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21 March 2018

Australian Competition and Consumer
Commission
Level 2
23 Marcus Clarke Street
Canberra ACT 2601
Attention: Theo Kelly

Dear Theo

**AA1000398 Central and Macquarie Mereenie - Response to Power and Water Corporation
Submission dated 16 March 2018**

We refer to the submission lodged with the Australian Competition and Consumer Commission (**ACCC**) by Power and Water Corporation (**PWC**) on 16 March 2018 in response to the ACCC's Draft Determination to grant authorisation, published on 2 March 2018 (**Draft Determination**).

Central Petroleum Limited and Central Petroleum Mereenie Pty Ltd as trustee for the Central Petroleum Mereenie Unit Trust (together, **Central**) and Macquarie Mereenie Pty Ltd (**Macquarie Mereenie**), (together the **Applicants**) thank the ACCC for the opportunity to respond to PWC's most recent submission. For convenience and ease of reference, the Applicants address the matters raised in the PWC submission below in the same order they appear in the PWC submission.

1 Public Benefit – Increased Supply/Availability of Gas

PWC submit that in circumstances where the ACCC does not consider that bringing on additional gas supplies results from joint marketing, that bringing the additional gas to market sooner could not then be considered to be a public benefit. PWC further proposes that the Applicants ought to negotiate an agreement to facilitate separate marketing rather than pursuing authorisation of joint marketing.

Firstly, that is a misrepresentation of the reasoning in the Draft Determination. As the Applicant's understand the Draft Decision – the ACCC is clearly satisfied that greater gas supply is a public benefit, and gas supply occurring sooner is a public benefit. The ACCC's concerns relate to whether the greater gas supply would only be possible through the authorised conduct.

Secondly, it is a matter of basic economic principles that a benefit that occurs earlier (i.e. greater gas supply) is of greater benefit than a benefit that is delayed or deferred until a later point in time.

As outlined in the Applicants' submission dated 16 March 2018 (**the Applicants' Submission**), the Applicants strongly support the ACCC's view that bringing Mereenie gas to market sooner than what would occur if the Mereenie joint venture participants were required to negotiate a life of field balancing agreement clearly produces a material public benefit. Furthermore, as set out in the Applicants' Submission, the estimated timeframe in the Draft Determination for reaching agreement on a life of field gas balancing arrangement for Mereenie is highly optimistic such that even if it could be assumed that the field would be

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developed without authorisation, the delay would be significantly longer than the ACCC considered – being more in the order of years than months.

Thirdly, as noted in the Applicants' most recent submission the Applicants remain of the view that without the authorisation, the Mereenie development will not occur, given:

- (a) Central is not in an economic position to sole-risk the development of the Mereenie field (nor are all the developments required to maximise production from Mereenie capable of being sole-risked under the current terms of the Joint Operating Agreement dated 1 September 2015 (**JOA**)); and
- (b) Macquarie Mereenie is not economically incentivised to proceed with the developments necessary to meet the needs of east coast gas customers without joint marketing given that it currently has the rights and capacity to separately market the Mereenie gas (albeit limited by the Production Limit).

Authorising the joint marketing will result in the promotion of competition in the market (which the Applicants maintain is broader than the Northern Territory/Mt Isa region (**NT-Mt Isa region**)) given that this is the only circumstance in which Central or Macquarie Mereenie will supply to that market.

If the Applicants considered that those negotiations were viable in the short term, the Applicants would have pursued that avenue rather than the course of seeking authorisation. However, for the reasons set out in the Applicants' Submission, a life of field gas balancing arrangement at Mereenie is particularly difficult to negotiate given:

- (a) the material imbalance that has already built up through a combination of:
 - (i) the current gas imbalance that has arisen as a result of historical contracts that pre-date the current owners of Mereenie;
 - (ii) Central's existing sales;
 - (iii) the limitations on Macquarie Mereenie's ability to make its own sales prior to the completion of the Northern Gas Pipeline (**NGP**) – due to the limited uncontracted customer base that exists in the Northern Territory, customers seeking a larger volume of gas supply than Macquarie Mereenie can individually provide and the lack of existing pipeline connections to the East Coast Gas Market,which together create complicated commercial issues about how economic interests should be aligned and the gas balance should be restored. In the Applicants' view, joint marketing with the associated mechanisms to restore a balanced lifting position from sales opportunities through joint marketing address these commercial differences;
- (b) the illiquid and immature market for supply of Northern Territory gas into the East Coast Gas Market that initial sales will need to be made into still consists of 'lumpy demand' arising through a smaller number of opportunities to commercial and industrial customers, such that rebalancing through individual sales contracts will be difficult;
- (c) the current uncertainties about the full extent of reserves that will be economically viable to extract from the Mereenie field (which requires the proposed development including appraisal drilling to proceed);
- (d) the current uncertainties about the impact of gas pipeline tariff reforms, which will have a material impact on the cost profile and therefore economic life of the field; and
- (e) the current uncertainties about gas and energy policy and regulation more generally (both at a State and federal level), which impacts on both domestic gas demand (through gas fired generation capacity) and likely competing gas supply for the Mereenie field.

As already submitted, the reasons above resulted in the initial discussions between the previous Mereenie joint venture participant, Santos, and Central resulting in only the current interim balancing arrangement being reached and an impasse in respect of any permanent solution between the parties.

The Applicants do not at all consider that by authorising the joint marketing the ACCC would appear 'to reward the Applicants' delay in negotiating appropriate arrangements and bringing on the additional gas supplies' but rather, that the ACCC is promoting competition in the region by facilitating the increased supply of Mereenie gas which would not otherwise be available to the market for a number of years, if at all.

By providing authorisation for a limited initial period (that is well short of the life of the field) the ACCC is actually facilitating the transition to separate marketing, by allowing the Mereenie development to proceed with a view that the passage of time in which to negotiate new arrangements and the increased maturity / liquidity in sales from the Northern Territory to East Coast gas customers, will provide the Applicants with the necessary window to negotiate workable gas balancing arrangements from the remainder of the field's life.

Lastly, the Applicants consider that the size of the public benefit should not limit the ACCC's power to authorise the joint marketing. Given the ACCC's clear reference to the broad approach supported by the *Competition and Consumer Act 2010* (Cth) and the Tribunal (Draft Determination p. 38), the Applicants consider any argument made by PWC to the contrary to be misguided and inconsistent with the test the ACCC is required to apply under the Act.

2 Other Public Benefits

As outlined in section 6 of the Applicants' Submission, the Applicants maintain that the increased supply/availability of gas (also discussed above at section 1 of this submission), aggregation of gas volumes, cost savings and synergies and other benefits created in bringing Mereenie gas to market sooner creates substantial public benefits.

As outlined in section 6.2 of the Applicants' Submission, the Applicants have been approached by commercial and industrial customers seeking supply of a larger volume of gas, at a larger flow rate, for a longer period than either of the Applicants could supply alone (given the practical limitations of the Mereenie field and plant and the contractual Production Limit) such that aggregation of gas supply remains a material public benefit.

That large commercial and industrial customers do not value aggregation of gas volumes and instead value key supply terms such as 'price, term, firmness of supply and contracted quantity' is in itself, contradictory. Given that only a supplier with a large volume of available gas would be placed to negotiate such appealing supply terms by virtue of economies of scale, the Applicants consider it erroneous to suggest that there is no link between aggregated gas/larger gas volumes and negotiating other favourable supply terms. Authorising joint marketing by the Applicants facilitates competition in this market by enabling an additional competitor to enter. Moreover, given PWC is a supplier that aggregates gas from a number of sources (including Blacktip and supply from Central itself) to meet supply to its customers, the Applicants consider PWC's allegation that it 'does not believe the large commercial and industrial customers value the aggregation of gas volumes' lacks any real merit or real world experience on which it could have an informed opinion about that matter and fails to reflect PWC's own experience supplying to this market.

In respect of the argument that joint marketing would 'remove competitive tension' in respect of secondary capacity being traded between the Applicants and the service provider for the Amadeus Gas Pipeline and NGP or existing shippers, the Applicants maintain that the state of competition would remain the same with or without the proposed conduct. In both scenarios, there is only one supplier capable of bringing Mereenie gas to market. If authorisation is not granted, and in light of the fact that Central has contracted to its Production Limit, the sole supplier would be Macquarie Mereenie. Alternatively, if the authorisation is granted, the Applicants would jointly supply to the market to trade for secondary capacity such that there would not be any detrimental effect on the competitive tension. In fact, the Applicants contend that competition would be improved in circumstances where authorisation was granted, given that Central and

Macquarie Mereenie would be able to better compete with incumbent gas 'majors' than either of them could alone, given the relative size of the Applicants' gas marketing activities comparatively. PWC's arguments in relation to this issue also seem to ignore that it is highly possible that gas customers will contract the pipeline capacity, and that it should not be assumed that only gas suppliers would contract pipeline capacity.

3 Public Detriment

3.1 Competitors

As stated in section 7 of the Applicants' Submission, the Applicants support the ACCC's conclusions that:

- (a) the proposed conduct is likely to result in a clear public benefit in providing a timely supply of gas to the market and that the joint marketing of Mereenie gas is unlikely to result in any public detriment because it does not materially change the Applicants' ability to supply gas at higher prices and/or less favourable terms and conditions than they would likely achieve with separate marketing; and
- (b) commercial and industrial customers in the NT-Mt Isa Region are likely to have a number of alternative sources of supply and will assess the Applicants' offer against those of rival suppliers, including PWC from the Blacktip Field in the NT, Cooper Basin gas suppliers and, in the future, potentially Galilee Basin gas suppliers. These alternative sources of supply are likely to provide significant competition to the Applicants as well as constrain the Applicants' price and service offers to NT-Mt Isa customers.

PWC appears to continue to ignore the principal issue that Central, as a Mereenie Joint Venture Participant, is not a seller to any customers (in the Northern Territory or in the East Coast) in the absence of the authorisation.

Even if the NGP remains single direction, the Northern Territory gas prices (given the abundance of potential supply but limited demand in that jurisdiction) will be influenced by East Coast parity (on a net back basis taking into account transmission costs), such that it does not need to be possible for East Coast gas suppliers to sell into the Northern Territory in order for East Coast gas competition to constrain Northern Territory gas prices.

3.2 The day-ahead auction process

The Applicants consider it is largely moot to critique authorisation and speculate on the basis of what may come to pass as a result of a policy package which proposes to include a day-ahead auction process of contracted but un-nominated capacity.

That is the case because, where such an auction process was implemented, the Applicants do not consider that the concerns raised by PWC (principally that authorisation of joint marketing would limit competition in any day-ahead auction process as the only competitors in the process would be PWC and the Applicants jointly) would arise at all. First, Central would likely also compete in the day-ahead auction process with PWC and either Macquarie Mereenie or the Applicants jointly (depending upon the outcome of the authorisation) by virtue of Central's Dingo or Palm Valley gas supplies. Second, given that Central has currently contracted to the Production Limit and that resolution of any gas balancing agreement will not occur in the near term (if it can occur at all in the absence of the authorisation), if authorisation was not provided Central would still be precluded from marketing any Mereenie gas.

Consequently the likely state of the auction process both with and without the authorisation, is there only being three potential suppliers to any day-ahead auction (Central, PWC and Macquarie Mereenie, or Central, PWC and the Applicants jointly).

In fact, the Applicants consider there would clearly be more rivalry in any such auction process if authorisation were to be granted given that the joint marketing sought to be authorised would facilitate the

Mereenie development and result in the seller of Mereenie gas having far greater volumes of supply to potentially sell into any such auction process.

4 Balance of Public Benefit and Detriment

For the reasons set out above and in the Applicants' Submission, the Applicants strongly consider that the public benefits outweigh the anti-competitive detriment (if any) of the proposed conduct sought to be authorised, such that it is clearly appropriate for the ACCC to proceed to a final determination to grant authorisation.

5 Length of Authorisation

As discussed in the Applicants' most recent submission, the Applicants:

- (a) are willing to accept the proposed time periods for authorisation provided for in the Draft Determination in order to bring the regulatory process to a swifter end so that the Applicants can get on with the Mereenie development and plant upgrades with a view to bringing on the additional Mereenie gas supply by the time the NGP is commissioned; but
- (b) consider that the ACCC has been conservative in relation to the periods for which it can be satisfied that the public benefit outweighs the anti-competitive detriment, and that it should be able to be satisfied over the periods of authorisation initially sought by the Applicants.

In terms of the length of gas supply agreements that are needed:

- (a) the certainty being sought by large commercial and industrial customers; and
- (b) the need for long term contracts to underwrite the return of capital required for financing and investment in the development,

demands the capability to supply for a period at least as long as the period provided for by the ACCC (until 31 December 2028).

In terms of the length of time permitted to negotiate, the three year period provided is not very much time to negotiate arrangements where the opportunities for sales of Northern Territory gas into the East Coast gas market are still going to be fairly illiquid and 'lumpy' in nature.

Finally, as noted earlier in this submission and in the previous submission, the ACCC's estimated timetable for negotiation of a life of field gas balancing arrangement is highly optimistic, with the Applicants anticipating such negotiations will continue for a matter of years rather than a matter of months – such that the 3 year timeframe proposed by the ACCC is the absolute minimum period which would be appropriate. Many of the discussions around a gas balancing arrangement to date have raised difficulties around controls and information sharing on contractual terms which can only really be resolved with joint marketing.

The Applicants hope this response assists the ACCC in finalising its consideration of the authorisation application as swiftly as possible.

As always, please do not hesitate to contact me if you have any queries in respect of the above.

Yours sincerely



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Partner

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