

**ECONOMICS AND INDUSTRY
STANDING COMMITTEE**

INQUIRY INTO DOMESTIC GAS PRICES

**TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 15 NOVEMBER 2010**

SESSION ONE

Members

**Dr M.D. Nahan (Chairman)
Mr W.J. Johnston (Deputy Chairman)
Mr M.P. Murray
Mrs L.M. Harvey
Mr J.E. McGrath**

Hearing commenced at 12.32 pm

JOHNSTON, MR STUART RICHARD

Chief Executive Officer, Dampier to Bunbury Natural Gas Pipeline, examined:

COOPER, MR MARK ANDREW

General Manager, Commercial, Dampier to Bunbury Natural Gas Pipeline, examined:

CRIBB, MR ANTHONY IAN

Company Secretary, Dampier to Bunbury Natural Gas Pipeline, examined:

The CHAIRMAN: We might as well get going. I will go through an introductory or opening statement. Welcome. Thanks for your attendance today. This committee hearing is a proceeding of Parliament and warrants the same respect that proceedings in the house demand. Even though you are not required to give evidence on oath any deliberate misleading of the committee may be regarded as a contempt of Parliament. Before we proceed, there are a number of procedural questions that I need to ask. Have you completed the “Details of Witness” form?

The Witnesses: Yes.

The CHAIRMAN: Do you understand the notes at the bottom of the form?

The Witnesses: Yes.

The CHAIRMAN: Great. Did you receive and read the information for witnesses briefing sheet about giving evidence before parliamentary committees?

The Witnesses: Yes.

The CHAIRMAN: Do you have any questions about giving evidence before a committee?

The Witnesses: No.

The CHAIRMAN: Thank you very much. Before we start asking questions do you wish to make an opening statement?

Mr S. Johnston: Yes; if that is okay.

The CHAIRMAN: Please go ahead.

Mr S. Johnston: DBP is pleased to have the opportunity to present at the hearing. As I have said, my name is Stuart Johnston. I have been CEO of DBP since April of this year; prior to that, I was with Shell for 20 years, and I have previously had some time here in Perth working on LNG projects. Mark Cooper is DBP’s GM commercial. He has been with the pipeline for the past 10 years. Anthony Cribb is our GM corporate services. Both of my colleagues were heavily involved in the transition of ownership of the pipeline back in 2004, and in the growth of the business since then.

I have just a few comments with respect to this inquiry. Firstly, DBP supports efforts to secure and grow domestic gas supply, and to maintain and increase customer demand. For us, more suppliers feeding gas into the pipeline and more customers taking gas out along the route, not only enhances our business model, but is, we believe, good for WA. We believe gas offers many benefits; that is, it is an abundant long-term resource for WA, there is a robust existing infrastructure, and there are, obviously, environmental benefits when compared with alternatives. It also provides long-term support in terms of a fifty-year transition towards a low-carbon economy and it supports renewable power-generation technologies.

We are also aware that there have been questions during this inquiry about the robustness of WA's infrastructure. The second point that I wanted to make is that we believe the pipeline is safe; that is, it is reliable and it is flexible. There has been no curtailment due to pipeline failure since June 2004—since the current ownership came in. In fact, there have been only two interruptions to supply in the past 26 years, and both of those were for only a few minutes' duration and were isolated to a single delivery point.

DBP has invested \$1.7 billion into the pipeline and infrastructure over the past five years to meet customer demand. This expansion was done in three phases, all of which were completed on time, on budget and in advance of when the customers required the gas. The recent expansions—this is an important point—actually mean that the pipeline is now 83 per cent duplicated; it can really be thought of as two parallel pipelines. In recent months, we have used this, if you like, additional capacity, and have been able to work with upstream producers to use the line pack gas in the pipeline to cover planned and unplanned outages—both at Karratha and at Varanus Island. The overall system integrity will be improved over the next few years as Devil Creek, Macedon, Pluto, Gorgon, all of which are post final investment decision, are tied in to the system.

My third point is that we support growth and are willing to invest further, provided we have sensible economic regulation that does not act as a disincentive to that investment. We have full-time business development staff currently working with power generators and project proponents to investigate opportunities that could lead to further expansion of the pipeline.

Finally, a comment on supply and pricing. We believe that there is an abundance of gas capable of servicing the domestic market and our asset for the next 50 years and beyond. Unlike many places in the world where I have worked, the declining resource volume is not an issue. Also, unlike many places around the world, there are very few restrictions on companies developing and exporting the gas resource. For the WA economy, we believe and we recognise that security of demand is as important as security of supply; therefore, we support the domestic gas reservation policy as an appropriate component in an overall framework for investment. That means our customers will know that the gas is available in the long term. Our understanding is that, compared to many investment locations, a reservation policy set at 15 per cent of discovered volume would not be excessive and would not act as a disincentive to further investment.

In terms of pricing, our only business is the transportation of gas through the DBNGP, and as such we do not sell gas on behalf of producers, nor do we trade gas. The market needs to find a balance between the needs of the producers to cover costs and deliver an acceptable return to their shareholders, and the needs of the gas and electricity users to contain their energy costs to a level that allows them to compete in the market, and to support the state economy. From a commercial perspective, it is in our interest that our customers have long-term access to gas at a price that is affordable to them. Whether that gas is \$4.00, \$6.00 or \$8.00, is a matter that needs to be resolved between the producers and the customers, as well as the state, given the long-term impacts on investment, development and energy security.

That is it; we are very happy to take your questions.

The CHAIRMAN: Thanks very much. As you probably know, the major reasons for this inquiry are the perceptions out there, despite large volumes of gas, particularly of the north west shores, of a growing physical shortage of domestic gas and also the rapidly rising prices in new contracts. Do you see this? Is it impacting your business in any way?

Mr S. Johnston: There are two answers to that. Firstly, we are obviously a significant user of gas in our own right. For fuel gas to operate the pipeline we have recently agreed, working with Alinta, to an increase in fuel gas prices. We have, therefore, I suppose, seen some of the direct impact. Our fuel gas varies according to the amount of gas that is flowing through the line at any time, but we have seen that increase and it represents a very significant part of our operating expense.

[12.40 pm]

Secondly, we are aware from speaking with a lot of our customers, as we obviously do, that they are very concerned about the medium and long-term outlook. I think the important point of the feedback I have had since I have come into this role is that it is not only price that is the issue for them; it is the terms and conditions and, particularly, the length of contract that is available to them. We talked about this internally: I advocate that terms and conditions are just as important as price when it comes to looking at long-term viability of the sector.

The CHAIRMAN: I think you said that you are contracted to purchase gas from Alinta? Was that up for renewal? Is that why you have seen the prices? Or is it because of escalation clauses in the contract?

Mr S. Johnston: I will let Mark answer part of that. In fact, it was in an ongoing commercial discussion we had during their restructuring. Mark, do you want to add some detail?

Mr Cooper: It is in the public domain that there was a price arbitration between Alinta and North West Shelf Gas that was not in Alinta's favour. I think that is fair to say. As a result of that, we were approached by Alinta to renegotiate some aspects of the contract to help mitigate some of the impacts of that on their business and to allow them to continue with their operations. There was a commercial discussion around that without any contractual basis. It was purely a commercial negotiation.

The CHAIRMAN: Was it just a flow-on effect of those negotiations that are in the public domain?

Mr Cooper: Yes.

The CHAIRMAN: Do you share the concerns of a physical shortage of domestic gas under current policy settings, including the reservation?

Mr S. Johnston: As a pipeline operator we are fully contracted out to 2019 in terms of capacity. That capacity would —

The CHAIRMAN: Until 2019?

Mr S. Johnston: Yes, 2019. The capacity in the pipeline is fully contracted to that point. The terms of our contracts for our standard shipments—and obviously we have Alcoa as well—mean that the take-or-pay arrangement that sits with those contracts goes out at least until then. In some ways, giving you real evidence and proof—all I can give you is anecdotally, yes, I can express those concerns being put to me by several customers, but for the pipeline's business model, if there was demand disruption through lack of supply, that impact would obviously be felt later.

The CHAIRMAN: Given that the concerns about physical shortage of supply lie largely with customers in the south—the committee has not heard too many concerns from the big miners up north; I have not heard them say too much—but if your pipeline is a single pipeline to the south and it is fully contracted through to 2019, what is the worry?

Mr S. Johnston: We are there not only to maintain and operate the pipeline, but also to keep growing it and keep investing in it. We think it is a great asset. Obviously, it is our business and our only business.

The CHAIRMAN: Sure, you want to grow it.

Mr S. Johnston: The fact is that whilst the contract structures are in place, having more offtake and having that security of demand, about 85 per cent of our load is indeed in the south west; it is the majority of the load. When people look at our business model and us going out to refinance the business, people are looking at a long-term future, not just the fact that we are contracted up to 2019. They are looking at the long-term future and we want all those customers and others to be there after the next regulatory agreement and well into the next decades. If you take a long view of

this business, it is a concern that there is adequate supply of gas and the customers have security of supply.

The CHAIRMAN: Do some of the contracts go beyond 2019?

Mr S. Johnston: They do.

The CHAIRMAN: Let us say hypothetically, if Gorgon comes onstream, sells—I think they are committed to selling 150 —

Mr S. Johnston: To start with.

The CHAIRMAN: To start with. They carry out their schedule and most of it goes to the south—I am not sure where it is going—could you meet that or would you have to expand your pipeline?

Mr S. Johnston: Firstly, as I understand it, Gorgon's start-up will probably be some time in 2015 with initial domestic marketing of 150 terajoules a day, going up to 300, Mark?

Mr Cooper: Up to 300.

Mr S. Johnston: Up to 300 later. In that overall dynamic in 2014, I understand the North West Shelf joint venture may change the amount that it —

The CHAIRMAN: But is yours not already contracted up to 2019?

Mr S. Johnston: No, the capacity is contracted by the customers, not necessarily where they are getting the gas from. They have written a contract with us to have capacity available to us for a certain volume. It is not saying that they have back-to-back contracts securing that volume. It is just that they have contracted capacity in the pipeline.

The CHAIRMAN: Are some of your customers a bit long on capacity?

Mr S. Johnston: It could be. Obviously a lot of this investment was pre-GFC and I think they have invested for the long term. We are running—what did we do over the weekend? About 656 terajoules, 660, something like that?

Mr Cooper: In that order, yes.

Mr S. Johnston: It is one of the shoulder months at the moment and we are currently running about 660 terajoules a day full haul to the south west versus a current maximum capacity of 845 terajoules. At the moment, on a day-to-day basis there is some spare capacity, if you like, available in the pipeline.

Mr Cooper: May I add that if Gorgon is incremental gas—that is an “if”—we have demonstrated over the last five years that we can build capacity as fast as production can come onstream or demand can be built. If someone wants to come to us and say, “Look, we have contracted for a new project from Gorgon,” we can certainly build the capacity that is required in a complementary time frame to facilitate that project getting up.

Mr S. Johnston: To add to Mark's contribution, that is probably something that has changed over the last few years; when I have talked to project proponents—we are talking about new business development options—we are not seen now as the constraint or the bottleneck or the critical path on their decision-making. So many of these guys are ultimately looking at the electrons and the power generation that they need for their minesite or whatever, rather than the additional gas. Therefore, they work back and the track record that we have of being able to invest and expand the pipeline over the last five years, gives them a sense of comfort that we are not going to be the bottleneck in terms of those investment decisions.

Mr J.E. McGRATH: Along those lines, you say that you are not a factor in any bottleneck; could you give the committee some idea of how the cost of gas transportation has risen over the years since the pipeline was first constructed and give us some idea of the percentage of the cost of gas to the domestic market is taken up by the actual transportation cost, which you guys provide?

Mr S. Johnston: I will start with the answer and then for a bit of the background I will turn to my colleagues who have been here a little longer than I have. As you are probably aware, the tariff is currently a negotiated tariff at \$1.49 per gigajoule full haul. That is escalated to the end of 2011 at CPI. You can see how it is going to go up over the next few years and then from 2011 to 2016, CPI minus 2.5 per cent is the escalator. That negotiated tariff, which has basically been in place over the last X years to allow the expansion, sits above a regulated tariff of about \$1.20.

Mr Cribb: That is correct. The negotiated tariff has a tariff path that in 2016 reverts to a regulated tariff. At this point in time, it is a tariff above what a regulator set: in the order of \$1.49 versus \$1.20. In terms of the other components that get the gas to the customer, obviously the wellhead price and if they need to transport through the distribution system, there is that cost as well. Pipeline transportation costs have not changed significantly over the course of the last five years. We have seen an 83 per cent increase in duplication of the pipeline over that time—\$1.7 billion. The tariff in 2004 was \$1.05 and we are now at \$1.49. Notwithstanding the fact that we have effectively doubled the cost of the asset over that time, we have effectively only seen a 45-cent increase in the tariff over that time.

[12.50 pm]

The CHAIRMAN: And the difference between the negotiated and gazetted rate is a negotiated incentive to expand the pipeline?

Mr S. Johnston: I am going to make it very clear: without the negotiated tariff, the expansion would not have been able to happen.

The CHAIRMAN: And the negotiated one lasts a period of time to pay back the expansion?

Mr S. Johnston: So it is a negotiated tariff up until the next regulatory reset, which is early 2016.

Mr W.J. JOHNSTON: There is a gap between your maximum capacity and your regular daily capacity. Are shippers allowed to onsell capacity?

Mr Cooper: Yes.

Mr W.J. JOHNSTON: So there are no restrictions on what they do with their capacity?

Mr Cooper: No, and there is quite an active bilateral trading market that happens on a daily basis. It is bilateral and it is literally that someone picks up the phone and rings someone else that they know and does a deal. The proposal for a bulletin board would make that more transparent, but it is actually quite a liquid market already.

Mr W.J. JOHNSTON: Would you support a bulletin board?

Mr Cooper: In the right format. We are involved in the discussions with the Office of Energy about their proposed bulletin board. I think if there is more transparency in the market, which would improve the liquidity, it would improve the throughput on the pipeline and use up some of that headroom that we currently have. However, it needs to be constructed and applied in a way that does not impose burdens on parts of the industry, which do not—I suppose the impositions on the sectors of the market need to reflect the benefits that those particular sectors derive from it, so I think it just needs to be done the right way.

Mr Cribb: It is just important to note that the contract that we have with most of our customers allows the customer to use that gas or that capacity—100 per cent of that capacity—any day without advising us in advance, so we are effectively not able to free up that capacity to third parties while we have a contract that enables customers to use that at any point in time.

The CHAIRMAN: You know that it is a peaky demand driven by electricity. So you could be very sure with various numbers of tolerance that you are not going to hit full capacity on certain days. Could you negotiate taking a risk that you never know what is going to happen, but taking it? So

could you allow somebody else to use that capacity, even though it is already committed to by somebody else but you know they are not going to use it?

Mr Cooper: That is actually quite explicitly allowed for in the contracts, Mr Chairman. We have the right to offer unutilised capacity as spot capacity. Anybody can purchase that but they are at risk that we may have to take them out to provide it back to the, if you like, owner of the capacity if they change their operations and seek to use that capacity during the course of the day.

The CHAIRMAN: Do you have a market in spot capacity?

Mr Cooper: Yes we do.

The CHAIRMAN: Is it published?

Mr Cooper: It is published to everyone who has a contract on the pipeline. Within our business-to-business electronic system, is a page where all shippers have access to the available spot capacity and it is, effectively, an auction process that occurs daily.

Mr W.J. JOHNSTON: Is there much utilisation of that the capacity in the market?

Mr Cooper: It varies from time to time. Currently, there is not very much. As Stuart said, we are in a shoulder period in terms of throughput on the pipeline, plus there is this headrooming capacity. In times past when the capacity has been a bit more constrained, there has been quite active trading in the spot market. It varies depending on the market dynamics at the particular time.

The CHAIRMAN: To facilitate that, do you charge different prices for a shipment according to peak and non-peak and spot and long-term contracts?

Mr Cooper: The spot process is that we post the minimum price at which we will sell spot on the day, and that tends to be at a premium above the 100 per cent T1 tariff, because it is the incremental throughput that is the most expensive to transport. The cost of running compression is not linear; the more you move, it becomes exponentially more expensive. The actual price paid is then determined through an auction process where the shippers have the right to bid a volume price pair, if you like, and then we allocate to the highest bid first. It is cleared actually at the bid price, it is not like an electricity clearing market where everyone pays the high price; if you bid \$1.50 and the next guy bids \$1.40, you will get yours and then he will get his at \$1.40 and so on until it is exhausted.

The CHAIRMAN: What would be wrong in just publishing all this information to the general public?

Mr Cribb: The standard shipper contract terms and conditions are all publicly available, so already all of our contracts are in the public domain, including price. We have to offer a single price to everyone; that is the way we operate. The spot pricing arrangements are already available in the market, but I guess capacity is one thing, gas is another. We do not get involved in the sale of the spot gas, it is just —

Mr S. Johnston: It is just the capacity.

The CHAIRMAN: But your spot capacity bidding, could I find that out somewhere?

Mr Cribb: You need to have a transportation contract to be able to get it across —

The CHAIRMAN: I mean taking it out of the group that has the contracts to the general public. I might want to enter into a contract; I might have a mate who is already there who could relate the information to me, but for transparency, one of the issues is opening up more generally. What would be the problem with that?

Mr Cooper: We already have parties who have just an interruptible or just a spot-type contract where they can come into the system and purchase spot capacity. They go through a process, which is a publicly available process, to apply for capacity and apply to be an approved shipper, which

involves having the appropriate credit support and so forth to be able to transact on the pipeline. We are dealing in fairly insubstantial sums for most transactions, so it —

The CHAIRMAN: There is an issue about the fiduciary control about using the pipeline, I expect that. But this is information about people understanding the market dynamics.

Mr S. Johnston: I think if you split those two, Mark was addressing the commercial kind of “we want viable people who we know are going to pay the bill. I think in answer directly to your question, we have no objection in principle to more transparency; in fact, in the last few months we have started publishing the daily throughput on the line every day on the website. There is nothing hidden here in terms of that.

Mr W.J. JOHNSTON: The gas bulletin board that operates on the east coast, do you have any particular comment about your observations of the way it operates? Is there anything that we should be learning about it or is it satisfactory? As you know, they are sitting there with all of their infrastructure ready to include Western Australia, but Western Australia is not included. Do you think we should just pick that up or is there something that does not work there?

Mr S. Johnston: I do not know it myself that well.

Mr Cribb: It is a fairly heavy-handed arrangement for the market that is operating, and that is our feel at the moment. There does not need to be as much systems and information to enable things to work over here in the west.

The CHAIRMAN: Why? Is it because our market is not as complex and there are not enough traders? What is the difference? It seems to work over there all right; when we travelled there everybody seemed to be happy with it. What is the difference over here? Give us some examples if you could.

Mr Cribb I think the sense is the level of information that is made available. As we have already said, some of that information is already in the public domain, so having to create another process to collect that information and impose those obligations, particularly like that when it is already in the public domain, does not seem to be adding any value —

The CHAIRMAN: Except that it might be bringing it together.

Mr Cribb: It may be.

Mr J.E. McGRATH: We are talking about the price of gas transportation. Is there much difference around Australia? How do we compare with the gas pipelines in the east coast of Australia? What is the difference in the markets from your point of view as a provider of transportation in Western Australia?

Mr S. Johnston: There will be a difference, but it is very, very straightforward; it is because we are a unique asset—you do not find any other 1 600-kilometre 26-inch lines. It is just driven by distance and the amount of compression. Then, obviously, with the expansions we have put in place, you will see a difference between different markets and internationally. But having said that, again, as a regulated asset, it is pretty transparent as to how that adds up and how the costs are put together.

[1.00 pm]

Mr Cribb: It is fair to say that the price that we talked about—\$1.05 in 2004—derived from the price that the government set back in the 1990s —

Mr Cooper: 1998.

Mr Cribb: — which was called the gas transmission regulations. That is how it evolved. Since then the increases have reflected the costs of expanding the capacity of the pipeline. It is a cost-based derivation after that.

Mr J.E. McGRATH: How much of a factor is the extra competition that is evident on the east coast of Australia? Do you think that could lead to a lower transportation cost or do you not think that would be a factor? We accept the point that the distance is enormous.

Mr S. Johnston: It is the unique nature of WA as well. As a general principle, more competition is good and that would have a positive effect on pricing. If you look at what it would take if I was to come along and propose a pipeline to run alongside the DBNGP, the amount of additional volume they would have to secure to underpin the project in the first place would make it a bit of a moot point because they would be in exactly the same place, having to finance it and recover those costs and get sufficient volume to build a competing asset. Whilst I could not give a definitive answer, it would not have a markedly positive impact on pricing, again given it is a regulated regime. You can see where the stats are over time and how that price is calculated. They are going to be in exactly the same market with exactly the same cost structure that we have got if someone built a competing asset.

The CHAIRMAN: Except that it would cost a hell of a lot more to build that pipeline.

Mr S. Johnston: Yes. It would be a very, very expensive bit of kit.

The CHAIRMAN: How much?

Mr Cribb: It would cost almost \$1.7 billion to duplicate 80 per cent of it.

Mr S. Johnston: That is without a corridor and the infrastructure you have got going alongside it. Northwards, as a rough guess, it would be several billions.

Mr J.E. McGRATH: Where do you see the possibilities or the challenges in transportation if other forms of gas come on board such as coal seam gas or shale gas or unconventional gas that is from inland Western Australia? How do you see that tapping into the Dampier to Bunbury pipeline? What challenges would there be in transportation from those new fields?

Mr S. Johnston: It entirely depends on where the gas is found. If major incremental volumes are found, if someone found a 50 TCF field next to Bunbury, I have probably got my work cut out over the next few years! But if it is elsewhere, there is a good chance you would be able to tie it into the DBNGP and use the existing backbone, if you like, without spending the additional capital. In terms of overall cost, depending on the numbers you take, you have a resource base at the top end of the existing pipeline that is world scale and has not reached the sort of inflection point on the creaming curve in terms of the exploration success that has been seen in the past few years—160, 180, 200-plus TCF the top.

The CHAIRMAN: Are you saying that we have a big resource out there and you are still finding good results from exploration?

Mr S. Johnston: Yes.

The CHAIRMAN: Usually they start tailing off and we have not even got to that point yet.

Mr S. Johnston: That is right. Anybody else coming in would have to be able to ultimately displace that or be able to offer something that does not come close to the market or whatever. It is what happened in the US with the tight gas players over the past few years.

Mr J.E. McGRATH: Do you see that being a factor maybe against people coming into that form of exploration? Do you think that could be a negating factor against someone coming in to look for a new form of gas if we have so much offshore gas up on the shelf?

Mr S. Johnston: I do not think so. Again, there should be space in this market for people to explore. Just following what is in the public domain, I am aware that several people are looking and investigating options for tight gas and shale gas. We have seen these technology breakthroughs that are happening elsewhere that could be applied here. I think it probably acts as a disincentive. Again,

most people looking at this market would see that clearly a lot of the big projects are targeting LNG exports rather than targeting domestic gas.

Mr W.J. JOHNSTON: You say that if somebody found 50 TCF at Bunbury, you would have some issues there. The Whicher Range is a famous tight gas field. People have been trying to get it to work for a long time and it has not worked. If you get a flow like that to work, can you run that gas up the pipeline—the Bunbury part of your pipeline? Can that be used to bring gas in without much adjustment?

Mr Cooper: From my knowledge of the Whicher Range, using it as a live example—I did a bit of work on it 10 or 12 years ago—that gas meets the state gas quality standards so there is no reason for it not to be blended into the DBNGP and delivered to customers using the DBNGP as a delivery mechanism.

Mr Cribb: Physically, we already have a back haul arrangement where gas, for example, comes in at what we call compressor station one and it is delivered further upstream to customers. It is not a physical flow of gas but a commercial arrangement allows to it to happen.

Mr W.J. JOHNSTON: Is compressor station one in Karratha?

Mr Cribb: It is about 150 kilometres south of Karratha.

Mr W.J. JOHNSTON: I understand Burrup Fertilisers' gas is Varanus Island gas. Is that the case?

Mr Cribb: Yes.

Mr W.J. JOHNSTON: Even though it is going south, you are —

Mr Cribb: Commercially, it is sold upstream.

The CHAIRMAN: Do you plan to extend the pipeline in the future, at both ends or with more looping?

Mr S. Johnston: Two or three points should be made here. First, stage 5B is also complete. We have punchless \$50 million or so to spend and the river crossing to complete. We are closing that out now. At the moment with the figures we have given today, there is no immediate need for us to expand further with what we see as daily flows and customer demand. The flip side of that, as I said in the opening statement, is that business development staff are chasing and working with our developers and working with other people to investigate opportunities and doing the state development as well. We are open for business. Again, I think we will leave it at that. We are open for business and actively pursuing other investment opportunities all connected to our business to the DBNGP

The CHAIRMAN: Your only business is the DBNGP?

Mr S. Johnston: That is right.

The CHAIRMAN: When the gas goes to the domgas plant at the Burrup, you do not take it up north or put it to Rio or BHP. Do they have pipelines coming off yours?

Mr Cooper: Without going into the specifics of individual customers, we do and have supplied gas for many years to facilities in the Pilbara. You mentioned Burrup Fertilisers; that is one. The power station at Dampier, which is a Rio facility, has been a pipeline customer since day one. We do supply customers in the Pilbara as well as in the south.

The CHAIRMAN: Do you own the pipeline?

Mr Cooper: In some cases the laterals are owned by the customers and we deliver on the DBNGP corridor through a meter into their bit of pipe which goes to their power station. In other cases we own the lateral and supply it a point further downstream. It varies from customer to customer.

The CHAIRMAN: Are you considering other investments outside your pipeline?

Mr S. Johnston: No.

The CHAIRMAN: What about storage? We understand that there has been some consideration.

Mr Cooper: For a couple of years now we have been providing relatively small volumes of in-pipeline storage, helping people match their purchase obligations with producers with their actual off-take arrangements that they have in their own facilities. We have provided a relatively small volume over a relatively short term but we have certainly been providing that service as a bridge in the market. We are working actively with a couple of parties that are dealing with the APA Group for development of the Mondarra storage facility and trying to put together a transport service that makes that work. If you apply our standard contract terms and conditions, I do not think the economics stack up, or at least that is what we are being told. We are working with them to develop a more creative transport solution that matches their purchase into storage, back out of storage into their load with a slightly different service so that that whole facility can be made to work.

Mr S. Johnston: We have only recently received those requests. That was a matter of weeks ago. People have come and asked us to put this service together. That is what we are doing.

Mr Cooper: It is very much at the concept level at this stage. We are talking to a number of parties to try to facilitate that.

The CHAIRMAN: Have you looked at other storage facilities or reservoirs?

Mr Cooper: Since we acquired the pipeline in 2004, we have been fairly busy spending \$1.7 billion on pipe. We have not had a lot of people banging on the door saying, “Can you please develop a storage facility.” We have been fairly busy with our own capital program so we have not gone out actively exploring it.

Mr S. Johnston: That is not to say that we would not but we have nothing at the moment.

[1.10 pm]

The CHAIRMAN: One of the complaints that I have heard in the past is that we have a very restricted structure to our gas system. We have a few sellers up north—actually two right now. They expanded a few and then down south we have five major buyers that are connected with a single pipeline, which is regulated. It is hard to develop competition. You get rivalry, but not too much competition. Part of that structure means that, first you have to get your demand, down here, I would say, and then you have to go up there and get the gas and then you have to contract it. There are a lot of hoops to jump through to effect delivery. One of the criticisms is that the regulation we have means that you never build excess capacity. If you want capacity you have to go there and negotiate, get it built and plan way ahead accordingly. Can you comment on that?

Mr S. Johnston: I am happy to. I think we have covered some of those points in earlier answers in a different way. I think part of that sentiment is going back a few years. Today, when people look at the track record of how long, physically, it took the steel to be put in the ground and the pipeline to be expanded, there is now broad acceptance that that is not going to be the critical path for getting their project or whatever kicked off. That is point one.

The second point is that for us as a business model, it is around the regulatory regime. Building on spec just is not something we could do. Quite simply, already there is a risk in this business in the way the capital is treated and rolled into the regulated asset base that sets the tariff ultimately. It would be foolhardy to build on spec because you would not know whether, if ever, you could recover those costs. Anthony, do you want to add anything to that?

Mr Cribb: At the moment, even though we are not priced on a regulated basis, spare capacity could be available at that regulatory price. We have to make a call as to whether that would be treated. Also if, at the end of the contracts, the customers revert to the regulated tariff, we have to understand that impact now before we make the investment decisions. The regulatory framework at the moment provides a mechanism for getting, I guess, a binding ruling from the regulator before

you make your investment decision. But the framework is structured in such a way that it requires the accuracy and the detail of information to be available at least six months before you have to make your final investment decision. The nature of pipeline projects are such that you do not have information six months ahead of an investment decision that is as accurate, as certain and as detailed as would be needed to enable a regulator to make its decision. Also, pipeline projects and customer demand requirements are developing in that period. If your project fundamentally changes in its scope during that time, you have to effectively restart the process again with the regulator. That was the experience we were confronted with during our stage 5 expansion program. We started with quite a large expansion project with demand based on access requests that we had received from our customers. That demand suddenly fell away quite significantly and we had to reconfigure design of our expansion.

The CHAIRMAN: When did it fall away—during the GFC?

Mr Cribb: No, in 2006. It was at the stage of where gas pricing issues started to come to light. But this was more a case of having to make a call, so we started on a base of quite a large expansion and then we wanted to phase it into what we now call the stage 5A and stage 5B expansions, which we have done. But the regulatory process did not allow us to modify the application we had lodged. We had to restart the process if we were going to start. Of course, that would have taken another six months to do and we needed to make an investment decision because we ultimately have to deliver to meet our customers' requirements. That is the inflexibility of the regulatory framework when it comes to giving certainty on pre-investment decisions.

The CHAIRMAN: If you have that problem, your customers on both sides also have similar issues. You will go out there and be building this additional capacity and you have some indication either on the demand or supply side and those change. Let us face it, given the nature of our economy, things change quickly.

Mr Cribb: Yes, that is why we have a negotiated framework for expansions that have enabled us to undertake expansions without that process of getting regulatory sign-off.

Mr W.J. JOHNSTON: In respect of that criticism of the regulatory framework, is that about the application by the ERA of the regulation or is it the underlying gas law or whatever it is called that the ERA applies to regulate the pipeline?

Mr Cribb: Obviously, the structure is not flexible enough to allow this to occur.

Mr S. Johnston: We should be clear that that is not just an issue here. If you look at all the pipeline investments in Australia, they are all happening outside the regulatory regime to enable them to happen. Which is a statement of fact.

The CHAIRMAN: As I understand it, almost all pipelines on the eastern seaboard now are non-regulated.

Mr Cribb: All the expansions have occurred outside the regulatory framework so they have priced it out so that commercially negotiated arrangements are outside regulatory pricing.

The CHAIRMAN: Would you operate much differently if you were not regulated?

Mr Cribb: I guess the framework of our business is such that we need to ensure that we have downstream customers who are competitors able to operate on an equal footing. If we start to offer differential pricing to, for example, one power generator over another, that is going to lead to problems, particularly, given the cost of our expansions is quite cyclical.

Mr S. Johnston: Also, if you consider what our company does and the way we operate, without being flippant about it, no, we would not change that much. Our main thing is safe, prudent operation of the pipeline. That is what we do. In that way the cost structure is pretty transparent. It is fairly predictable as well. That is the other thing. We have only a few moving pieces and we

know when they need to be maintained and we know how to maintain them, which gives a fairly smooth and predictable profile. No; I do not think we would change that much.

Mr W.J. JOHNSTON: There is often discussion in the media about security of supply, particularly after Varanus, because it was always referred to as a pipeline explosion, whereas in fact it was the gas processing facility that blew up.

Mr S. Johnston: Thank you, yes.

Mr W.J. JOHNSTON: It has been put to us in evidence that it is pretty quick to repair. Even if you did have catastrophic failure of the pipeline, it would be pretty quick to repair. Would you like to give us some idea of how quickly you could get back on line if you did have a catastrophic failure?

Mr S. Johnston: I can make a few points here. Again, the whole thing is about overall system integrity. So I do not divorce ourselves from the up-stream producers and working with them either. Since I have come into the role I am extremely pleased, at a working level, of the level of communication between Mark's control room operators that no-one ever sees. It is brilliant. We try to work very, very closely with the existing suppliers. The second point is that the system integrity will improve over time, as I said in the opening remarks, as these other projects come on and providing there is a mechanism by which one can trade off with the other. Once you have the physical connection to the DBNGP, lots of other gas can come into the system.

[1.20 pm]

In terms of a physical interruption, again we have got the benefits of the expansion program. So when it talks about duplication, it literally is just that; it is two pipes running together, with lots of valves, and you can bypass and work from one pipe to the other and still maintain most of your flow. The other thing is that if you had an incident at any one of the 10 compressor stations, it is possible to bypass that compressor station entirely so the gas keeps flowing. In terms of what you can do now, in terms of response time to cover it, we keep emergency store stocks of tested pipe at various locations up and down the line. We have very robust emergency response procedures. If I can give you a definitive answer, it depends on the nature of what would happen, but the worst case is a remote area where there is a rupture to the pipeline caused by whatever. It would be a matter, hopefully, of a few days to actually have that restored. It is not months and months.

Mr Cooper: It is probably significant to comment that probably the biggest time factor is getting access to the site, particularly if there has been a natural disaster and you have to wait for the floodwaters to recede, or if there has been a really terrible disaster and there have been some deaths, then access from the coroner. Those issues will actually take longer than the physical time to weld the pipe together.

Mr Cribb: The other thing, Stuart, is the Goldfields interconnection, which was completed in 2007. If that had not been finished, then the impact of the Apache processing plant explosion would have been more significant for the customers in the Goldfields region. The only way that gas could flow down to that area was through that interconnect.

The CHAIRMAN: Where is the interconnect?

Mr Cribb: It is at what we call compressor station one, which is about 150 kilometres south of Karratha.

Mr Cooper: It actually connects with our compressor station one to the Yarraloola compressor station on the Goldfields gas pipeline, which are only 1 kilometre apart across a paddock.

Mr Cribb: So the DBNGP it is fully interconnected with all of the main pipelines in Western Australia. It is connected out to Goldfields interconnect; it is interconnected with the Pilbara pipeline system, which is the Epic Energy owned system; and it is interconnected with the Parmelia line.

Mr S. Johnston: Just a last couple of points on that particular question. One is, again, just the additional storage, the in-line storage we have got, allows you to cover several more hours of the short-term interruptions, so even now today you are seeing the benefits of that. Without going into all the details, there are three or four occasions when customers have not noticed gas coming off, simply because we have been able to use line pack to meet the requirements. The other thing was that if you had, say, an incident at North West Shelf, we have started to look at that, we are working with them and we have done some more modelling work, with the idea of free-flowing gas. Say, if their domestic plant went down, if their compression went down, free-flowing gas from the platform and then turning all our compression on at CS1 would allow you to pull, I think we modelled it, about one-third of the maximum volume, a bit more into the line anyway. So it is all these kinds of operational things. We just keep working on that to beef up the robustness

The CHAIRMAN: Who owns your firm?

Mr S. Johnston: We are 60 per cent owned by an infrastructure fund called Duet, which is ASIC listed, so 60 per cent Duet; 20 per cent is another infrastructure fund called Prime, although that is 20 per cent holding is part of a thing called Australia Energy Transmission and Distribution, which is currently held for sale, so there is a chance that that 20 per cent shareholding may change; and 20 per cent by Alcoa.

The CHAIRMAN: Has Alcoa been an equity holder for a long time?

Mr S. Johnston: Since 2004.

Mr Cribb: Alcoa's position is that it funded a significant portion of the upfront capital costs to construct the pipeline, so Alcoa's position has been a de facto equity contributor for quite some time.

Mr Cooper: Since the beginning of the pipeline in 1984.

Mr J.E. McGRATH: There is no government restriction on changes within the entity in itself, so the partnership could change, but the tariffs will always stay in place whoever owns the pipeline.

Mr S. Johnston: That is correct.

Mr Cribb: We would have to go through the standard sort of change of control issues with pipeline licence regulation and those sorts of issues. It would depend upon the structure of the sale.

The CHAIRMAN: But in terms of use of the pipeline, does Alcoa have preference of its use or anything through its equity arrangement?

Mr S. Johnston: There is the Alcoa exempt contract, which is an evergreen contract that sits outside the regulatory regime. It means that our card pays a portion of operating capex and opex and a margin that is agreed. What else would you say about that?

Mr Cooper: That contract does not derive from its equity ownership; that was the original foundation of the contract negotiated with the state in the early 80s to underpin the original construction. That contract is either altered as a result of Alcoa's equity participation in the pipeline. It is the same contract.

Mr Cribb: Probably about all we could stay in open forum anyway.

The CHAIRMAN: Yes, I thought that might be the case; that they had an arrangement for a long time.

Mr J.E. McGRATH: You mentioned the Goldfields pipeline. It has been raised with us during this inquiry that the capacity of the Goldfields pipeline might have been at full capacity and that some mining operations, I think, were having trouble getting onto the pipeline. Are you aware of any capacity issues?

Mr S. Johnston: Personally I am not.

Mr Cribb: I do not think it is our position to comment on that.

Mr S. Johnston: We would not know.

Mr J.E. McGRATH: Is the Goldfields pipeline running at maximum capacity at the moment?

Mr S. Johnston: I do not know.

Mr Cooper: I understand it is fully contracted. What its utilisation is I am not sure.

Mr J.E. McGRATH: But it is fully contracted?

Mr Cooper: That is my understanding, but I do not have visibility of the exact details, but their public position is that it is fully contracted—whatever that means.

Mr J.E. McGRATH: One further question. You talked about when Alinta came to you—was it in 2004?—and you had some discussions.

Mr Cribb: That was 2009 as a result of the outcome of their arbitration.

Mr J.E. McGRATH: As a result of that, did you rewrite contracts with Alinta? You mentioned they wanted some sort of concession because of the situation they were in.

Mr S. Johnston: That process is still ongoing, subject to them successfully completing. They are involved in a debt for equity swap essentially. So we have a side agreement with them that will step through commercially as they get to finalise their internal restructuring.

Mr Cribb: We have a contract with Alinta to supply fuel gas, and we have a contract with Alinta, who is a customer on our pipeline.

Mr S. Johnston: So there are both. The one I was referring to in the earlier answer was the one around the fuel gas.

The CHAIRMAN: So right now you take gas from Apache —

Mr S. Johnston: Yes.

The CHAIRMAN: And then of course the —

Mr S. Johnston: Shelf.

The CHAIRMAN: Gorgon is building a domestic gas plant, and you will take it from there. Are there other areas that you are receiving gas from or planned—Pluto?

Mr Cooper: Yes. We are currently working with Woodside for connections with Pluto, and with Apache for Devil Creek—that is under construction. We are working with Chevron for both Gorgon and Wheatstone. They are both in planning. And with the Macedon joint venture for a Macedon connection as well. Those are all in planning. We are certainly working actively with all of them to tie their facilities into the DBNGP, and historically we have taken gas in from the Tubridgi and Griffin fields, which are of course now fully depleted.

The CHAIRMAN: Are there any other things you want to talk about?

Mr S. Johnston: Not from us.

The CHAIRMAN: Okay. I will read a closing statement. Thanks for your evidence before the committee today. A transcript of this hearing will be forwarded to you for correction of minor errors. Please make these corrections and return the transcript within 10 working days of the date of the covering letter. If the transcript is not returned within this period, it will be deemed to be correct. The new material cannot be introduced via these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate a particular point, please include a supplementary submission for the committee's consideration. Thank you.

Mr S. Johnston: Thank you.

Hearing concluded at 1.28 pm
