



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

STANDING COMMITTEE ON ECONOMICS

**Reference: Gas explosion at Varanus Island, Western Australia**

WEDNESDAY, 29 OCTOBER 2008

CANBERRA

BY AUTHORITY OF THE SENATE



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**SENATE STANDING COMMITTEE ON  
ECONOMICS**

**Wednesday, 29 October 2008**

**Members:** Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Bushby, Cameron, Furner, Joyce, Pratt and Xenophon

**Participating members:** Senators Abetz, Adams, Arbib, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Ellison, Farrell, Feeney, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

**Senators in attendance:** Senators Bushby, Cameron, Eggleston, Hurley, Johnston and Pratt

**Terms of reference for the inquiry:**

To inquire into and report on:

- a. the economic impact of the Western Australian gas crisis, including but not limited to:
  - i. the extent of losses faced by business and industry failing to meet production targets due to the lack of gas supplies,
  - ii. the disproportionate disruption to industry in the south west of Western Australia, and
  - iii. the nature of contractual arrangements forced on business and industry during the gas crisis and their status since the resumption of gas supplies from Varanus Island; and
- b. the government response to the Western Australian gas crisis, including but not limited to:
  - i. the adequacy of the crisis management response,
  - ii. the adequacy of reliance on one source supplies of gas for domestic markets,
  - iii. the provision of reliable and affordable supplies of alternative energy,
  - iv. the feasibility of developing emergency storage facilities of gas in depleted reservoirs or other repositories, and
  - v. the justification for any refusals to release relevant facts and documents publicly.

**WITNESSES**

**ADAMS, Mr Simon, Senior Legal Counsel, Electricity Retail Corporation trading as Synergy ..... 2**

**MITCHELL, Mr James, Managing Director, Electricity Retail Corporation trading as Synergy ..... 2**



**Committee met at 5.10 pm**

**CHAIR (Senator Hurley)**—I declare open this meeting of the Senate Standing Committee on Economics inquiry into matters relating to the gas explosion at Varanus Island, Western Australia. This is the fourth public hearing of the inquiry. The Senate referred this inquiry to the committee on 28 August 2008 and the committee has received over 25 submissions. The committee is due to report to the Senate by 13 November 2008. The inquiry's terms of reference require the committee to examine:

- (a) the economic impact of the Western Australian gas crisis, including but not limited to:
  - (i) the extent of losses faced by business and industry failing to meet production targets due to the lack of gas supplies,
  - (ii) the disproportionate disruption to industry in the south-west of Western Australia, and
  - (iii) the nature of contractual arrangements forced on business and industry during the gas crisis and their status since the resumption of gas supplies from Varanus Island; and
- (b) the government response to the Western Australian gas crisis, including but not limited to:
  - (i) the adequacy of the crisis management response,
  - (ii) the adequacy of reliance on one source supplies of gas for domestic markets,
  - (iii) the provision of reliable and affordable supplies of alternative energy,
  - (iv) the feasibility of developing emergency storage facilities of gas in depleted reservoirs or other repositories, and
  - (v) the justification for any refusals to release relevant facts and documents publicly.

We will begin this hearing in public session for a short time and then move to an in camera hearing for the remainder of the afternoon.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground which is claimed.

[5.12 pm]

**ADAMS, Mr Simon, Senior Legal Counsel, Electricity Retail Corporation trading as Synergy**

**MITCHELL, Mr James, Managing Director, Electricity Retail Corporation trading as Synergy**

**CHAIR**—I welcome representatives of Synergy. Do you have an opening statement?

**Mr Mitchell**—Thank you for the opportunity to make a submission to the inquiry and also for the opportunity to give testimony before the inquiry. I have a lot of empathy with the gas consumers impacted by the Varanus Island gas explosion, because our customers were in the same position last January. We issued force majeure notices while others' customers took their market share, suspended operations and so on.

Our submission is weighty but it was important to give you some perspective with respect to what is happening to gas and the gas market in Western Australia. We included in our submission an ERA in June 2007 and an Argonaut Securities review of the market in September 2007. They both received wide press coverage and Argonaut Securities' report was widely referenced by both government and private industry. This is important context on the long-term gas pricing and availability within Western Australia and also on consumers' perception of what they perceive to be price gouging.

Substantial increases in wholesale gas markets over the last one to two years are not obvious to parties who come to the market every two to three years. This is due to the fact that there is no visible market for gas prices in WA either in wholesale, where generally those prices are held confidential, or in the larger retail market. Argonaut Securities, on page 20 of their report, cite who the losers might be in this environment. They said:

Over a longer period of time, retail consumers may start to feel the impact of higher prices ... but we believe the issue for large commercial customers who do not as yet have long-term supply contracts in place to be more serious.

And they cited, firstly:

Adequate supply may be unobtainable in the short-term—

and, secondly—

Even if it is available, the gas could be prohibitively expensive.

The nature of the market in WA for the medium- to long-term is basically all bilateral contracts both in gas and haulage. It is dominated by very few players. In gas supply there are basically two players: the North West Shelf and the Santos-Apache joint venture. In transmission there is one: the Dampier to Bunbury pipeline. In the distribution of gas around the south-west there is WestNet. With respect to retailers, there are two and they are the small and medium enterprise



market and the industrial and commercial market and the player in the wholesale market is Alinta.

In our submission we provided historic and forecast gas price graphs. Argonaut's domestic gas price forecast was on page 5. Our benchmark pricing path on wholesale price points was on page 6. It basically shows where wholesale prices have moved over the last two years. Customers coming out of contract on these historic price contracts are experiencing shock with these new market prices. The gas market is just as much about gas haulage as it is about electricity production and consumption, so any gas crisis invariably has a consequence with respect to electricity and the ability to produce it, given that 60 per cent of electricity in WA is produced by gas fired engines. With capacity haulage you need both haulage and upstream gas supply to deliver gas to the end customer.

Synergy was on the gas supply coordination committee and we were called to the meeting with the Premier early in June. We took it from a retailer's perspective but especially on our impact on electricity customers as, having 970,000 customers, if there were any consequent flow-on to electricity we would have been right at the front of that. Also we were there when the discussion about the priority schedule was discussed and tabled and I need to point out that in line it started at first with the same priority list that happens with power, with electricity, and from there it moved on.

Use of gas was critical in the first few weeks as coal generation was down. There was insufficient liquid storage and refuelling available and when it is available it is extremely expensive with a distillate equivalent price of about \$35 a gigajoule. With respect to the coal generation, Verve Energy at Collie was out. There was a problem with the blading and a couple of their other machines went to maintenance. Basically, a lot of our gas or nearly all our spare gas was diverted to Verve.

The WA gas market is a large gas market per se—about 1,000 terajoules per day. Households are a pretty small part of that with just under five per cent and the I&C and SME, the industrial and commercial and the small and medium enterprise, areas represent just under 10 per cent of the market. In total it is not a very large share. Synergy is a small player in the market. In the total market sense we probably have about three per cent of the market and we probably have approximately 35 per cent of the I&C market. We have a load of just under 25 terajoules a day compared to the 350 terajoule shortfall, so we fell well short at less than 10 per cent of what the problem was. Our own customers were unaffected. We had diversity of gas supply. We had some spare gas of the order of only two to three terajoules a day which represented a small, modest amount for growth. We had a little bit of spare transport to match that spare gas but that has finally balanced to match gas purchases. Our ability to assist was, in fact, limited.

Synergy's gas pricing approach for long-term retail customer contracts remained unchanged throughout the Varanus Island gas explosion and following that and it continues to apply today. During June and July Synergy started contracts with 25 customers on two- to three-year contracts honouring contractual commitment offerings that we had made pre Varanus Island with respect to both price and term. We had set aside that gas and where we were able to honour those offerings this pricing was based on our 6 May gas price.

We were able to assist five Alinta customers who had either declined our offer previously or sought our offer subsequent to the Varanus Island gas explosion. This included Harvey Fresh who had previously declined our offer. All but one of those customers had been in negotiation with Synergy and seeking long-term contracts prior to the Varanus Island gas explosion. The remaining 20 customers were Synergy customers being renewed or customers out of contract. Synergy did not change its price on contract offers on legal advice that it should not seek to take the benefit of the crisis to steal Alinta's customers nor induce them to breach their contract with the other retailer. We honoured all price offers that were offered pre Varanus Island, which were based on the gas price at 6 May, 28 days before Varanus Island. In fact, we did not increase our gas price until 7 July, some 36 days after Varanus Island, and hence we were able to assist the Alinta customers with previous gas pricing.

In the first few weeks all spare gas was diverted, predominantly to Verve and some to Horizon Power, to ensure that they had sufficient gas to provide enough electricity in the south-west and around Kalgoorlie and thus avoid load shedding. Collie was down and another plant was out for scheduled maintenance. We were approached by up to 50 customers and could not help them in those first few weeks as we had no gas available. Only when Verve got some of their units back on did we have some small gas available and then we could really try to help Alinta's customers.

The North West Shelf made about 100 terajoules of gas or more available after the first few weeks. You may recall Fran Logan's comments on page 139 were that North West Shelf got 'quite upset about accusations levelled at them that they were involved in some form of price gouging' and it led them to go to price auctioning. We recognised that small customers could not compete with larger companies in bidding for that gas. In addition to assisting those five Alinta customers with medium-term contracts, Synergy did everything in its power to help other small customers, remembering our own customers' similar situation last January.

Gas transport arrangements go hand in hand with gas supply. We approached the Dampier to Bunbury pipeline for new haulage contracts to assist short-term customer needs, which they responded to. We aggregated demand for Alinta's customers who had approached us and sought 10 to 15 terajoules per day from the market on a number of occasions. We had the support of the CME, the CCI and a lot of impacted customers in seeking that gas. Indeed, Reg Harold-Smith on page E100 spoke about CME's support and intimated limited intervention. He was supporting us in every way possible through stakeholders to see if we could get some gas for small customers. James Pearson from the CCI was positively supporting our purchasing initiatives as well for exactly the same reasons. The pricing we were able to offer fell well short of what was necessary in the market. I note Fran Logan's estimate in his testimony that it will end up at at least \$16.50.

Synergy was instrumental in changing the transfer provisions in the gas market to next-day transfer by urgently requesting all market participants to agree to such a rule change. There are similar rules with respect to the electricity market with a five-day transfer rule. I notified the head of the Economic Regulation Authority that we would be breaching those rules to save jobs and I then obtained the support of my counterpart at Western Power, Doug Aberle, in undertaking the same-day transfer and we were successful in doing that.

With respect to the Gas Bulletin Board, after allocating all available gas to those 25 customers that we continued to contract post the Varanus Island gas explosion previously mentioned our gas was committed. We then sought out small amounts of further gas for the Gas Bulletin Board.

Our customers went into forced outage and thus allowed us to divert the gas that they would otherwise have used to go onto the Gas Bulletin Board. We were able to source gas from secondary market industrial customers and we were able to use Verve's gas in mid-July once they could release gas after their issues were solved.

Synergy was the only party to sell gas on the Gas Bulletin Board. We had assisted some who wanted supply for one to four weeks through that and subsequent offerings. We undertook 63 trades with 10 customers. The charts on page 7 of our submission show the gas price obtained from the markets versus our long-term gas price. The gas from the market was at prices significantly higher than our long-term price offerings. The first bid on the Gas Bulletin Board was for one terajoule at \$15.90. There were five bids totalling five terajoules, all greater than \$18, and one bid for five terajoules on the bulletin board that day at \$8.50. We had, in fact, dissected right in the middle.

Our original offer to Harvey Fresh was based on our 27 July price when it was made in March 2008. It was also based on the one site notified to us by Harvey Fresh. We rely upon the customer's advice as to the number of sites that they have, as we have no visibility of which sites belong to which customers. On 15 May 2008 they advised that they would not contract with Synergy, so their gas was committed elsewhere. Harvey Fresh were advised three days before then, on 12 May, that the gas price would be going up if they sought further extensions. On 17 June, 14 days after the Varanus Island, we were requested to again supply them with gas. We were able to secure their gas needs, but the price was based on our 6 May 2008 gas price, as previously advised. Notwithstanding we were told of only one site, we were able to supply them with gas for their second site, again based on our 6 May long-term price. We had run out of transport capacity for the second site and the Dampier to Bunbury pipeline would only provide haulage at a penalty cost. The delay in accepting Synergy's offer did not deliver benefits to Harvey Fresh. It was not due to the Varanus Island gas explosion but due to rising gas and transport commodity costs. Prime Laundry state in their submission:

... all unused gas went back to market and resold by our gas supplier / transporter and no credit issued to us. We averaged 200-400 GJ unused each week.

I would like to point out that Synergy delivered all the gas into the pipeline. Their gas transporter would have received the benefit of that surplus gas and they should seek their credit from them.

In summary, Synergy refutes any suggestion that it acted improperly following the Varanus Island gas explosion and that it undertook any form of price gouging. Further, we categorically refute any implication made in previous testimony that Synergy engages in or has ever engaged in collusion with Alinta or any other competitor in the electricity and gas market. We acted as responsible corporate citizens. We did everything in our power to assist impacted parties. The actions of Synergy saved the jobs of many Western Australians.

**CHAIR**—The committee will now go in camera.

*Evidence was then taken in camera—*

**Committee adjourned at 6.22 pm**

