

CHAPTER 4

Response by the energy industry

4.1 A variety of views about how effectively the energy industry responded to the incident were put to the committee.

An overview of the structure of the Western Australian energy industry

4.2 Even though the explosions and fires on Varanus Island only directly affected gas production facilities it is necessary to consider the structure of both the gas and electricity markets in assessing the impact of the incident. Over 60 per cent of electricity in Western Australia is produced by gas fired engines so any interruption to gas supplies invariably has consequences for the production of electricity.¹

Electricity

4.3 The structure of the Western Australian energy market has undergone dramatic change in recent years. In 2006 the Western Power Corporation was restructured into four separate state-owned corporations – Synergy, Horizon Power, Verve Energy and Western Power.²

4.4 Synergy is Western Australia's largest energy retailer with approximately 970 000 electricity customers. Synergy is responsible for the sale of electricity within the South West Interconnected System (SWIS) – an area bounded by Kalbarri to the north, Kalgoorlie to the east and Albany to the south. Synergy is currently only a small player in the gas market with about three per cent of the overall market. Synergy's customers were unaffected by the incident.³

4.5 Horizon Power is responsible for the generation, transport and sale of electricity in areas outside the SWIS and therefore operates in the Pilbara, Kimberley and Gascoyne regions and the southern goldfields around Esperance.⁴

4.6 Verve Energy generates 75 per cent of the energy produced in the SWIS. Verve Energy owns and operates four major power stations – Kwinana, Cockburn, Pinjar and Muja, while a fifth at Collie is owned by Verve, but operated by a private company.⁵

1 Mr James Mitchell, Synergy, *Proof Committee Hansard*, 29 October 2008, p. 3.

2 Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

3 Mr James Mitchell, Synergy, *Proof Committee Hansard*, 29 October 2008, p. 3; Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

4 Horizon Power, *Annual Report 2007*, p. 3; Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

5 Verve Energy, *Annual Report 2006-2007*, p. 3.

4.7 Western Power is responsible for operating, maintaining and expanding the electrical transmission and distribution network in the SWIS.⁶

4.8 A number of private companies throughout Western Australia also generate electricity, although many do so primarily to supply their own mining or other operations. In 2004 private generation accounted for approximately 45 per cent of total electricity generation capacity. Synergy and Horizon Power remain the major supplies of electricity to the residential and commercial markets.⁷

Gas

4.9 Gas demand in Western Australia is dominated by industrial usage and power generation. Five large customers – Alcoa, Alinta, BHP Billiton, Burrup Fertilisers and Verve Energy – account for 90 per cent of gas consumption in Western Australia.⁸

Gas retailer

4.10 Alinta, owned by Babcock & Brown Power, is the major supplier of natural gas to residential and commercial customers in the south west of Western Australia, supplying approximately 570 000 customers. Alinta also supplies electricity to around 1600 commercial and industrial customers. Half of Alinta's gas supplies for its residential and commercial customers and for its two cogeneration electricity generators are normally supplied from the Varanus Island terminal. Alinta's earnings in 2007-08 were cut by approximately \$11 million as a result of the Varanus Island incident. Alinta established a steering committee to manage the impact of the incident and as a result of the incident:

- Alinta purchased more expensive power from the market, replacing power normally sourced from Alinta's Pinjarra plants affected by gas curtailments;
- Alinta purchased more expensive gas from non-Varanus sources; and
- Gas sales to commercial and industrial customers were lower than expected for the year.⁹

Gas producers

4.11 The North West Shelf Venture (NWSV) produces natural gas for the domestic market in Western Australia, and exports liquefied natural gas to Japan and condensate, crude oil and liquefied petroleum gas to international markets. The

6 Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

7 Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

8 Australian Petroleum Production and Exploration Association, *The Western Australian Gas Market*, http://www.appea.com.au/content/pdfs_docs_xls/NewsMedia/APPEAMediaReleases/domestic_gas_fact_sheet_-_july_2007.pdf, p. 3.

9 Babcock & Brown Power, *Annual Report 2008*, pp 23 & 55.

NWSV comprises BP Developments Australia Ltd, Chevron Australia Pty Ltd, Japan Australia LNG (MIMI) Pty Ltd, Shell Development (Australia) Ltd, BHP Petroleum (North West Shelf) Pty Ltd and Woodside Energy Ltd. Woodside is the operator of the NWSV.¹⁰ The NWSV is Western Australia's largest single producer of gas for the domestic market providing about 65 per cent of total State production.¹¹

4.12 Apache Energy is the Australian operating subsidiary of Apache Corporation. It is the second largest producer of both oil and gas in the offshore Carnarvon Basin in Western Australia. Its primary production hub is on Varanus Island, and it provides over 30 per cent of Western Australia's domestic natural gas supply.¹²

4.13 BHP Billiton's Tubridgi field and the ARC Energy fields around Dongara provide about five per cent.¹³

Gas transporters

4.14 The Dampier to Bunbury Natural Gas Pipeline (DBNGP), owned by the Dampier Bunbury Pipeline Group, is the only natural gas pipeline connecting the Carnarvon Basin on Western Australia's north west shelf with industrial, commercial and residential customers in Perth and the surrounding region. The pipeline runs from the Burrup Peninsula, near Dampier, to Bunbury in south west WA and is connected to the production facilities on Varanus Island.

4.15 The pipeline was built by the State Energy Commission of Western Australia, with the support of Alcoa, in the mid-1980s. In 1998 the Western Australia Government sold the pipeline to Epic Energy, and in October 2004 the pipeline was purchased by a consortium comprising Diversified Utilities & Energy Trusts, Alcoa and Alinta. In August 2007 Alinta's 20 per cent share was purchased by Babcock & Brown Infrastructure.

4.16 Since December 2006 the DBNGP has been interconnected with the Goldfields Gas Pipeline (GGP) allowing gas suppliers to deliver gas to customers along the GGP via the DBNGP. The GGP transports gas from the North West Shelf area to customers in the Pilbara and eastern goldfields regions.¹⁴

4.17 Other major natural gas transmission pipelines include the

10 North West Shelf Gas, *About NWSG*, <http://www.nwsg.com.au/sp-frameset.html?about/nwsg.html>.

11 Woodside, *North West Shelf Venture*, <http://www.woodside.com.au/Our+Business/Production/Australia/North+West+Shelf/>.

12 Apache Energy, *Welcome*, <http://www.apache-energy.com.au/>.

13 Hon Fran Logan MLA, *Proof Committee Hansard*, 2 October 2008, p. 135.

14 Dampier Bunbury Pipeline, *DBP and pipeline information*, <http://www.dbp.net.au/about/>.

- Parmelia Pipeline, which transports gas from various fields in the Perth Basin to customers in the south west;
- Pilbara Energy Pipeline, which transports gas from the North West Shelf area to Port Hedland;
- Kambalda to Esperance Gas Pipeline;
- Mid West Pipeline; and
- Telfer Gas Pipeline.¹⁵

4.18 All gas delivered into the pipeline systems is already owned through long and short term contracts. This means that there is no spare gas in the system waiting to be bought or be made available should there be a sudden shortage. Therefore there is no gas available for trading unless a customer chooses to make some of their contracted supply available.¹⁶

Deployment of alternative conventional power sources

4.19 As noted in Chapter 3, one of the Western Australian Government's aims in trying to manage the impact of the incident was to access energy from other sources to free-up gas.¹⁷

Coal

4.20 Several of Verve Energy's coal-fired power stations were rushed back into service from maintenance or decommissioning thereby freeing up some gas used to fuel gas fired power stations. Mr Logan told the committee that:

Verge Energy workers excelled themselves by putting in round-the-clock shifts to bring back the biggest coal-fired power stations on line, with Muja, Collie A and Kwinana B units generating. This released from Verve Energy up to 100 terajoules of gas into the system for on-sale to industry and distribution to industry.¹⁸

Diesel

4.21 Verve Energy and other businesses also switched to using other fuels such as diesel to free-up gas:

Obviously there was very significant concern about diesel. Given that we were shifting so much power and industrial production from gas onto diesel, there was concern about the actual stocks of diesel, but the fuel companies worked extremely well with government, sourcing tankers that

15 Office of Energy, *Overview*, <http://www.energy.wa.gov.au/2/2063/64/overview.pm>.

16 Hon Fran Logan MLA, *Submission 31*, p. 1.

17 Hon Fran Logan MLA, *Proof Committee Hansard*, 2 October 2008, p. 133.

18 Hon Fran Logan MLA, *Proof Committee Hansard*, 2 October 2008, p. 134.

were en route to other places around the world and diverting them to Western Australia and making road haulage tankers available to be able to continue stock supply at various power stations around the south west.¹⁹

Contractual arrangements and prices charged by energy retailers

Liability waiver agreements

4.22 The committee heard allegations that in order to secure energy supplies during the shortage a number of businesses signed confidentiality and liability waiver agreements:

I was also told that business people felt they could not talk openly or fairly at times and that the signing of confidentiality and waiver agreements was also an issue.²⁰

4.23 Synergy was asked at a hearing whether they ever sought, or considered seeking, an indemnity from litigation for damages as part of their contractual arrangements. Synergy responded that they had never sought such indemnities in their contracts. When Synergy's Managing Director was asked why anyone would have to seek an indemnity when Synergy did not, he responded: 'There are certain things I heard third-hand in the market which disappointed me.'²¹

Prices charged by energy retailers and length of supply contracts

4.24 The spot price of gas and electricity rose after the Varanus Island incident. Some witnesses saw price rises as a normal market response, and pointed out that in some cases firms had had the option of paying more to guarantee supply:

I do know that some companies were, let's say, surprised, unhappy, at the rise in prices of energy. That was simply a product of a disruption to a market, with less supply, and demand staying the same, chasing that reduced supply. Inevitably, one of the responses that happens in a free market is that price goes up. Some people made a decision not to pay those prices, as I understand it, and therefore not to receive that energy; others made the decision to pay those higher prices and receive that energy. We also know of cases where others had contracts for supply of gas, for supply of energy, which were uninterruptible and which had a higher value, a premium, for buying that uninterruptibility, and they were not adversely affected by the shortage of gas.²²

We sought to obtain advice and we sought legal advice on the issue of whether there was price gouging. I must say that we never received any

19 Hon Fran Logan MLA, *Proof Committee Hansard*, 2 October 2008, p. 134.

20 Ms Nola Marino MP, *Proof Committee Hansard*, 3 October 2008, p. 50.

21 Mr James Mitchell, Synergy, *Proof Committee Hansard*, 29 October 2008, pp 16–17.

22 Mr James Pearson, Chamber of Commerce and Industry of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 43.

evidence. In part that evidence may not have been forthcoming because of confidentiality of contracts, and we are a policy organisation...I think there were significant increases and, when you have 30 per cent of the gas supply or thereabouts that is no longer available for a short period of time, you are going to have increases in price. That price would head towards the price of diesel, as a generalisation, because that was the substitute. That is just the market operating.²³

When you have got a situation where there is a shortage of any commodity I guess it is not unreasonable to expect the price to go up. That would be a way of allocating scarce supplies.²⁴

4.25 However, there were also claims that price rises may have gone beyond this. The Mayor of Bunbury commented:

Alinta in particular were completely independent of Government so there was no transparency or accountability for what they were doing. What is apparent is that they substantially increased the cost of what they were supplying, but whether they were price gouging, or their customers were independently bidding up the price could not be identified.²⁵

They obviously know in retrospect what prices they were actually charging customers during the early stages and later stages of the crisis as compared to what they were charging in terms of the diesel comparison—was it simply a diesel comparison or was it something more than that? They are the only ones who have that information, apart from the companies, and whether the companies are prepared to share it with you I do not know.²⁶

4.26 Similarly, in its submission the Food Industry Association of Western Australia suggested that:

Synergy, a State Government owned entity, could redistribute apparent 'spare gas' to new customers under new contracts, reportedly at substantially higher prices and for periods of 2 to 3 years.²⁷

4.27 However, the former Minister for Energy, Hon Fran Logan MLA, told the committee that 'there was no evidence of price gouging' and that energy costs had increased due to more expensive diesel being used to replace gas usage where possible.²⁸

23 Mr Reg Howard-Smith, Chamber of Minerals and Energy of Western Australia, *Proof Committee Hansard*, 2 October 2008, p. 100.

24 Mr John Griffiths, Department of Resources, Energy and Tourism, *Proof Committee Hansard*, 28 October 2008, p. 19.

25 Mayor of Bunbury, *Submission 23*, p. 2.

26 Mr David Smith, Mayor of Bunbury, *Proof Committee Hansard*, 3 October 2008, p. 16.

27 Food Industry Association of Western Australia, *Submission 24*, p. 4.

28 Hon Fran Logan MLA, *Proof Committee Hansard*, 2 October 2008, pp 139–140.

4.28 In relation to the electricity market, the Independent Market Operator also suggested that higher costs were due to the increased use of liquids in power generation:

Given the fact that our market participants were burning considerable amounts of liquid, diesel and oil, to service the load...those higher prices that you saw were not unexpected. They were largely driven by the high cost of generating using liquids rather than our usual base, which is coal and gas. To put that into perspective, prior to Varanus Island occurring, the average weekday contribution by liquid generators was around one per cent. So we moved from one per cent of the market being serviced by liquid-diesel and oil-to 31 per cent in the weeks after Varanus Island.²⁹

4.29 Synergy strongly rejected the accusation of gouging or improper conduct:

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...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 summary, Synergy refutes any suggestion that it acted improperly following the Varanus Island gas explosion and that it undertook any form of price gouging.³⁰

4.30 Synergy also told the committee that they sought to assist customers that required gas for shorter periods during the gas shortage:

29 Mr Allan Dawson, Independent Market Operator, *Proof Committee Hansard*, 26 November 2008, p. 5

30 Mr James Mitchell, Synergy, *Proof Committee Hansard*, 29 October 2008, pp 3–5.

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.³¹

4.31 These trades were at the market price applicable at the time:

Trades on the GBB were at higher prices than the market standard two and three year contracts due to a number of factors, including the fact that the price of the gas source for supply was higher and to the nature of the contracts. They were short term contracts at spot prices and with unknown counter-parties.

Synergy undertook 63 trades with ten customers via the GBB and subsequent bilateral trades. The average price of these trades was reflective of the current market price and was approximately 50 per cent of the diesel substitute price.

Synergy refutes any suggestion it has priced customers at the diesel substitute price.³²

Committee view

4.32 The committee is concerned about allegations raised during the inquiry relating to contractual arrangements and prices charged by energy retailers during the gas shortage.

4.33 From the totality of information provided to the committee, there was no evidence that Synergy acted improperly in its response to the shortage. Synergy cooperated with the committee and provided extensive and detailed evidence in relation to their actions during the crisis including details of contracts.

4.34 However, the committee did not receive evidence from the gas and electricity retailer, Alinta, during the inquiry. Alinta declined the committee's invitation to attend a hearing of the committee on the grounds of their contractual obligations not to disclose confidential information. The committee believes that allegations relating to the contractual arrangements, including liability waiver agreements, and prices charged by Alinta to both its gas and electricity customers during the shortage could have been dealt with in a similar manner to Synergy and the committee regrets the lack of co-operation from Alinta.

Industry involvement in the allocation of available energy

4.35 As noted in Chapter 3, due to the privatised gas market in Western Australia the government was required to adopt a market-based response to the gas shortage and therefore had only an indirect role in the allocation of available energy after the initial priority order had been determined.

31 Mr James Mitchell, Synergy, *Proof Committee Hansard*, 29 October 2008, p. 5.

32 Synergy, *Submission 29*, p. 8.

4.36 There was criticism of how available energy was allocated by Alinta:

Major users were initially offered a one model fits all rationed supply of 24hrs on 24hrs off with 12 hours notice. This failed to take into account the needs of heavy industrial users who required a minimum of 2-7 days supply to turn on and off kilns.³³

...a number of local governments, for example, received letters from their gas suppliers advising them that they would be 'cut off tomorrow' and to take actions forthwith. They were quite firmly worded letters. It was, in our view, within the contractual rights of the supplier to issue those letters, so we do not have any qualms with them from that point of view, but they appeared to some local governments and did not appear over the boundary, so people were quite unsure of the basis for them...

...I believe that they were Alinta clients in all cases...

...in some of those cases a letter was received advising that the gas would be terminated and then it was not.³⁴

I think it is important to understand how they did make the allocations of gas, how they did decide who got gas, when and for how long. One of the issues was that businesses would be told at five o'clock in the afternoon that they would get so many gigalitres of gas tomorrow for so many hours. In a lot of cases it took them perhaps two days to ramp the plant up to the temperature or the operating level they needed to actually start. The point was made a number of times that a lot of industries would prefer to get less gas more often, rather than a lot of gas in very short bursts. But when we were asking those questions of Alinta they were unable to give us any of that information.³⁵

4.37 In a media update issued on 2 July 2008 Alinta outlined some reasons for the difficulty in giving businesses advanced warning of outages:

Energy availability varies daily according to a number of factors, including the weather and residential demand. Consequently, if residential demand increases there will be less gas available to industry. At this time we can only allocate on a daily basis, but we are working hard to provide businesses most affected with as much information as is available so they can plan in advance.³⁶

33 Bunbury Wellington Economic Alliance, *Submission 2*, p. 1.

34 Mr Ian Duncan, Western Australian Local Government Association, *Proof Committee Hansard*, 2 October 2008, p. 78.

35 Mr Allan Birrell, Bunbury Chamber of Commerce and Industries, *Proof Committee Hansard*, 3 October 2008, p. 28.

36 Alinta, *Draft Media Update: Domestic Gas Supply, 2 July 2008, 4.30pm WST*, http://www.alintacustomer.com.au/varanus/pdf/Alinta_Media_Update_-_02_July_2008_4.30pm_WST.pdf.

4.38 The former Minister for Energy, Hon Fran Logan MLA, also noted that significant disquiet was raised, particularly by small customers, about the method Alinta used for the distribution of gas to its customers. Mr Logan informed the committee that:

The matter was raised with Alinta on a number of occasions and we were told that all available gas was distributed in a fair and reasonable manner. There are, however, no legislative means of being able to qualify or investigate these statements and so they had to be accepted on face value.³⁷

4.39 Mr Logan suggested that more powers should be given to the Office of Energy to demand greater transparency from Alinta. In his submission he stated that the Office of Energy:

...should be able to see, with all the right commercial confidentiality provisions in place, how much gas is being bought and distributed each day by the retailer, so that complaints by smaller consumers of being overlooked or unfairly treated, can be clarified.³⁸

Committee view

4.40 The committee received a substantial amount of evidence criticising the process used by Alinta to allocate available gas to industrial and commercial customers. The committee notes that energy availability would vary depending on a variety of factors, including weather and residential demand, and this would present some difficulties in allocating gas on a firm basis.

4.41 However, given the volume of evidence received by the committee relating to the allocation of available gas, the committee considers that the process used by Alinta to allocate gas during the shortage requires further investigation so that appropriate lessons can be learned for the future.

4.42 The committee also believes that greater transparency in how gas is distributed is required so that the government is able to verify how much gas is being bought and distributed each day by gas retailers. The government would therefore be able to examine complaints from small customers relating to their gas supply.

37 Hon Fran Logan MLA, *Submission 31*, pp 6–7.

38 Hon Fran Logan MLA, *Submission 31*, p. 6.