. The fact that projects such as Gorgon have sold domestic gas suggests it remains a highly profitable market for oil and gas companies. In Western Australia domestic gas prices have been rising sharply from $2.50 per gigajoule in to as high as $12 per gigajoule in the last decade. This compares to natural gas in the United States which has recently traded in a range between US$3 – 4 per gigajoule.

The bottom line is that the massive expansion in LNG production for overseas markets, will at the same time see Western Australian industry and households staring down the barrel of an extra $3.1 billion in annual gas bills (source: BREE, Energy in Australia 2012). This cost will be borne directly or indirectly by every business and household in the State.

Increased Gas Price Impact on Annual Gas Bills

State	Annual gas consumption (PJ)	Annual gas bill historical prices	Annual gas bill new prices	Additional cost
Queensland	199	$597 million	$1.2 billion	**$597 million**
NSW	155	$477 million	$954 million	**$477 million**
Victoria	263	$789 million	$1.6 billion	**$789 million**
South Australia	133	$399 million	$798 million	**$399 million**
Western Australia	566	$1.4 billion	$4.5 billion	**$3.1 billion**

Source: Annual gas consumption from BREE *Energy in Australia 2012.* Domestic gas prices used are Western Australia $2.50/GJ historical, $8/GJ new; Eastern States $3/GJ historical, $6/GJ new

Natural gas is also playing a critical role in Australia's transition to a lower carbon economy. The adoption of natural gas fuel by many industrial plants has delivered significant reductions in global greenhouse emissions as natural gas produces less than half the greenhouse emissions compared to coal. However rising gas prices and gas supply shortages could jeopardise this shift to a cleaner and a more environmentally friendly economy as key industries and industrial plants are forced to switch to coal-fired power as natural gas becomes more and more costly.

The implications of floating LNG on the Western Australian economy

If the situation for domestic gas users is bleak now, the Alliance believes that the adoption of FLNG technology will cause even more adverse impacts on industry and broader consumers in Western Australia.

The reasoning is simple - because gas would not "land" in Western Australia for processing if FLNG was used, it means the gas reservation policy for WA would have no effect on these projects. FLNG effectively means that oil and gas companies could bypass the State based reservation policy and the obligations to Western Australia they would face if they were processing the gas onshore.

This has huge implications for the State. Take for example the increasing likelihood that Shell and its partners will develop the massive Browse gas field off the Western Australian coast through FLNG rather than processing the gas onshore at the proposed James Price Point facility as originally planned. The field holds over 15 trillion cubic feet of gas, enough to supply WA's entire gas needs for 15 years, but much of it is in Commonwealth waters, which means if FLNG goes ahead, Western Australia will receive virtually no benefits from the Browse fields as a large portion, if not all of the gas could be used for export at the expense of domestic use. Supplies that might have otherwise been available to the domestic market will be shipped offshore; the end result would be the removal of a potential longer term replacement for the declining NWS supplies and further strain on domestic gas supplies.

"In the absence of a gas reservation policy, it is unlikely that LNG producers would develop adequate domestic gas processing facilities."

Economics and Industry Standing Committee, Inquiry into Domestic Gas Prices, March 2011, Finding 19

If the proposed FLNG development by Shell and its partners is approved, Browse would then join the Prelude (FLNG) and Ichthys (gas located off the Western Australian coast piped to the Northern Territory) as projects where producers can avoid domestic gas requirements. As a result, Western Australian businesses and consumers will suffer in terms of energy security, value adding onshore investment and construction and operational jobs. Flow on effects would include a reduction in community benefits that arise from having the gas processed here.

Importantly, once LNG or FLNG projects are put in place the decision becomes irreversible. In other words, when long term contracts for sale of LNG are entered into (typically for up to 20 years), they cannot be redirected to domestic gas use. In fact, based on experience during the early part of the NWS Project, domestic gas prices were higher than LNG prices, but because of contractual commitments, the gas could not be redirected to the higher value domestic use.

In summary, the Alliance holds the view that floating LNG represents a significant long-term threat to the energy security and economic well being of Western Australia, which has historically been driven by ready access to of world standard, competitively priced domestic gas supplies. There is a need to act now to avoid the destruction of this competitive advantage.

The Western Australian State Government, in particular through Premier Colin Barnett, has repeatedly voiced its concerns about FLNG. Furthermore, a representative of the Department of State Development has stated, during a briefing to this Committee that it will hold negotiations with Browse joint venture partners on how they intend to meet their domestic gas obligations for the small portion of the Browse field which is located in State waters.   The Alliance applauds the effort of the Western Australian Government in this regard but the geography of the Browse field in itself highlights a major problem for domestic gas supplies – the loss of opportunity from fields which are in Commonwealth waters.

FLNG underlines the need for a national policy to give the highest priority to domestic gas use

Australia is the <u>only</u> country in the world that allows international oil companies to access and export natural gas without prioritising local supply. While Western Australia has a domestic gas reservation policy, the Alliance strongly believes that the Commonwealth Government needs to consider how the domestic market will be served as part of any commitment granted to FLNG.

The Alliance believes a strong, effective and transparent mechanism could be implemented to balance the needs of producers and those of domestic customers. Such a requirement could be written into an amended Commonwealth Offshore Petroleum and Greenhouse Gas Storage Act 2006 as a condition in exploration permits, retention leases or production licences. While a detailed description of a possible domestic gas prioritisation policy is not essential for this forum, key features could include:

- An obligation would attach to the individual company, not a joint venture (Companies could trade commitment within their own organisation or with third parties. For example there is sufficient gas in the Carnarvon Basin to offset obligations from Browse or Prelude);

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- An obligation should apply to both production and reserves (This would ensure any commitment is maintained with new discoveries and when new fields are added to an existing LNG project).

The Alliance believes there should be a bi-partisan approach by the major political parties in Western Australia to push for a prioritisation policy, and the move to FLNG provides a compelling case study on why this critical energy security reform is required. Finally, what remains clear is that however producers try to “dress up” FLNG, the consequences of offshore processing could prove damaging for Western Australia which is already struggling to cope with spiking gas prices and facing a potentially serious domestic gas shortfall.

Yours sincerely,

The Members of The DomGas Alliance