

**ECONOMICS AND INDUSTRY  
STANDING COMMITTEE**

**INQUIRY INTO DOMESTIC GAS PRICES**

**TRANSCRIPT OF EVIDENCE  
TAKEN AT PERTH  
WEDNESDAY, 17 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**

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**Hearing commenced at 9.12 am****LENZO, MR BASIL****Solicitor/General Counsel, Burrup Fertilisers Pty Ltd, examined:**

**The CHAIRMAN:** Good morning. I will read out an opening statement. Thanks for your attendance here today. This committee hearing is a proceeding of Parliament and warrants the same respect that proceedings in the house itself 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. In the lead-up to today's hearing you indicated to the secretariat that you will request restriction on some of the questions that we may ask you. In accordance with this, we will close the latter part of the proceedings, go in camera and clear anybody at the back of the room. Now there are a number of procedural questions. Have you completed the "Details of Witness" form?

**Mr Lenzo:** Yes, I have.

**The CHAIRMAN:** You understand the issues on the bottom of the page?

**Mr Lenzo:** Yes, I do.

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

**Mr Lenzo:** Yes, I did.

**The CHAIRMAN:** Do you have any questions about giving evidence?

**Mr Lenzo:** No, it is perfectly clear.

**The CHAIRMAN:** Before we ask any questions, do you wish to make an opening statement?

**Mr Lenzo:** No, I am open to you guys.

**The CHAIRMAN:** Could you just give a brief history of Burrup in Western Australia, what you do, and the issues relating, of course, to gas, which is the reason we are here?

**Mr Lenzo:** Burrup Fertilisers was established in 2000. The project got financial closure at the end of fiscal year 2002. A gas supply agreement was negotiated at that time between 2000 and 2002 with the Harriet gas sellers, which consist of Apache Corporation—or Apache Australia effectively, their fully owned subsidiary—Tap Oil and Kufpec Australia Pty Ltd. The project started construction at the beginning of 2003, completed construction in 2006 and commenced operation around June with its first shipment of ammonia and has been producing ammonia ever since. The gas supply agreement, which is obviously the main issues that we are here for, is a 25-year gas supply agreement. It is on a take-or-pay basis. It is a volume-based contract; in other words, the contract is 25 years or 707 petajoules over a 25-year period.

**The CHAIRMAN:** Do you have restrictions on how much can be taken in a single year?

**Mr Lenzo:** We have a daily contract quantity and we have a maximum contract quantity.

**The CHAIRMAN:** Over the 25-year period?

**Mr Lenzo:** That is right; over the 25-year period. The contract is structured so that the plant can continue to operate at its absolute minimum requirement, which is around 66 to 68 terajoules a day. Our typical operating requirement is around 85 terajoules a day. That gives the plant 100 per cent capacity. So the 707 petajoules is effectively worked out on the basis of 25 years at our typical operating rate. Contractually at the time there was an EPCM contract.

**The CHAIRMAN:** What is an EPCM?

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**Mr Lenzo:** An engineering procurement construction management contract that the company entered into with SNC-Lavalin. The technical requirements of that contract were made available to the gas sellers, so they were aware of how much gas we actually needed to operate the plant. That is where the 707 petajoules came from. So the contract effectively works on the basis that we can take as much as we like up to the gas lateral capacity, which is around 100 terajoules a day, so we are actually limited by the constraints of the gas lateral to 100 terajoules a day, and the contract will go out to 25 years. If we decide to expand the plant, then of course we can take more than our typical 85 a day, but then the 25 years drops away because it is 25 years or 707 petajoules over that 25-year period. So that is typically how the gas supply contract works. We have a minimum take-or-pay, so if we do not take it out at a minimum level, we pay for it anyway.

**The CHAIRMAN:** Can you tell us what that minimum would be or do you want to have that in camera?

**Mr Lenzo:** I would rather have that in camera, if I can, just as there is commercial confidentiality there.

**The CHAIRMAN:** You had some issues in 2006 with a contract.

**Mr Lenzo:** Yes, we did, and I think it is probably public knowledge anyway, which is that the plant started operation in about June 2006. A couple of months after the Harriet gas sellers issued a notice of force majeure, effectively saying that they did not have the gas to fulfil the requirements of the contract. There was a non-litigious series of meetings and process that went ahead. Two of the gas sellers, Apache and Kufpec, retracted that particular force majeure and, as probably everyone knows, we are now currently in litigation with Tap Oil in respect of their interpretation of their obligations under the gas supply agreement.

**The CHAIRMAN:** Why Tap Oil?

**Mr Lenzo:** A good question. Probably because in our view Tap Oil has got the highest exposure. Tap Oil in terms of its gas reserves in Western Australia, particularly on the North West Shelf, is very limited. They have probably got some gas out of John Brookes and probably some other gas spots that they are entitled to, but typically they do not have any large reserves.

**The CHAIRMAN:** They will be the smallest.

**Mr Lenzo:** Exactly, and they supply 12.2 per cent of our contract. If you look at the contract, Apache supplies the majority of it, which is 68.8 per cent; Kufpec then comes in between at around the 32 or 28; and then you have got Tap at around 12.

**The CHAIRMAN:** When you sign the contract, let us say with those joint ventures Harriet, do you sign it to a specific set of reservoirs or just with them? Let us say that the reservoir does not pan out or something. Is it, under your contract, the provider's obligation to get the gas from somewhere?

**Mr Lenzo:** Under our contract, our view of the contract is that they have an obligation to get that gas from anywhere. Whilst we have identified certain permit areas, the contract is quite clear that it refers to certain exploration permits, certain licence areas, and then ultimately it falls back that they have an obligation to procure that gas from wherever they need to get it. That is how we interpret the contract.

**The CHAIRMAN:** And your business is obviously making fertiliser.

**Mr Lenzo:** Our business is actually making ammonia. Whilst the company is called Burrup Fertilisers, it is probably a little bit misleading. We do not actually make fertiliser; we make anhydrous liquid ammonia. Anhydrous liquid ammonia is used, I suppose, primarily in the fertiliser business. You take the ammonia and you convert it into a urea product. Some other countries like the US, for example, do direct ammonia injection into the ground. Ammonia is also used in industrial applications as well. So our product tends to go to the Southeast Asia region and is a

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mixture of agricultural based for the production of fertiliser and also industrial based. We make shipments out to Korea, for example, that effectively get used in industrial applications.

**The CHAIRMAN:** Where do you ship to?

**Mr Lenzo:** The major areas are the Philippines, Korea, China; and we supply into Australia as well. We supply to CSBP. We supply to Incitec Pivot. So that tends to be the major areas that we supply to.

**Mr W.J. JOHNSTON:** I just ask: is your off-take on long-term contracts or do you sell it on the spot market?

**Mr Lenzo:** No, our contract is effectively a 100 per cent off-take by Yara Switzerland. Yara Switzerland effectively does the marketing and sales for the company. So they will place that cargo into the marketplace. It is against long-term—when I say “long-term” contracts, most of the contracts tend to be negotiated on a 12-monthly basis, but some of those companies we have been supplying since we started in 2006 and will probably continue to be supplied as long as we are producing ammonia.

**Mr W.J. JOHNSTON:** If I can just follow that up. Is the price like iron ore, where the parties agree to sell the product and then have a process to agree the price, or is it a long-term price as well?

**Mr Lenzo:** The contracts are placed on a longer term price, and they will enter into agreements that will have a pricing mechanism. That is still subject to rise and fall. There is some spot pricing, but the spot pricing is quite limited. The majority of the cargoes are against longer term commitments by clients. They effectively know what they are producing. If they are taking ammonia as their raw material to produce an end product, then basically they will commit to that particular product. Some of it might be locked away. A lot of it is a floating price, so it is really a demand model. If you look at the price of ammonia at the beginning of the GFC, you know it dropped right away to just sub-\$200 a tonne. Today in Southeast Asia, what we call the middle price, or even low-end price, is around \$400 a tonne. So it really is a product that does float with demand in the market place, but you do get that occasional spot cargo. But we do not sell on to the spot cargo market.

**The CHAIRMAN:** Do you take the market risk or does the Swiss mob do it?

**Mr Lenzo:** Yara Switzerland effectively takes the market risk for us, but we actually get paid whatever they sell it for. So whilst they take the product off us —

**The CHAIRMAN:** You take the market risk.

**Mr Lenzo:** Yes, there is a bit of a sharing there. We actually produce a product. They have got to clear it out of our tanks. So at the end of the day their responsibility is to place that product. We are guaranteed a price, which is then subject to, I suppose, adjustment over the period of a year, depending on what they sell it for.

**The CHAIRMAN:** What is your workforce size and location?

**Mr Lenzo:** We have around 85 people up at Karratha on the Burrup Peninsula and we have approximately 30 people in the Perth office. The Perth office is mainly made up of corporate, contracts, procurement and of course finance and the accounting functions, and the site of course is the main facility for the production of the ammonia. The company has made a heavy investment up in Burrup Fertiliser, of course, on the Burrup Peninsula, including we are going through an acquisition of houses in the area. Originally when they started we had most of the houses on leases. We have been slowly converting those on buying our own properties. So I think the company now has something like 30 houses, and we are looking at buying another 10. So effectively we supply housing for around 85 people up there, and we employ 85 direct people and then, of course, all the additional support services that we contract out. We have our major operators on the plant, but we do a lot of the maintenance on a contract-out basis. So any of the day-to-day maintenance

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requirements that are typically outside what we call an operator skill level—your boilermakers, fitters, electricians and painting, that type of stuff—is typically contracted out. We have probably a workforce that is contracted out that varies between 30 and 50 people.

**Mr W.J. JOHNSTON:** This is a technical question. I have no idea about these things, but how much gas do you need to make a tonne of ammonia?

**Mr Lenzo:** We need around 40 gigajoules to produce one tonne of ammonia. We produce 2 200 tonnes a day. The plant goes a bit better than its nameplate suggests, but if you work on 2 200 a day and do find it by around 82 terajoules, you are roughly getting what you need to produce. It is around the 40 mark.

**The CHAIRMAN:** The plant now you have not expanded; you are still operating as you first designed it to capacity?

**Mr Lenzo:** Correct, yes. We have done some de-bottlenecking and improved some of the systems, and we have been able to take it from around 2 200 tonnes a day up to probably just under 2 350 tonnes a day.

**The CHAIRMAN:** It is reported that you have got a good gas price.

**Mr Lenzo:** We have a very good gas price, but it was a relative price at the time the contract was entered into.

**The CHAIRMAN:** Did you enter into it at about the same time that the partners in the North West Shelf sold the gas to the Chinese?

**Mr Lenzo:** That is a good question. We entered into a contract in 2000.

**The CHAIRMAN:** You entered in 2000 or 2002?

**Mr Lenzo:** It was between 2000 and 2002 when it was finalised. I could probably give you an exact date actually. It was 17 December 2001.

**The CHAIRMAN:** Okay. It was about that time.

**Mr Lenzo:** It was about that time.

**The CHAIRMAN:** Oil prices were not that high, if I remember correctly.

**Mr Lenzo:** Correct, yes.

**The CHAIRMAN:** The origin of our inquiry is that there is concern about lack of supply and the rising price of gas in the domestic market. Let us talk about that a bit. Do you think that is a real issue in Western Australia?

**Mr Lenzo:** A very real issue. Burrup Fertilisers, whilst we are based in Western Australia, we are obviously keen on trying to expand the operation even if means setting up new operations in different locations. So we spend a bit of time analysing what is happening in the gas market, not only here locally in Western Australia but throughout the east coast of Australia and in other parts of the world. The reality is that we now have probably some of the highest gas prices in the world. We can acquire gas out of the east coast. Some of it I suppose is being driven by the new CSM fields that are coming out, but part of it, in our view, is that even out of the Victorian regime, we are talking prices of probably around \$4 to \$5 a gigajoule, which is substantially lower than what we are currently paying here. Some of the CSM prices that we have been talking about with people on the east coast have been getting down to around \$3 to \$3.50.

**The CHAIRMAN:** When you say “we”, are you still operating your plant on that original contract?

**Mr Lenzo:** We are still operating that plant on the original contract, but we are looking at other opportunities.

**The CHAIRMAN:** When you refer to “we”, you mean in the general domestic —

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**Mr Lenzo:** Correct.

[9.30 am]

**Mr W.J. JOHNSTON:** It has been put to us that that \$3, \$3.50 price on the east coast out of the coal seam methane is because of the ramp of the coal seam where they need to prove up their reserve and therefore must produce gas and at this stage they do not have an export market. It has been put to us that that is an artificially low price. Are you saying that you think that you could get that price over a long term or, what do you say about that?

**Mr Lenzo:** We are comfortable that we can get that price over a longer term. There are risks in coal seam methane. A lot of those lower prices are around stranded fields, which is obvious, but gas is available out of Victoria that is certainly not around the \$8 or \$9 a gigajoule that we are seeing here. Whilst there are developers on the east coast that are trying to get their projects up and going and getting some slightly artificially lower prices, it is certainly not jumping back up to the high levels in other parts of the east coast. That may change with some of these larger projects that are being kicked off, targeting the export LNG market. That is obviously the issue that we believe is problematic for us; that is, everyone is targeting the energy market and energy users, generally, will pay a lot more for gas than what a downstream converter like us can afford to pay.

**The CHAIRMAN:** We heard that over in the eastern states no-one can get medium to long-term contracts because of what Bill mentioned; everyone is focused on the ramp up. Once it is ramped up, they do not know what is going to happen. If LNG comes, they have to go to an overseas market or there might be a glut in the market. We were told that no-one could get long-term contracts. Are you confident that you can?

**Mr Lenzo:** I do not think you will get a 20-year contract in Australia again. That will not happen. But certainly three to five years is what we are seeing as your typical contract term. You could probably squeeze them out to maybe seven years. In some cases, some of the operators would probably go to 10 years to get their project up and going.

**Mr W.J. JOHNSTON:** Given the extremely large capital investment that you would need to get a plant going, is a five, seven or 10-year contract sufficient to bank your project?

**Mr Lenzo:** No. If we were to do a new project, we would have to look at what type of project we did. You certainly would not want to be banking this size project on a five-year contract. If you had a five-year contract that had some upper and lower thresholds as to gas price, yes, but you certainly could not run a gas project like ours on gas prices that are—I mean, it does not take much arithmetic to work out that at \$40 a tonne and ammonia prices at \$400, plus your costs of operating, where you really need to be to operate downstream.

**The CHAIRMAN:** Where do you need to be?

**Mr Lenzo:** We certainly would not want to be—I mean as cheap as possible, that is the reality. I think probably for us as an operator, if the prices were to be maintained at that level. It is always one of those, “If we have another GFC, it will be disastrous”, but if you turn around and say, “Well, things have stabilised and we are not going to have something like that”, you are probably talking about \$4 to \$5 a gigajoule is where we need to be.

**The CHAIRMAN:** Where else is your product produced around the world?

**Mr Lenzo:** The Middle East.

**The CHAIRMAN:** Qatar?

**Mr Lenzo:** In Qatar, yes. Egypt produces it.

**The CHAIRMAN:** Out of their own domestic gas?

**Mr Lenzo:** Yes, out of their own domestic gas. The US has a few plants.

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**The CHAIRMAN:** Down in the gulf area?

**Mr Lenzo:** Yes, and they are fed out of the Henry Hub. Then you have plants scattered through Europe that are generally fed from the Russian gas.

**The CHAIRMAN:** How do they afford it? I mean, Russian gas is pushing \$10.

**Mr Lenzo:** A lot of those plants, particularly during the GFC, were closed down. They have a slightly different model in the US in which they—a lot of them are what are called “swing producers”. They will swing from ammonia production to, effectively, producing LNG or selling it on to the power grid, something of that nature, whereas we do not have that flexibility at the moment.

**The CHAIRMAN:** They have pretty low Henry Hub prices right now.

**Mr Lenzo:** Correct. But prior to the GFC, Henry Hub prices were up at \$12, \$13 a gigajoule there as well. I mean, they pegged right back.

**The CHAIRMAN:** They pegged right back. Are you seeing competitors coming in and building urea or ammonia projects? We have had growth particularly in China and India. There has been a lot of growth in our region and that means agricultural growth, I would assume. Are you seeing new projects coming on the horizon outside Western Australia?

**Mr Lenzo:** Most of the ammonia projects that are being built are being built in the Middle East at the moment. That is where the concentration seems to be.

**The CHAIRMAN:** What prices do they charge?

**Mr Lenzo:** We have only got some speculative information on it, but it could be anything from \$3 to \$5. It is a bit difficult to tell. A lot of them are tied up with the government, so it is very difficult to get real prices. It could be as low as \$2 a gigajoule still out there.

**The CHAIRMAN:** What about places like Iran, which has a bit of gas, and Iraq and difficulties exporting it?

**Mr Lenzo:** We actually have not been looking in Iran and Iraq because of the —

**The CHAIRMAN:** Oh, you surprise me!

**Mr Lenzo:** We try to stay in countries where we know we are going to get a bit of support, particularly from the financiers.

**Mr W.J. JOHNSTON:** I am a complete novice at this stuff and I am interested in learning. Is there anywhere that LNG is then used as a feedstock for an ammonia or similar plant?

**Mr Lenzo:** No, it is all pretty much natural gas.

**The CHAIRMAN:** Are there any other ways to make urea or ammonia outside natural gas?

**Mr Lenzo:** If you are trying to produce an end product of, I suppose, urea, your only other option is coal gasification and that is a very expensive process. Most of the plants in the world that operate in a coal gasification environment are generally government owned. From recollection, I think there is a plant in South Africa and China has a plant for coal gasification, but it is a very complex and very expensive way of going about it.

**The CHAIRMAN:** It has been put to us that, from the state’s perspective, the state owns the gas in the ground and then leases it under a royalties arrangement. The issue is, from the state’s perspective, one of the ways to look at this is to say: What is the net present value to the state? We want to maximise the use of the gas. This is not arguing that we are going to take gas from existing users. We want to maximise the value and one is LNG and it basically has a frozen pipeline to Japan, China and Korea, and they add a lot of value to the state. The alternative is to use it in the domestic market, for instance as a feedstock as you do and as others do. If we can get a higher price

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and higher royalty arrangements from LNG, why should we manufacture a lower price for domestic for feedstock?

**Mr Lenzo:** I think you hit the nail on the head in your first statement; the gas belongs to the people of Western Australia. From our perspective, we have made an investment and the company wants to preserve that investment. There is always this dichotomy of “Let’s produce and export LNG” and we get the best price for it, and you get your royalty return and that is fair enough; that is a hard argument to fight against. But if there is really a domestic reservation policy, that domestic reservation policy should be for the benefit of companies that are domiciled here, outside of LNG producers. Our view is that we should be entitled to some of that gas. We do provide employment. We may not make the same returns as some of the larger corporates in the LNG market, but we certainly provide a level of direct and indirect employment. We are producing a product and doing some downstream processing, and, therefore, we are value-adding to what we are doing. If you want to have the view that we need to maximise royalties and LNG is the best way, that is fair enough, but that will obviously have implications not only for producers like us, but also other users of gas in the general marketplace.

**The CHAIRMAN:** Let us say the LNG producers have a choice of putting the gas up through the LNG plant with a sense they want to invest in it or a domestic gas plant. Right now do you get yours from non-LNG providers?

**Mr Lenzo:** At the moment they are not LNG providers. Apache is currently—Kufpec and Tap Oil are obviously non-LNG providers, but Apache —

**The CHAIRMAN:** Apache is considering it with the joint venture and they are also considering Canada, by the way. Do you think that the underlying price that LNG producers can get from exporting LNG exceeds your maximum price?

**Mr Lenzo:** That we can pay?

**The CHAIRMAN:** Yes.

**Mr Lenzo:** Certainly. If they are getting netback prices of \$10 a gigajoule, let us say, the gas price alone puts us currently at what our sale price or a netback price of sales of ammonia without the additional costs of ownership and maintenance of the plant, payment of debt, et cetera. You would just have to mothball it. You could not operate.

**The CHAIRMAN:** You think you need a maximum price of \$3.50 to \$5?

**Mr Lenzo:** In that range, depending on where the ammonia prices are. We have had discussions with supposed suppliers into the marketplace on models that are, effectively, tied to the price of ammonia where, effectively, they will give us a base price for the gas that makes a new project, for example, viable and then that price shifts and a profit sharing as the ammonia price goes up—then they profit share on that ammonia price. At the end of the day, they do not lose out. We have our views about how much we think it costs them to get the gas out of the ground and, effectively, they can then move it into another source of revenue. It is a question of: do I want my \$10 netback or do I want to start off at \$2.50 or \$3 and then take the risk on the product?

**The CHAIRMAN:** Is your problem that the ammonia prices would be tied to gas prices?

**Mr Lenzo:** Correct.

**The CHAIRMAN:** Those gas prices that you are tied to are largely stranded gas prices, which cannot be tied into the LNG market? But that is not actually true, because Qatar is the largest exporter of LNG in the world.

**Mr Lenzo:** Ammonia plants around the world are not tied to stranded gas. They are generally tied to main supplies of gas. They are tied to Henry Hub, Russian and Qatar gas.

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**The CHAIRMAN:** The plants are always—most of the places where they are built are competing with international prices of gas.

**Mr Lenzo:** Correct.

**Mr W.J. JOHNSTON:** If you are not making ammonia from gas, where would somebody be sourcing their feedstock? Apart from gas, what do you make ammonia from?

**Mr Lenzo:** Gas.

**Mr W.J. JOHNSTON:** If the price of gas is too high, if people are not using ammonia for fertiliser, what else do they use? Why is your price so sensitive to the gas price where the gas price is higher, like in Russian gas or whatever?

**Mr Lenzo:** As the Russian gas price went up, as I said, the plants started to shut down.

**Mr W.J. JOHNSTON:** Where would they then source them?

**Mr Lenzo:** Out of the Middle East. We have done shipments to Europe. We are in the process now—there is new legislation in Europe to actually import chemicals into Europe. We have done certain shipments into Europe and into the US. They will source it from wherever they can get it even if they have to pay the freight costs on top. That is really what it comes down to; people will source where they can afford to buy it from. If the gas price goes to \$10 out of Russia, for example, you will find those plants will go again into a mothball situation. Our biggest competitor market is the Middle East.

**The CHAIRMAN:** What proportion of the total ammonia production is out of the Middle East?

**Mr Lenzo:** That is a good question.

**The CHAIRMAN:** I imagine—it used to be a lot out of the gulf area of the states used to be the major ammonia —

[9.45 am]

**Mr Lenzo:** Yes, I would have to think it is probably getting close to 60 per cent, I would have thought. I mean, they tend to supply a lot of the ammonia into the Indian region and up into Europe now, competing more and more with the local plants there.

**The CHAIRMAN:** Did Europe have barriers to importation of your ammonia?

**Mr Lenzo:** No. The only thing they are introducing now is, I think, a type of guidelines in respect to environmental issues and importing of chemicals and making sure that the chemicals imported are of a particular standard, and that is pretty much it.

**The CHAIRMAN:** Qatar exports a hell of a lot of LNG, but they also produce a lot of the urea—I mean ammonia. How do they choose between them, as they have the same issues that we do?

**Mr Lenzo:** Yes. I think at the end of the day it really depends on how the plant is designed. A lot of the earlier plants were designed either as urea plants, so effectively they just take it straight through to urea.

**The CHAIRMAN:** Yes, that is right.

**Mr Lenzo:** And other plants like ours are what we call merchant ammonia plants. We actually produce the ammonia that might go out to a plant that produces urea, for example. So, some of our exports that go into China are actually taken into plants that take that ammonia to put it into urea, and they produce urea.

**The CHAIRMAN:** Where do the Indians get their urea?

**Mr Lenzo:** They have a lot of plants themselves that they operate.

**The CHAIRMAN:** So they buy the feedstock?

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**Mr Lenzo:** They buy the feedstock and they produce urea plants, yes. They have got several urea plants. And India is different because the urea is actually subsidised to the farmers.

**The CHAIRMAN:** Yes, but the state pays.

**Mr Lenzo:** Yes, like the Egg Marketing Board or the Potato Marketing Corporation.

**The CHAIRMAN:** It is the same in Indonesia.

**Mr Lenzo:** Exactly; it is all subsidised from the government back into the farmers because, of course, that is one of probably the most important aspects of the country: being able to feed the people. They tend to control what you get paid by the government at a particular amount to produce your urea that you then give to the farmers.

**The CHAIRMAN:** Are there any arrangements—you sell into the international market, which is very complex, and you have got a man to media helping you there—is there any way that you can hedge and shunt some of the price risks?

**Mr Lenzo:** Not in the ammonia market, no. The only thing the company tends to do is just try to hedge its US dollar exposure, because it is a product that is sold in US dollars. So, generally gas is sold in US dollars anyway, so a major consumable or a major raw material is in US dollars and therefore we try to hedge in the US dollar market. But that is about it. You cannot actually hedge; there is no hedging market for ammonia.

**The CHAIRMAN:** You may enter into a contract where you kind of share some of the price risks with your buyer. You mentioned that—having a gas price attached to the ammonia or urea.

**Mr Lenzo:** Still always subject to what is currently happening in the marketplace. There are a couple of publications: fedacom is one publication, FMB is another publication, and you will see that they actually publicise what the sales are. And that tends to be a bit of a guideline for where people work out what they should be paying; and we leave a lot of that to the off-take in Switzerland.

**The CHAIRMAN:** The rumours and information in the paper were that you were thinking about expanding, at least a few years ago.

**Mr Lenzo:** Yes.

**The CHAIRMAN:** Are you still looking to expand?

**Mr Lenzo:** Yes. The company is interested in developing an ammonium nitrates project, which is a course for the explosives for the mining industry. We are well down the track on that. One of the issues, of course, that the shareholders will have to tackle and come to a decision on is the current gas supply run.

**The CHAIRMAN:** And you are looking to do that here?

**Mr Lenzo:** We are looking to do that here. It is about, we are hoping, around a \$500 million to \$555 million investment. But we are very close to that, I think. We have pretty much come to the front end of our engineering design, and prices should be coming in shortly. So, it is really the beginning and the first quarter of next year will be probably the final investment decision, I would think.

**The CHAIRMAN:** Is that a different market to the ammonia?

**Mr Lenzo:** Taking ammonia and feeding it to the plant to produce ammonium nitrate: a totally separate market.

**The CHAIRMAN:** Yes, but the product there is mainly for explosives for the mining sector.

**Mr Lenzo:** Explosives for the mining sector, yes.

**The CHAIRMAN:** And the mining sector is doing very well now.

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**Mr Lenzo:** Yes.

**The CHAIRMAN:** There is a derived need for it, so it is not like you are going and selling to paddy rows in India.

**Mr Lenzo:** That is right, yes.

**The CHAIRMAN:** You might be able to withstand a higher gas price for the nitrate. Do you think the gas price that you need between, let us say, \$3.50 and \$5 for ammonia is the same as you need for the nitrates?

**Mr Lenzo:** No. We would probably be able to withstand a higher price for the nitrates, but if you were talking about a total capital investment and you combined the plants together, what it will cost to build them today, you would be getting close to \$2 billion. And then the \$10, we just then cannot make it work. I mean, you have got to pay that amount of money back over a period of time and one of the risks, of course, is if you are getting a five-year contract, where are you going to be in five years' time? So that is why one of the models that we are pretty keen on is to do a gas price that is tied to a product price. The gas suppliers do it; they will peg part of their price to oil, for example.

**The CHAIRMAN:** Of course they do, yes.

**Mr Lenzo:** That has happened already on several pending projects in the Pilbara where they have pegged part of their price to the oil prices.

**The CHAIRMAN:** If you built the nitrate plant, what kind of level consumption would you need? What gas supply would you need?

**Mr Lenzo:** We are trying to run off our current projects, so what we would actually do is just feed off some of our ammonia and not change the requirements on our gas at the moment. If we could secure another gas contract, then we would probably do an expansion of the ammonia plant.

**The CHAIRMAN:** If there are no other questions, we will go in camera.

**[The committee took evidence in camera]**

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