Australian
Thursday 27/7/2006
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Call to reserve gas ignites row

Billions of dollars in investment and corporate earnings are at stake, writes **Nigel Wilson**

AUSTRALIA'S biggest single resources contract, the $25 billion deal to supply China's Guangdong Province with North West Shelf liquefied natural gas (LNG), is underpinned by gas once allocated for domestic use.

The transfer serves to highlight issues in the increasingly vocal debate about a West Australian government suggestion that up to a fifth of known offshore gas reserves be kept for the Australian market rather than exported as LNG.

At the time the Guangdong contract was being negotiated, the North West Shelf joint venturers became concerned the then proven reserves were not sufficient to meet all obligations.

China, through the China National Offshore Oil Corporation, had demanded an equity stake in the gas as part of China's drive for energy security.

In May 2003, China became the first foreign country allowed to own a stake in Australia's gas reserves when CNOOC paid $543 million for 5.3 per cent of the North West Shelf project, effectively owning 1.1 trillion cubic feet of gas and 210 million barrels of liquids.

But the government of former premier Richard Court agreed to allow gas previously reserved for future domestic needs to be released to enable CNOOC's demand for a stake in the gas reserves to be met.

While the Guangdong deal is regarded as extremely cheaply priced, the return is still higher than the gas being sold for the domestic market.

That's a key point in the debate sparked by the West Australian Government earlier this year releasing a discussion document aimed at developing a policy on securing domestic gas supplies. Australia has some of the cheapest gas prices in the world outside of the Middle East.

There's a fear these could rise and quite sharply if gas is arbitrarily reserved for domestic use.

This is no esoteric debate. Billions of dollars in investment and future corporate earnings are at stake.

Woodside, which is trying to commercialise the Pluto gas discovery and turn it into Australia's third liquefied natural gas project, has been told, even before the concept of gas reservation becomes firm government policy, it should look to the prospect that 15 per cent of the estimated 4 trillion cubic feet of gas in the reservoir should be set aside for domestic use.

If a similar ratio was applied to the estimated 40 million-plus trillion cubic feet estimated to be contained in the Gorgon reservoirs, then more than 6 trillion cubic feet of gas

Considering that every year the whole of Australia uses only around 1 trillion cubic feet of gas for domestic and export needs, then the level of reservation proposed assumes substantial proportions.

The reservation debate kicked off in February when the state Government released a "consultation" paper.

It begins by saying Western Australia has gas reserves of about 113 trillion cubic feet, or about 80 per cent of the nation's gas reserves.

"The discovery of such large gas reserves has understandably given rise to expectations that Western Australians will have long-term access to large quantities of low-cost gas, providing a secure energy future and underwriting industrial development in the state, particularly the ability to develop and process the state's rich mineral resources," it says.

Federal Resources Minister Ian Macfarlane slammed the proposition and said the federal Government believed in allowing the market to determine how the gas was used.

He has subsequently threatened to use federal powers to block any move by Western Australia to turn the discussion paper into action.

Export LNG has always been priced at a premium to domestic gas mainly as a result of energy-short Japan being prepared to pay a premium for long-term contracts to secure its energy supplies.

While gas producers were happy Mr Macfarlane was keen for them to maximise their returns, there was less enthusiasm from big domestic consumers such as alumina producer Alcoa and domestic gas retailer Alinta.

While some have cast West Australian Premier Alan Carpenter in the role of a latter day Rex Connor the Whitlam government minister who famously opposed the development of open-cut coal mines because the needs of future generations were better served by using traditional underground methods others believe the issue is of such national importance that it should be decided at a federal level.

Mr Carpenter has appeared to back the reservation concept even before the Government completes the evaluation of the submissions before it. Indeed, the level of angst the possibility has created has led to a rather more sophisticated assessment process being adopted by the Government, including the acquisition of specific economic modelling which means the bureaucracy does not now anticipate coming to firm conclusions until the end of the year.

Gas is estimated to represent 23 per cent of world energy supplies and is anticipated to grow to 29 per cent by 2020 (with oil anticipated to remain at 40 per cent and coal

In April 2001, Woodside predicted that Australia could be producing 28 million tonnes of LNG by 2012 with six trains in Western Australia and three in the Northern Territory.

It was estimated that by 2010 sales of LNG worldwide would be 146 million tonnes a year.

These estimates have proved to be overly optimistic at least in terms of timeframe.

Aside from a new fertiliser plant on the Burrup there have been no major new domestic customers for North West Shelf gas this decade.

While LNG production from the North West Shelf project is expanding to 16 million tonnes a year by late 2008, Gorgon, which aims to produce 10 million tonnes a year, has still to commit and the Browse Basin projects further north are looking to the middle of next decade before they are in production.

But among domestic customers, the West Australian discussion paper has created intense analysis.

Alcoa has called for up to 20 per cent of reserves to be kept for domestic use, claiming existing market mechanisms are unlikely to guarantee the continued security of supply.

Alcoa is the biggest single user of gas in Western Australia, producing 8 million tonnes of alumina a year 13 per cent of world demand from three refineries at Pinjarra, Kwinana and Wagerup, and generates annual export revenues of $3 billion.

Its submission says the cost of energy represents 28 per cent of its production costs in Western Australia. "Alcoa considers state government intervention to reserve gas to meet domestic needs is necessary and appropriate. Ongoing availability of gas to domestic users is of fundamental importance to the state's economy," Alcoa says.

"There is a material risk that, in the absence of near-term government intervention, the availability of gas will be constrained and the price of gas significantly increased."

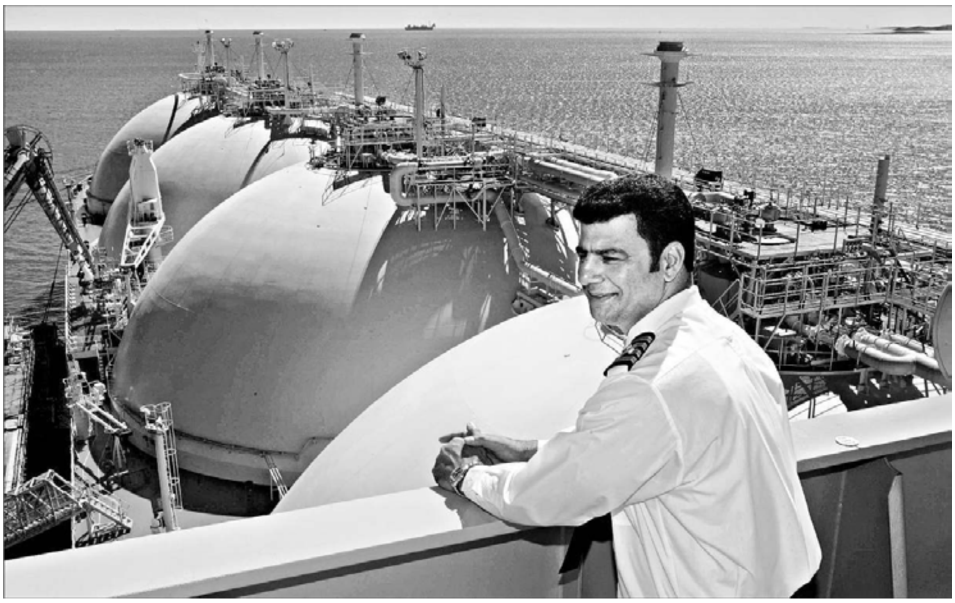
But such market distortion is not supported by economic consultants ACIL Tasman, which in a report commissioned by Western Australia's No 2 coal producer, Griffin Energy, warns such a policy could render new LNG projects uneconomic.

The oil and gas industry's peak lobby group, the Australian Petroleum Production and Exploration Association, also argues that the reservation proposal may threaten Australia's reputation as a supplier of LNG to the world market.

"We do not believe that mandating gas reservation is the answer," says the association's executive director, Belinda Robinson.

"It could affect Australia's reputation as a reliable supplier of LNG. It will inevitably lead to higher than necessary prices in the long term and potential shortages."

But then her critics would say: "Why do Chinese customers have more rights to Australian gas than we do?"



Leaving home: Master of the North West Sea Eagle, Cornelius Johnston, looks over the first shipment of LNG departing from the Pilbara for China in May