

Goninon, Helen

From: Coorey, Charles [Charles.Coorey@aar.com.au]
Sent: Friday, 24 February 2006 4:20 PM
To: Bastick, John; Buckley, Mike
Cc: Brewster, David
Subject: TRIM: Further submission from Applicants

Attachments: PNG Gas non-confidential version of 20% submission.pdf; PNG Submission to ACCC on 20% ownership limit.pdf
TRIM Dataset: AC
TRIM Record Number: D06/13723
TRIM Record URI: 734614



PNG Gas PNG Submission to
non-confidential versi ACCC on 20% ...

I attach a confidential and non-confidential version of a submission that the Applicants wish to lodge with the AER.

Please contact me if you have any questions.

Kind regards

Charles

Charles Coorey
Lawyer
Allens Arthur Robinson
Phone: 61 3 9613 8215
<<PNG Submission to ACCC on 20% ownership limit.pdf>>

Allens Arthur Robinson online: <http://www.aar.com.au>

This email (including all attachments) may contain personal information and is intended solely for the named addressee. It is confidential and may be subject to legal or other professional privilege. Any confidentiality or privilege is not waived or lost because this email has been sent to you by mistake. If you have received it in error, please let us know by reply email, delete it from your system and destroy any copies.

This email is also subject to copyright. No part of it should be reproduced, adapted or communicated without the written consent of the copyright owner. Any personal information in this email must be handled in accordance with the Privacy Act 1988 (Cth).

Emails may be interfered with, may contain computer viruses or other defects and may not be successfully replicated on other systems. We give no warranties in relation to these matters. If you have any doubts about the authenticity of an email purportedly sent by us, please contact us immediately.

PNG Gas Project – Submission to ACCC concerning joint marketing authorisation

1. Introduction

We refer to the Australian Competition and Consumer Commission's (**Commission**) Draft Determination issued on 11 January 2006 (**Draft Determination**).

The Commission proposes to grant authorisation to the Applicants to engage in Joint Marketing of Project gas. The Joint Marketing is authorised only if it is undertaken within the framework of the proposed confidentiality and ring-fencing arrangements, which are detailed in Appendix 1 of the Draft Determination. The Commission proposes that the Authorisation to engage in Joint Marketing be extended to Future Participants.

Appendix 1 to the Draft Determination defines a 'Future Participant' as:

Any person who becomes a participant in the Project pursuant to the Heads of Agreement or any agreement that replaces that agreement and seeks to engage in Joint Marketing of gas in accordance with the Authorisation who:

- (a) *does not itself, or through a Related Body Corporate, have an Economic Interest in any other gas business (production, sales and/or transportation) in Eastern Australia); or*
- (b) *if such an Economic Interest is held by the Future Participant or a related Body Corporate, then:*
 - (i) *the Future Participant's interest in the Project is less than 20%; and*
 - (ii) *the Future Participant does have the individual capacity, either directly or indirectly, to determine the outcome of decisions about the Project's financial, marketing and operating policies.*

The Applicants submit that the Authorisation should be extended to Future Participants in the Project, irrespective of their Economic Interests in other gas businesses in Eastern Australia and their interest in the Project.

In support of its submission, the Applicants attach a table which summarises the respective interests of the Project Participants before and after the entry into the Project of AGL, Santos and the PNG Government.

2. 'Future Participants' – impact of the Draft Determination

The exclusion from the Authorisation to engage in Joint Marketing of a significant sub-set of potential Future Participants has significant detrimental ramifications for the Applicants and their financiers. The Authorisation will not extend to a Future Participant which has an Economic Interest in any gas business in Eastern Australia and which has an interest in the Project of 20% or more. The effect of this is to make an interest of 20% or more in the Project potentially unattractive to any purchaser with any interest in a gas business in Eastern Australia. It will also act as a disincentive to any existing participant in the Project selling to such a purchaser. This may lead to undesirable fragmenting of interests in the

Project simply to avoid this problem. As a consequence it reduces the value of interests above 20% in the Project.

The exclusion of certain Future Participants from the Authorisation also has a direct impact on the ability of financiers to enforce security held over interests in the Project in excess of 20% because the pool of potential buyers is reduced. Any restriction on financiers' ability to realise their security will be a negative factor in Project borrowing.

The Applicants submit that these undesirable consequences are, having regard to the protections referred to below, unnecessary.

3. **'Future Participants' – protections**

The Applicants submit that the authorisation to engage in Joint Marketing should be extended to all Future Participants. The Commission expresses, in the Draft Determination, some concerns with this approach as it considers that the composition of the joint venture is crucial to the realisation of the public benefits and the minimisation of any anti-competitive detriment. The Applicants submit that the following matters, separately and in combination, fully address these concerns.

Material change in circumstances – the Commission's power to review the Authorisation

The Commission, as it notes in the Draft Determination, has the power under section 91B of the TPA to review the Authorisation if there is a material change of circumstances. The Applicants submit that a change to the composition of the joint venture which impeded the realisation of the public benefits or materially increased any anti-competitive detriment resulting from Joint Marketing of Project gas would constitute a material change of circumstances. In other words, the Commission has the power to respond very effectively if it apprehends that Joint Marketing involving a particular Future Participant may not result in the anticipated balance of public benefits and detriments.

Ring-Fencing Arrangements

The Draft Determination provides that the Authorisation only extends to Joint Marketing which is undertaken within the framework of the ring-fencing and confidentiality arrangements in Appendix 1.

The stringent ring-fencing arrangements are expressly intended to address issues that may arise where a party to the Project has or gains an Economic Interest in a gas business in Eastern Australia. The Applicants accept that these arrangements are regarded by the Commission as necessary to address the perceived risk that a party with an Economic Interest in a gas business in Eastern Australia may have (or be perceived to have) different economic incentives in relation to the marketing of the Project gas from those parties who do not have such an Interest.

The Applicants submit that the same logic should apply in relation to Future Participants in the Project; namely, the stringent ring-fencing arrangements will mitigate any risk that the Future Participant with an Economic Interest in a gas business in Australia could distort Joint Marketing decisions. In mitigating this risk, it is not clear why a breach of the ring-fencing requirements would become more likely, or be likely to have greater effect, if the interest held in the Project by a Future Participant was above 20%.

Section 50 of the TPA

The Applicants submit that the protection afforded by s 50 of the TPA should also address any of the Commission's concerns. The entry of a Future Participant under a Final Determination which did not contain a restriction on the ownership interest of Future Participants would nevertheless be subject to s 50. Accordingly, the Applicants submit that no restriction on the ownership interest of Future Participants is required.

The Applicants submit that such an application of the ownership restriction is likely to cause many commercial difficulties within the Project and, for the reasons provided in the Applicants' previous submissions, is likely to increase the risk that the Project cannot achieve the commercial alignment necessary for the applicants to proceed with the Project, particularly given that the composition of the Project Participants and their respective equity levels is still in a state of flux.

Summary

For the reasons outlined above, the Applicants submit that the ring-fencing provisions and s 50 of the TPA already provide adequate protection in relation to Future Participants in the Project, irrespective of whether the Future Participant has an Economic Interest in a gas business in Eastern Australia. Furthermore, the Commission can review the Authorisation if it has concerns that the inclusion of a particular Future Participant could materially alter the balance of public benefits and anti-competitive detriments resulting from Joint Marketing involving that Future Participant. Accordingly, the Applicants submit that the authorisation to engage in Joint Marketing should extend to all Future Participants in the Project subject to the requirements of ring-fencing, s 50 of the TPA and the Commission's power to review the Authorisation if there has been a material change in circumstances.

4. Future Participants – ability to determine the outcome of Project decisions

20% threshold does not correlate with Project agreements

If the Commission does not accept this approach, the Applicants submit that the definition of Future Participant should be amended so that the authorisation extends to Future Participants which do not have an Economic Interest in any gas business in Eastern Australia or, if it has such an Economic Interest, then the Future Participant's interest in the Project is 25% or less and the Future Participant does not have the individual capacity to determine the outcome of Joint Marketing decisions.

In selecting 20% as an effective cap on the interest which Future Participants may have in the Project and still engage in Joint Marketing, the Commission has apparently had regard to the *Corporations Act* provisions in Chapter 6 concerning control of a public company. The Applicants submit that the context in which the *Corporations Act* provisions apply is entirely different from that of an unincorporated joint venture and that no regard should be had to those provisions in specifying the level of interest for a Future Participant to which the benefit of the Authorisation would automatically be extended.

The *Corporations Act* provisions were developed to address the question of what level of interest in a public company might amount to a controlling interest. The arbitrary selection of 20% was against the background that it is frequently the case that less than 40% of shareholders attend general meetings in person or by proxy. In such circumstances

ownership of 20% of the issued capital of a company could confer a significant degree of control over the affairs of that company. The circumstances of public companies with fragmented share ownership and limited participation in general meetings are, however, entirely different from the circumstances of an unincorporated joint venture where it will usually, if not invariably, be the case that a party will vote its interest in the joint venture in accordance with the constitution of the joint venture.

The Applicants submit that the Commission should have regard to the specific circumstances of the Project in addressing the issue of determining the outcome of relevant discussions. This was the approach taken by the Federal Court in *Loy Yang*.

In *Loy Yang*, AGL sought to acquire up to a 35% interest in the Loy Yang A power station (LYP). AGL argued that this level of shareholding would not provide it with any control or substantial influence over the way in which the Loy Yang capacity was made available, bid, dispatched and contracted on a day-to-day basis. AGL submitted on the basis of specific provisions in the transaction documents that there was no credible evidence, even at the level of a realistic possibility, that the proposed acquisition would result in it being in a position to control the activities of LYP.

Justice French largely agreed with these submissions. The following points arose out of the judgement of French J:

- while AGL potentially had the role described in the Commission's submissions, French J still did not accept that the negative aspects of such power through a veto would be capable of being effectively deployed in such a way as to advantage it in respect of the detailed decision-making that must be taken in the day-to-day bidding and pricing functions;
- even absent a s87B undertaking which AGL proposed to provide, French J was inclined to regard the hypothesis that LYP somehow becomes hostages to AGL's interests as unlikely. His Honour felt reinforced by the undertaking in this regard. Accordingly, French J was satisfied that such influence as AGL might have in relation to the LYP operations would not extend to allow it to control or influence the detailed marketing decision-making of LYP;
- the undertaking was not the only form of safeguard against AGL exercising control or influence upon the operation of LYP in an anti-competitive manner. His Honour held that the presence of other major shareholders, the constraints likely to be imposed by external lenders and the fact that any further acquisition would be subject to potential action under s50 of the TPA combined to lead to the conclusion that it was appropriate to grant AGL the declarations it sought.

The relevance of *Loy Yang* to the present case is that:

- (a) similar to that case, the Applicants have described the structural arrangements in the HOA and CSA under which a Future Participant would have no control over the outcome of financial, marketing and operating decisions of the Project;
- (b) the Applicants submit that there is no basis to suggest that a 25% interest in the Project held by a Future Participant would put the Future Participant in a position to control the Project. In support of this submission, the Applicants point to the %

Pass Mark voting provisions in the HOA and CSA and the fact that the voting provisions may only be altered by a vote;

- (c) given the experience and expertise of some of the current Owners, any Future Participant would not be the only shareholder with experience and expertise in the gas industry, unlike the situation in Loy Yang where the Commission alleged that AGL would have a more significant influence as the only shareholder the experience in the energy industry.

Further, a Future Participant in practice has little ability to alter the commercial terms, including price, set out in the annexures to the ITAs. The gas marketing provisions in the HOA, which have been summarised for the Commission, do not give a 25% participant veto rights on gas marketing decisions.

Accordingly, the Applicants submit that, if there is to be effectively an equity restriction on the interest available to Future Participants it should be a 25% cap (subject to a further application to the ACCC). It should be recognised that this would be a serious restriction on the developers' commercial freedom. A 25% equity interest would not raise any competition concerns, and accordingly we submit that the Commission should arrive at the following conclusions:

- (i) that there would not be any negative aspects of a Future Participant having an equity interest of 25% as such an interest would not constitute a veto power as the HOA and CSA contain a % Pass Mark;
- (ii) that the Owners would not become hostage to the interests of a Future Participant with an equity interest of 25%;
- (iii) that a Future Participant would be subject to the presence of experienced Owners, the constraints likely to be imposed by external lenders and the fact that any further acquisition would be subject to potential action under s50 of the TPA;
- (iv) accordingly, any influence that a Future Participant would have would not extend to allow it to control or influence the outcome of financial, marketing and operating decisions of the Project and that, therefore, the restriction on the equity interest of Future Participants that is proposed in the Draft Determination should be increased from 20% to 25%; and
- (v) a 25% interest is unlikely in the foreseeable future to provide the holder with a leading position to influence the Project, given that the interests of both Oil Search and Esso significantly exceed that percentage.

Ownership threshold should be on entry into the Project only

The Applicants further submit that if there is to be a restriction on the ownership interest of Future Participants, this restriction should only apply to the Future Participant's acquisition *on entry* into the Project and not to any subsequent increase in its Project interest. This is because of the significant impediment that a threshold precluding further increases may have on the legitimate commercial operation and functioning of the Project.

For example, there are a number of situations in which a restriction, after entry, on a Future Participant increasing its ownership interest has the potential to create significant difficulties including:

- in the event of default by one Participant (for example, an event of insolvency), the other Participants are likely to acquire a share of that defaulting Participant's project interest in order for the Project to continue to operate. However, this may result in a Future Participant exceeding its 20% limit, and thus falling outside the authorisation. If that Future Participant has become a party to Foundation Contracts or other contracts, this could create very substantial difficulties if that Future Participant is no longer authorised.
- in the event that one Participant is unwilling to make required investments in the Project or to meet its cost sharing obligations, the other Participants may have to acquire that Participant's interest in the Project. Again, this may push a Future Participant's interest above the 20% threshold, and create potentially serious difficulties.

The Applicants submit that they should not be fettered in their ability to deal with such situations in a timely and commercial manner, without threatening the viability of the authorisation. For this reason, any limit that the Commission might wish to impose on a Future Participant should be a limit on entry only. Thereafter the Commission is free to use either section 50, or the revocation process, or both, if it considers that a Future Participant increasing its interest above the initial threshold raises any competition concerns.

24 February 2006

PNG GAS PROJECT EQUITY