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12 September 2000

Mr David Hatfield  
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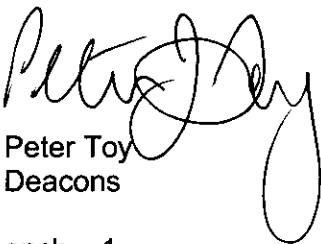
BY HAND

Dear Mr Hatfield

**PNG GAS - APPLICATION FOR AUTHORISATION IN RELATION TO  
 PRE-FINANCIAL CLOSE JOINT MARKETING**

We refer to our telephone conversation today in relation to the above matter and enclose a further copy of the Applicants' submissions in support of the application for interim authorisation filed on 7 September 2000. Would you please substitute this version of the document for the version filed with the application.

Yours faithfully

  
 Peter Toy  
 Deacons

encl: 1

**Lawyers**

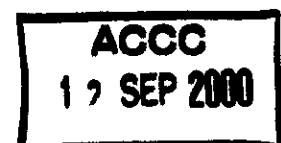
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# **PNG Gas Project**

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**Application for Authorisation to the Australian  
Competition and Consumer Commission**

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**12 September 2000**

## 1. Introduction

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The Papua New Guinea Gas Project (*Project*) involves a proposal to commercialise the gas reserves located in Papua New Guinea by developing the gas fields and by constructing a pipeline from Papua New Guinea to Queensland.

The Applicants listed in **Annexure 1** to the Application Form B have made an application for final authorisation under section 88(1) of the *Trade Practices Act 1974* (TPA). The application relates to joint marketing of Project gas that will occur prior to “Financial Close”.<sup>1</sup>

Although the participants in the Project do not believe their proposed activities would breach the TPA, they seek authorisation under section 88(1) and, in the short term, interim authorisation under section 91(2) of the TPA for contracts, arrangements and understandings which may breach section 45 of the TPA.

Authorisation is sought to allow the Applicants, who are participants in the Project, to discuss and establish the common terms and conditions (including price) upon which natural gas produced by the Project will be offered for sale and to jointly market the gas to customers in Australia (hereinafter referred to as joint marketing). The Applicants seek interim authorisation pending consideration of this application.

Some of the Applicants<sup>2</sup> have the benefit of prior interim authorisations for conduct associated with joint marketing activities preceding the date of this application<sup>3</sup>. As a consequence of marketing and feasibility studies, it has become apparent to the Applicants that the substantial amount of gas required to support the viability of the Project is not available from the gas fields of the original applicants alone. The Applicants now consider that the only way in which gas resources required by the Project will be brought to the market is if development and production from additional fields is part of the Project. Furthermore, the very nature of the joint venture and the requirements of customers for gas in Australia means that separate marketing is not feasible at this time.

In order for the Project to deliver first gas within the time frame sought by the customers in Queensland, the Project will need to commence detailed engineering as

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<sup>1</sup> Financial Close is the time at which key approvals and agreements required for the Project to proceed are obtained and reached. They include conditional gas sale agreements having been entered into, firm financing having been obtained and regulatory approvals necessary for the Project to proceed having been obtained.

<sup>2</sup> The Applicants other than ExxonMobil and Santos - refer to notes [4] and [5].

<sup>3</sup> These applications will be withdrawn contemporaneously with the grant of the interim authorisation sought by this submission.

a matter of priority. The decision to do so is predicated on the existence of the commercial agreements underpinning the Project, including the conditional gas sales agreements (*GSAs*). It is necessary to undertake the joint marketing activities for which authorisation is sought in order to arrive at *GSAs*. Because the Applicants do not wish to be exposed to the risk of contravention of section 45, interim authorisation is necessary to permit this joint marketing to proceed.

## **2. Background**

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### **2.1 Explanation of the Project**

The Project involves a proposal to commercialise gas reserves located in Papua New Guinea by developing the gas fields, including the installation of gas gathering lines and a gas processing plant. In addition, the Project includes the construction of a pipeline from Papua New Guinea to Queensland. The Project is based on production from various licences (Petroleum Development Licences or *PDLs* and Petroleum Prospecting Licences or *PPLs*) over fields in which the participants in the Project have an interest.

A Heads of Agreement (*HOA*) was executed in May 2000 between the PDL1 Owners Group and the PDL2 Owners Group to enable the Project to source the gas from the Hides, Kutubu, Gobe and Moran fields. The PDL1 Owners Group comprises the licensees of PDL1 (Hides Field) and PPL138 (a portion of Moran Field) whilst the PDL2 Owners Group comprises the licensees of PDL2 (Kutubu Field and a portion of Moran Field) and PDL4 (Gobe Field).

The PDL1 and PDL2 Owners Groups consist of various corporate entities, including ExxonMobil<sup>4</sup> and Santos<sup>5</sup>.

Gas from various fields will be combined into a single stream for preliminary processing into wet gas at the central processing facility. The wet gas is to be transported to an offshore processing and extraction plant, referred to as a marine processing facility, at which the wet gas will be converted to dry gas. The dry gas will be transported from Papua New Guinea to Queensland via a dry gas pipeline running from Papua New Guinea to Cape York, through Townsville and Gladstone, terminating in Brisbane. The current expectation is that the Project would supply

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<sup>4</sup> The ExxonMobil companies involved in the PNG Gas Project are: Esso Highlands Limited, Ampolex (PNG Petroleum) Inc, Merlin Pacific Oil Company Limited and Ampolex (Highlands) Limited (hereinafter referred to as *ExxonMobil*).

<sup>5</sup> The Santos companies involved in the PNG Gas Project are: Zan Star Limited and Lavana Limited (hereinafter referred to as *Santos*).

approximately 3.2 tcf of gas to Queensland pursuant to GSAs.<sup>6</sup> The Applicants intend to pursue conditional GSAs with customers such as Ergon Energy Pty Ltd (*Ergon*) and Energex Holdings Limited (*Energex*)<sup>7</sup> in terms that are acceptable to all producers. Ergon and Energex will on-sell gas to end-use customers including Comalco Limited (*Comalco*) and Stanwell Corporation Limited (*Stanwell*).<sup>8</sup> The Applicants are willing to, and may, enter into conditional GSAs with Comalco and Stanwell and others, but their understanding is that these customers prefer to source their supply through Energex and/or Ergon.

The amount of capital investment required for this Project will be substantial. Current estimates are approximately US\$2.5 billion. An operation of such immense scale will require the full co-operation and alignment of all participants, both to provide their own resources and to spread the risks associated with the Project.

## 2.2 Previous Authorisations

On 24 June 1998 applications were made<sup>9</sup> for final authorisation including an authorisation in relation to section 45 conduct. On 5 August 1998, the ACCC granted an interim authorisation for various arrangements in relation to the Project (*1998 authorisation*). In June 1999, the applicants to the original authorisation applications sought a modification of the 1998 authorisation to remove Mobil and BHP as applicants and to clarify the terms of the 1998 authorisation.

The ACCC revoked the 1998 authorisation and substituted a revised interim authorisation on 3 December 1999 (*1999 authorisation*). Following on changes in the Project participants, the prior applications and interim authorisations are no longer applicable. It is intended that the previous applications be withdrawn and the interim authorisation be revoked contemporaneously with the grant by the ACCC of the interim authorisation sought by this submission.

## 2.3 Current circumstances

As indicated above, the gas reserves of the original applicants will not be sufficient of themselves to meet the requirements of foundation volumes necessary for the Project. For the Project to be viable, it requires a substantial quantity of gas from the

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<sup>6</sup> The 3.2 tcf will be comprised of 1.2 tcf originating from the PDL2 fields and 2.0 tcf originating from the PDL1 fields.

<sup>7</sup> Energex (Allgas) sought, and was granted, interim authorisation (#A50025, A50024 and A90691) last year of its market aggregator arrangements.

<sup>8</sup> Comalco is planning to establish a gas fired alumina refinery and cogeneration facility at Gladstone and Stanwell proposes to build a gas fired power station at Townsville.

<sup>9</sup> By the Applicants other than ExxonMobil and Santos.

PDL1 gas field (Hides), in which both ExxonMobil and Santos have an interest. It is not commercially practicable for the Project to acquire gas from some but not all of the PDL1 producers because the PDL1 producers own the gas in common by virtue of their being joint licensees of that permit.

*(a) Necessity for co-operative development*

The Applicants have had to agree to co-operative development of their gas in order to secure sufficient resources to enable them to pursue an economically viable project. In doing so, they have recognised that the substantial undertaking involved in this Project requires the sharing of capital costs for infrastructure and field development.

Co-operative development of the fields can only be undertaken if the producers' long term interests in selling the gas being jointly developed and produced are aligned. All of the producers must have an interest in the gas from the point of initial production, through processing, transport and delivery to customers, over the entire term of each GSA. The Project cannot proceed unless all the producers have a common commitment to develop and sell the resource, with each seller participating in all costs, risks and rewards.

*(b) Necessity for joint marketing*

The Project can only proceed if all of the gas producers jointly market the gas and become direct contractual parties to the GSAs.

The nature of the Project and the nature of the gas resources preclude the Applicants from entering into separate negotiations with potential customers and requires that all Project producers sell on common terms. This is the only commercially feasible method of achieving the required alignment of commercial interests, risks and liabilities as between the Project producers.

With respect to the issue of separate marketing, the market into which the Project gas will be sold is a contract or project based market, similar to the markets considered by the ACCC in the North West Shelf and Mereenie Authorisations. The ACCC recognised in the North West Shelf Determination that a project or contract market does not support separate marketing. The ACCC expanded on the reasoning for this conclusion in its 1998 submission to the Upstream Gas Working Group Enquiry. In that context, the ACCC submitted that, for separate marketing to occur,

the following features must exist in the relevant market, which, in this case, would be the Eastern Australian energy market:

- a large number of customers creating a diverse gas demand profile;
- a number of competitive suppliers;
- a range of transportation options creating a pipeline grid;
- storage close to demand centres;
- brokers/aggregators providing supply and/or demand aggregation services as well as bundled supply packages;
- gas-related financial markets; and
- significant short term and spot markets.

As none of these conditions, with the possible exception of quantity of suppliers and customers, exist in the relevant market (and are unlikely to exist for some time), it is clear that separate marketing is not feasible. Any arrangement other than joint marketing would not be practicable in the circumstances. If all producers, for example, are not part of the same commercial agreement, each may have different long term interests with respect to the development and sale of the gas. Different long term interests could lead to a breakdown in the Project or at the very least substantially hamper its ability to function efficiently. Accordingly, if the Project is to go ahead, the Applicants must be able to jointly market the jointly-produced Project gas.

*(c) All Producers are required as Sellers*

It is not commercially practicable for the Project or one or more of the participants to acquire and on sell the gas of ExxonMobil or Santos. Such an alternative would essentially require those participants to bear the responsibility for delivering the ExxonMobil or Santos gas. The risk of default would not lie with ExxonMobil or Santos (because they would not be bound by GSAs with buyers) but with those other participants. This could only occur if some or more of the participants would be prepared to accept a disproportionate share of the risks associated with the gas. These options have been explored by the producers and have been found to be unworkable.

### **3. Interim Authorisation Under the Trade Practices Act**

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#### **3.1 Introduction**

This document should be treated as an initial submission in relation to final authorisation, and a complete submission in relation to the interim authorisation that is sought by the Applicants.

Section 91(2) of the TPA empowers the ACCC to grant interim authorisations without making a decision on the merits of the primary application for authorisation. If granted, interim authorisation allows applicants to engage in the relevant conduct as if it had received final authorisation while the substance of the application is reviewed by the ACCC. The Applicants submit that a grant of interim authorisation does not involve a high standard of proof because of the very nature of the authorisation to be granted. It is an interim authorisation and therefore should not require the kind of proof that is required in a final authorisation.

The Applicants are seeking interim authorisation for contracts, arrangements or understandings in relation to common terms and conditions (including price) upon which gas to be produced by the Project will be marketed and offered for sale to customers prior to Financial Close.

#### **3.2 Need for interim authorisation**

The Project producers need to be able to discuss price and other terms and conditions for the sale of gas with one another to enable gas to be marketed to potential customers. The Applicants are aware that contracts, arrangements or understandings arising among them in the context of these discussions have the potential to contravene section 45 of the TPA. They do not wish to be exposed to the risk of such a contravention, and accordingly, the Project cannot proceed unless interim authorisation or some other form of clearance is obtained. In the short term, an interim authorisation must be obtained as it is critical that marketing proceed as soon as possible. The Applicants anticipate that it would take at least 6 to 9 months to obtain final authorisation and that amount of time is not available in the current circumstances.

#### **3.3 Interim authorisation would not irreversibly alter market structure**

The ACCC's guide on authorisations states that interim authorisation is unlikely to be granted "where the effect of allowing the proposed conduct to occur would prevent



the market [from] being able to return to substantially its pre-interim authorisation state if the [ACCC] later denied authorisation."<sup>10</sup>

If interim authorisation is granted, the Applicants, now including ExxonMobil and Santos, will engage in joint marketing of gas to secure conditional GSAs required for the Project with a view to securing the GSAs necessary to underpin the Project as soon as possible. Failure to obtain interim authorisation for joint marketing will prevent the Project producers securing the necessary GSAs and will effectively end the Project. In that event, the suppliers and buyers of the gas will be in the same position as prior to the interim authorisation, namely, there will not be any marketing of Papua New Guinea gas in Queensland at all. These GSAs are not affected by the authorisation and their anti-competitive effects, if any, can be addressed separately by the ACCC at the appropriate time. Similarly, if the parties to individual GSAs have trade practices concerns, they may notify the agreements pursuant to section 93 of the TPA or seek authorisation.

### **3.4 Interim authorisation would not create any anti-competitive detriment**

The Applicants note that, notwithstanding section 91(2A), the issue of anti-competitive detriment may be considered by the ACCC to be relevant to its decision as to whether to grant interim authorisation.

The Applicants maintain that the appropriate market definition for considering whether any anti-competitive detriment will arise is the Eastern Australian energy market. However, irrespective of whether the ACCC adopts a narrower relevant market for the purposes of this application, the Project would not result in any such anti-competitive detriment.

#### *(a) No anti-competitive detriment in market for energy*

The Applicants submit that the Project would not result in any anti-competitive detriment in the Eastern Australian energy market.

Gas currently competes with other forms of energy such as coal, oil and electricity. The substitutability among these various forms of energy, such as gas and coal for electricity generation, depends on the nature of the project requiring the relevant energy source. Gas delivered under the Project will compete directly with coal, oil, other liquid hydrocarbons and, in some cases, gas and will substantially increase the amount of energy and the variety of sources of energy available to the market.

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<sup>10</sup> *Guide to authorisations and notifications*, November 1995, p 9.

As noted below in the discussion of public benefits, Queensland has been primarily dependent on coal, oil and other liquids (ie. diesel) to satisfy energy demands, with gas representing only 5.2% of primary energy demand in Queensland.<sup>11</sup> Accordingly, as Project gas will primarily be consumed in electricity generation, it will compete initially mainly with coal and not with Queensland gas. On this basis, market conditions are such that any increases in the participants' share of an energy market as a result of PNG gas sales would not have a substantial effect on competition.

*(b) No anti-competitive detriment in natural gas market segment*

Even if the ACCC adopts a narrower view of the market, the grant of an interim authorisation will not result in any anti-competitive detriment. The most common detriment generally argued to arise from joint marketing arrangements involves the possible increase in price or a restriction of output, either generally or by limiting supply to specific customers or geographic areas.

Although it is not explicit, the ACCC's exclusion of Santos in the 1999 authorisation, by stating that "maintaining separation between Santos and the Project is important if significant competition in the supply of gas in Queensland is to continue to develop" may reflect such a concern.<sup>12</sup> It would appear that the ACCC believes that competition will develop between Santos and the Project only if Santos is excluded.

However, the Applicants cannot see how the Project will go forward without access to the gas of all of the Project producers. Because separate marketing is not feasible, all of the producers need to be included in the joint marketing arrangements. The exclusion of any producer is likely to lead to a termination of the Project, with a corresponding significant detriment to the Queensland and Australian economies.

Neither ExxonMobil nor Santos supply gas in Queensland in sufficient quantities to be considered a competitor of the Project. Nor would the nature of joint venture arrangements result in either Santos or ExxonMobil dictating terms of an anti-competitive nature. Such an outcome would be wholly unacceptable to the other participants in the Project.

### **3.5 Public benefits**

Section 91(2A) of the TPA excuses the ACCC from the need to address the issues of public benefit and detriment when considering an application for an interim authorisation. Despite section 91(2A), an analysis of public benefit may still be

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<sup>11</sup> "Gas Statistics Australia 2000", the Australian Gas Association, page 51.

<sup>12</sup> See 1999 authorisation letter from Mark Pearson, General Manager, Regulatory Affairs - Gas, ACCC, dated 3 December 1999, p 2.

relevant to the consideration of such an application, particularly where, as suggested by the 1999 authorisation determination, the ACCC is willing to consider anti-competitive detriment. In such circumstances, the ACCC should also be willing to weigh any alleged detriment against the public benefits of the Project.

*(a) Definition of public benefit*

In *Re 7-Eleven Stores Pty Ltd*<sup>13</sup> the Trade Practices Tribunal explained the concept of public benefit.

Public benefit has been, and is, given a wide ambit by the tribunal as, in the language of QCMA...,' anything of value to the community generally, and any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress'. Plainly the assessment of efficiency and progress must be from the perspective of society as a whole: the best use of society's resources.

In 1991,<sup>14</sup> the Trade Practices Commission identified the following broad categories, among others, which may constitute a public benefit:

- economic development, such as encouragement of capital investment;
- promotion of business efficiency, especially where it results in enhanced international competitiveness;
- expansion of employment or prevention of unemployment in efficient industries, and employment growth in particular regions;
- development of import replacements and growth of export markets; and
- measures to protect the environment.

*(b) Public benefits associated with the PNG Gas Project*

The Project would promote competition and greater efficiency in the energy market in Eastern Australia, encourage capital development and investment in Australia, increase employment and reduce potentially harmful emissions.

The most direct public benefit from the Project will be the increased competition and efficiency of the energy market. Currently gas only constitutes a small portion, approximately 5.2%, of the Queensland primary energy demand.<sup>15</sup> It is not used extensively for power generation. In addition to its use as a fuel, natural gas is also used in Queensland as a major feedstock, particularly in the manufacture of fertiliser.

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<sup>13</sup> (1994) ATPR 41-357

<sup>14</sup> *Re ACI Operations Pty Ltd* (1991) ATPR (Com) 50-108

<sup>15</sup> *Supra* note [11].

Coal is the predominant source of energy in Queensland and is the main competitor with PNG gas. This is due at least in part to the relative scarcity of adequate gas supplies in Queensland. The Project would increase the amount of gas supplied from the current levels of approximately 75PJ per annum by an additional 100 to 200PJ/a, thereby enabling greater competition in the energy market, particularly as fuel for power generation.

As the cost of supplying fuel for electricity generation and large-scale industrial applications falls, generation and industrial applications will become more competitive and efficient. A stable supply of competitively priced gas (and electricity) will encourage capital investment by creating capacity in the Queensland energy market to support expansion of current operations and development of new projects. For example, gas is already used in chemical, fertiliser and explosives manufacture in Queensland. The availability of additional gas will encourage those sectors to expand. It will also promote business efficiency generally, where reduced energy supply costs and increased availability of energy will result in lower or contained unit production costs across many sectors.

The implementation of the Project will increase employment opportunities in Queensland and in the rest of Australia in four ways:

- It will create a large amount of employment in order to construct the pipeline and oversee the initial Australian set up;
- It will create a smaller number of permanent positions in Queensland to oversee the operation and maintenance of the pipeline;
- It will expand employment in the manufacturing and industrial sectors (the primary large users of gas) by expanding the fuel market and encouraging growth of current gas using facilities, and by attracting new projects; and
- It will expand employment in downstream sectors by increasing the availability of gas and lowering the prices of gas and electricity.

There is increasing international pressure to reduce greenhouse gas emissions. Coal fired power generation creates more greenhouse emissions than does natural gas. By guaranteeing a stable source of competitively priced gas, electricity generators and large industrial users will be encouraged to use more efficient gas fired systems. This is in keeping with the Queensland Government's recently released "Cleaner Energy Policy" and Australia's international commitment to cleaner energy policies.

#### **4. Conclusion**

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For the reasons set out above, joint marketing is an essential precursor to the Project proceeding. Joint marketing will not create any anti-competitive detriment.

Additionally, the public benefits associated with the success of this Project (and accordingly with the proposed joint marketing conduct) are very considerable.