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Mr Scott Gregson
General Manager Adjudication
ACCC
470 Northbourne Ave
Dickson ACT 2602

Dear Mr Gregson

APPLICATION BY WOODSIDE ENERGY, BENARIS AND CALENERGY FOR JOINT MARKETING OF LPG FROM OTWAY GAS PROJECT

Background

Elgas Ltd is a major purchaser of LPG in Victoria for sale into both the traditional and autogas sectors of the LPG market.

Elgas is interested in purchasing LPG from the Otway participants.

The Yolla LPG Project

As background to our views, we note Elgas' experience of the following marketing arrangements for the Yolla LPG Project which is very similar to the Otway Gas Project in that it:

- is a land-based extraction of LPG from offshore natural gas without access to export facilities;
- is a similar size;
- has a similar number of participants – several who are common to Otway.

The LPG associated with this project will commence production early in 2006 and be distributed to the market from Lang Lang. There are four producers associated with this development. The ownership structure is set out below.

- Origin Energy - 37.5%
- AWE - 30%
- Calenergy - 20%
- Wandoo - 12.5%

This structure will change shortly when Calenergy sells 5% of its entitlement to Origin Energy.

Elgas negotiated separately with AWE, Calenergy and Wandoo and has signed separate supply contracts with each of them. Total LPG production from this source is forecast at 80,000 tonnes per annum. This is smaller than the proposed Otway LPG production.

The process of negotiating LPG supply contracts with the market has been relatively straightforward with the majority of the operational issues resolved through truck (hauliers) lifting arrangements that are well established. The marketers assume this responsibility through simple lifting contracts with LPG haulage operators. These haulage operators have more than two hundred trucks and have managed the lifting of product at producer loading facilities for many years. They have also managed the impact of their operations on the community by observing regulatory and specific regional requirements where needed. These requirements are strictly controlled by regulations and the haulage operators are well versed in this operational mode.

Comments on Clayton Utz Submission to ACCC

1. Factual Material (Section 3)

   We make no comment on the basic background LPG Market material other than to note that we have been informed that during 2006 ExxonMobil will cease LPG supply from its Altona refinery to the market as all LPG produced will be sold to Qenos as feedstock.

   However, the competition analysis is not correct in the following respects:

   - Otway sits approximately mid-way between Melbourne and Adelaide and the only basis for describing it as falling within a "Victorian" LPG market is a function of where the state borders lie.

   - In Elgas' experience while Victoria has a net surplus of LPG over its consumption, there is extensive transportation between Victorian and South Australian supply and demand points as well as transportation between Victoria and other states including Tasmania and NSW. Further, there is extensive ripple or knock-on competition through transportation between NSW and Queensland. Substantial quantities of Victorian produced LPG are shipped in coastal tankers to a number of Queensland locations. Elgas is one company that undertakes such transport but it is also understood that other distributors optimise supply and demand opportunities through extensive interstate transport. In summary, the Otway basin sits within a broader LPG market.

   - The suggestion that there is no "market for butane in Australia" is not correct in two senses. Firstly, there are small quantities of butane consumed in addition to the mixed propane/ butane supplied to the autogas sector. Secondly, in Elgas' experience, through the ability for butane to be mixed to greater and lesser extents with propane for autogas applications, Elgas considers there is a single LPG product market for all propane and butane sales. This is evidenced by the very close price correlation between propane and butane.

- In summary, Elgas is aware that there is strong evidence that the market into which the Otway LPG will be sold is a market that includes at least all LPG (propane and butane for traditional and autogas applications) covering at least Victoria, South Australia, New South Wales, the ACT and much / all of Queensland.

- Elgas rejects the suggestion that the "traditional market sector is dominated by three customers: Elgas, Wesfarmers Kleenheat and Origin. In particular:

  - LPG distribution is a business activity that has very low barriers to entry. LPG can be sourced from a range of suppliers. Transportation is procured, and can be procured, readily from third party trucking companies. Storage facilities can readily be located on a wide range of industrial land and generally the tanks and cylinders can be readily purchased and re-sold. There is ample evidence of such entry.

  - Particularly as the crude oil and, therefore, LPG prices rise significantly, LPG distribution industry is under extensive threat from and ever more competitive array of substitutes such as electricity, natural gas, diesel and wood.

  - The oil majors between them have a more significant LPG business than the above companies. They have in the past, and could in the future, market LPG to the traditional sector.

  - Thus, Elgas finds that to remain viable between the squeeze of competition upstream and downstream, it must compete vigorously across all aspects of price, service and innovation.

- In fact, all sectors of the LPG market are dominated by LPG producers:

  - While the LPG industry is an important one, for producers, LPG is a secondary product line. Producers only have LPG to sell if they have invested either in a natural gas production business or a crude oil refining business. Therefore, the barriers to entry to LPG production on a stand-alone basis are, for all practical purposes, insurmountable.

  - If the producers were concerned in any way as to the alleged "dominance" of distributors, they can (and occasionally have) entered or sponsored entry to the distribution sector.

- The description of Australian LPG pricing is not correct:

  - Elgas strongly endorses the notion that Australian wholesale LPG prices are linked to international prices and the Saudi CP in particular.

  - The ability and extensive practice of LPG imports dictates that over a reasonable period the ceiling on Australian wholesale LPG prices is the import parity price.

- At present, the predominant determinant of prices (whether or not the supplies are drawn from Esso/BHP or other sources) in the Otway region is the export parity price from Esso/BHP adjusted for transportation costs.

- However, there is a likely potential for competition from Otway and Yolla sources to impose further downward pressure on wholesale LPG prices. Joint marketing arrangements between the Otway producers could significantly reduce that potential.

2. Buyer's Freedom of Choice (Section 4.2)

   Elgas is willing (and sees no practical barriers) to purchase from the individual participants.

3. Oversupply (Section 4.3)

   The Victorian market is "oversupplied" in terms of the total LPG production, with the balance being exported.

   LPG wholesale prices are thus internationally based, with a floor currently of export parity.

   One consequence of this is that the market has had to bear steep rises in the wholesale prices in recent years, broadly linked to rising oil costs.

   Elgas would hope that the Yolla and Otway projects, and any additional such projects, would provide an alternative source to existing supplies which would not necessarily be export parity priced. The local over-supply situation referred to by Clayton Utz and noted above would become more acute and, the fact that Otway and Yolla are not located near to export facilities, could create the potential for the South Eastern Australian wholesale price to experience downward competitive pressure below the current floor.

4. Difficulty for Benaris and Calenergy to Market Separately (Section 4.4)

   As stated above, Elgas has negotiated with Calenergy a supply contract for Yolla LPG.

   We see no obstacle to individual contracts for Otway.

5. Benefits of Joint Marketing (Section 5.4)

   LPG purchasers are highly experienced in logistics. At full production of 110,000 tonnes pa – 300 tonnes per day – there would be 10-15 truck movements per day depending on choice of single or B-double pick up.

   This does not present a scheduling challenge.

   Simple arrangements could be made among the Otway parties for logistics and contract administration.

Conclusion

Elgas can see no justification of, necessity for or public benefit from the proposed authorisation.

Elgas would also be concerned if the ACCC were to reach a conclusion that the market is as narrow as that proposed by the producers because it would potentially affect the negotiation of Elgas' supply relationships and have implications for its marketing activities. This letter constitutes Elgas' submission on Otway producers' interim authorisation application and Elgas may wish to provide further material as the ACCC consults on the application for the draft and final decisions on "full" authorisation.

These comments apply equally to the interim and long-term situations.

Yours sincerely

Ian Maloney
General Manager Commercial