

24 March 2006



Suite 1, Level 2,
19-23 Prospect St
BOX HILL Victoria 3128
Telephone: (03) 9898 3900
Fax: (03) 9898 7499
Email: euaa@euaa.com.au
Web page: www.euaa.com.au

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

PNG Gas Project – Application for Authorisation A40081
Further Submission on Draft Determination & Applicants’
Supplementary Submission

Dear Mike,

The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide a further 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, the Commissions’ Draft Determination and the PNG Gas Project Participants’ supplementary submission.

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

Yours sincerely

A handwritten signature in black ink, appearing to read "Roman Domanski".

Roman Domanski
Executive Director



**Further Response to the ACCC on the Draft
Determination of the PNG Gas Project – Application
for Authorisation & Applicants' Supplementary
Submission**

24 March 2006

CONTENTS

1. INTRODUCTION	1
2. JOINT MARKETING BEYOND FINANCIAL CLOSE	1
3. WHAT CONDUCT IS BEING AUTHORISED?	2
4. AUTHORISATION TERM BASED ON PROJECT FINANCING TERM	4
5. WHAT IS THE SHAPE OF THE MARKET?	5
6. CONFIDENTIALITY AND RING FENCING	6
7. PARTIES TO THE AUTHORISATION AND OWNERSHIP RESTRICTION ON FUTURE PARTICIPANTS	6

1. Introduction

This submission provides further comments from the Energy Users Association of Australia (EUAA) to the ACCC's Draft Determination published on 11th January 2006 ("Draft Determination") on the application (the "Application") made 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 that 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.

This submission focuses on the supplementary submission ("Supplementary Submission") made by the Applicants on 15 March 2006 following the Conference on the Draft Determination held in Brisbane on 1 March 2006.

2. Joint marketing beyond financial close

Submission by the Applicants

The future with and without test is clearly satisfied because:

- a) In the future with there will be significant public benefits and no anti-competitive detriments; and
- b) In the future without all public benefits will be foregone.

The material change clause can be invoked by the Commission if it believes the public benefits no longer outweigh the anti-competitive detriments.

Discussion

The EUAA's submission 15 March 2006, argued against such a counterfactual (Section 11). The EUAA called for the Commission to re-examine its future with and without test.

The EUAA does not disagree with the significant public benefits that the project will bring over its life. What the EUAA does question is:

- Whether the project needs joint marketing for 16 years to ensure it proceeds
- Whether the anti-competitive detriments over that period outweigh the public benefits

On the former, the EUAA submission on 15 March 2006 suggests that it does not need a 16-year period. The analysis showed that there is a very high chance that the pipe with the 225PJ/yr capacity as described in the ExxonMobil EIS for the Project will be almost full at financial close. The EUAA invites the Applicants to explain how the ability to jointly market a small proportion of the pipe's capacity is a "go or no go" decision for financiers and the Applicants.

On the latter, the EUAA believes that there may be anti-competitive detriments in the future with joint marketing authorisation. The Commission in its Draft Determination further acknowledged the existence of potential anti-competitive detriments

“Given the high barriers to entry to gas production, the limited availability of substitutes for some customers and the bargaining power the Project will possess at various times, the ACCC considers that the Project is likely to possess market power at various times throughout its life.”¹

And

“The exercise of market power in an anti-competitive manner is another potential detriment associated with joint marketing arrangements. It was noted earlier that the Project is expected to dominate the market at some time in the future and may have market power at some stage. The extent of cross-ownership may heighten market power concerns. If a firm with other gas interests in eastern Australia had the ability to influence the decisions of the Project, it could use this ability in an anti-competitive manner and restrict competition between gas basins.”²

The latter comment by the Commission is intensified by the imminent entry into the Project of Santos, which has substantial gas interests in eastern Australia.

The Applicants seek to give comfort that the provisions of s91B of the Trade Practices Act 1974 allow the Commission to review the authorisation in the case of a material adverse change in circumstances. This was addressed in Section 4 of the EUAA submission. Put simply, the Commission has, in past decisions on the joint marketing of gas, expressed grave reservations about the section’s usefulness and this is reflected in the fact that the Commission has only used it on one occasion in the last 7 years in a minor matter. The EUAA believes that the burden of proof to continue the authorisation should be on the Applicants at the end of a much shorter authorisation period. Given the Applicants’ confidence about meeting the net benefits test, they should have no concerns about their ability to convince the Commission that an extension should be granted.

Finally, while the EUAA is pleased to see that the Applicants really want to separately market their gas (refer to section 2.2 of the Supplementary Submission), it should not be solely up to the Applicants to decide when this should occur. This is also a matter for the Commission.

3. What conduct is being authorised?

Submission by the Applicants

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 Applicants in Gas Sales Agreements (GSA). Grandfathering clauses are essential.

Discussion

¹ Draft Determination p.58

² Draft Determination p.61

The EUAA's submission 15 March 2006 Section 9, draws out the precise points the EUAA wanted to make and the issues the EUAA wished to be clarified.

From the Applicants' further supplementary submission it appears that they wish the joint marketing of both dry and wet gas to be authorised. It remains to be clarified however as to whether the Commission intend to authorise the joint marketing of both dry and wet gas or whether it would wish to limit the authorisation.

We would like to reiterate our position that the authorisation be limited to dry gas. 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 and this would limit one of the claimed benefits of the project namely the ability of others to use the pipeline. The EUAA believes that other PNG producers wishing to access Australian markets (e.g. Cheetah Oil and Gas) may also be disadvantaged by this. This is particularly the case if the ExxonMobil EIS is to be believed and most of the pipeline capacity will be made up from foundation contracts.

The EUAA does not agree with the need for grandfathering clauses for any contracts entered into after financial close.

The EUAA has made two points on grandfathering:

- It supports the Applicants position that the authorisation should cover the full term of contracts entered into prior to financial close

Given the proposition in the EUAA submission of 15 March 2006 that by financial close most of the pipeline capacity will have been committed, this means the EUAA is effectively supporting joint marketing for these contracts for a period of nearly 24 years, given that these foundation contracts will not expire until around 2029.

- For any contracts entered into after financial close then the authorisation should apply for the term of the authorisation, or the term of the contract, whichever is the shorter.

To apply the authorisation in the second situation effectively defeats the decision by the Commission not to have a long-term authorisation as originally requested by the Applicants. Once the Project is up and running then the public benefits will flow as outlined by the Applicants. To accept the applicants' position involves acceptance of the proposition that the Project will not proceed unless the full term of the contracts entered into beyond financial close are covered by the authorisation. This is very difficult to believe and the EUAA does not accept the Applicants' submission that failure to extend the authorisation to the full term of contracts entered into after financial close will inhibit further contracting by long-term offtakers.

The Applicants make reference to:

"Confidential submissions provided by the Project financial advisor support the above submissions of the Participants"³

It is unclear whether this refers to the original submissions made at the time of the Application in December 2004 or more recent submissions. As the EUAA Submission commented, the Commission needs to take its own independent advice on these matters, particularly if the quote is referring to a December 2004 submission when the market for Project gas has changed considerably since that time.

³ Supplementary Submission p.7

4. Authorisation term based on project financing term

Submission by the Applicants

Both Project and APC financiers require a long-term authorisation since they intend to commit for a period many years past financial close.

Discussion

Nothing in this Supplementary Submission convinces the EUAA to change from its position as expressed in its 15 March 2006 submission.

The Project, which the EUAA defines as the upstream project in PNG, is not merely a gas project, it is a gas and liquids project and this is widely recognised by both the Applicants and the investment community. The key to achieving the Project rate of return will be the ability to extract liquids that currently cannot be extracted because gas has to be re-injected. The only reason the Applicants can sell the gas to Australian customers after transporting it over 2,000 km from its source is because of the liquids revenue. Without this revenue there would be no Project. Arguments focusing on a low return gas project are irrelevant to the Commission's considerations because that it not how the financiers look at the Project.

The Applicants state that:

"...the financiers are seeking assurances that:

(a) the Participants will be capable of securing additional sales..."⁴

As we have indicated, due to there being little spare capacity in the 225PJ pipeline, securing additional sales should not concern the financiers to the extent that they would not finance the project.

However, it would concern the EUAA if this argument were used to justify joint marketing in order to secure sales for future supplementary capacity for the pipeline, e.g., added by compression. This is not relevant to the financiers' decision to support the initial Project capacity. Furthermore, the costs/GJ of delivery capacity are substantially lower for compression than the initial investment and financiers will not require joint marketing to underpin this investment.

The EUAA agrees with the Applicants that:

"...the benefits of joint marketing to the Project to date are clearly evident"⁵

But does not agree that financiers will not step up without long-term authorisation.

As mentioned above, the Applicants refer to the confidential advice provided by the Project's financial advisors but do not actually say whether this advice said that the financing term will be around 12 years post first deliveries which is implied with a 16 year authorisation term. The Applicants also do not state when that advice was prepared and when it was "...tested in the bank financing and PRI underwriter market...and the Participants are very confident that this term can be accommodated"⁶ without saying what "this term" actually means. At no time have the Applicant's explicitly stated that the latest advice from their financial advisors is that the Project will not get financing without long term joint marketing, nor whether the Project will get financing – just that the margin might be slightly higher and the Applicants are simply

⁴ Supplementary Submission p.8

⁵ Supplementary Submission p.8

⁶ Supplementary Submission p.8

seeking to offload this cost to buyers. Naturally financiers in the ideal world would want to eliminate all Project risks and get certainty on their returns – and still earn their large project financing margins. However at the time of financial close they have to make a judgement about the risk/return profile that will involve some uncertainty.

In the absence of any information to the contrary the EUAA believes that the confidential advice referred to by the Applicants was provided as part of the original submission in December 2004, when the Project has considerably less volume (i.e. no Alcan, AGL or Santos) than it has now (Alcon/AGL) or could have in the very near future (Santos).

If the Applicants are seeking to assist the EUAA understand the financing situation then they would have more transparency around this confidential advice. All the EUAA can do is highlight what appear to be shortcomings in the advice and support the Commission getting its own independent advice. In this way the Commission would be undertaking the same process it does in many of its other activities eg assessing revenue cap applications from transmission providers.

Finally, the EUAA believes that the Commission should not consider the financing issues associated with the Australian portion of the pipeline. If the upstream Project proceeds then the downstream pipeline will be financed.

5. What is the shape of the market?

Submission by the Applicants

Separate marketing is not currently possible. The Project does not want to bear the regulatory risk of short-term authorisation. Re-application for authorisation is time consuming and expensive.

Discussion

Again the applicants have said nothing that convinces the EUAA to change its position as expressed in the 15 March 2006 submission. The regulatory risk of no long-term authorisation is very low with a project that has most of the pipe full at the time of financial close. As mentioned above, the Commission has grave reservations about the material adverse change clause of the Trade Practices Act and this is reflected in the fact that it has only been used on one occasion in the last 7 years in a minor matter.

The EUAA does not share the confidence of the Applicants that they, or consultants, can forecast today that the conditions for separate marketing will not appear over the next 16 years.

The EUAA believes that it is unacceptable that the Applicants gain such market power and advantages from joint marketing and nevertheless the onus be, not on them, but on the Commission to prove that the conditions no longer give a net public benefit when they invoke the material adverse change clause. The EUAA believes that parties gaining such an advantage must be prepared to have to clear some additional hurdles and hence it is better that a shorter term authorisation be given requiring the applicants to reapply.

Additionally, EUAA members would not support that the project going ahead and the authorisation staying in place at whatever cost – namely if the anti-competitive detriments were to prove to be larger than the public benefits or the balance were to change at some point during the life of the authorisation.

Finally it is worth noting the recent Commission decision in relation to joint marketing of LPG from the Otway Basin⁷. At the Conference, and in their submissions, the Applicants have argued that separate marketing is not possible by MRDC and Merlin. This is not a reason to justify joint marketing. The Commission recognised in the Otway decision that Benaris and CalEnergy Gas were small players who would not wish to incur the costs of separate marketing and hence were likely to sell their entitlements to Woodside anyway. This allows a Woodside/Benaris/CalEnergy joint marketing alongside an Origin separate marketing. In the PNG Project we currently have Oil Search and AGL effectively separately marketing⁸. In the same way joint marketing in this case could be limited to the small players leaving the large players to (continue to) separately market.

6. Confidentiality and ring fencing

Submission by the Applicants

Confidentiality and ring fencing is onerous and adequate.

Discussion

The EUAA reiterates its position stated in Section 11 of its submission.

7. Parties to the authorisation and ownership restriction on future participants

Submission by the Applicants

The 20% restriction on the level of ownership should be amended to at the very least 25%. The level of ownership restriction should be clarified to only apply on entry of the participant

Discussion

The EUAA would like to reiterate its position in Section 12 of its submission.

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 Commission has in setting a benchmark and also its effect on the participants. The EUAA would also like the Commission to be aware of the potential for gaming that arises by using a limit to ownership on entry only, namely that a party could enter with 10% share and a short time later upgrade its share to above the limit specified.

⁷ ACCC proposes to allow a joint marketing arrangement for the sale of LPG from the Otway Gas Project 16 February at <http://www.accc.gov.au/content/index.phtml/itemId/724795>

⁸ See EUAA 15 March Submission p9.