



**Australian
Competition &
Consumer
Commission**

Issues Paper

PNG Gas Project

Application for authorisation

December 2004

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Introduction

On 14 December 2004 the joint venture participants in the PNG Gas Project applied to the Australian Competition and Consumer Commission (ACCC) for authorisation to:

- negotiate the common terms and conditions (including price) under which gas produced by the project will be offered for sale
- jointly market that gas to a common buyer or common buyers
- enter into and give effect to contracts, arrangements and understandings between the participants relating to common terms and conditions (including price and price arbitrations/determinations) upon which gas will be offered for sale and sold by the participants to buyers.

The applicants have requested that authorisation be granted for the life of the project. They have also requested that the authorisation be expressly stated to apply to future participants in the project.

Authorisation is a process whereby the ACCC has the power to grant immunity from court action by the ACCC or any other party for certain arrangements or conduct that might otherwise breach the *Trade Practices Act 1974* (the Act).

The PNG Gas Project involves the development of petroleum fields in the Southern Highlands of PNG and the marketing of natural gas produced from those fields to Australian customers. The gas will be transported to customers via a pipeline from PNG to Queensland.

The applicants are certain companies within the Exxon Mobil Group and the Oil Search Group, the Mineral Resources Development Company Limited group of companies, and Merlin Petroleum Company.

The applicants originally submitted an application for authorisation in 2000 and an interim authorisation has applied since then. For various reasons, including delays to the PNG Project itself, this matter has not progressed beyond the interim authorisation stage. The application for authorisation recently submitted by the applicants updates the previous applications.

Following recent announcements that the project will now proceed to Front End Engineering and Design (FEED) phase, it is now timely that the matter be progressed to final determination.

Submissions sought

The authorisation assessment conducted by the ACCC is a public process and the ACCC therefore seeks comment in the form of written submissions from interested parties.

This issues paper is intended to assist interested parties in preparing their submissions to the ACCC by highlighting the key information and issues in the applicants' submission on which the ACCC seeks comment. In addition to commenting on matters raised in this paper, interested parties may bring to the ACCC's attention additional issues they consider to be relevant.

Submissions should be addressed to:

Mr Mike Buckley
General Manager
Regulatory Affairs – Gas
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602

All submissions must be in writing and should also be supplied in electronic form, if possible. The email address is gas@acc.gov.au.

The closing date for submissions is 15 February 2005.

Copies of the applicants' submission and supporting material can be found on the ACCC's website <http://www.accc.gov.au> under 'Gas'. Previous applications by the project participants and submissions from interested parties can also be found on the ACCC's website.

If you have any inquiries, please contact either John Bastick on (02) 6243 1364 or Helen McPhee on (02) 6243 1245.

Confidentiality

Unless confidentiality is requested, submissions will be made publicly available and placed on the ACCC's public register and website.

If you wish to include information that is confidential, it should be clearly marked as such and a claim for confidentiality for the material should also be submitted. Please provide reasons why you consider the information to be confidential. You will be informed of the outcome of that claim and if it is refused the relevant material will be returned to you on request.

Material for which confidentiality is granted will not be publicly available, but will be taken into account by the ACCC in considering whether to authorise the conduct.

Guidelines for confidentiality claims are attached.

The authorisation process

The application was made under section 88(1) of the Act. Specifically, the applicants have sought authorisation under section 88(1):

- to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act
- to give effect to a provision of a contract, arrangement or understanding which provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

Before granting authorisation (under section 90(6) of the Act in this case) the ACCC must be satisfied in all circumstances that:

- the provisions of the subject arrangements or conduct would result, or be likely to result, in a benefit to the public
- that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed arrangements were made or given effect to.

In assessing public benefits and detriments, the ACCC will consider the likely position in the future with and without the proposed arrangements.

Based on this assessment, the ACCC may decide to grant authorisation, grant authorisation subject to conditions, or decline to grant authorisation.

Prior to making its final determination, the ACCC will prepare and distribute a draft determination stating its proposed decision and setting out its reasons. Once the draft determination is published, interested parties may request a pre-decision conference to discuss the ACCC's draft determination.

Interested parties will have the opportunity to make further submissions in relation to the draft determination. The ACCC will subsequently issue its final determination.

Key issues for consideration

Market definition

The ACCC assesses the public benefits and detriments arising from the conduct for which authorisation is sought in the context of the relevant markets.

Market definition is crucial in assessing the impact of the proposed arrangements on the level of competition. Defining the market too broadly would lead to an understatement

of market power, as some producers and sellers would be inappropriately included. Likewise, defining the market too narrowly would result in an overstatement of market power, due to the exclusion of relevant producers and sellers.

On the issue of market definition, the Australian Competition Tribunal (the Tribunal) stated in *Queensland Cooperative Milling Association (1976) ATPR 40-012 at 17, 247*:

We take the concept of a market to be basically a very simple idea. A market is the area of close competition between firms, or putting it a little differently, the field of rivalry between them... Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another in response to changing prices. So a market is a field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.

Market definition can be considered in the context of product, geographic and functional markets. Markets should also be considered within a time frame, as over a longer time frame substitution possibilities will usually be expanded.

The applicants have submitted that:

- the product market is energy
- the geographic market is eastern Australia
- the functional market encompasses retail and wholesale of gas and electricity.

The applicants also submitted that in the gas and electricity industries it is appropriate to consider substitution possibilities with other forms of energy over the long term.

Issues

Product market

Is the product market a gas market or, as the applicants have submitted, a broader energy market?

Can users readily switch between gas and other forms of energy?

If switching between forms of energy is occurring, is this being driven by price or other factors?

To what extent can suppliers of different forms of energy switch between gas and electricity or other forms of energy.

Are coal seam methane producers in competition with the PNG producers?

Geographical market

Is the geographical market eastern Australia, as submitted by the applicants, or a narrower market?

Are other gas producers in competition with the PNG producers?

Functional market

Does the functional market encompass retail and wholesale, as submitted by the applicants?

Temporal aspect

Over what time frame should substitution possibilities be considered?

How will the product, geographical and functional markets evolve over time?

Feasibility of joint marketing

The applicants have submitted that separate marketing for the PNG project is not feasible and are emphatic that the project will not proceed unless authorisation is granted. In support of their submission the applicants have referred to reports by KPMG and Lateral Economics which discuss the issue of joint marketing in the gas industry.¹

¹ KPMG, Report to the CoAG Energy Market Review, *Separate Marketing of Natural Gas in Australia*, October 2002.
Lateral Economics, A Supplementary submission to the Energy Market Review, *'Accomplishing precisely nothing': Requiring joint market producers to market their gas separately*, September 2002.

Issues

Would the project be likely to proceed in the absence of joint marketing?

If the project does not proceed, are other producers in a position to meet the gas needs of the market?

If so, would the sale of that alternative gas likely to be under separate marketing or joint marketing arrangements.

Is separate marketing feasible for the PNG Gas Project?

Are you aware of any instances in Australia where separate marketing has occurred (for either natural gas or coal seam methane)? If so, please provide details.

Public benefits and anti-competitive detriments

Public benefit is not defined in the Act. In *7-Eleven Stores Pty Ltd (1994) ATPR 41-357 at 42,677*, the Tribunal discussed the concept of public benefit in the following terms:

Public benefit has been, and is, given a wide ambit by the Tribunal as, in the language of QMCA ‘anything of value to the community generally, any contribution to the aims pursued by the 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. We bear in mind that (in the language of economics today) efficiency is a concept that is usually taken to encompass ‘progress’; and that commonly efficiency is said to encompass allocative efficiency, production efficiency and dynamic efficiency.

In summary, the applicants have identified the following benefits accruing directly to the Australian public:

- economic development, including the encouragement of capital investment, and fostering regional development
- increased inter-basin and inter-fuel competition and the provision of an essential supply of gas to eastern Australia
- fostering business efficiency, including improved international competitiveness
- employment growth
- development of import replacements and growth in export markets
- environmental protection.

In addition, the applicants have submitted that the economic benefits accruing to PNG will enhance regional security and thus directly benefit Australia.

The Tribunal has also given a broad interpretation to the concept of anti-competitive detriment. In *7-Eleven Stores Pty Ltd (1994) ATPR 41-357 at 42,683* the Tribunal said:

In the present context, anti-competitive detriment refers, in the language of s. 90(6) to 'the detriment to the public constituted by any lessening of competition that would result, or be likely to result, from the system under examination. As with the assessment of benefit we give the characterisation of the 'detriment to the public' a wide ambit, namely, any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency, in the sense we have adopted.

The applicants have submitted that there are no anti-competitive detriments associated with the joint marketing of PNG gas. On the contrary, they have submitted that the PNG project will be pro-competitive. Even if the ACCC were to find that there are some anti-competitive detriments, the applicants have submitted that these would be substantially outweighed by the public benefits.

Issues

Public benefits

What are the public benefits associated with the arrangements for which authorisation is sought?

Apart from any anti-competitive detriments, are there any other factors intrinsic to any of the purported public benefits which would mean less weight should be given to those benefits?

Anti-competitive detriments

What are the anti-competitive detriments?

To what extent would the proposed conduct for which authorisation is sought lessen competition:

- between participants in the PNG joint venture?
- between gas basins?

Do the PNG project participants have market power?

If separate marketing is feasible, would this lead to lower prices than those that would prevail under joint marketing?

What additional costs are associated with separate marketing?

Would separate marketing lead to a less efficient development of the gas fields than joint marketing?

Would any benefits of separate marketing be offset by increased transaction costs and/or reduced efficiency?

Would gas users prefer to deal with each participant individually, or with one party acting on behalf of all participants under joint marketing arrangements?

Weighing process

Do the public benefits outweigh the anti-competitive detriments?

Scope of the authorisation

Section 90(1) of the Act states that ACCC may:

- (a) make a determination in writing granting such authorisation as it considers appropriate; or
- (b) make a determination in writing dismissing the application.

The applicants have requested that the authorisation be expressed to include future participants to the project. This request is derived from section 88(10) of the Act, which broadly states that an authorisation may be expressed to apply to another person who becomes a party to a contract, arrangement or understanding at a time after it is made.

The applicants have not expressly identified who those participants might be. However, they stated:

There is some scope for these interests [the interests of the participants] to be amended, including as a result of the decision of the Independent State of PNG as to whether it will exercise its right to participate further itself or through a nominee in the Upstream Joint Venture ...²

It is noted that Santos has a 31 per cent interest in one of the fields proposed to be developed as part of the project, but at this time is not a participant in the project. Santos was an applicant to the previous application for authorisation, but later withdrew from the project.

Issues

Should the ACCC grant authorisation?

If so, should it be to the same extent as requested by the applicants? If not to the same extent, how should the authorisation be varied?

Should authorisation be extended to future participants in the project?

If so, should conditions be imposed?

Should it be limited to certain companies?

Should certain companies be expressly excluded?

Conditions

Section 91(3) of the Act allows the ACCC to grant authorisation subject to conditions.

² Allens Arthur Robinson, Submission to the Australian Competition and Consumer Commission in support of an application for authorisation, *PNG Gas Project*, 14 December 2004, p. 12.

Issues

If the ACCC grants authorisation, should conditions be imposed on the applicants?

If so, what conditions should be imposed?

Term of the authorisation

Section 91(1) of the Act states that an authorisation may be expressed to be in force for a specific period.

The applicants have submitted that the authorisation should apply for the life of the project. The previous application was expressed to apply up to financial close only.³

Issues

Should authorisation be granted for the life of the project?

If not, what time limit should be placed on the authorisation?

Should the authorisation be granted up to financial close only?

³ Financial close is defined as the time when key approvals and agreements required for the project to proceed are obtained and reached. They include conditional sales agreements having been entered into, firm financing having been obtained and regulatory approvals necessary for the project to proceed having been obtained.

Appendix: Guidelines for confidentiality claims

The process whereby the ACCC assesses applications for authorisation is public, transparent and consultative. The Trade Practices Act (the Act) requires the ACCC to maintain a public register in respect of authorisation applications.

Applicants and interested parties can request that a submission, or a part of a submission, be excluded from the public register.

The ACCC is required under the Act to exclude from the public register upon request details of:

- secret formulae or processes;
- the cash consideration offered for the acquisition of shares in the capital of a body corporate or assets of a person; or
- the current manufacturing, producing or marketing costs of goods or services.

The ACCC also has the discretion, under s89 of the Act, to exclude material from the public register if it is satisfied that it is desirable to do so, either by reason of the confidential nature of the material or for any other reason. The ACCC expects that a party claiming confidentiality on these grounds will present a case for its treatment in this manner.

Under Regulation 24 of the Trade Practices Regulations, when a request for confidentiality is made to the ACCC:

- where the request is that a whole document be excluded, the words “**Restriction of Publication Claimed**” should appear in red writing near the top of each page; and
- where the request is that part of a document be excluded, the words “**Restriction of Publication of Part Claimed**” should appear in red near the top of the first page of each document, and the part for which confidentiality is claimed should also be marked in red. A submission of more than 5 pages should also include a description of the whereabouts of the parts for which confidentiality is claimed.

However, even if a document does not meet these technical requirements, the ACCC may still grant confidentiality where, in the ACCC's view, it is desirable to do so.

If the ACCC denies a confidentiality request, the requesting party may ask that the material be returned. As a matter of practice, the ACCC will specify a period (usually 14 days) in which they can request the return of such material. Upon response, the ACCC will return the original material and destroy all associated copies. The ACCC will not consider this material when reaching its decision.

If the ACCC does not receive a response within the specified period, the original material will be placed on the public register.

Information or documents granted confidentiality may be used by the ACCC pursuant to its powers generally under the Act.