



Ayres, Lisa

From: Marjory Morris [Marjory.Morris@sd.qld.gov.au]
Sent: Monday, 25 September 2000 2:10 PM
To: 'lisa.ayres@accc.gov.au'
Subject: Application for authorisation of Joint Marketing by PNG Gas Producers



Ltr to Ms Kanwaljit Kaur,
ACCC...

Please quote: MN11920
Contact officer: Ray Garrard
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Ms Kanwaljit Kaur
Acting General Manager
Regulatory Affairs Division - Gas
Australian Competition & Consumer Commission

By Email: lisa.ayres@accc.gov.au

Dear Ms Kaur

Re: Application for authorisation of Joint Marketing by PNG Gas Producers

Thank you for the opportunity to provide comments in relation to the application by the PNG Gas Producers for interim authorisation to jointly market gas.

The Queensland Government is committed to developing competitive gas markets and in this regard has recently released an Energy Policy which is aimed in part at facilitating increased competition and development in the gas industry. The Queensland Government believes that the PNG Gas Project can potentially play a significant role in achieving this objective and in light of this and broader public benefit issues would support the granting of an interim authorisation to the PNG Gas Project.

The attached Submission outlining the Queensland Government's comments raises a number of issues in relation to the role that PNG Gas Project could play in:

- developing a national gas grid;
- supplying interim and long term gas to north Queensland;
- stimulating regional development throughout central and north Queensland; and
- diversifying the State's energy mix.

I urge you to consider the issues raised in this Submission and look forward to your early deliberation on this matter.

Yours sincerely

Ross Rolfe
Director-General

PNG Gas Project

Application for Interim Authorisation for Joint Marketing

Queensland Government Response

22 September 2000

Introduction

The Queensland Government is committed to developing competitive gas and electricity markets. Queensland has the potential to become a major gas user for value adding industries and electricity generation, but this potential is being constrained by limited supplies and a lack of price competition.

The Government's Energy Policy released in May 2000 introduced a number of major initiatives to facilitate increased competition and development in the gas industry. The key objectives of the Energy Policy are to:

- diversify the State's energy mix towards the greater use of gas and renewables;
- facilitate the supply of abundant and competitively priced gas in Queensland;
- facilitate the development of gas fired power stations, particularly a base load power station in Townsville; and
- reduce the growth in greenhouse gases.

The Government's comments in relation to the application for joint marketing by the PNG Gas Producers are framed in the context of this Energy Policy and address the following issues:

- the necessity for Santos and ExxonMobil to joint market;
- anti-competitive concerns about joint marketing;
- the existing gas supply situation in Queensland;
- developing a national gas grid;
- gas and electricity supply in north Queensland; and
- the Queensland Government's Energy Policy.

The Necessity for Santos and ExxonMobil to Joint Market.

The Queensland Government acknowledges that the commercial complexity of the PNG Gas Project would increase significantly if gas from the Santos and ExxonMobil interests was not jointly marketed. This is especially the case in the absence of mature gas supply and

transportation markets. The extra burden of any added commercial complexity could serve to create significant delays which could have serious implications for the PNG Gas Project.

The Queensland Government supports the application for interim authorisation of joint marketing by the PNG Gas Producers in order to secure establishment, foundation and other necessary loads to establish the commercial viability of the project. The Queensland Government accepts that at an appropriate time after the development of the Project, the ACCC may wish to review any final authorisations that may be granted to determine whether market developments or changes in circumstances would warrant a continuation of joint marketing arrangements.

The PNG Gas Producers contend that joint marketing is necessary because gas reserves of both Santos and ExxonMobil are required to meet the needs of foundation customers.

The Queensland Government has been advised that the PNG Gas Project needs to secure annual contract quantities ramping up to 550 TJ/day, with these quantities lifted annually under 20 year contracts.

These quantities are significantly higher than was first proposed. The higher volumes have arisen in part because of the extension of the PNG Gas Project to Brisbane and the realignment of establishment and foundation loads to include more gas-fired generation. The PNG Gas Project must meet the market in terms of the price required for this gas fired generation to be competitive in the market.

Anti-competitive Concerns about Joint Marketing

The PNG Gas Producers claim that neither ExxonMobil nor Santos supply gas in Queensland in sufficient quantities to be considered a competitor to the Project.

The majority of gas currently sold in Queensland is supplied from South West Queensland Gas Producers (SWQGP) and the Denison Trough which are fields in which both Santos and ExxonMobil have significant interests. Santos and ExxonMobil combined control 81 per cent of the SWQGP gas while Santos has a 50 per cent interest in the Denison Trough.

The development of the PNG Gas Project is expected to result in a quantum growth in the Queensland gas market from around 90PJ/a to in excess of 260 PJ/a. A substantial proportion of this market growth is expected to be in central and north Queensland where Santos/ExxonMobil are unlikely to have any significant market share (especially for establishment or foundation loads) beyond 2004 when existing Denison Trough contracts are expected to expire.

Although there may not be substantial head-to-head competition between PNG Gas Producers and Santos/ExxonMobil in central and north Queensland markets some competition would be expected in south east Queensland markets especially for industrial loads. In addition there is the prospect that PNG Gas would be supplied to markets in South

Australia and possibly New South Wales where it would be competing directly with Santos/ExxonMobil interests.

To overcome market concerns about any anti-competitive pricing behaviour the ACCC could request that ring-fencing arrangements are put in place between the marketing groups and organisational and board structures within Santos and ExxonMobil. The Queensland Government questions the effectiveness of such ring-fencing arrangements in quarantining information about price and other commercial issues. The more significant issue is to ensure that Santos and ExxonMobil are not able to use any market power to effectively set the price in both the PNG Gas Project and South West Queensland Gas.

The PNG Gas Project is well advanced and needs to finalise contracts with establishment and foundation customers in order to proceed to financial close. Granting of an interim authorisation will allow the PNG Gas Project to proceed with commercial negotiations and any competition issues could, if necessary, be addressed in the final authorisation determination and in any consideration of gas sales agreements.

A key issue in considering the application for joint marketing is whether any reduction in competition arising from joint marketing is outweighed by the broader public benefit and longer term competitive benefits in the energy sector that would arise from granting authorisation. These broader public benefit issues are addressed in the remainder of this submission.

The Existing Gas Supply Situation in Queensland

The south west Queensland (SWQ) portion of the Cooper Basin is currently the major supplier of gas for Queensland supplying markets in Brisbane and Mount Isa/north west Queensland. Currently no SWQ gas is sold in the central Queensland market. The Cooper Basin in South Australia currently supplies the Sydney market and the South Australian market and about 30 PJ/a of SWQ is also committed to South Australia until 2007.

The Central Queensland market is currently supplied from the Denison Trough with existing reserves largely committed to QAL until 2004. Additional reserves in the Denison are being proven but are not of sufficient quantity to enable long term contracts to be offered. Coal Seam Methane is playing an increasing role in supplying markets in both central and south east Queensland but largely on a short term or "as available" basis. Santos has recently signed a gas supply contract for gas from its Scotia field to supply a new 385 MW gas fired power station proposed by CS Energy at Swanbank.

The depletion of the Surat and Denison Basins means that Queensland will become increasingly reliant on gas from south west Queensland. These reserves are limited and likely to be committed to supplying existing markets or markets in South Australia or New South Wales rather than markets in central and north Queensland.

Unless additional sources of gas, which are competitively priced and abundant, are connected to Queensland's growing industrial areas in central and north Queensland then these regions will be restrained in meeting their full industrial potential as major mineral processing centres in Australia.

The most likely sources of competitive and abundant gas supplies available to the State in the future are Coal Seam Methane, PNG Gas or gas from the Timor Sea.

A National Gas Grid

The ACCC should also consider the role the PNG Gas Project could play in developing a national gas market and the implications of this for future competition in the gas industry.

A significant obstacle to developing a truly national gas market in Australia is the construction of an interstate natural gas pipeline grid.

The PNG Gas Pipeline has the potential to be an integral part of a national grid. It could link the markets of north, central and south east Queensland as well as gas markets in South Australia, Northern Territory, New South Wales and Victoria.

The big winners from the development of a national gas market would be the customers. Gas prices would fall due to increased competition and the customer would have a greater choice of supply options. Contestability of markets should, in time, remove inflexibilities in existing contractual arrangements and allow customers to negotiate the term of gas contracts they prefer. Eventually a mature national gas market would see increasing spot sales of gas and gas swaps.

Increased competition in the gas industry as a result of the interconnection of gas networks is estimated to yield \$1 billion in economic benefits over 35 years, double the benefits that arise from creating a national electricity grid.

Achieving the significant gas sales volumes that the PNG Gas Producers state are necessary for the project is likely to require the sale of PNG Gas to markets outside of Queensland. In the medium to longer term customers in southern markets are expected to be short on gas and therefore these markets offer a potential opportunity for PNG Gas. The extent to which the PNG Gas Producers actively explore opportunities to sell PNG Gas into South Australia or New South Wales, in competition with existing supply sources, will be a test of the producers commitment to developing competitive gas markets.

Gas and Electricity Supply in North Queensland

The development of a gas-fired base load power stations in north Queensland and supply of competitively priced gas is fundamental to the successful implementation of the Government's development strategies for north and central Queensland. Townsville is

currently not supplied with gas and local industry relies largely on power transmitted long distances and at considerable cost from central Queensland.

A base load power station is therefore needed in Townsville if the region is to fulfil its potential as the pre-eminent base metals processing centre of the Asia/Pacific region. The location of base load generation in north Queensland will help reduce electricity prices to industry especially if generators are co-located with industry.

In the absence of world-competitive gas and electricity tariffs in the north, Australia will miss valuable mineral processing opportunities.

In order to facilitate the supply of gas and base load generation in Townsville the Queensland Government in its recent Energy Policy announced that:

- the Government will work with the developers of the PNG gas pipeline, AGL Petronas to advance the construction of the Townsville- Gladstone section of the PNG Gas Pipeline; and
- subject to the successful facilitation of gas into Townsville, the Government will build a gas fired power station in Townsville or negotiate the conversion of one or more existing peaking power stations in Townsville to gas and base load operation.

The Queensland Government is aiming to have the Townsville-Gladstone Pipeline and power station in Townsville commissioned by end 2002. This will require interim gas supplies to be sourced until longer term gas supplies are available from PNG or other sources which is expected around 2004.

The PNG Gas Producers could play a significant role in facilitating the supply of interim gas in north Queensland by negotiating swap or other arrangements with either Denison Trough or SWQ gas producers or from other supply sources. This may require Santos and ExxonMobil to consider issues including commercial terms and conditions across a number of business units, and if possible this should be considered and supported under any interim joint marketing authorisation by the ACCC .

PNG Gas and the Queensland Government's Energy Policy

The PNG Gas Project could result in a quantum change to the energy mix in Queensland and presents an opportunity for the State to:

- secure abundant and competitively priced gas throughout Queensland;
- obtain base load electricity generation in North Queensland which is important if the region is to maximise its full industrial potential;

- stimulate new gas based regional development throughout central and north Queensland;
and
- secure a cleaner fuel source which could help mitigate the adjustment costs and maintain the State's competitive advantage if legally binding greenhouse emission targets are enforced.

These broader benefits underpin the Queensland Government's Energy Policy and they should be a consideration of the ACCC in assessing the application by the PNG Gas Producers.