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15 March 2006

Mr Mike Buckley
General Manager
Access Branch
Australian Energy Regulator
PO Box 1199
Dickson ACT 2602

PNG Gas Project – Application for Authorisation A40081

Submission on Draft Determination

Dear Mike,

The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide a submission to the Australian Competition and Consumer Commission (ACCC) on its Draft Determination.

The attached submission sets out our views on the PNG Gas Project Application for Authorisation and the Commissions' Draft Determination. The views expressed are based on what is in the best interests of energy users with respect to the application for joint marketing of PNG gas by the Applicants. The EUAA is uniquely placed to provide the ACCC with such a view, given its involvement in both national and state issues and its position as the national association of energy users.

If you have any queries regarding our comments you can contact me on 03 9898 3900 or roman.domanski@euaa.com.au.

Yours sincerely

Roman Domanski
Executive Director

Response to the ACCC on the Draft Determination of the PNG Gas Project – Application for Authorisation

March 2006

CONTENTS

1. Background

This submission provides comments from the Energy Users Association of Australia (EUAA) to the ACCC's Draft Determination published on 16th January 2006 on the application (the "Application") on 14 December 2004 by the upstream Joint Venture members (the Applicants") of the PNG Gas Project ("the Project") to jointly market gas for the life of the Project, estimated to be at least 30 years.

The Commission concluded that there is a net public benefit from the Project proceeding and proposed the Project receive authorisation for joint marketing for a period of 16 years from 2006 subject to a framework of confidentiality and ring fencing arrangements. The authorisation would also apply to future participants in the Project subject to certain conditions.

The EUAA requested that the Commission convene a conference (the "Conference") in relation to the draft determination. This was held in Brisbane on 1 March. The submission therefore also refers to discussion at the conference.

2. Overview of the EUAA's Position

The EUAA has been a strong supporter of the opening up the eastern Australian gas markets to new entrants to improve the competitive choices available to gas users. For too long the gas market has been dominated by a small number of suppliers. The Australian economy needs new sources of competitive gas to underpin its future growth and gas is an important fuel for our carbon-constrained future.

The PNG Gas Project has enormous potential for bringing significant public benefits to the Australian community, provided the regulatory arrangements under which the gas is marketed provide a competitive framework. For energy users, there is little benefit in a project such as the PNG gas project going ahead unless there are net public benefits. The period of the joint marketing authorisation is a key part of this regulatory arrangement, along with the access principles for the AGL/Petronas (APC) pipeline.

In its original submission on this matter to the Commission, the EUAA argued, as did a number of other submissions, that the Commission should allow joint marketing only until the date of financial close[1]. The EUAA believed that once financial close was achieved it would indicate that there were sufficient foundation customers to make the Project viable and could see no reason why the Project would require continued joint marketing authorisation.

The EUAA believes that the Draft Determination and the arguments presented by the Applicants at the Conference have not provided sufficient evidence to justify the Commission's draft decision. The EUAA's position is that:

- We see no reason to change our view, expressed in our original submission that joint marketing should be allowed only until financial close. In fact, information provided to the Commission since our original submission has supported our case.
- Public statements by the Applicants indicate that:
    - o They are proposing a pipeline to Australia with a capacity of around 225PJ/yr, and

[1] EUAA, Energex, Comalco and BHP Billiton submissions at:
http://www.accc.gov.au/content/index.phtml/itemId/571032

  - Long term contracts in place by the time of financial close, assuming Santos joins the Project, appear to account for most if not all of this – creating a considerably more optimistic outlook for financing than was the case at the time of the Application in December 2004.

- On this basis it is difficult to understand the Applicants' argument that the ability to jointly market a small amount of gas is a "go or no go" factor in achieving financial close and hence achieving the public benefits that would come with the Project – especially when the Applicants agree the price will be no lower with separate marketing.

- Whilst there may be an augmentation of the capacity via compression this should not require joint marketing since the costs of implementing this are small relative to the initial capital investment and represents additional profit for private investors.

- The authorisation should cover the life of contracts entered into prior to financial close.

- The EUAA agrees with the Commission, and contrary to the submission of the Applicants, that the material adverse change provisions of the Act are of little or no use in allowing the Commission to review its authorisation prior to the end of the authorisation period. This means that the best approach for the Commission to ensure that the public interests of joint marketing are preserved is to have a shorter authorisation period and allow the Applicants to reapply for an extension to the authorisation.

- If the Commission were to see the need, on the benefits test, to allow joint marketing beyond financial close and believe that the term of the project financing is a relevant measure then the Commission should:

  - Seek a new submission from the Applicants on the current likely project finance term (to set a provisional authorisation term) and not accept the term provided by the Applicants in their submission in December 2004 when the market for gas offtake was considerably less optimistic than it is now.

  - Seek the actual project finance term from the Applicants after financial close and replace the provisional term with this.

  - Consistent with its approach in other similar matters, e.g consideration of revenue cap applications by TSNPs, seek independent advice to confirm the Applicants' new contentions on project finance term.

  - For contracts signed after financial close and within the authorisation period, the authorisation should apply only until the end of the authorisation period, not for the life of the contract if it extends beyond the end of the authorisation period.

  - Alternatively, the EUAA favours the Commission aligning the period of authorisation to achievement of the necessary volume to meet reasonable Project return requirements. Given that there may well be little uncontracted capacity at the time of financial close the required volume may be achieved at or soon after financial close.

- In the Queensland market, CSM is unlikely to be an effective competitor, particularly if rationalisation in producers continues. The Commission has a significant role to play in fostering the regulatory framework that will allow upstream gas competition and allow the market to develop such that separate marketing is feasible. The EUAA is concerned that the very long term Draft Authorisation will act against this market development.

- The authorisation should cover the joint marketing of dry gas into the pipeline at the Australian/PNG border.

- The EUAA is concerned about the efficacy of the proposed ring-fencing arrangements.
- The EUAA believes that the mix of participants in the Project, in part, determines the ability of participants to separately market gas. If a significant entrant (defined in terms of equity in the Project or economic interest in upstream gas in eastern Australia) sought to join the project and seek authorisation then this should require a new application to the Commission.

3. Joint marketing until financial close

Draft Determination

The Commission has accepted the Applicant's position that the Project will not proceed beyond FEED without joint marketing continuing beyond financial close and used this as the basis for their 'future with-and-without' test.

Discussion

The EUAA submission, along with other submissions, argued that joint marketing was only justified until financial close and that there is a need for the Commission to monitor the market to assess when the conditions for separate marketing might be present.

The basis for this argument was that the Project's achievement of financial close indicated that:

(a) the revenues from jointly marketed gas sales contracts in place at the time of financial close, plus associated oil and liquids, would provide sufficient cash flow to meet the debt service obligations under Project financing; and

(b) the revenues from (a) , plus the Joint Venture's judgements about the likely future sales contracts over the life of the Project, would meet their return on equity.

The Applicants have argued, and the Commission accepted, that unless the risks associated with separate marketing after financial close are addressed through the ability to joint market, then the Applicants will not get their required rate of return, that they will not get Project financing and that the Project will not proceed. Without the Project there will be no public benefits. With the Project there will be public benefits that more than offset the anti-competitive detriments flowing from Joint Marketing.

The implication is that the Applicants need a further period of time of joint marketing beyond financial close to get to their private break even hurdle rate of return. The Applicants have effectively argued "Unless we get our hurdle rate (i.e. private benefits), the community will not get the public benefits of the Project".

The fundamental argument being made by the EUAA is that, on the basis of the evidence available to it, the lack of joint marketing beyond financial close will not prevent financial close being achieved. This means that the Project will proceed and the large public benefits accrue. Bankers will only approve Project financing when they are satisfied that debt service ratios are well covered and that the Applicants will stay in the Project for the duration of the Project financing, i.e. the Applicants will make sufficient return not only to service the Project finance repayment profile but also fund the required opex and capex and still leave an acceptable rate of return on equity. We presume that the achievement of the break-even rate of return is more likely to occur, and will occur sooner, the higher the gas price. And yet the Applicants seem inconsistent in their arguments given their argument that separate marketing will not lead to lower prices than with joint marketing:

> "In a report submitted by ExxonMobil to the Parer Review and also by the Applicants in support of their application for authorisation, Lateral Economic expressed the view that separate marketing will not lead to more competitive prices."[2]

If prices are no less under separate marketing, then the EUAA would like to understand why separate marketing would not allow the Applicants to get their hurdle rate of return.

EUAA Position

Overall, the EUAA is not convinced that the arguments advanced by the Applicants and accepted by the Commission that joint marketing beyond financial close is required to achieve financial close. This is examined further below.

4. Material Adverse Change Provisions

The Applicants have sought to give comfort to interested parties that the Commission has powers under the material adverse change sections of the Trade Practices Act to review any part of its authorisation if circumstances change. The EUAA has little faith that this would prove to be an effective means of ensuring that public benefits will continue of the life of a long-term authorisation. The Commission has also doubted the efficacy of these provisions.

In the North West Shelf case the applicants argued the same line as the Applicants in this matter, particularly in respect of allowing the authorisation to apply to any future participants. The Commission commented:

> "The Commission believes, however, that s. 91(4) is inherently uncertain. In order to apply s. 91(4), the Commission would have to show that there has been a material change in circumstance. Because of this uncertainty, the Commission believes restricting the authorisation to the current Applicants is more appropriate."[3]

The Commission's view was not changed when the applicants made reference to its s. 50 powers.

A review of the Commission's authorisations register for the period 1 January 1999 to date showed only one instance when the Commission has threatened to use its power to revoke an authorisation for a material change in circumstances – the Royal Australian Institute of Architects case in 2005.

The reason the provision is rarely used is twofold:

- A revocation involves a reversal of the onus of proof – the Commission has the onus to prove that public benefits no longer outweigh any anti-competitive detriments; and
- Only the Commission can initiate this review – while an interested party can make a submission on the matter, the Commission is under no obligation to act on that submission.

[2] Draft Determination p.32
[3] North West Shelf Project (1998) ATPR (Com) 50-269 at 55,782

EUAA Position

If the Commission believes that some authorisation period should be given beyond financial close, then they should restrict this to a shorter period and allow the Applicants to re-apply if they so wish. This maintains the burden of proof on the Applicants.

5. What is the Applicants' response to the draft determination?

Discussion

The Applicants commented in their original submission that:

> "The Participants seek authorisation for the life of the Project which is currently estimated to be up to 30 years. Without the commercial and regulatory certainty of a long term authorisation, it will not be possible to attract sufficient customer commitments necessary over the life of the Project to justify the substantial costs and the financial risks to the Participants"[4]
>
> ... and ...
>
> "The Participants do not believe that they will be in a position to progress the Project beyond FEED stage without an authorisation which provides long term security to the Participants to dispose of their gas entitlements by joint marketing."[5]

EUAA Position

Given this, the EUAA expected the Applicants to be arguing that the Project will stop unless the Commission changes its Draft Determination.

The participants indicated at the Conference that they are willing to accept the draft determination period of 16 years as "...it does cover off the financing period"[6] and is the minimum period of time required. This is contrary to the statements in their application that implied that a full 30-year term was required. This causes the EUAA to wonder at what authorisation term would they have objected (as below the minimum required)- 14, 12, 10, 8 years, financial close?

6. Why joint marketing beyond financial close?

Draft Determination

The Commission will allow joint marketing for a period of 16 years from the date of authorisation, presumably some time in 2006, which is 15 years beyond financial close and around 12 years beyond first gas deliveries.

Discussion

It is unclear whether the Commission's decision was driven by the term of Project financing or by some judgement about when separate marketing might be possible. The Commission is clear in its view that there is no net public benefit once separate marketing is feasible:

[4] Application p.5 para 1.8
[5] Application p.6 para 1.11
[6] Comments by Bob Reed at the Conference

> "...the ACCC is not satisfied that a net public benefit will arise after the point at which separate marketing becomes feasible, regardless of the dimensions of the market"[7]

and that after this time private benefits accrue to the Applicants when separate marketing is feasible.[8] The Commission also considers that:

> "Given the uncertainty surrounding future market conditions the ACCC cannot be confident that the public benefits will outweigh the detriments for an indeterminate time or even for a period as long as 30 years."[9]

So, in trying to decide what the time limit should be if it is less than 30 years, the project financing term was seen to be an appropriate benchmark given that the Applicants argued that the Project would not reach financial close without joint marketing.

The EUAA highlighted in its original submission the instances of separate marketing that are occurring and this has only expanded in the period since. Oil Search is vigorously marketing PNG gas to potential projects in PNG, e.g. petrochemical plants with Mitsubishi and Itochu in PNG, gas pipeline to Port Moresby, and CNG to New Zealand. AGL is marketing to Australian customers.

AGL is effectively separately marketing PNG gas, a portion of its original gas purchases, with its on-sale agreement with NRG Flinders in South Australia. The EUAA presumes that NRG had the option of purchasing from the JV participants but chose to go with AGL because it offered a better deal. This seems to suggest that separate marketing can already occur for PNG gas and raises questions about the need for joint marketing arrangements to underpin the viability of the project.

If the Applicants wish to argue that this is not an example of separate marketing, e.g. because the price offered by PNG JV and AGL is similar, it cannot be joint marketing given that when the NRG deal was announced on 9 February 2006[10], AGL was not a JV participant (which it became on 17 February 2006) and not covered by the Interim Authorisation on Joint Marketing of 13 October 2000 (which it applied to be covered for on 2 March 2006).

The Commission comments that:

> "Setting a time limit (prior to the end of the Project) on the authorisation does not mean that the Project participants will be forced to separately market their gas when the authorisation has expired. The Applicants have the option of re-applying for the authorisation ... and the ACCC will consider the application on its merits at the time."[11]

As discussed below, the eastern Australian gas market is currently undergoing significant change and this is likely to continue. It is difficult to forecast what this market might look like in 5 years time, let alone 16 years. The EUAA submits that the Commission should either retain an ability to review its decision outside the constraints of the s. 91(4) provisions, discussed further below or only allow a short authorisation term with the ability to reapply as described above. It is unclear from the Draft Determination what would happen if the Commission judged that sufficient of the conditions for separate marketing were present at a time prior to the expiry of the 16-year authorisation. The Commission should not lock itself

[7] Draft Determination p.64
[8] Draft Determination pp44-45
[9] Draft Determination p67
[10] "First PNG gas sales to NRG Flinders" *AGL Press Release*, 9 February 2006 at http://www.agl.com.au/agl/press+releases/9+february+2006.htm
[11] Draft Determination p.68-9

into a position where the Applicants retain their authorisation at a time when there are only private benefits and no net public benefit.

EUAA Position

- In the event that the Commission decides to continue authorisation beyond financial close then it should allow itself to review - whether self initiated or as a result of a submission by an interested party – whether sufficient of the conditions for separate marketing exist and hence that the authorisation period should end.
- If the Commission do not include such a clause then the authorisation term should only be short in length in order that the burden of proof rest on the Applicants in their reapplication for joint marketing rather than the Commission in withdrawing the authorisation.
- We are unclear as to why the Commission believes it is necessary to have a joint marketing authorisation when two of the applicants, Oil Search and AGL, are effectively already separately marketing? It would seem to us that the relatively small size of some of the Applicants would be of limited relevance here as they would effectively be shielded by the large parties involved.

7. The term of the authorisation based on Project financing

Draft Determination

The main reason given by the Commission in supporting a 16-year authorisation period is their judgement on the Project financing term.

> "Information obtained by the ACCC in confidence suggests that given the nature of the Project, Project financiers are likely to require authorisation for the term of the Project finance, which would likely to be in the order of 15 years"[12]

Discussion

The EUAA's position is based on three propositions:

- Consistent with the EUAA's view that the authorisation should only relate to marketing of the gas into the pipeline at the Australian/PNG border, the discussion of the Project financing requirements should only relate to upstream investment, stated by the Applicants as $US2.5b[13] and not to any financing requirements for the APC pipeline in Queensland, and
- This upstream investment is about not just extracting sales gas (of which Australia is the major market) but also a significant amount of associated liquids that the Applicants cannot currently extract due to having to reinject the gas.
- Not all of the Applicants will be seeking project financing. Exxon Mobil confirmed at the Conference that it would not be seeking project financing.

[12] Draft Determination p.68

[13] Esso Highlands Limited PNG Gas Project "Environmental Impact Statement Executive Summary" December 2005 p.8 at http://www.exxonmobil.com.au/pdf/png/PNG%20Gas%20Pjt_EIS_ExSum_text_Rev4.pdf

It is important that the Commission distinguish between two projects as do the Applicants in their EIS on the upstream project in December 2005[14]:

1. " 'PNG Gas Project': the proponent of the PNG component of the project is the PNG Gas Joint Venture, with Esso as the Operator on behalf of its co-venturers" i.e. an upstream project to extract gas and liquids being developed by the Applicants, and
2. "'PNG – Queensland Gas Pipeline Project': the proponent of the Australian component of the project is AGL Petronas Consortium (APC), which will operate and own the sales gas pipeline from the international border between Papua New Guinea and Australia in Torres Strait to markets in Australia" i.e. a midstream project to deliver gas to Australia

This accords with the view put by the Applicants in their submission.

In assessing the application for authorisation, the Applicants are asking the Commission to enable them to jointly market PNG gas in Australia to assist them in underwriting the project financing by some of the Applicants for a gas *and liquids* project in PNG. At the Conference the Applicants pointed to the low returns in the early years of Greenfield projects. This may be the case if only the gas revenues are considered. However, this is a gas and liquids project where the liquids returns in the early years are likely to be large. Certainly all the stockbroking analyses evaluating the AGL purchase of 10% of the Project analyse it as predominately a liquids project, particularly in the early years:

> "Based on a purchase price of $US 400m and a value split of 85% oil and 15% gas, the implied value of the Project is $US600m. This compares with our valuation of ~$US750m with which we remain comfortable".[15]

Oil Search sees the Project as a gas and liquids project. As they note:

> "Commercial banks to provide primary funding commitment,
>
> ...
>
> - Reviewing opportunity to maximise leverage by merging oil & gas financing, should enhance pricing by removing need to capitalise interest, & provide completion support"[16]

In other words, banks in assessing their required debt coverage ratios for the project financing, will be looking at both gas and liquids revenue that will be driven by the volume of gas sales.

The Applicants' second submission seemed to confirm the view that they are interested in a certain volume, rather than a certain time period:

> "A short-term authorisation will increase the risk that investment returns will not be met in the future and as such the Participants may decide to delay the Project until the threshold volumes have been met, or decide not to go forward with the Project at all."[17]

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[14] Esso Highlands Limited PNG Gas Project "Environmental Impact Statement Introduction" December 2005 p.3 at http://www.exxonmobil.com.au/pdf/png/EIS_Main_Rpt_Ch01_Rev4.pdf.
[15] Goldman Sachs JBWere, "Oil Search Limited/Australian Gas Light Company" Research Note, 16 January 2006.
[16] Oil Search Limited "PNG to Australia Pipeline Project – Alignment Matters", Presentation to Australian & PNG Gas Conference, December 2005, slide 20 at http://www.oilsearch.com.au/resource/051205%20AJM%20PNG%20Gas.pdf.
[17] Allens Arthur Robinson "Supplementary Submission" 8 April 2005 at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D05+19917.pdf&trimFileTitle=D05+19917.pdf&trimFileFromVersionId=725437.

The ACCC was unable to provide the EUAA with the confidential information on which it assessed the Project financing term, but it did confirm that it had not sought external advice on Project financing matters but had taken the advice of the Applicants. The EUAA submits it is important to note that the information on Project financing provided by the Applicants was part of their original application in December 2004, prior to the significant developments in the intervening period including the Alcan and AGL contracts and prior to the significant increase in oil prices in the last 12 months. The EUAA would expect that these factors would make the project significantly more attractive to project finance providers and swamp any impact that the presence or absence of joint marketing may have on the banks risk profile.

In the absence of access to this confidential information, the EUAA has made its own enquiries in the last month. These revealed that:

- The Applicants are yet to go to the market to formally seek Project finance and so, at this stage, do not know exactly what term will be offered.
- There are varying comments around the market about the likely term of Project finance, but it appears that this will be limited by the term of political risk insurance (PRI) and export credit agency (ECA) finance.
- Getting PRI longer than 5-7 years for PNG will be difficult; ECA financing will depend on the input sourcing strategy.
- Debt service ratios will be based on the capacity of total Project revenues, i.e. dry gas, liquids and oil revenues.
- The fact that there is an active debate in the market about the terms of the Project financing indicates that the banks are confident about the Project meeting commercial hurdles and proceeding.[18]
- Project financiers seek to shift risk back to borrowers who seek to shift risk back to other parties including customers.
- Banks would expect that the PNG Gas Joint Venture would put in place measures to manage credit risk of customers.

The Commission made reference to the Macquarie Bank report on the risks to debt and equity participants in Greenfield gas Project and then noted that:

> "...regulatory risk is just one of many factors (and) ... the term of the authorisation may be one of many factors influencing the structure, level and cost of finance."[19]

The following discusses the likely concerns of the potential project finance banks in the assessing the ability of the Applicants having sufficient funds to cover debt service ratios.

Applicant's balance sheets

Strong oil prices have considerably improved the balance sheet of Oil Search, which is likely to have the major portion of the project financing.[20] Oil Search recently presented a very bullish view of their ability to get project financing.[21]

[18] "Road testing of Preliminary Information Memorandum very well received" Oil Search Limited "PNG to Australia Pipeline Project – Alignment Matters" Slide 20
[19] Draft Determination p.68
[20] See article by Stephen Wisenthal, "Oil Search flush with cash" in *Australian Financial Review*, 22 February 2006 p.50 quoting the Oil Search CEO, Mr Botten, as saying: "With $US530m in the bank and no debt, the company had enough money to cover its share of the gas project and a record drilling program – with enough left over to consider acquisitions."

ExxonMobil acknowledged at the Conference that it will not be seeking project funding. Based on the $US2.5b upstream funding requirement[22], the Oil Search proposed 70:30 debt equity ratio[23] and ownership positions at financial close[24], the likely project financing requirements for each Applicant are:

		Financing $USm		
	Equity Share	Debt	Equity	Total
Oil Search	37.2%	651	279	930
AGL	10.0%	175	75	250
JPP	3.4%	60	26	85
MRDC/State	14.3%	250	107	357
Santos	9.5%	166	71	237
Sub total	**74.3%**	**1,302**	**558**	**1,860**
ExxonMobil	25.7%			642
Total				**2,500**

The amounts involved do not appear to be significant given the participants' balance sheets. No doubt the requirements of MRDC/State financing are subject to considerable discussion, but the EUAA notes that the State has the ability to access concessional funding for both its debt and equity portions from development banks.

Market size and securing contracts with high credit quality customers

The Applicants have regularly revised upwards their estimate of the potential market size in Australia:

- 150-200PJ/yr[25]
- 200PJ/yr[26]
- 300PJ/yr[27]

with the Applicants now saying they are increasing the size of the delivery facilities.

There is also growing confidence that the Applicants will be able to secure this market with long-term contracts. As Peter Botten, the Oil Search CEO, recently commented, in reference to the negotiations for offtake agreements and in the context of the Alinta bid for AGL and Oil Search's 2005 results:

> "The market itself, in our belief, is largely underwritten."[28]

While it is difficult to reconcile the 300PJ figure with the Applicants Project EIS referred to above, which states the capacity at 225PJ/yr[29], the table below shows that by financial close there could be contracts in place with high credit quality buyers for well over 200PJ/yr for a 20-year period.

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[21] Oil Search Limited, "PNG to Australia Pipeline Project – Alignment Matters" Presentation to Australian & PNG Gas Conference, December 2005, slide 20 at http://www.oilsearch.com.au/resource/051205%20AJM%20PNG%20Gas.pdf.
[22] Esso Highlands Limited PNG Gas Project, "Environmental Impact Statement Introduction", December 2005, p.6 at http://www.exxonmobil.com.au/pdf/png/EIS_Main_Rpt_Ch01_Rev4.pdf.
[23] Oil Search Limited, "PNG to Australia Pipeline Project – Alignment Matters", Presentation to Australian & PNG Gas Conference, December 2005, slide 19 at http://www.oilsearch.com.au/resource/051205%20AJM%20PNG%20Gas.pdf.
[24] Macquarie Research Equities, "Oil Search – Happy New Year for OSH?", 17 January 2006.
[25] Oil Search, "Industry Presentation", 8 May 2002, slide 10 at http://www.oilsearch.com.au/resource/pres-020508-Industry.pdf.
[26] Draft Determination p.21
[27] "Alinta's lunge for AGL won't block PNG pipeline, says Oil Search boss" *Sydney Morning Herald,* 22 February 2006
[28] "Alinta's lunge for AGL won't block PNG pipeline, says Oil Search boss" *Sydney Morning Herald,* 22 February 2006, see also Oil Search Limited, *Full Year Results Presentation*, 21 February 2006, slide, 20http://www.oilsearch.com.au/resource/060221%202005%20Full%20Year%20resultsPRINT%20correct.pd.
[29] The APC EIS on the Ballera lateral, also submitted in December 2005[29] did not mention the gas capacity but it is assumed it is consistent with the ExxonMobil EIS. AGL Petronas Consortium PNG-Queensland Gas Pipeline Project, "Initial Advice Statement Ballera Lateral", December 2005 at http://www.coordinatorgeneral.qld.gov.au/library/pdf/mp_pnggas_ias_part1.pdf.

	Lower Limit	Upper Limit	Duration
Binding contracts			
AGL	75	95	20 yrs
Conditional contracts			
Alcan	43	43	20 yrs
Comalco	14	50.5	20 yrs
Queensland Alumina	12	30	20 yrs
CS Energy	10	10	20 yrs
Other potential customers			
Santos	60	60	
TXU /TRU Energy	10	20	
Total	224	308.5	

Source: Goldman Sachs JBWERE "Oil Search Limited" Research note 21 February 2006

Given this, it is not surprising that Oil Search CEO, Mr Peter Botten would say:

> "And demand is now so strong that Oil Search, ExxonMobil and their partners might have to turn away some customers for their gas…"[30]

> "Botten also rejected the notion that a significant new customer would need to come on board prior to financial close and even went as far as to say that the number of existing conditional agreements meant the Project was now looking at the upper end of its production scope. 'I think the view is that there are well and truly enough conditional agreements out there and looking at the customer base there is enough off-takers of gas that we think will take us to the upper range of the Project build. So we are well above what we consider to be the threshold for an economic Project.'"[31]

This suggests that, by the time of financial close most, if not all project capacity (based on EIS 225PJ/yr capacity), will be taken up with jointly marketed contracts with high credit quality customers for 20 years, much longer than any project financing term and hence of great comfort to potential banks.

Further, apart from these gas sales to Australian customers, there are also the in country PNG sales, eg Mitsubishi/Itochu petrochemical Joint Venture and CNG sales to New Zealand[32]

Capital cost

This has increased recently due to both the increase in project size to respond to the increased market and higher input costs. This does not seem to be a concern to the Applicants, nor the market, given the increase in the gas market size and the oil price.

[30] Stephen Wisenthal, "Oil Search flush with cash", *Australian Financial Review*, 22 February 2006, p.50
[31] "Botten on top of PNG gas project – Part 1" *PNG Industry News*, Tuesday, January 17, 2006
[32] Oil Search Limited *Full Year Results Presentation*", 21 February 2006, slides 42-43 http://www.oilsearch.com.au/resource/060221%202005%20Full%20Year%20resultsPRINT%20correct.pdf.

Oil and gas prices

There has been a significant rise in oil prices in the last 12 months. The only difference among forecasters appears to be whether they will stay high or very high depending on your view about peak oil.

Banks have numerous ways to limit their repayment risk, such as requiring oil price hedging, eg, in early 1999 Oil Search was required to put hedging in place as part of its refinancing[33] and it did in 2006 as part of its sale of equity to AGL.[34] It is assumed that the banks are happy to take re-pricing risk where their gas sales contracts have price re-openers.

Separate marketing

Given the Applicant's view[35] that the price will be no lower than with joint marketing then there should be little concern over whether the Applicants market separately or together. The Project's cash flow is maintained. Presumably if there was separate marketing, bank covenants would not allow the borrower to lower the price if it breached debt service coverage ratios.

It is interesting to note that a recent report by Macquarie Research discussing the areas of project uncertainty that appear to present the greatest risk to project sanction and timelines, did not mention joint marketing authorisation[36].

While MRDC and Mitsubishi commented at the Conference that they do not wish to separately market because they do not have the resources to do so, this is not a sufficient reason to justify extended joint marketing.

CSM competition

The EUAA does not see significant competition coming from CSM – see comments below.

Political Risk Insurance (PRI)

Comments by Oil Search CEO Mr Peter Botten suggest this should not be a concern:

> "PRI cover to come from private sector and ECAs
>
> - Expect banks to provide uninsured tranche
> - Initial testing indicates that more than sufficient (PRI and ECA) cover available"[37]

In summary, the Project finance banks potentially have a project that at financial close will have:

- Most if not all of the pipeline capacity under 20 year contracts – much longer than the project financing term – to high credit worthy customers.
- Borrowers having generally very strong balance sheets due to the strong oil price.
- Access to oil and liquids revenues to support debt service coverage ratios.
- The reputation of ExxonMobil as an operator and Oil Search's experience in PNG.

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[33] Oil Search, Annual Report, 2000, p.14
[34] Oil Search Limited, "Completion of Sale of Assets to AGL for $US427m", Press Release, 17 February 2006.
[35] Frontier Economics "Implications of emerging patterns in energy markets for the PNG Joint Venture" Annexure 2 in Application at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D04+61951.pdf&trimFileTitle=D04+61951.pdf&trimFileFromVersionId=725437.
[36] Macquarie Research Equities, "Oil Search", 17 January, 2006
[37] Oil Search Limited, "PNG to Australia Pipeline Project – Alignment Matters", Presentation to Australian & PNG Gas Conference, December 2005, slide 20 http://www.oilsearch.com.au/resource/051205%20AJM%20PNG%20Gas.pdf.

- Availability of required PRI/ECA support.

It is difficult to understand why banks will not support the project simply because the Applicants do not have joint marketing for a small part of pipeline capacity.

EUAA Position

- The confidence in the project proceeding is considerably higher now than in December 2004 at the time of the application. With the confirmation of existing conditional contracts and a deal with Santos – all done under a joint marketing authorisation - the project will be attractive to potential financiers given that PRI is expected to be available.
- A long period of joint marketing beyond financial close simply to cover only a small proportion of pipeline capacity does not seem to be a crucial factor tipping the project one way or the other. The other project positives/risk profile seem much more important.
- The Commission should obtain independent advice on what the likely terms of the project financing are likely to be. This is consistent with the Commission's approach in other areas, eg in assessing the revenue cap for a transmission network service provider the Commission seeks detailed independent advice on the applicant's arguments to justify its revenue cap decision.
- In obtaining this independent advice the Commission should:
  - Only consider the project financing requirement for those parties who will obtain project financing.
  - Only consider the project financing required for the upstream facilities in PNG. Any project financier of the APC pipeline should obtain sufficient comfort from joint marketing into the pipeline.
  - Include all "Project" revenues – gas and liquids – in assessing the project financing term.
- If, following this independent advice, the Commission decides to extend the joint marketing authorisation term beyond financial close, then the Commission should consider having a term that is less than the Project finance term and allow the Applicants to reapply to extend the authorisation based on demonstrated public benefits at the time.

This is because, as pointed out above, the material adverse change provision in the Act is of little or no use for the Commission in seeking to review the authorisation prior to the end of the authorisation.

Alternatively, the Commission could consider an approach based on joint authorisation until certain threshold volumes are achieved to meet reasonable Project return requirements. This would suggest that if there is little uncontracted pipeline capacity at the time of financial close, then the threshold volumes may well have been achieved. This seems to be more relevant to the continuation of public benefits from any joint marketing authorisation than linking it to a time period.

8. What is the shape of the market?

Draft Determination

The Commission argued that:

> "While the Project is likely to enjoy a large share of the Queensland market, the ACCC considers it is likely that coal seam methane, other sources of natural gas and alternative forms of energy will provide some competitive constraints on the Project."[38]

... and ...

> "Given the uncertainty surrounding future market conditions the ACCC cannot be confident that the public benefits will outweigh the detriments for an indeterminate time or even for a period as long as 30 years. ... It is uncertain that separate marketing will not become feasible at some stage."[39]

... and further ...

> "Once constructed the pipeline could be utilised by other producers ...(to) encourage the development of gas reserves in Queensland and further production in PNG, resulting in additional supply to Australia which would further enhance competition."[40]

Discussion

(a) Competition for PNG Gas

The EUAA believes that the competitive pressure on PNG gas, particularly in the Queensland gas market will be limited for the foreseeable future. There are important constraints on the ability of CSM and the smaller producers involved to compete against a project such as PNG.

<u>CSM and other gas competition</u>

The significant trend towards consolidation in Queensland CSM producers over the last 1-2 years continues. For example:

- Origin acquisition of Fairview and Durham (February 2002)
- Santos acquisition of Tipperary (2005)
- Origin acquisition of Pangaea Oil Gas' CSM assets (February 2006)
- BHPB is selling its CSM interests in the Bowen Basin (March 2006)
- QGC takeover attempt on Sydney Gas (February 2006)

as well as moves such as the Alinta acquisition of AGL shares (February 2006) and vice versa (March 2006) impacting on market structure.

The EUAA does not agree with the Commission's assessment in its review of the Santos acquisition of Tipperary Corporation in 2005 that "...the existence of a significant number of other coal seam gas producers..." and "potential for new coal seam methane gas producers to enter the market":

- would replace the competition previously provided by Tipperary which the Commission acknowledged was "...a vigorous competitor"; and
- Ensure that "...the potential for co-ordinated conduct between the gas suppliers would be limited...".[41]

[38] Draft Determination p.6
[39] Draft Determination p.67
[40] Draft Determination p.38
[41] ACCC "Santos Limited's acquisition of Tipperary Corporation", Public Competition Assessment, 11 October 2005.

There have been a number of smaller CSM companies floated in recent years but their share of reserves is small and market capitalisation low compared to the now dominant players – Santos and Origin – so their continued independence is not guaranteed for any period. The table highlights the disparity in market capitalisation and the ease with which larger players could acquire the smaller companies.

	Market Capitalisation
Santos	$6.5b
Origin	$5.3b
QGC	$304m
CH4	$126m
Arrow	$125m
Mosaic Oil	$75m
Sunshine Gas	$75m

Source: *Courier Mail*, 10 March 2006

Even for those that remain independent it will be difficult to compete against the larger companies on both price and deliverability/reliability. The Applicants acknowledged that CSM would only be a potential competitor for "incremental demand". [42]

Smaller CSM producers are in a "Catch 22" situation of not being able to get to the markets that provide long-term ability to expand their production. As the Frontier Economics study, submitted by the Applicants comments, in the context of PNG gas losing large load customers:

> "Although these users (large users, such as large industrial loads) represent potentially very attractive customers to the Applicants, there is also a problem if these customers subsequently obtain their gas requirement from another supplier since they typically enter into (a) long term agreement – which generally denies the Applicants an opportunity to contract with these customers... the loss of even a small number of (these) potential customers places a significant obstacle in front of Applicants"[43]

Taking the example of the central Queensland region, the EUAA agrees with comment in the ACIL Tasman study, submitted by the Applicants, on the central Queensland region that "...PNG becomes the dominant supplier in the region..."[44] but that the report's comment "...that Bowen Basin CSM remains a competitive source..."[45] is at best only applicable to small

[42] Allens Arthur Robinson, Supplementary Submission, 8 April 2005 p.10 http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D05+19917.pdf&trimFileTitle=D05+19917.pdf&trimFileFromVersionId=725437.

[43] Frontier Economics "Implications of emerging patterns in energy markets for the PNG Joint Venture" Annexure 2 in Application at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D04+61951.pdf&trimFileTitle=D04+61951.pdf&trimFileFromVersionId=725437.

[44] ACIL Tasman "Economic Impacts of the PNG Gas Project" p.27 Annexure 4 in Application at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D04+61956.pdf&trimFileTitle=D04+61956.pdf&trimFileFromVersionId=725437.

[45] ibid

volumes, assuming that these producers can deliver to Gladstone. In fact, ACIL Tasman's modelling results seem to agree when it forecasts "CSM Bowen" as supplying only about 15% of Gladstone demand by 2020[46].

The EUAA believes the other possible alternative sources are unlikely to assist with joint marketing in place:

- Transport costs are too high for Bass Strait, even with swaps.
- Timor Sea gas will not provide this competition because there is no foundation market, particularly if PNG gas is delivered to Mt Isa and Moomba.
- High transport costs from Cooper Basin, even if there are sufficient uncontracted reserves.

The EUAA concludes that the CSM market in Queensland is likely to be dominated for some years by two players – Origin and Santos, the latter currently in negotiations with the Applicants to re-enter the Project – and that it is highly questionable whether this is going to provide vigorous competition for a jointly marketed PNG gas.

We note that the Commission has itself expressed scepticism that the entry of PNG gas will bring a sustained drop in gas prices:

> "... the ACCC considers that some of the benefits, such as the extent of the price decreases, may be overstated."[47]

EUAA members in Queensland have commented about how gas prices have fallen in recent years due to a combination of the maturing CSM market where new fields have been developed, a fall off in availability of Cooper Basin gas and the potential entry of PNG gas. Whilst this is welcome, it remains to be seen if, once the Project reaches financial close, the two dominant local CSM based suppliers, one of whom is expected to be part of the Project, continue to offer competitive terms to PNG Gas.

<u>Energy market competition and countervailing market power</u>

The EUAA is sceptical about the Commission's view that:

> "...the Project will promote competition between gas and other energy sources. A large number of negotiations undertaken by the Project have been unsuccessful due to potential customers choosing alternative energy sources such as coal and liquid fuels. The fact that potential customers have chosen alternative energy sources attests to the competition Project gas currently faces from these other energy sources"[48]

Our scepticism is based on two reasons:

- What has caused potential customers to choose an energy supply other than PNG gas; and
- What are the real alternatives faced by potential customers?

On the former, the issue of the inability of PNG gas to guarantee a delivery date was acknowledged by the Commission:

[46] ACIL Tasman, op cit, Figure 33.
[47] Draft Determination p.49
[48] Draft Determination p.46

> "The lack of certainty regarding timing of delivery of Project gas has been a significant impediment to obtaining purchase commitments from some customers."[49].

Comalco's preference was for using PNG gas for a gas fired co-generation plant as part of Stage 1 of its alumina refinery in Gladstone. The reason it choose coal was because PNG gas could not meet the delivery schedule for the refinery.

On the latter point, the Applicants have commented that even if the Commission accepts the EUAA proposition that CSM is not going to be an effective competitive source for large users, these users have countervailing market power – either through the ability to use other fuels or other gas suppliers. [50]

In the absence of alternative gas suppliers, sellers jointly marketing have little incentive to offer buyers appropriate flexibility of supply terms. Energex found in 2005 that it had no countervailing market power in its attempts to get appropriately flexible arrangements for the supply of gas for power station use in Townsville from joint marketing sellers. Energex reported in a submission to the Commission on the PNG Project application that they have observed an unwillingness by joint marketing gas sellers to:

- Engage in separate negotiations where they are in joint marketing arrangements.
- Offer flexible, innovative and competitive products.
- Offer terms other than very long term contracts.
- Offer "unbundled" contracts or other flexibility such as backhaul and pipeline storage options that assist with gas fired generation.[51]

This led Energex to only support joint marketing of PNG gas until financial close, rather than for three years beyond financial close as they had supported in their earlier submission.[52]

The Commission evaluated this proposition in the North West Shelf decision and concluded that this was not the case given limited availability of alternative suppliers.[53] The EUAA submits that the situation is no different in the current case. Large users do not have many competitive options once PNG gas proceeds.

While a large energy user may have an energy source option before it decides whether to use say gas or coal, this disappears once the decision is made for a long life asset, so choice is a one off decision at the time of capital investment. These are the same arguments that led the Commission in the North West Shelf Project decision to reject the Applicants' view that the relevant market was the "energy" market broadly defined. The Commission concluded that the relevant market was the market for gas in WA.[54]

(b) Pipeline benefits to competing gas producers

The Commission accepted the argument of the Applicants that the pipeline will encourage the development of other gas sources without, we assume, knowing the pipeline access principles, because they have yet to be published.

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[49] Draft Determination p.47
[50] Bob Reed, comments at the Conference – see transcript
[51] Energex Submission 7 November 2005 at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D05+69582.pdf&trimFileTitle=D05+69582.pdf&trimFileFromVersionId=725437.
[52] Energex Submission 15 February 2005 at http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D05+7078.pdf&trimFileTitle=D05+7078.pdf&trimFileFromVersionId=725437.
[53] North West Shelf Project (1998) ATPR (Com) 50-269 at 55,776
[54] North West Shelf Project (1998) ATPR (Com) 50-269 at 55,747

Yet the original approved AGL/Petronas access principles in 1999 prohibited backhaul for a number of years from first gas – a measure deliberately designed to prevent competition from other Queensland gas producers.

We agree with Commissioner Willett's comments to the *Australian* and at the *PNG Gas Conference* in Brisbane last December:

> "The PNG gas Project … has the potential to spur on the development of new Queensland gas fields … . (C)rucial to the success of such Projects would be the access regime applied to the pipeline. … But Australia will only maximise these benefits if the access regime for the pipeline properly takes into account the rights of all parties involved in the Project, including third parties who wish to gain access to the pipeline, in order to promote further economic development."[55]

The AGL Demerger document refers to the MCE process reviewing the gas access regime framework and the potential for greenfields pipelines to apply to have no economic regulation for a period of 15 years from the commencement of operations.[56]

The EUAA would like to understand from the Commission what action it will undertake to ensure that the PNG gas pipeline access rules will, in fact, encourage the development of full and unrestrained third party access from the commencement of operations. The EUAA would be strongly opposed to the use of access principles as a regulatory barrier to entry for new producers. For example, a postage stamp tariff for the APC pipeline (Macquarie Research estimates it at around $1.40/GJ[57]) would act as a significant barrier to Bowen Basin CSM producers being able to compete with PNG gas on an equal footing.

While outside the Commission's jurisdiction, it remains to be seen whether the PNG section of the liquids processing facilities and the pipeline are truly open access to allow other PNG gas producers to market their gas to Australian customers – this was claimed as a public and competitive benefit.

(c) When conditions for separate marketing exist

While there are different views on whether the conditions for separate marketing exist now or will exist by the time PNG gas arrives, all parties would agree that the Eastern Australian and Queensland gas markets are very dynamic. The table provides some measures:

	Number of Primary Gas Contracts		**Number of Primary Gas Buyers**	
	Eastern Australia	Queensland	Eastern Australia	Queensland
2000	26	14	19	11
2005	66	37	35	22
Growth 2000 to 2005	40	23	16	11

Source: EUAA compilation from public information

55 Ed Willett "PNG gas pipeline spur to other developments: access regime crucial" *News Release*, 6th December 2005
56 AGL Demerger of AGL Energy Limited Detailed Information Sections p.85
57 Macquarie Research Equities "Oil Search – Happy new year for OSH?" 17 January 2006.

The number of primary gas contracts (with a gas producer) and primary gas buyers (from a gas producer) have more than doubled since 2000, creating a much deeper pool of buyers for small producers to sell to. In Queensland, a significant part of the increase is associated with gas-fired generation Projects, which according to ABARE, will significantly enhance the likelihood of short-term gas trading. However this growth has occurred prior to the considerable consolidation in CSM gas producers that has occurred in the last 12 months and the EUAA expects this will impact adversely on future growth.

Finally, the crucial role the ACCC play in molding and progressing the market is highlighted by the ABARE report in 2003 *Australian Gas Markets moving toward maturity*, which compares the Australian market to the USA and UK markets. Both of these markets required regulatory intervention before they could mature and develop spot markets. This implies the ACCC will have some role in promotion of a gas market mature enough to support separate marketing – and the 16 year long authorisation proposed would narrow the opportunity to do this.

EUAA Position

The dynamic nature of the Eastern Australian gas industry is shown by the dramatic changes that have occurred in recent years which have served to decrease the number of players in gas supply, particularly in the Queensland market. This change will continue and make it very difficult to forecast what market conditions may exist even a few years into the future. This, plus the fact that the APC access principles have not been published and approved, means that the EUAA finds it difficult to understand how the Commission could confidently forecast that the conditions for separate marketing would not occur sometime within the next 16 years.

9. <u>What has actually been authorised?</u>

Draft Determination

The draft determination authorises joint marketing for a period of 16 years from the time of the authorisation within a framework of confidentiality and ring fencing arrangements. The authorisation includes future participants under certain conditions.

Discussion

The draft decision is vague in its specification of what is actually authorised.

(a) Wet or dry gas?

The Commission's description of the Project refers to dry gas. [58] The EUAA understands that the PNG Gas Joint Venture are yet to decide if they will bring wet or dry gas into the Queensland pipeline and whether there will be subsequent liquids stripping in Australia and that this is a matter being negotiated with Santos.[59] Customers negotiating Gas Supply Agreements (GSAs) are negotiating for the purchase of dry gas according to the Queensland gas specification.

The Applicants made no mention of seeking authorisation for joint marketing of liquids in the gas. The EUAA is concerned that the inclusion of liquids in an open access gas pipeline will use up capacity that would be otherwise available for other gas suppliers to compete in the market. This may create problems for other potential PNG gas producers, e.g. Cheetah Oil &

[58] Draft Determination p.21
[59] A. Marx "Pressure on Santos to buy into PNG pipeline", *Courier Mail*, 18th January 2006

Gas and limit access to the pipeline by Queensland producers. One of the claimed benefits of the project was purported to be the ability of others to use the pipeline. The transportation of wet gas would hold back this benefit.

(b) Delivered to the customer?

The draft decision is vague on this point – does it mean joint marketing of PNG gas into the pipeline at the Australian/PNG border; or joint marketing of PNG gas to the customer's door in Australia?

Previous Commission decisions on joint marketing have all related to production from Australian gas fields with approved publicly available access principles for the pipeline that transports the gas to customers. This is the first decision to consider marketing of gas from another country. The EUAA submits that the Commission's consideration of joint marketing for offshore gas should be the same whether it comes 'by pipe or boat'. The authorisation should relate to the marketing of that gas at its point of entry into Australia, not to the customer's door, and hence not cover the APC pipeline, for two reasons:

- APC is not a party to this application[60] and made no reference in their submission supporting joint marketing supporting the authorisation being for delivered gas[61]; and
- The access principles for this pipeline are yet to be proposed and approved.

Given this, the Applicants should not be able to agree on the terms and conditions for transporting the gas from the border to the customer's gate when the customer has no idea of what the access principles contain. The transport terms and conditions should be published separately in the relevant access principles and then subject to the normal Commission review and approval. The customer should be able to see the access principles to ensure they are reflected in the gas contracts.

An example of the importance of this is shown in the Commission's discussion of delivery points in the North West Shelf decision. There the Commission referred to the need for gas contracts to:

> "...make provision for parties to readily nominate alternative or additional delivery points for gas, (as) this has the potential to foster more flexible and efficient supply arrangements"[62]

The EUAA does not believe that this objective can be achieved if the Applicants are able to jointly agree on the transmission terms and conditions where the access principles are not available to the user. The failure to do so can also frustrate CoAG gas reform initiatives.

(c) How long is the term of the authorisation?

The language used by the Commission in Chapter 11 implies that the Applicants are able to jointly market long term contracts up until the end of the 16 year period in 2022, i.e. a 20 year contract entered into in year 15 would be covered. [63] This has the effect of giving the Applicants up to a 35-year authorisation - well beyond what we consider was the Commission's intention given its comment:

[60] Draft Determination Section 2.2 pp10-11
[61] Letter from Ross Gersbach to ACCC, 21 February 2005.
[62] North West Shelf 55,784
[63] Draft Determination pp73-74

> "Given the uncertainty surrounding future market conditions the ACCC cannot be confident that the public benefits will outweigh the detriments for an indeterminate time or even for a period as long as 30 years."[64]

Apart from this concern, the EUAA is concerned that, by the time of the expiry of the authorisation, there may be no capacity left in the pipeline for the Applicants to separately market. With a stated potential capacity of 225PJ/yr[65] and, with the Santos deal completed, confirmed markets prior to financial close of most of that amount, will leave only a small capacity to then jointly market beyond financial close. With the proposed 15-year authorisation period beyond financial close, this remaining capacity is likely to be fully contracted by the time of the end of the proposed authorisation in 2021 under contracts that last until well past 2035. In this case the Commission finding that, in the lead-up to 2022 (based on the Draft Determination) the conditions for separate marketing exist, could well have no impact on PNG gas competition. Hence, there would be no public benefits simply because the APC pipeline is full. Future customers (and public benefits) would need to wait until 2029/2030 for the initial 20-year foundation contracts to expire. In this case there is no capacity to separately market PNG gas when the proposed authorisation finishes in 2022. The Commission considered this issue in the North West Shelf decision[66] as it recognised the potential for uncertainty in the lead-up to 2005, as purchasers would not want to enter long term contracts if they think that the authorisation will conclude in 2005. The Commission's decision in this case also needs to eliminate this uncertainty.

EUAA Position

The Authorisation should cover:

- Dry gas according to the Queensland gas specification.
- Gas into the pipeline at the PNG/Australia border, i.e. it does not include authorisation for the Applicants to jointly agree the terms for transport of that gas from the Queensland/PNG border to the customer's delivery point.
- The full life of contracts entered into prior to financial close and negotiated under the joint marketing arrangements, e.g. the Applicants can engage in joint marketing for price review for the life of these contracts.
- In the event that the Commission decides to give authorisation beyond financial close then any contract entered into after financial close - will only last up to the end of the authorisation period and not for the life of the contract.

10. What is the Appropriate Counterfactual?

Draft Determination

The ACCC has assessed the application for joint marketing of PNG gas on the basis of a counterfactual "with and without" test. This essentially establishes the balance of anti-competitive detriments versus public benefits based on a counterfactual proposition of what the situation would be without the project going ahead. In its Draft Determination, the ACCC has assessed this as being that there would be no PNG gas, or that additional gas would eventually be forthcoming from the Timor Sea (or some other source) but that this would be an inferior outcome and would not deliver the same public benefits.

[64] Draft Determination p.67
[65] Esso Highlands Limited PNG Gas Project, "Environmental Impact Statement Executive Summary", December 2005 p.8 at http://www.exxonmobil.com.au/pdf/png/PNG%20Gas%20Pjt_EIS_ExSum_text_Rev4.pdf.
[66] North West Shelf op cit 55,786-789

Discussion

The EUAA seriously queries whether this is an appropriate counterfactual with which to assess the project. If it is not appropriate, then it may well skew the ACCC's determination of public benefits.

For example, another feasible counterfactual is that the PNG project would still go ahead but on a delayed timetable. If this were the case, then the public benefits it provides would still be realised, albeit later in time. In addition, this would be with less detriment to competition if the project were to eventually go ahead without joint marketing being sanctioned by the ACCC, or if the period of authorisation for joint marketing were shortened. For end users of gas, the delay in PNG gas may well be worth the wait.

In any case, we do not believe that a delay would necessarily occur or that it would be considerable.

In our view, the evidence presented here and elsewhere as to why a long period of joint marketing is not justified is so compelling as to seriously question the ACCC's approach to establishing the counterfactual. Moreover, this would have had a significant impact on the calculus of the public benefits in the Draft Determination. A counterfactual that allowed for the entry of PNG gas on a delayed timetable either without or with a shorter period of joint marketing, would seriously negate the public benefits allowed for by the Draft Determination.

EUAA Position

The EUAA believes that the ACCC has erred in its approach to establishing the counterfactual for this authorisation and that it should consider an alternative scenario of a delayed entry of PNG gas with separate marketing or with a shorter period of joint marketing. The evidence presented in this submission suggests that this is feasible and that the ACCC's counterfactual of no PNG gas in the absence of an extended authorisation for joint marketing is questionable.

11. <u>Confidentiality and Ring Fencing Agreements</u>

Draft Determination

The Commission proposes that the joint marketing take place within confidentiality and ring-fencing arrangements, outlined in Appendix 1[67] to the Draft Determination, to protect commercially sensitive information obtained through the joint marketing activities.

Discussion

The EUAA agrees with the Commission's comments that:

> "Further detriments associated with joint marketing … (include) … the potential for a Project participant to inappropriately disclose confidential information obtained through joint marketing"[68]

and appreciates the effort put into drafting the proposed ring-fencing and confidentiality arrangements.

EUAA Position

We wish to raise two issues:

- ***[Confidential point deleted]***

[67] Draft Determination pp75-83
[68] Draft Determination p.64

- The proposed arrangements seem reasonable, for example, to ensure that information does not flow between the marketing staff involved in PNG gas sales and the Marketing Staff involved in sales from an Australian field. However, the EUAA would like understand how the Commission would see the proposed arrangements working in the case where a participant's Board is concurrently considering gas deals with the same customer for gas from different fields, including PNG.

Clause 2.2[69] seems to allow disclosure in this case and the EUAA is interested in understanding how this does not lead to a potential anti-competitive detriment.

12. Parties to the authorisation

Draft Determination

The Commission has proposed rules for when a new participant would trigger a requirement to re-apply for authorisation.

Discussion

The EUAA notes the Applicants' amendment of their application to include AGL though the purchase of its interest in the Project through AGL Gas Developments (PNG) Pty Limited.

The EUAA's concern is with the Applicants' claim to extend the authorisation to any future party in the Project, no matter what their existing gas interests in Eastern Australian and no matter what their economic interest in the Project.

The Commission examined the same issue in the North West Shelf case and limited the authorisation to the existing participants, with future participants required to re-apply for authorisation.

EUAA Position

The EUAA believes that the mix of participants in the Project in part determines the ability of participants to separately market gas. A significant entrant or change in the mix of participants should be examined by the Commission for impacts on the authorisation. The EUAA would propose that this re-examination should occur if the new entrant has either:

- A significant equity position in the Project; or
- A significant economic interest in upstream gas in the eastern Australian market.

The EUAA acknowledges the difficulty the ACCC has in setting a benchmark and also its effect on the participants. However, given that any authorisation is based on an assessment of public benefits and grants immunity from contravention of the anti-competitive provisions of the Trade Practices Act, the EUAA believes that the right to jointly market gas should be conditional on Project participants abiding by certain rules and Applicants should be prepared to have some restrictions imposed upon them that will help to ensure that an appropriate balance between public benefit and anti-competitive detriments is maintained.

[69] Draft Determination p.77