

**ECONOMICS AND INDUSTRY  
STANDING COMMITTEE**

**INQUIRY INTO DOMESTIC GAS PRICES**

**TRANSCRIPT OF EVIDENCE  
TAKEN AT PERTH  
MONDAY, 13 SEPTEMBER 2010**

**SESSION TWO**

**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 1.46 pm**

**ROWE, MR LYNDON GEOFFREY**

**Chairman, Economic Regulatory Authority, examined:**

**WATKINSON, MR GREGORY PAUL**

**Chief Executive Officer, Economic Regulatory Authority, examined:**

**The CHAIRMAN:** The 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 under oath, any deliberate misleading of the committee may be regarded as a contempt of Parliament. Before we commence there are few procedural questions. Have you completed the “Details of Witness” form?

**The Witnesses:** Yes.

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

**The Witnesses:** Yes.

**The CHAIRMAN:** Do you have any questions relating to your appearance before the committee today?

**The Witnesses:** No.

**The CHAIRMAN:** The committee has received your submission; thank you for it. Do you wish to propose any amendments to your submission today?

**The Witnesses:** No.

**The CHAIRMAN:** Before we ask any questions, do you wish to make a statement in addition to your submission?

**Mr Rowe:** I am happy to take the submission as read, Chair.

**The CHAIRMAN:** Thank you very much and thank you for your previous briefing. As you know, the motivating factor for this inquiry was concerns about the future for gas availability and pricing in Western Australia. We use a lot of gas for energy here, both as feedstock electricity—more than in other states. We are highly dependent upon it. We have a fragile market in terms of the limited number of suppliers in the pipelines, and also there are concerns about continued availability for a variety of contractual and other issues. There is a general view in the market—expressed to us, at least, and to others—that the market is being dominated by exports over domestic, and it is translated into prices. That is, there is evidence, they say, of contract domestic prices exceeding LNG netback prices. In your submission, and your briefing previously, we have heard your view about the market. One of the key things you have stated is that the market is coming to a point where we need to provide—I will use my words not yours—an incentive for exploration, and that needs to adjust in over time, and then we might see market responses on this issue. From our perspective, I guess, we would be concerned, given the fragile nature of that market—it is not a widely competitive market in terms of structure or conduct, if you wish—that there are some risks about that actually happening. Could you discuss that a bit?

**Mr Rowe:** As we make clear in our submission, there is always a potential in the short run, at least, for domestic gas prices to be higher than LNG netback prices. As, hopefully, our submission makes clear, if there is no gas-on-gas competition, there is a potential for gas prices to go the next-best

alternative fuel, which in some parts of the state will mean \$20 gas, because diesel is the next-best alternative. In the short term at least, there is always the potential for that to happen. What you hope happens out of that though is—let us go back a step. As we talked about last time, given that in our view at least that prices were artificially low for a long term and there were fixed-term contracts, that incentive for exploration and development was not there. As prices are now more realistic, we would expect that to take place; and, in our view, that is taking place. Does that mean that we are faced with a situation that everyone is happy with? No, but the question then is: is there anything you can do about that in the short term that will help that situation or do you need to wait for the market to work? The basis of our submission is that you need to wait for the market to work. In fact, if you were to artificially try to suppress prices, you have the potential for delaying the outcome we are looking for. Having said that, it is not likely that we are going to return to gas prices of the past, for a variety of reasons. Your guess is as good as mine about LNG prices in the future, but clearly domestic gas prices are going to have some relationship to the LNG netback price, and the LNG netback price is going to have some relationship to oil prices. Even if we get gas-on-gas competition, because there are fields discovered where the only market is a domestic market—there is no LNG, and that is why in our view you are seeing lower prices in Victoria—even in that area it is likely that the next discoveries are not going to have the cheap source of gas that we have had in the past, so the minimum price of gas is going to be whatever it costs to recover that to get that gas in the first place. If we are talking about tight gas, then it is likely that is going to be more expensive. We are certainly not going to go back to the \$2, \$3 or even \$4 gas that we have had in the past. Our view is that as the price impact takes effect, then we will see more gas-on-gas competition.

[1.52 pm]

Although we are all frustrated about how long that is taking, I think the more interesting question is: what, if anything, can we do to speed that up? I suspect that the answer is “very little”.

**The CHAIRMAN:** We did a tour of the eastern states and it was rather enlightening—my knowledge of it was a bit rusty—as the gas market has transformed itself over 10 years from a very narrow base in Victoria to quite an eastern seaboard vibrant market with competition at all major nodes. It adds a robustness, predictability and great incentive because of the proliferation of pipelines, finding fields close to those pipelines, multiple markets and back-ups. It looks like it is something that we should duplicate because it is not just supply and prices issues, there is also the security of supply issue, which we experience. In a policy sense—I know that you are not a policy, as such, outfit—it would seem to be strategic to start asking how can we go and engineer it so that we have multiple suppliers and multiple routes or pipelines, if you wish, like they do in Victoria, particularly if there is potential for onshore fields. The key thing in Queensland for onshore fields was a government purchasing limit; they said 15 per cent of electricity had to be gas-fired, but they also found gas near pipelines that led to the coal seam methane explosion. Do you think there is much capability for the state to, say, in terms of pipeline design and construction, encourage pipelines to connect, have different routes and have additional capacity beyond regulated capacity?

**Mr Rowe:** There is a range of things there, I guess. The government can do a number of things to speed up the discovery process, and approval processes is the obvious one. I am not sure that building pipelines in anticipation that we might go past a gas field is necessarily a good thing, so the issue is to find the gas fields —

**The CHAIRMAN:** You could not do that, but you could take it to markets and hope that the gases belong to use and sources.

**Mr Rowe:** I have lost my train of thought. There was one other issue that I wanted to—it has gone, sorry.

**The CHAIRMAN:** Do you think strategically developing the onshore fields is an important issue? One theme would be that there is a lot in Queensland and off overseas there is a lot of find in onshore-type shale gases and other types of unconventional gas, they call it.

**Mr Rowe:** In terms of domestic gas, the best thing that we can do is find lots of onshore small fields that do not have LNG potential. That would give us the gas on gas competition which would see gas prices go to gas cost, which would be clearly the best outcome.

**Mr W.J. JOHNSTON:** Following up on that, on page 12 and 13 of your submission you have LNG import prices for various locations, and then figure 7 is the price of natural gas. I just wonder whether you can make any comment about the fact that the cheapest gas in the world appears to be the gas Australia sells to China.

**Mr Rowe:** Only my understanding of that—it is just my understanding of it—and that is part of getting the project up in the first place was long-term gas contracts and part of that is why we have low prices to China. My understanding is that it is the same reason why we had, up until recently, low gas prices in Perth, because it was all based on long-term contracts.

**Mr W.J. JOHNSTON:** When you say “getting the project up” that is what, train 5 for the LNG exports to China?

**Mr Rowe:** It is making the project bankable, yes.

**Mr W.J. JOHNSTON:** Is there any sort of lesson for us to think about the approvals processes? Now you have five trains sitting on the Burrup, the capital of that, I imagine, is basically spent. Is there anything that we need to do in regulating those gas operations to allow us to get access to that type of price?

**Mr Rowe:** If you try to artificially do it and do it at a price that is less than what the LNG netback price is, then you are subsidising; that will deliver an inefficient, in an economic sense, outcome. That is possible and it may have longer term consequences because it may well lead to the establishment of industries that do not actually have the capacity to compete on what would normally be a gas price and there will be a day of reckoning for that, I suspect.

**Mr W.J. JOHNSTON:** So when is the day of reckoning for that for the Chinese?

**Mr Rowe:** The Chinese was a commercial deal done on a long-term contract to satisfy the bankability of the project.

The issue that I was going to come back to was pipeline capacity, if I can. There is no reason now why even regulated pipelines cannot build spare capacity. The regulatory authority will take into account in looking at adding capital to the capital base whether there is a legitimate expectation over the next period, whatever we might decide that is, that that capacity will be used and therefore it is appropriate that the cost of that expansion be added to the capital base. You may well have had a suggestion from the owners of the Dampier to Bunbury pipeline that that is not possible, but that is in a sense a slightly different issue. The problem that the Dampier to Bunbury pipeline has is that in selling the pipeline and enabling a price for that pipeline when it was sold to be high enough to pay out the banks, so that they would take the foot off the hose—if I can put it in those terms, I think that is how the then managing director of Alinta described it—they agreed to have a tariff that was significantly above the regulated tariff. The problem they have is those contracts that they signed at that stage have got most favoured nation clauses in them, so the problem becomes if there is spare capacity on the pipeline, there is an opportunity for somebody under regulation to seek access to that capacity at a regulated price that would undermine, if you like, the basis for the sale of the pipeline in the first place and would cause all those tariffs to fall. The Dampier to Bunbury pipeline, at the moment, will only expand the pipeline consistent with contracted capacity. That is not a regulatory issue; in my view, at least, it goes to the issue of the commercial basis for the sale of the pipeline.

[2.00 pm]

**The CHAIRMAN:** That does not apply to pipelines other than the DomGas pipeline.

**Mr Rowe:** It does not apply to the Goldfields gas pipeline.

**The CHAIRMAN:** Okay. We were told that there is a potential problem in that if a pipeline that exists decides to expand and gets a new price that is lower than the existing users', the risk is that the marginal new price might apply to all users of the pipeline.

**Mr Rowe:** In the case of the Dampier to Bunbury pipeline, as I say, there is, in the standard shipper contracts, a most favoured nation clause, so there was a spare capacity, yes, that would happen, but the authority will not interfere with commercial contracts. If there is a commercial contract out there, it will stand.

**The CHAIRMAN:** In the regulatory regime for regulated pipelines, is there an impediment for spare capacity in pipelines to be built? That is, if a pipeline company wishes to build capacity beyond the contracted demand, is there anything to inhibit them from doing so, whether it is the pricing mechanism that applies to the DomGas pipeline, or inability to recoup the costs of that?

**Mr Rowe:** If we just talk about regulated pipelines generally, not necessarily Dampier to Bunbury, the risk for pipelines generally is that, in making those expansions, if it is a regulated pipeline, they want to have confidence that the costs of those expansions is going to be added to the capital base, so that when you work out the reference tariff that is going to apply to the pipeline, they get a return on and off the capital they have spent. As I said, there is nothing to stop them making that assessment. We, in assessing that, would look at whether or not it is reasonable that the capital expansion is appropriate and is likely, over a reasonable period—maybe 15 or 20 years—to mean that that capacity will be used, and there is no reason why a regulator would not add that to the capital base. But, as I say, the Dampier to Bunbury pipeline has a particular set of circumstances.

**The CHAIRMAN:** Is there a grandfather clause in those circumstances? Does it end, or is it fixed into the system?

**Mr Rowe:** The understanding at the time of the sale of the pipeline was that the higher agreed tariff, over and above the regulated tariff, would apply until the end of 2016, I think it is.

**Mr Watkinson:** The start of 2016.

**Mr Rowe:** The start of 2016—sorry, I will have to check that—at which stage, the understanding was that the regulated tariffs would then apply. The objective of that period was to ensure that there was sufficient revenue to justify the price that was paid to the banks, and that is the basis of the calculation.

**The CHAIRMAN:** Would that coincide with renegotiation of the DomGas contract, which is expected to start in 2014–15?

**Mr Rowe:** I am not sure; I do not know the answer to that.

**Mr J.E. McGRATH:** On another subject, I refer to the 15 per cent reservation policy. Given the high-risk nature of the LNG projects, do you think that having this policy could add to the risk and impact on those projects? Also, could there be an unintended consequence of some of those projects maybe moving to other jurisdictions, like the Northern Territory, or processing offshore?

**Mr Rowe:** There is a risk that they add to the uncertainty, and, indeed, that was part of the argument, I guess, four or five years ago, when the discussion first arose about why we were not getting increased domestic supplies. It adds to the uncertainty for the proponents and adds a factor into their business case. It could have that effect, but, I suspect, from our point of view, that the concern would be greater if it actually works, because as we said in the submission, at the end of the day it is going to be an economically inefficient outcome. It will be, one way or another, a subsidy, and the state will not be getting its best return on the resources.

**Mr J.E. McGRATH:** The opposite of that, I guess, is that you might have a situation where all the gas goes offshore for a higher price and you do not have the supply into the domestic market; or do you think those things will sort themselves out with proper competition?

**Mr Rowe:** The quick answer to that is the latter. Providing we have gas-on-gas competition, my expectation would be that the LNG netback price would actually be the maximum price you would have for domestic gas, so it becomes almost a ceiling on domestic gas rises. It is not at the moment, because in the short term we have not got gas-on-gas competition.

**Mr W.J. JOHNSTON:** And the netback price is \$4?

**Mr Rowe:** It depends on how you calculate it, but in Perth it is a little more than that because that is netback up there, but down here, there are transport costs on top.

**Mr W.J. JOHNSTON:** So you are saying that an efficient market would deliver gas to domestic users for about \$4?

**Mr Rowe:** It depends; if you can tell me what happens to LNG prices, sure, but you can expect that at a point in time the ceiling on domestic prices will be the next best alternative use, if there is one, which will be LNG. Your hope is that you will actually find smaller onshore fields, ideally, that compete for gas-on-gas and do not have an LNG option, in which case the minimum will be whatever the cost of producing that gas is. If the cost of producing that gas is more than LNG netback, you might end up with a higher price.

**Mrs L.M. HARVEY:** Plus transport costs.

**Mr Rowe:** Yes, LNG plus transport, which is \$1.50 to \$2.

**The CHAIRMAN:** I refer to the Parer review on the retention lease debate. I know it is in commonwealth waters offshore. You have a view on whether or not we should adjust retention leases so that discoveries are brought into the market in a more contestable matter?

**Mr Rowe:** As a personal view, I do not have a problem with the time frame. I think there is a question mark about whether the commercial tests are rigorous enough. Given the amount of investment that is involved and the exploration activity, I think the time frames are not unreasonable. I would question whether the tests on whether they are commercial or not are stringent enough.

**Mr W.J. JOHNSTON:** I have a question unrelated to those we have been discussing. As I understand it, you regulate our pipeline network in Western Australia from the gas processing plant. Do you have any view about whether, in the same way as the debate going on in the iron ore industry about access to train lines, that access to gas processing plants and the pipes that are used to bring the gas onshore, should that be a contestable market?

**Mr Rowe:** Should there be common-user access? In principle, there is an argument for monopoly infrastructure to have common-user access, certainly. It becomes reasonably clear when you have a pipeline the length, size and cost of the Dampier to Bunbury pipeline or the Goldfields gas pipeline. It becomes less clear when those facilities are much shorter and less capital intensive, because the barriers to entry are then much less. So, for example, the Kambalda lateral, which was a covered pipeline that has just been granted light-handed regulation, and we certainly did not oppose that. It is a judgement call, I guess, in terms of the costs involved in regulating, because regulation is not inexpensive either. It becomes a question of balance. The larger the infrastructure and more capital intensive the infrastructure, probably the stronger the argument is.

**Mr W.J. JOHNSTON:** So there is more likely to be a strong argument for regulation of large capital equipment like an LNG plant.

**Mr Rowe:** Yes, the risk, of course, is that if you create uncertainty for the developer of the infrastructure about their ability to tap their own resources, you might create some uncertainty in the market through that process. So, again, there are trade-offs there.

[2.10 pm]

**Mr J.E. McGRATH:** It has been raised with us that some mining companies had problems getting onto the Goldfields pipeline. It was also explained to us that because of the uncertain nature about how long mining projects will last, the mining companies are not as good a customer as someone who will be there for 20 or 30 years. Some of those companies, I believe, had to transport diesel up there when there was a gas supply shortage caused by the Varanus Island problem and they could not get onto the pipeline. Are you aware of any problems along those lines?

**Mr Rowe:** No, I am not. I am aware that some time in the past—it would be going back six or seven years—there was an issue with respect to the Kambalda Lateral when there was difficulty getting access to that. I have forgotten who it was for, but I think it was one of the nickel mines. It was covered at that stage, but there was no access arrangement. The threat of disputing the access arrangement resolved that issue and they came to a commercial resolution. I am not aware of access issues to the Goldfields gas pipeline.

**Mr M.P. MURRAY:** Collie is in the same position with the expansion of its gas pipeline. Do you think that in time there will be a national hook-up of regulators, or do you see it moving in any way in the near future?

**Mr Rowe:** In terms of?

**Mr M.P. MURRAY:** Of being one body.

**Mr Rowe:** In the gas area, we operate under the same legislation. There are minor differences in the state legislation, but it is basically mirror legislation, so it is basically the same. Would I see the ERA's role being transferred to the AER? If we ever had a trans-Australian gas pipeline, that would be possible. Obviously that is a political decision at the end of the day. It is less likely in the area of electricity because we are less likely to have an interconnected electricity network.

**Mr J.E. McGRATH:** On the point about the trans-Australian gas pipeline, is it possible that it might happen one day? The idea has been around for a long time. With the gas supplies that they are finding up in Queensland, it might become more of a remote possibility, but do you think that it could happen one day?

**Mr Rowe:** I do not know. I have not looked at the economics enough to make a sensible comment.

**Mr J.E. McGRATH:** But you did mention it.

**Mr Rowe:** I mentioned it in the sense that if we were interconnected with a transmission line, it would make sense for one authority to be regulating the gas transmission lines. I have not looked closely enough at it to be able to offer a sensible comment on whether it makes commercial sense.

**Mr M.P. MURRAY:** Are you actually working under the same regs but with a few minor alterations?

**Mr Rowe:** Yes. The national gas law is consistent legislation across Australia. We passed our own legislation in WA, but it mirrored that legislation with some very minor amendments with respect to small-use customers. That is the only difference.

**The CHAIRMAN:** One of the things that they are doing over east is a statement of opportunity. I believe that is what they are called. They are looking at all the opportunities. The second thing is a short-term gas market. When we were over there, they were all excited because it had just opened up in Sydney. That did not thrill us, but nonetheless they were very thrilled about it. Queensland set up a gas commissioner to annually review the gas market. Do you have any comments on those three regulatory initiatives, or on any others?

**Mr Rowe:** We would see value in a gas bulletin board, which is what we have nationally. Information is always good to help the market operate effectively. We would also see value in a gas statement of opportunities, similar to what the IMO does in the electricity sector.

**The CHAIRMAN:** Who would do those?

**Mr Rowe:** There are three possible candidates to do the gas bulletin board and the gas statement of opportunities. You could have it done via the Australian market operator for Western Australia as well. We could certainly do that for the gas bulletin board. The bulletin board is set up so that it could do WA. The other two options would be REMCo, which is the gas marketing corporation, or you could also have the independent market operator, which currently does a similar thing for electricity, do the same for gas. My personal view—it is not the authority's view—is that it would be logical to do it either nationally or through the IMO.

**The CHAIRMAN:** Does anyone do something like the gas opportunities, which they do in the eastern states?

**Mr Rowe:** Not to my knowledge in WA. On your fourth suggestion about a short-term gas market, there are private proponents looking at establishing a gas market in WA.

**Mr J.E. McGRATH:** I have a very general question. This matter was raised with me by one of my constituents who is in the dry-cleaning industry in quite a big way. He told me that the price of gas that he has to access was going up. If the North West Shelf operators have long-term contracts with China, and China is still getting the gas at the same price it has been paying for a long time under that contract, why has the price of domestic gas gone up?

**Mr Rowe:** Because we had similar long-term contracts and they have come to an end.

**Mr J.E. McGRATH:** Were there similar domestic long-term contracts?

**Mr Rowe:** We had a 20-year take-or-pay contract, which was the start of getting the North West Shelf underway through the domestic gas plant, and that has come to an end. In our view, because we do not have a particularly deep market, the long-term contract meant that price signals were non-existent and there was not the incentive for exploration to look for gas for the domestic market because it would not have been justified at the long-term contract price. That long-term contract price has now come to an end and we have seen the prices respond. We are going through that cycle at the moment, which is a fairly painful one.

**The CHAIRMAN:** Are you aware that Queensland set up a gas commissioner?

**Mr Rowe:** No.

**Mrs L.M. HARVEY:** Going back to pricing and the ACCC's decision to allow joint marketing through the North West Shelf, do you have a view on the potential market distortion that that might create and the impact it may have on our ability to lock up long-term contracts for domestic use at a good price?

**Mr Rowe:** In a pragmatic sense—again, this is a personal view because the authority has not looked at this issue—I doubt very much whether it would make much difference to the price of gas whether or not we had joint marketing. The problem is the excess demand over supply.

**The CHAIRMAN:** The argument is that there would be four or five firms—both in the North West Shelf and Gorgon projects—that would have separate streams of gas for domestic gas and that they would compete with each other.

**Mr Rowe:** There is still the same quantity of gas coming into the market place.

**The CHAIRMAN:** And through the same pipelines.

**Mr Rowe:** Yes. In a situation where you do not have gas-on-gas competition, I am not sure whether it will make a lot of difference.

**The CHAIRMAN:** From the same projects?

**Mr Rowe:** Yes.



**Mr J.E. McGRATH:** On the issue of the gas price and getting back to the question I asked earlier, the buyers in the domestic market have been caught in a hiatus because the long-term contracts have expired and the prices have gone up. Will the same apply when the long-term contracts to China expire? Will they go up too, or could China do a special deal and the people in the domestic market will still be paying more?

**Mr Rowe:** I am assuming that the operators of the North West Shelf will be looking to maximise a return to their shareholders. When the contract comes up for renegotiation, they will be renegotiating the best possible price they can get.

**Mrs L.M. HARVEY:** Going back to the previous comment you made about the joint marketing, the other potential distortion to the market is the retention leases and the management of them. Do you think that the government could be more active if it enforced a domestic supply to address that demand and supply issue?

**Mr Rowe:** As I said earlier, there is a role for the government in making sure that the tests that it applies to whether those projects are commercial and therefore whether the lease can be rolled over because they are not commercial needs to be much more stringent, but if you are asking me whether that test should be a special test for domestic gas, my answer would be no.

[2.20 pm]

**Mr W.J. JOHNSTON:** Are you aware of the Department of Mines and Petroleum's prediction of a potential reduction in domestic gas supply? Are you aware of those predictions?

**Mr Rowe:** Yes; I think so.

**Mr W.J. JOHNSTON:** Yes; that is, because of the maturing of the North West Shelf fields, the joint-venture partners may cease to sell the gas that they currently sell domestically to feed their five export trains. Are you aware of that?

**Mr Rowe:** Yes.

**Mr W.J. JOHNSTON:** Is that a market failure? Is that something that the regulation needs to deal with? Or is that just something that Western Australians have to cope with?

**Mr Rowe:** No. It is something that Western Australians have to cope with; that is the short answer.

**Mr W.J. JOHNSTON:** So my concluding question is: what is the purpose of the gas supply industry in Western Australia? Why we involved in the gas industry? If 300 terajoules a day are withdrawn from sale domestically to feed an export industry, what is the purpose of our involvement?

**Mr Rowe:** It is to make sure that we use the resources that we have to develop the economy. I mean, you could make the same analogy about why we do not then have a 15 per cent reservation policy for alumina.

**Mr W.J. JOHNSTON:** Sure; you easily could. And I am not —

**Mr Rowe:** You could build all sorts of industry structures if you put the right protections around them. The question is whether they are sustainable.

**Mr W.J. JOHNSTON:** Do you think it will be sustainable to withdraw 300 terajoules a day from domestic supply?

**Mr Rowe:** You are assuming that that is the net effect. My assumption, from what we are seeing in the market place, is that if that declines happens it will be offset by growth in other areas. I am not as pessimistic about the total outlook—rather than just looking at the North West Shelf on its own.

**Mrs L.M. HARVEY:** Just to follow up your comment about the test of commerciality at the rollover of the retention leases. It seems to be a mystery test and I am wondering if the ERA has done any work on what that test should be.

**Mr Rowe:** No; we have not.

**The CHAIRMAN:** One of the issues about the domgas rollover contract for the North West Shelf is will it act in a commercial manner, from the perspective of the state? Once the domgas contract is up, it has the potential to put the gas on the domestic market, as it has, but perhaps at a different price, or to put it through, if it has the capacity, the current trains for export. Do you see any strategic reasons why the company would act in a non-neutral manner; that is, are there strategic reasons why it would prefer to sell LNG through to the export market rather than to the domestic market—even if the domestic market were to pay as high or higher price?

**Mr Rowe:** I have not thought about it, Chair, but under that assumption you would have to assume that it was willing to let a domestic gas train sit idle as well.

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

**Mr Rowe:** I am not sure what the commercial argument for that would be.

**Mr M.P. MURRAY:** Returning to what Liza was saying: what about the commercial viability of a field when someone has X-amount in a well, X-amount in another well and X-amount in yet another well and the three together could be a commercial proposition? Are there any rules in the state to say that they have to hook up or —

**Mr Rowe:** I do not know; you outside my area of expertise. I am sorry; I do not know.

**Mr M.P. MURRAY:** Can you hear what I am saying?

**Mr Rowe:** Yes; I can see the point you are making.

**Mr M.P. MURRAY:** They could sit on that for an age saying it is not commercial, when really the basin could be commercial if it were one operator.

**Mr Rowe:** Sure, but I do not know the answer to that.

**Mr J.E. McGRATH:** I do not know if this is a question that you really want to address, but I want to know about the future supplies of gas. Are there any fears that one day Western Australia might run out of gas? Or do you think there is no worry at all because there is so much gas up there that you will continue to be able to provide the domestic market as well as a very profitable LNG export market?

**Mr Rowe:** Again, I am happy to answer personally, but this is not an ERA view. I do not have concerns about a shortage of gas; the issue is what price we are going to have to pay for it, rather than whether we run out. In that area, I guess my personal view is that I am reasonably optimistic—given some of the technological changes that are occurring—that we will end up with gas-on-gas competition in the domestic market; in which case I would hope we would see reasonable prices for that gas. But your guess is as good as mine.

**The CHAIRMAN:** And your expectation is based in part on onshore gas supplies.

**Mr Rowe:** Either. In reality, if you had near offshore gas, you would get the same answer. It is about getting gas-on-gas competition. The problem at the moment is that we do not have gas-on-gas competition, so we are looking at alternative fuels—which is diesel, and we see very high gas prices.

**Mr J.E. McGRATH:** Is there nothing that you can see that the government can do to stimulate this competition, apart from making the approvals process a lot more easy to work through? What other assistance could the government provide? What other steps could the government take to speed up entry into the gas exploration market?

**Mr Rowe:** There are some other issues, which I am certainly not an expert on, that go to the taxation arrangements for exploration; that is, flow-through share schemes. However, this would be

a federal tax issue rather than state issue; that is, providing a greater incentive for exploration goes largely to federal taxation issues.

**Mrs L.M. HARVEY:** Hindsight is a wonderful thing. Looking at the pain that we need to go through as the market corrects itself to an appropriate price of gas, is there something that we could have been doing five or six years ago to address the situation that we are in now? Something that did not happen. This market seems to be one of those markets in which nobody is willing to make any kind of prediction. Where I am looking at it from, we are going through this pain, we are going through a crunch time while the market corrects itself and we come out of that period of long-term contracted gas at a low price. Obviously, the government would prefer to see a seamless flow through with the price shifting more realistically towards the actual price of gas that we are now finding has jumped astronomically. With the benefit of hindsight, what could we have done four, five or 10 years ago—if anything?

**Mr Rowe:** It was partly the shallowness of the market, I suppose. Normally, when confronted with these sorts of situations in a more matured market with greater depth, financial instruments are in place; that is, people make financial arrangements to hedge against what might happen to gas prices. I guess the market was too shallow or that companies did not have the foresight to put in place those steps that would have mitigated that process. A large part of gas use is industrial or for electricity generation and I guess there was a false sense of security around that.

**Mrs L.M. HARVEY:** That is where I am going; that is, domestically we have such a very high reliance on gas-fired electricity generation, which was basically founded on this low cost price of domestic gas flowing into that generation capacity. Of course, now we are in a situation in which the ball game has completely changed. We have put all our eggs in one basket—if you like—and been caught short.

**Mr Rowe:** Feel free to buy in at any stage, Mr Watkinson. I take issue with your comment that we had cheap gas, because when the contract started that \$2.50 gas was not cheap gas. In fact, it was very expensive gas, because we had to take-or-pay contract and we were not using a large amount of the gas we were paying for. There were some significant costs in holding that gas and electricity users in the state paid for that. At the end of the project, when gas prices had moved, yes, we had quite cheap gas. However, over the life of the project, it was not cheap gas all the time. I think that needs to be borne in mind, too.

**The CHAIRMAN:** The point is that we have, relative to other states, a very high reliance on gas both in electricity generation and consumption.

[2.30 pm]

**Mr Rowe:** One of the challenges for us going forward is that because we have such a low overnight load on the electricity network in WA, the potential for coal-fired baseload power stations is not all that great either because the overnight load is so low.

**The CHAIRMAN:** Because of the peaks in the system.

**Mr Rowe:** Yes, and they need to be kept running.

**The CHAIRMAN:** As far as our industrial base is concerned, Alcoa comes to mind as a major gas user. It will have its own long-term contracts, I presume. It will be highly sensitive to gas prices. I am sure there are other operations located here that are reliant on gas and build their competitive strength on the price of gas. There will be an adjustment cost to this.

**Mr Rowe:** It is also true to say that those same organisations that are in the mineral resources sectors have had increases in their prices over the past few years as well.

**Mr J.E. McGRATH:** What about retailers of gas? When we were in the other states we noticed there were a lot more retailers over there, and I think you made that point. Is there a potential for

more retailers to come into the market here or do you think it is too much of a closed shop at this stage?

**Mr Rowe:** We have had full retail contestability in gas for five years and we have not seen a lot of competition. It is more likely to come in when we open up full retail contestability in electricity as well and we provide the opportunity for players to retail both gas and electricity. Until we have cost reflective prices on electricity, we will not have full retail contestability of electricity either. We have to deal with the electricity price first.

**The CHAIRMAN:** Do you have a concern about the adequacy of capacity in the electricity market in the south west interconnected system? Some people in the eastern states had some concerns because people were not building enough coal capacity for greenhouse issues mainly. No-one is building coal-fired power stations anyway. There were limits to investment, even in combined cycle gas, because of uncertainty about carbon prices. In some states, not all, there were concerns about adequacy of supply.

**Mr Rowe:** Adequacy of generation?

**The CHAIRMAN:** Yes.

**Mr Rowe:** It is not an issue in this state at the moment. If anything, we actually have an oversupply. The margin through a large part of last summer of plant available compared with plant used was about 30 per cent, up to 40 per cent at times.

**The CHAIRMAN:** There is a huge amount of baseload capacity for the growth in demand up north. It is all gas. We are using a hell of a lot of gas to process iron ore and other minerals. I imagine CITIC Pacific's steel plant is the only one anywhere around the world using gas. LNG is a very expensive fuel stock. I know it is way outside the ERA's gamut, but is there an alternative to the source of energy used up north? If you did that, you would free up a hell of a lot of gas for other users.

**Mr Rowe:** It could be nuclear.

**The CHAIRMAN:** Or coal, once you get it on board ship.

**Mr Rowe:** The short answer is that I do not know. I am not competent to answer that.

**The CHAIRMAN:** Just in summary, you are more on the optimistic side. We looked at the Department of Mines and Energy's forecasting. If you look at that data, which you have seen, particularly with the uncertainty of the North West Shelf domestic gas contract, you would see significant shortages of supply relative to its estimated demand and therefore very high prices going forward, and then it added on a couple of scenarios. Even in the scenario where it was more optimistic about the North West Shelf domestic gas sales and the sales of Pluto and Gorgon, there was still some tightness in the market and the forecast going forward. The most optimistic supply for most of the period looked at was at or below higher level demand. You are more optimistic than that. I do not think that one included too much of a price response. I am not sure if unconventional gas sources were considered. Your view is that you are more optimistic about the supply and demand balance.

**Mr Rowe:** I would answer it in a slightly different way and say that regardless of whether we are optimistic or pessimistic, the question is: what can we do about it? What I have seen in these proposals that would supposedly lower the price or guarantee a quantity to the domestic market has the potential to make the matter worse, not better. In a sense, it does not matter whether I am optimistic or pessimistic; the question is: what can you do about it?

**The CHAIRMAN:** Thank you for your evidence today. A transcript of this hearing will be forwarded to you for minor corrections. Please make these corrections and send the transcript back within 10 working days of the date of the covering letter. If the transcript is not returned, it will be deemed to be correct. 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 on a particular point, please include a supplementary submission with your transcript of evidence. Thank you very much.

**Hearing concluded at 2.36 pm**