

FURTHER SUPPLEMENTARY SUBMISSION TO THE  
AUSTRALIAN COMPETITION AND CONSUMER  
COMMISSION IN SUPPORT OF AN APPLICATION FOR  
AUTHORISATION

PNG GAS PROJECT  
(A40081)

## 1. Introduction

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### 1.1 Purpose of submission

The PNG Gas Project Participants (**Participants**) refer to the issues raised for discussion at the pre-decision conference hosted by the Australian Competition and Consumer Commission (**Commission**) on 1 March 2006 (**Conference**) and specifically to the issues raised in the presentation given by the Energy Users Association of Australia (**EUAA**) at the Conference.

The purpose of this submission is to assist the Commission in its consideration of the propositions raised for discussion by the EUAA, by providing it with the Participants' views on those propositions. The propositions raised by the EUAA were:

- (a) is joint marketing beyond financial close problematic?;
- (b) do the applicants object to the draft determination?;
- (c) what conduct is being authorised?
- (d) is the authorisation term based on the Project financing term?;
- (e) what is the shape of the market?;
- (f) confidentiality and ring-fencing; and
- (g) the parties to the authorisation.

The Participants will address each of these issues individually.

The Participants will also submit that the Commission should clarify its proposed ownership restriction on Future Participants with Economic Interests in any gas business in Eastern Australia so that it is clear that the restriction will only cover the entry level of interest of a Future Participant.

## 2. Joint marketing beyond financial close

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### 2.1 Submission made by the EUAA

At the Conference, the EUAA submitted that:

- (a) it was unclear whether the Commission's Draft Determination dated 11 January 2006 (**Draft Determination**) was driven by advice from the Participants on the project financing term, or on a judgment that separate marketing is not feasible for 16 years; and
- (b) the Commission should not lock itself into a final determination of 16 years as there is a risk that authorisation for joint marketing will continue when there is no net public benefit but only a private benefit.

## 2.2 Submission by Participants

The Participants submit that the argument being put by the EUAA that there will be a lack of public benefit over the proposed 16 year term of the authorisation is misconceived for a number of reasons.

First, the Participants have stated repeatedly since applying for authorisation in December 2004, that there is a real risk that the Project will not proceed if long term authorisation is not granted. Accordingly, by making the submission in paragraph 2.1(b) above, the EUAA is assuming that the Participants will proceed with the Project even if the Commission only grants authorisation to financial close. The Participants once again submit that this is not the case. The Participants submit that the future with and without test is clearly satisfied because:

- (a) in the future with a long term authorisation in place, there will be significant public benefits and no anti-competitive detriment; and
- (b) in the future without a long term authorisation in place, the public benefits will be foregone and a critically important opportunity to facilitate a major infrastructure development and investment in Papua New Guinea and rural and regional Australia will have been denied.

Secondly, the Participants have repeatedly identified a large number of obvious public benefits that will result in a net public benefit for the *life* of the Project, the foremost being increased competition in the eastern Australia energy market and substantial benefits to rural and regional communities including employment opportunities.

Thirdly, by granting authorisation for a period of 16 years, the Commission is not unconditionally locking itself into continuing to authorise the Project for this period. Under s 91B of the *Trade Practices Act 1974* (Cth)(*TPA*), the Commission may revoke an authorisation at any time if there has been a material change in circumstances since the authorisation was granted. There is no reason why the Commission could not use this power if in the future it determined that the benefits of the authorisation continuing did not outweigh any detriments. It is clearly a preferable course, indeed it is the only appropriate course, for the Commission to grant authorisation for a period that is sufficient to ensure that the Project comes into existence, rather than, as proposed by the EUAA, to jeopardise the Project proceeding by granting a very limited authorisation due to an unspecified and unwarranted reticence to use the power under s 91B.

Finally, as was stated during the Conference, the Participants currently view authorisation for long term joint marketing as a necessity in order to establish the Project and in order to successfully market Project gas given the illiquid and shallow dynamics of the eastern Australia energy market. However, should these market dynamics change then the Participants' preference may be to separately market Project Gas. Indeed, ExxonMobil stated in its submission to the Parer Committee that it preferred to separately market gas where that was possible. Santos expressed the same view at the pre-decision conference. However, separate marketing can only occur where to do so is feasible, and as the Participants have repeatedly illustrated (and as the Commission has accepted) that is not the position here. The Participants' position is that:

- (a) the current market conditions including a lack of liquidity and depth;
  - (b) the currently high levels of financial risk associated with the Project; and
  - (c) the current inability of the smaller Participants to separately market gas
- mean that long term authorisation for joint marketing is necessary for the Project to proceed.

### **3. Do the Participants object to the Draft Determination?**

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#### **3.1 Submission made by the EUAA**

At the Conference, the EUAA submitted that:

- (a) the Participants had suggested that, without a 30 year joint marketing authorisation, the Project would not proceed beyond the FEED stage;
- (b) this suggests that the Participants would object to the term proposed in Draft Determination; and
- (c) the term of authorisation that the Participants would have objected to is unclear.

#### **3.2 Submission by Participants**

The Participants continue to seek authorisation of joint marketing for the life of the Project. However, in light of:

- (a) confidential information lodged with the Commission by the Project's financial advisor; and
- (b) recognition by the Participants of the Commission's need to have a fixed term authorisation

the Participants view the proposed 16 year term for authorisation as the minimum term required for the Project to proceed.

### **4. What conduct is being authorised?**

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#### **4.1 Submission made by the EUAA**

At the Conference, the EUAA submitted that the Draft Determination was unclear on whether:

- (a) the gas to be jointly marketed was wet or dry gas;
- (b) any authorisation would cover gas delivered to the customer or delivered in the pipeline at the Australian border; and
- (c) the term of the authorisation, given that, for example, a 20 year contract signed in year 15 of the authorisation period would extend the conduct covered by the authorisation to 35 years.

## 4.2 Submission by the Participants

In its application for authorisation, the Participants seek authorisation for all contracts, arrangements or understandings in relation to:

- (a) the negotiation of common terms and conditions (including price) under which gas produced by the Project will be offered for sale;
- (b) the joint marketing of Project gas to a common buyer or common buyers; and
- (c) the common terms and conditions (including price and price arbitrations/determinations) upon which Project gas will be offered for sale and sold by the Participants to buyers.

Accordingly, the gas to be jointly marketed is *any* gas produced by the Project. This gas will be delivered to delivery points agreed to between the customer and the Participants in Gas Sales Agreements (**GSAs**).

The Participants are unclear as to the meaning of this submission by the EUAA and would welcome the opportunity to respond to a clarification of it.

In relation to the issue of grandfather clauses, the Participants submit that there are a number of reasons why if authorisation is granted for a period less than the life of the Project, then it would be essential that a grandfathering mechanism similar to that in the North West Shelf authorisation form part of this authorisation.

### ***Owners' and financiers' investment in the Project***

If the authorisation expired prior to the term of GSAs and there was no grandfathering provision to extend the authorisation for the remaining term of the GSAs, then this would create a real question in the minds of financiers and the Participants in terms of the Participants' ability to continue to conduct their business affairs in relation to those contractual management or renegotiation matters without being at risk of potential claims under s 45 of the TPA.

Accordingly, the need for the Participants to continue to jointly discuss and manage GSAs over their life necessitates that the authorisation should be extended to those activities for the length of these contracts.

Grandfathering clauses are also needed so that the AGL-Petronas Consortium (**APC**) can satisfy its financiers of the Project's long-term stability.

### ***Market dynamics***

The Participants submit that the market in which the Project is attempting to market gas is a projects-based market, in the sense that it is illiquid with few customers, the majority of whom will acquire gas for use in large projects such as co-generation plants and power stations, or for new development projects. While the authorisation will relate to joint marketing conduct, and not specifically to the GSAs between each Participant and a customer, it is the case that unless customers have certainty regarding the legal status of the Participants' dealings with them, and thus the ability of the Participants to administer and properly manage the GSAs, then there is a real question about whether customers would have the confidence to commit to the Project.

If there is a significant risk as to customer commitment over the life of the Project, then there is also a real question about whether the Participants, their financiers, APC and APC's financiers will have the confidence to commit to the Project.

***Structural features of the market***

The structural features of the market exacerbate the difficulty of a greenfields project that requires very substantial, firm customer commitments to obtain the necessary volumes and certainty of cash flows to justify an investment. Any additional uncertainty as to the ability of the Participants to deliver Project gas on time and pursuant to reliable and enforceable GSAs may undermine the confidence in the Project of the Project's customers and financiers and APC's financiers.

***Ability of the Owners to compete***

The ability of Participants to compete may be reduced in the long term if the authorisation did not continue to apply to GSAs in the period following expiration of the authorisation. The Participants consider it very unlikely that customers in a projects-based market, such as the eastern Australia energy market, will enter into:

- (a) contracts clouded by regulatory uncertainty; or
- (b) short term contracts.

For example, if a customer investing in a project approached the Operator in year 10 of the authorisation seeking to enter a 20 year contract, the Participants consider it unlikely that this customer would enter into the contract due to the regulatory uncertainty surrounding the renegotiations of prices from the sixth year of the contract onwards.

The Participants also consider it unlikely that such customers would enter into contracts simply for the remaining term of the authorisation, given the long term nature of the customer's project requirements.

Accordingly, if authorisation of the Project did not cover the GSAs following expiration of the authorisation, then the ability of the Participants to compete would be reduced as competitors to the Participants would be able to offer customers the certainty they require for their own project investments.

***Reduced incentive for future investment by Participants***

Further, if the Participants were unable to obtain security of returns through long term incremental contracts then the Participants would be unlikely to undertake future investment in the Project beyond the term of the foundation contracts and the expansion of the Project may be threatened.

***Nature of the relationship between the Participants***

Project gas is jointly produced, and there is common ownership of every molecule of gas produced. If the legal protection offered by the authorisation lapsed prior to the term of a GSA, then although it is the case that each Participant would have a separate GSA with a buyer, these are based on common terms for joint production and it would not be possible for the Participants to begin dealing separately for the supply of that gas unless upstream arrangements such as gas balancing agreements had been negotiated in advance. For the reasons outlined in the Participants' original authorisation application (see paragraph

6.46 to 6.49) such arrangements are extremely complex and are not easily amended. Further, the cost and difficulties of attempting to negotiate such agreements would need to be considered against the short period that might remain under a GSA.

Joint production of gas by the Project and common ownership and marketing of gas is the basis upon which the Project has been structured, and therefore the basis upon which financiers will assess the Project. If the parties are required to separately supply gas under agreements entered into during the period of the authorisation then this will change the risk profile of the Project, and thus the assessments made by financiers.

Confidential submissions provided by Project financial advisor support the above submissions of the Participants.

## **5. Authorisation term based on project financing term**

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### **5.1 Submission made by the EUAA**

At the Conference, the EUAA submitted that:

- (a) the proposed authorisation term of 16 years appeared to be based on advice from the Participants on the Project financing term;
- (b) the EUAA research indicated that the finance term is likely to be limited by the term of political risk insurance (*PRI*) and export credit agency (*ECA*) finance;
- (c) the EUAA found evidence in the debt market indicating that banks are confident about the Project meeting commercial hurdles; and
- (d) the amount of Project financing may be less than implied by the Participants.

### **5.2 Submission by the Participants**

The Project has provided the Commission with confidential submissions from the Project's financial advisor stating that Project financiers will require a long term authorisation as they intend to commit for a period many years past financial close and need certainty as to the Project risks and returns over that period. Similarly, APC's financiers also require certainty as to the Project risks and returns over the long term.

In addition, greenfields projects like the Project have low initial rates of return and very high upfront costs. These projects rely on growth to achieve a required rate of return, and this means that authorisation is needed well past financial close. This is particularly the case when they are marketing gas into a very shallow, illiquid market such as the eastern Australian gas energy market.

The Participants submit that it is misconceived for other parties to say that financiers and banks are not concerned about the Project meeting its goals. The very reason why the Project's financial advisor lodged submissions with the Commission is because of the concerns potential Project financiers have had. To the extent that banks may now, after many years and significant expenditure by the Participants, perceive the Project as likely to secure sufficient customer support to proceed is in fact a further illustration of the reliance placed by banks on joint marketing, since all of the Project's efforts to date have been made possible by joint marketing under the current interim authorisation. If the Participants

had not been able to act in this way, banks would not currently be expressing interest in the Project as the Project would not have progressed to this stage. Indeed, even with joint marketing over the past five years, the progress of the Project has still been limited despite the concerted effort of the Participants.

Given the scale and complexity of the Project, the Participants have faced significant challenges in dealings with potential financiers. These challenges have been heightened given the diversity of the Participants, some of whom have no track record in Australia and in projects of this scale. Accordingly, potential Project financiers have been very keen to see the Project obtain an authorisation for joint marketing beyond financial close so that the Project may be as robust as possible. In particular, the financiers are seeking assurances that:

- (a) the Participants will be capable of securing additional sales; and
- (b) the way that the Project is operated will not upset the Project's revenue base and cash flows.

The best way for the Participants to provide their financiers with these assurances is to obtain a long term authorisation for joint marketing. Since receiving interim authorisation for joint marketing in October 2000, the Participants have been able to progress the Project substantially. Accordingly, the benefits of joint marketing to the Project to date are clearly evident. However, much remains to be done. If the Participants are to continue to progress the Project and satisfy their financiers, long term authorisation is required.

By obtaining long term authorisation, it is also likely that APC will be able to satisfy its financiers of the Project's long term stability.

In response to the submission that gas balancing agreements will address any concerns, the Participants again submit that gas balancing agreements are:

- (a) extremely complicated;
- (b) do not work in illiquid markets such as the eastern Australia energy market; and
- (c) do not work with projects the size of the PNG Project.

In response to the EUAA's claim that PRI availability will potentially constrain the financing term to 5 – 7 years, the Participants submit that:

- (a) the financing term proposed by the Project's financial advisor in its confidential submissions has been tested in the bank financing and PRI underwriter markets by the Project's financial advisor and the Participants are very confident that this term can be accommodated;
- (b) the loan tenor assumes a 20% balloon payment at maturity; acceptance of this balloon means that the banks will be looking for reasonable cash flow certainty beyond maturity to mitigate refinancing risks. Regulatory certainty is a factor for financiers in their consideration of cash flow certainty and associated risk assessment; and
- (c) regulatory certainty is also likely to be a key issue for APC in its long-term financing.

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## 6. What is the shape of the market?

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### 6.1 Submission made by the EUAA

At the Conference, the EUAA submitted that the market has undergone considerable change in recent years and this is expected to continue due to:

- (a) small coal seam methane producers starting up but being acquired by larger companies;
- (b) the deepening pool of buyers and sellers; and
- (c) imminent gas reforms through the Ministerial Council on Energy process.

According to the EUAA, the implications arising from the above are:

- (a) that the market is dynamic and it is therefore difficult for the Commission or anyone to forecast the market even a few years into the future;
- (b) that the Commission cannot claim that the conditions for separate marketing would not eventuate in the next 16 years;
- (c) that at the end of the authorisation term the Participants can re-apply for authorisation of joint marketing; and
- (d) that the material change of circumstances test is problematic and that the Commission should give itself flexibility to review the authorisation at its own or other parties' suggestion to ensure the net public benefits test is still met.

### 6.2 Submission by the Participants

At the Conference the Participants submitted that despite the preference by some of the Participants to separately market gas, separate marketing of Project gas is currently not possible for the reasons given at paragraph 2.2 above. The Participants wish to repeat this submission.

Further, the proposition that a short term authorisation would be preferable as the Participants could re-apply for authorisation every few years is commercially and practically unrealistic. The Participants, their financiers, APC and APC's financiers require long term certainty in their investments. The regulatory risk that a short term authorisation would pose would create too high a level of uncertainty to proceed with such a significant investment. Investment in the Project involves significant risks which the Participants must manage, and it is essential that the risks involved are minimised as much as possible. It is unacceptable for beneficiaries of the Project, such as EUAA members, to effectively suggest that the Participants and their financiers should assume higher levels of risk when they are not required to bear the costs of the Project.

As discussed at paragraph 2.2 above, under s 91B of the TPA the Commission has the power to revoke an authorisation if there has been a material change in circumstances. The Participants submit that it would make a nonsense of the Commission having this power if the Commission were to craft a Final Determination that allowed it to review the authorisation intermittently.

Additionally and from a practical point of view, it has taken the Participants and the Commission almost 18 months and significant costs to obtain a Draft Determination. In light of this, the prospect of having to go through this timely and expensive process again in a few years time is not acceptable to the Participants. This highlights the level of uncertainty, and thus additional risk, that a requirement for the Participants to have to reapply for authorisation after a short period would bring.

The Participants accept that there are some difficulties in predicting exactly how the eastern Australian energy market will develop over the next few decades. However, they do not accept that a reliable estimate is beyond the ability of themselves as Participants in that market, nor the Commission, nor experts such as ACIL Tasman. To the extent that there might be some uncertainty in the long run, this is again what the power in s 91B is designed to address. What is clear is that unless the Project comes into being under the protection of a long term authorisation, competition in the eastern Australian gas market will be significantly less than what it might be and the other public benefits arising from the Project will also be lost.

## **7. Confidentiality and ring fencing**

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### **7.1 Submission made by the EUAA**

At the Conference, the EUAA submitted that:

- (a) ring fencing and confidentiality arrangements are never failsafe and cannot be fully relied upon;
- (b) the EUAA is aware of an incident in the Project's history where there was doubt about the ability of the joint venture to protect confidentiality;
- (c) there would be a level of uncertainty if the board of one of the Participants was concurrently considering gas contracts from different fields, including PNG; and
- (d) the EUAA would be concerned if future participants with high shares in the Project were allowed to be a party to the joint marketing arrangements.

### **7.2 Submission by the Participants**

The Participants submit that the proposed confidentiality and ring fencing arrangements are extremely onerous and are more than sufficient to address any third party concerns. The consequences of a breach of these obligations by any of the Participants are significant and act as a deterrent to the Participants.

The proposed confidentiality and ring fencing arrangements are consistent with the provisions in s 4 of the Gas Code and, therefore, any suggestion that these arrangements are inadequate is also a suggestion that the Gas Code arrangements are inadequate. No evidence or arguments have been presented to suggest that this is the case, and such an argument is clearly untenable.

In relation to the EUAA's allegation that there was an incident in the Project's history where there was doubt about the Participants' ability to protect customer confidentiality, the

Participants wish to state that they are not aware of this incident. The Participants wish to reinforce:

- (a) that they regard their obligations under the current Marketing Information Confidentiality Deed extremely seriously, just as those which are bound by the Gas Code regard those requirements extremely seriously; and
- (b) that conduct that does not fall within the confidentiality and ring-fencing requirements would not be authorised conduct. This acts to deter the Participants from breaching the confidentiality and ring-fencing requirements.

## **8. Parties to the authorisation**

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### **8.1 Submission made by the EUAA**

At the Conference, the EUAA submitted that:

- (a) it believed that the mix of participants in the Project in part determines the ability of participants to separately market; and
- (b) a significant entrant or change in the mix of participants should be examined by the Commission for impacts on the authorisation.

### **8.2 Submission by the Participants**

The Participants submit that, as discussed above:

- (a) the rigorous nature of the proposed ring fencing arrangements; and
- (b) the powers of the Commission under s 91B and also s 50 of the TPA

more than adequately address any concerns third parties may have about the parties to the authorisation.

Accordingly, the Participants submit that the proposed mechanism for the automatic entry into the Project of Future Participants who satisfy certain conditions should remain.

Further, for the reasons given by the Participants in their submission of 24 February 2006, the Participants submit that the 20% restriction on the level of ownership by a Future Participants with an Economic Interest in a gas business in Eastern Australia should be removed, or at the very least relaxed to a 25% limit upon entry to the Project.

## **9. Ownership restriction on Future Participants**

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### **9.1 Request for clarification of restriction**

The Participants now understand that the 20% equity limitation proposed by the Commission in its Draft Determination is intended to cover only the *entry level* of interest of a Future Participant with an Economic Interest in a gas business in Eastern Australia. The Draft Determination does not, therefore, propose any restriction on the interests of Future Participants changing over time.

The Participants submit that the present drafting of:

- (a) cl 9(b)(i) of the Draft Determination; and
- (b) the definition of 'Future Participant' in cl 7.1 of Appendix 1 to the Draft Determination

should be clarified so that the Commission's intention that the ownership restriction should only cover the entry level of interest of a Future Participant is made clear.