15 February 2005

energex

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

Dear Mr Buckley

ENERGEX welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (ACCC) Issues Paper regarding the PNG Gas Project (the Project) Application for Authorisation.

ENERGEX strongly supports and encourages the development of the Project. Its successful completion would be a welcome development for the gas industry in Australia, particularly for Queensland. ENERGEX is also firmly committed to the operation of competitive markets. As such, it has some concerns regarding the PNG Participants' application for authorisation to joint market.

ENERGEX would first like to make some general comments about the proposed arrangement:

- The Participants state that even if the ACCC found that a substantial lessening of competition was involved, this would "clearly" be outweighed by the public benefits of the Project. The position is put that, absent the indefinite Authorisation, the Project is either unlikely to or would not proceed, denying benefits to the Australian public.
- ENERGEX understands that in making a determination to grant an Authorisation, the ACCC undertakes an assessment of the public benefits and the anti-competitive detriments of the proposed arrangement. ENERGEX believes that this means that the 'future-with-and-without test' should be considered in the context of joint marketing rather than in the context of the Project. The Participants do not appear to have identified any public benefits associated specifically with the proposed joint marketing arrangements.
- The Participants have put that the 'future-with' test is a joint marketing arrangement with the Project proceeding. The Participants have also put that the 'future-without' test is separate marketing without the Project proceeding. ENERGEX questions whether the viability of the Project in fact relies on joint marketing for the life of the Project. If the Project does not require an Authorisation for the life of the Project, the 'future-with' test is a joint marketing arrangement with the Project proceeding and the

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'future-without' test is separate marketing with the Project proceeding. As the public benefits claimed by the Participants are associated with the Project itself, the public benefits exist under both the 'future-with' scenario and the 'future-without' scenario.

- In any event, any public benefits associated with the proposed Authorisation are likely to be offset to a significant extent by two matters. The first is the resource misallocation resulting from the restraining of price competition. The second is the additional costs imposed by a monopoly margin.
- An Authorisation for the life of the Project would likely result in monopoly pricing and higher costs. ENERGEX is of the view that granting what would in effect be a permanent monopoly status to the Participants would be untenable.
- ENERGEX acknowledges that the Project's successful development would produce benefits for the gas industry in Queensland. ENERGEX recognises the need for a joint marketing arrangement for the period to financial close to allow the timely and efficient development of the Project. ENERGEX respectfully suggests that the period of any Authorisation should be for a period of not more than three years post financial close with no possibility of renewal. In addition, any future joint venture partners should be subjected to the ACCC's Authorisation process and not be automatically covered by an existing Authorisation. An Authorisation for a period of three years should facilitate the project reaching financial close and provide the Participants with a short period to transition to a competitive market.

ENERGEX's specific reasoning and concerns are outlined below.

The Participants have put forward the 'future-without' scenario that the ACCC should consider is one without the Project. That is, the 'future-without test' is not a comparison of without joint marketing but rather without the Project proceeding. The Participants argue that the Project will not proceed should the ACCC authorise a joint marketing arrangement for any period less than the life of the project (30 years).

ENERGEX questions the requirement of a joint marketing arrangement for the viability of the project. The Interim Authorisation granted by the ACCC in 2000 should provide the Participants with a sufficient period to secure the necessary foundation contracts that would provide the basis for the Project to successfully reach financial close. Foundation contracts would ordinarily form the basis for securing project finance as these contracts should provide a firm, steady revenue stream over the life of the Project.

Another argument posed by the Participants is that separate marketing post financial close is not feasible as they believe that it "would be extremely difficult, if not impossible, for some of the Participants to separately market Project gas". ENERGEX understands that the available gas reserves associated with the joint venture have been artificially divided by the Participants into two sections - Project gas, which is subject to the Application for Authorisation and Non-Project gas, which is subject to separate marketing arrangements. ENERGEX also understands that many of the Participants are already separately marketing Non-Project Gas. It therefore appears that some, if not all, of the Participants have the capability to separately market gas.

ENERGEX is also aware of other instances where at least some of the Participants are separately marketing gas within Australia. ENERGEX is also aware of other joint venture arrangements in Australia (including Queensland) where separate marketing arrangements operate successfully.

The Participants raise the difficulties associated with establishing a gas-balancing arrangement as another reason for requiring a joint marketing arrangement. While ENERGEX agrees that gas demand in Queensland currently develops largely on a project basis, imbalances can be addressed with a gas-balancing arrangement forming part of the joint venture agreement. There are other joint ventures in Queensland currently operating successful gas-balancing arrangements that do not require joint marketing. ENERGEX does not believe that there are any specific circumstances that would prevent the Participants implementing a similar arrangement. The implementation of a gas-balancing arrangement should also alleviate concerns regarding the likelihood of a less efficient development of the gas fields under a separate marketing arrangement compared with a joint marketing arrangement. With the operation of a gas-balancing arrangement, the joint venture agreement is likely to be able to effectively manage additional capital requirements for further development stages.

In addition, ENERGEX considers that the current concerns regarding the lumpy nature of demand in the Queensland gas market should begin to be alleviated over the coming years. In particular, there are indications that the market is moving towards a more integrated and liquid market. A current work stream for the Ministerial Council on Energy (MCE) relates to gas market principles with the objective of developing fundamental principles and design concepts to guide the future development of Australian gas markets. ENERGEX believes that the project nature of the gas market in Queensland should diminish over time, albeit slowly. As a result, while the Participants' concerns regarding imbalances can be addressed with a gas-balancing arrangement, the reliance on this arrangement should reduce over time as the market for gas in Queensland, and in Australia, becomes more physically integrated.

The Participants have also stated that they "believe there to be a customer preference to negotiate with a single commercial operator, and to treat the Participants as a 'unit'". ENERGEX sees a place for joint marketing for the Project up to financial close. Joint marketing will facilitate a timely conclusion to the development stage of the Project thereby providing customers with some assurance that the Project will proceed. However, ENERGEX is of the view that it may choose to negotiate with an individual Participant at a future date for the purchase of gas and does not have a preference for negotiating with the Participants as a 'unit' post financial close.

With the decline of the Cooper Basin gas reserves, ENERGEX expects that, for at least some periods over the life of the Project, the Project will dominate the gas supply available for ENERGEX to contract with in Queensland. Authorising a joint marketing arrangement for the life of the project may result in monopoly prices and terms and conditions for at least those periods where the Project has market power. ENERGEX is concerned that a joint marketing arrangement for the life of the Project may impose conditions within gas supply agreements that would be unlikely to be imposed if the Project was to be separately marketed. For example, ENERGEX may wish to optimise price, terms and conditions and such other elements as credit risk to procure a package that best meets its needs. By joint marketing, dynamic efficiencies are likely to be lost. Specifically, innovation may be stifled, as the Project will be marketed with common prices and terms and conditions.

Further to this, even if the ACCC were to authorise a joint marketing arrangement for a lesser period, ENERGEX opposes the automatic inclusion of any new joint venture partners to the joint marketing arrangement. ENERGEX has concerns that existing producers may be able to use their position in the joint venture to leverage their other commercial interests in Australia if a joint marketing arrangement is authorised. This would lead to a decline in competition.

In summary, ENERGEX questions the validity of the public benefits claimed by the Participants. It considers that an appropriate assessment of the application for Authorisation by the ACCC involves an evaluation of the joint marketing arrangements. In any event, ENERGEX questions the requirement for joint marketing to make the Project viable.

An Authorisation for the life of the Project would likely result in monopoly pricing and higher costs. ENERGEX respectfully suggests that the period of any Authorisation should be for a period of not more than three years post financial close with no possibility of renewal. In addition, any future joint venture partners should be subjected to the ACCC's Authorisation process and not be automatically covered by an existing Authorisation. An Authorisation for a period of three years should facilitate the project reaching financial close, providing the Participants with the necessary foundation contracts to secure project finance and provide them with a short period to transition to a competitive market.

If you have any questions or require further information, Mr Richard Abraham, A/Regulatory Affairs Manager – Retail, is available on (07) 3407 1863.

Yours sincerely

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