BRIEFING

28 JUNE 2002



1. CURRENT SITUATION

Timor Sea Treaty

The Timor Sea Treaty was signed between Australia and East Timor in Dili on 20 May. However, the Treaty needs to be ratified in order for phase two of the Bayu-Undan project to proceed. The Australian Government is insisting that unitisation of the Sunrise field be agreed to before the treaty is ratified. The East Timorese Government wants this dealt with as a separate issue.

The Northern Territory Government is hopeful the issue can be resolved earlier than the December deadline the two governments have set for themselves.

Bayu-Undan

The first (liquids stripping) phase of the Phillips Bayu-Undan project has begun, with the installation of wellheads and start of drilling in the Timor Sea. A Baker Hughes Inteq mud drilling plant has opened at East Arm Port, Toll Energy is establishing a supply base at Berrimah, and supply vessels are calling in regularly at East Arm Port.

The only matter holding up final commitment by Phillips is the treaty ratification.



LNG Plant at Wickham Point

Once the Timor Sea Treaty is ratified, Phillips will start work on its LNG plant at Wickham Point and pipeline from the Bayu-Undan field.

The Northern Territory Government this week released an environmental assessment report prepared by the NT Office of Environment and Heritage covering the expansion of the LNG site, from the already approved 3 million tonnes per annum to 10 mtpa. Strict environmental controls have been agreed to by Phillips (for more information see the Internet at either http://www.lpe.nt.gov.au or http://www.otd.nt.gov.au).

Sunrise

However, the main challenge is to get Sunrise gas to shore as this field is three times the size of Bayu-Undan. The Northern Territory Government welcomed the recent announcement by Sunrise partners Shell, Woodside and Phillips to reexamine the domestic gas case for Sunrise gas. However Shell and Woodside made it clear at last week's SEAAOC conference that they still prefer the floating LNG option and are focussed on what they feel is a more profitable American LNG market. Phillips believes there is a commercial case for domestic gas, as opposed to the floating offshore proposal which would see all Sunrise gas exported straight to America.

Federal Resource Minister Ian Macfarlane's latest public statements suggest he prefers the onshore option as being in Australia's best interests and carrying less technological risk, however he is watching with interest the debate on the relative risk and economics of the two projects.

2. WHAT HAS BEEN HAPPENING SINCE THE LAST TEAM NT MEETING?

- Chief Minister Clare Martin did an East Coast 'road show', winning support from influential bodies such as Bob Herbert of the Australian Industry Group, and from fellow Premiers for a special Council of Australian Governments (COAG) meeting to discuss the need for a national energy policy.
- Advertisements appeared in the *Australian Financial Review* and *Australian*, leading to strong interest from members of the public, who have been placed on a supporters' data base.
- The business group has mailed out a synopsis of its report commissioned from Dr Peter Brain and received strong support from about 450 Territory businesses, who have been placed on a database.
- A major outcome of **Team NT's** work was the announcement by the producers of a review of the domestic gas case.

- A team of senior Northern Territory government officials has travelled interstate to talk to gas customers.
- The Territory Government put its case at the recent SEAAOC (South East Asia and Australia Offshore Conference) in Darwin, where Chief Minister Clare Martin was a keynote speaker and Minister Paul Henderson opened the inaugural offshore expo. (See the Chief Minister's speech at http://www.otd.nt.gov.au).
- The business group has travelled to Canberra and met with numerous politicians, backbench committees and industry groups, winning strong support for the Territory's case.
- The Northern Territory Government prepared a detailed submission to the Parer Committee's Energy Market Review and has conducted presentations for many officials and Federal Parliamentarians, including Resources Minister Ian Macfarlane.

3. WHAT IS HAPPENING NEXT

- The Chief Minister meets next week with Queensland Premier Beattie and South Australian Premier Rann (interestingly at a time when power shortages and price increases have been front-page news in Adelaide).
- The developers are reviewing the domestic gas case.
- More meetings are planned with potential customers.
- Territory officials are meeting with the Commonwealth Government on the Timor Sea Treaty and unitisation.
- The Office of Territory Development is coordinating a range of studies, including:

    - market research into attitudes and awareness of the Sunrise campaign,
    - investment incentives required for foundation gas customers,
    - energy policies of overseas countries,
    - assistance offered to the North West Shelf Gas Project,
    - customers' needs, and
    - economic models.

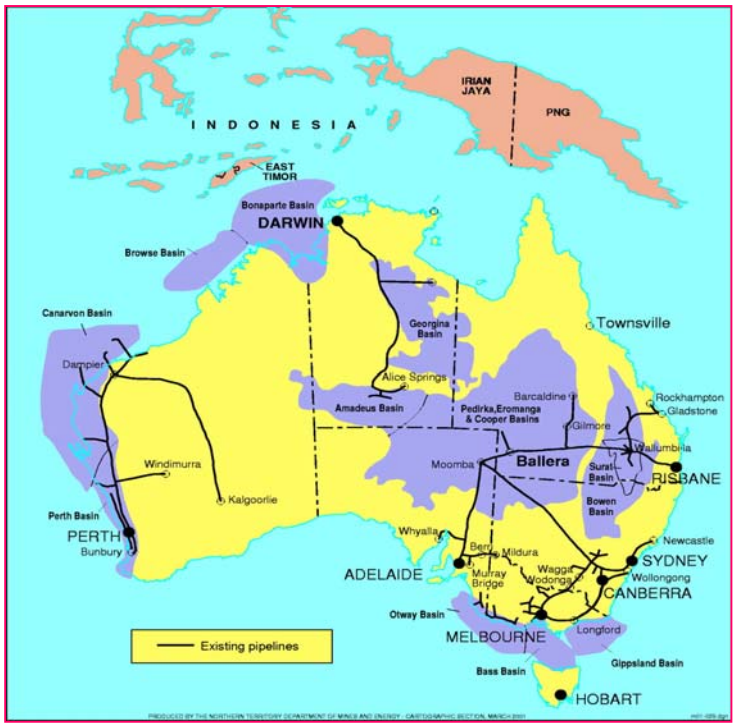
The next few weeks will be critical as we work with the Commonwealth Government, customers, industry groups, producers and industry groups to achieve the outcome we are seeking: Sunrise gas to shore.

4. THE TERRITORY'S MAIN ARGUMENTS

The Territory's gas supplies are declining: Industrial development in the Territory has been hampered by high energy prices. Current reserves in the Amadeus Basin are declining, which is threatening the security of the Territory's future energy supplies.

Regional development: Timor Sea gas will underpin the Territory's development, diversification of its economic base, and ability to wean itself off dependence on Commonwealth funding. Direct impacts include Darwin's role as Australia's fourth gas hub and a thriving supply and service industry. Equally important is competitively priced energy as a key input to industrial development, providing jobs and a wealth of multiplier benefits.

Value adding: A range of major projects is dependent on significant and price competitive gas supplies coming onshore. This includes a $3.6 billion aluminium smelter and power plant by Pechiney in Darwin, expansion of Alcan's Gove plant, a zinc smelter by MIM at McArthur River, a pipeline to the national gas grid at Moomba, minerals processing projects at Batchelor, and a range of gas-based industries.



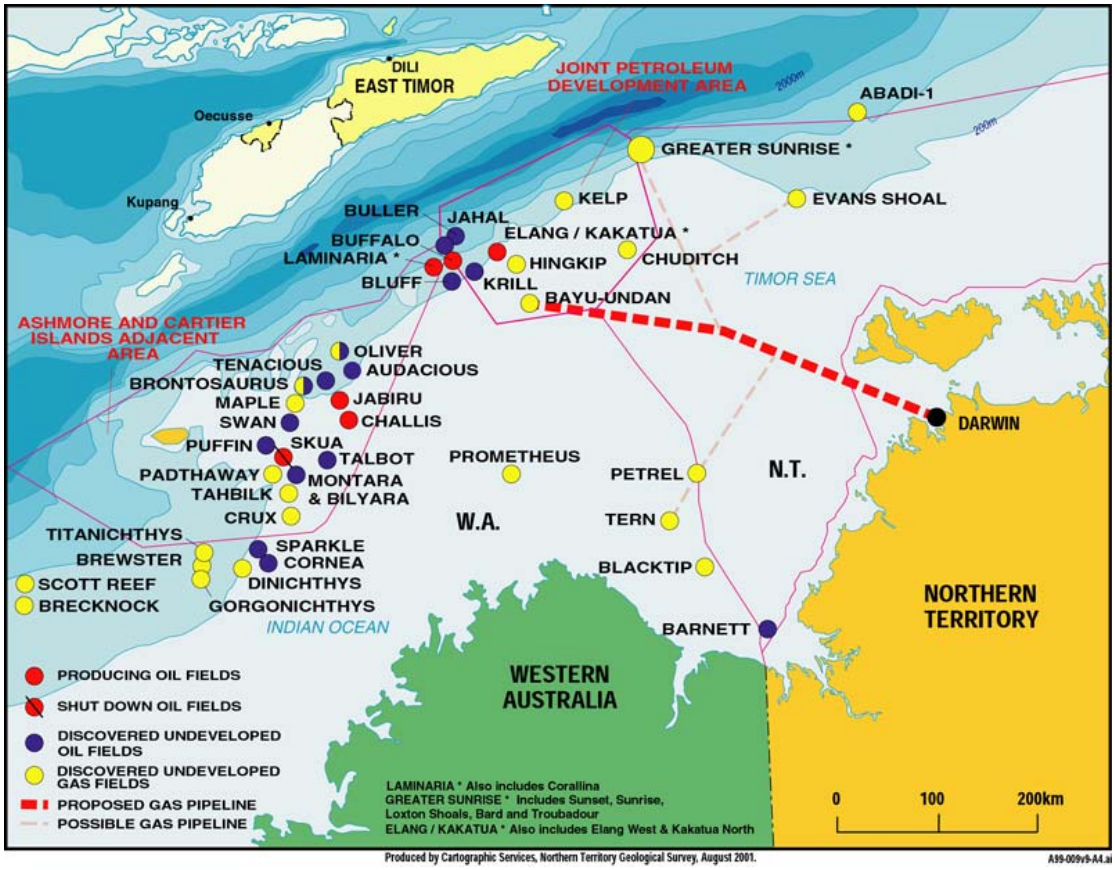
Don't 'dig it and ship it', transform it: The difference between offshore LNG and gas piped onshore is the difference between seeing a resource belonging to the Australia people simply shipped to America, without ever crossing Australian shores, or coming onshore to underpin economic development and allow a range of activities which transform minerals resources through processing in Australia, creating billions of dollars worth of exports. For example, the McArthur River smelter project would increase current concentrate output worth $130 million to exports worth about $970 - and MIM also wants gas for its Mt Isa and Century Zinc mines. In summary:

a) **offshore development**: a 'dig it and ship it' approach, where Australia gets royalties but no other benefits;

b) **onshore development**: an additional 4400 jobs for Australia, $15 billion in additional GDP over the life of the project, and an additional $100 million a year in government revenue.

However, customers need certainty of supply now. We have already lost major investors such as Methanex. French company Pechiney is threatening to go to South Africa because of the current impasse. Alcan has warned that its investment capital is mobile, even within global units of the company.

Other sources of supply just aren't the same: While prospective fields such as Evans Shoal, Blacktip and Petrel/Tern offer potential for the future, they are much smaller fields, at early stages of development, and the quality of their reserves is still uncertain. Bayu-Undan's 3.4 trillion cubic feet reserves are committed to the Japanese LNG market, while Sunrise's 8.4 tcf is the largest discovered field in the Timor Sea - large enough to provide for the Territory and Australia's immediate gas needs.



So why is Phillips taking gas offshore?: Phillips' LNG proposal occurred at a stage when the joint venture partners were talking about cooperative development of Timor Sea reserves, which catered for both exports and domestic gas use, with a shared pipeline to shore from Bayu-Undan and the Sunrise fields. The advantages of the shared pipeline also include improved economies of scale for development of other Timor Sea reserves. It makes sense to develop the Timor Sea as a province, rather than uncoordinated development of scattered reserves.

5. THE NATIONAL INTEREST ARGUMENT: ENERGY IS A STRATEGIC COMMODITY

In addition to commercial profitability, governments need to be concerned with benefits not captured by the producers:

- regional development
- Australia's economic development
- security of energy supplies for domestic and industrial users
- environmental benefits.

Australia needs to move up the value chain: The Australian economy is dependent on natural resources, which are subject to commodity price fluctuations. Australia needs investment in infrastructure, enhanced industrial capabilities and a maturer manufacturing sector.

Competitive advantage: A key source of competitive advantage for modern countries is competitive, plentiful energy supplies. If Sunrise gas is all exported, other countries will be buying our competitive advantage from us - just when we need it most.

Australia is running out of discovered, deliverable gas reserves: Long-term gas contracts signed 30 years ago start to run out in 2006, and there are clear signs of a tightening of gas supplies in states such as New South Wales and South Australia. If Australian gas customers are forced to become dependent on incremental development and short-term contracts, certainty and diversity of supply will be lost and prices are predicted to rise sharply over the next decade - at a time when ABARE is predicting gas demand will double by 2020.

There have been developments of coal seam methane gas as a possible alternative source, but results have been mixed and so far commercial production opportunities are limited.

Woodside and Shell argue they are facing a 'window of opportunity' for the American gas markets. Well, Australia is also looking through a window of opportunity to ensure long-term security and competitiveness of future gas supplies. Decisions which must be made by the end of 2002 will cast the die for the future of the Northern Territory and Australia.

Energy policy: At present, much of our energy is generated by coal-fired plants, which are cheaper than gas fired energy plants. However, the Council of Australian Governments (COAG) has committed to a move to cleaner sources of energy - which depends on plentiful gas supplies.

What is of growing concern to the States and Territories, however, is that, unlike other developed countries, Australia does not have a national energy policy providing a strategic approach to these issues.

Research commissioned by the Northern Territory's Office of Territory Development shows that countries such as America, Canada and England have policies which balance national interest with oil and gas producers' commercial interest - and this hasn't caused any 'flight of capital'.

International precedent

The United States has been aggressive in securing desired energy outcomes through use of legislation, legislative orders and regulatory policies. An Energy Market Policy Act (2002) now before Congress has bipartisan support and is designed to ensure the development of the North Slopes Alaska project to secure gas to the American energy market. Mechanisms include:

- a $10 billion subsidy to the producers
- securing a minimum price for the producers of $US3.25 per thousand cubic feet of gas.

From this investment, the American government will secure the development for the US energy market and dictate the size and route of the pipeline.

Canada is considering similar legislation to support the Mackenzie Delta Development project.

Why not leave it to market forces?

Market forces includes the danger of *market failure* of such a strategic national asset. A decline in gas reserves and deliverability for southern and eastern Australia, as well as the Northern Territory, will place upward pressure on gas prices, undermine security of supply, and reduce Australia's competitive advantage.

Market based policies do not capture wider benefits to the nation and represent a type of market failure. A national energy policy will provide these benefits, including:

- development of North Australia, including industry and enhanced infrastructure development, particularly gas transmission pipelines
- maintenance of Australia's competitive energy advantage through gas on gas competition
- environmental benefits through reduced carbon dioxide emissions as gas-fired energy plants displace other fossil fuels,
- increased security of supply
- national security benefits, such as increased population and diversified capabilities

What did the Commonwealth Government do for the North West Shelf?

The North West Shelf received billions of dollars in Commonwealth Government assistance in the 1970s because the Commonwealth and Western Australian Governments recognised the importance of this development for the nation. The Commonwealth secured priority for Western Australia's gas needs over gas for LNG export. Extensive financial assistance is estimated at $2 billion or 12.5% of the capital cost of the project. Benefits secured for Western Australia, not captured by the project's proponents, include:

- annual export revenues of $3 billion
- increased Gross State Product of $1800 million
- 44,000 direct and indirect jobs.

The same 'hands on' approach is sought for the Timor Sea, which will lead to similar benefits.

But the companies say their option is cheaper

There is a debate about relative costs of the project. However, we believe relative costs are higher for the floating LNG plant.

6. WHAT DO THE CUSTOMERS SAY?

We are not asking for charity. We believe the domestic gas customer case is commercial in its own right and offers profits for both the owners of the resource - the Australian and East Timorese people - and the producers.

Considerable research has been conducted to verify the domestic gas customer case, with encouraging results. Interstate customers have been visited and a breakfast was held with prospective customers during SEAAOC to confirm their needs for Sunrise gas.

Potential customers include Pechiney, Alcan, MIM, Epic Energy, Power and Water, Compass Resources, and Mt Grace. Other mining companies, such as Western Mining Corporation, Placer Dome Asia Pacific, Pasminco, Western Metals and Giants Reef support the need for gas onshore.

Customers do not share the confidence of Woodside and Shell in the ability of other sources of gas to meet Australia's medium to long-term gas needs. They cite declining reserves and technical problems in the Cooper Basin and Longford as examples of vulnerability to single sources of supply.

Industry groups: A range of major industry groups is expressing concern at the impact on their members if longer-term gas uncertainty contracts energy markets and constrains industrial development in Australia.

Epic Energy: Ms Sue Ortenstone, the CEO of Epic Energy, which wants to build a pipeline to Moomba, applauded the Territory Government for its stand on Sunrise gas. She said the pipeline would ensure "efficient usage of existing pipeline infrastructure", and that development of Australia's gas industry was at a fork in the road. All stakeholders had a role in determining the future path. She said the industry wanted a "supplier highway", not a "stagnant low-growth industry".

MIM: Mr Peter Lynch, of MIM, told the SEAAOC conference that the company was still using 1960s technology for its lead and zinc smelting operations and that MIM sends "shiploads of dirt" to smelters in Europe. The cost of transporting high bulk, low value product was making this business unprofitable. Gas from the Timor Sea or PNG would allow the company to build a smelter at its McArthur River Mine site, using new more environmentally friendly technology being trialed in Brisbane. This would ensure that value-adding occurred in Australia, with extra jobs and economic development, as well as enhanced profitability for the company.

Alcan: Mr Doug Grimmond of Alcan said the company wanted to expand its operations at Gove, as well as moving from its dependency on the world's only supplier of diesel fuel to cleaner gas-fired power. However, he warned, Alcan needs certainty of supply in order to expand its processing activities within the Territory. He pointed out that investment capital is mobile and much competition exists for this capital, even within Alcan. If the issue of gas supplies is not resolved soon, this investment can easily go elsewhere, whereas expansion will provide jobs and exports.

AGL: AGL is a major gas supplier in Australia and believes a window of opportunity exists for Timor Sea and PNG gas as long-term contracts signed in 1969 and 1970 start to expire. AGL forecasts a supply gap of up to 200 petajoules emerging in 2006 and a gap of between 200 and 400 petajoules from 2010.

PROTECTING OUR RESOURCE -

INVESTING IN AUSTRALIA'S FUTURE

