

**North West Shelf Project
authorisation applications
A91220, A91221, A91222, A91223**

Submission in response to certain interested party
submissions

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1 Introduction and overview

- 1 On 31 March 2010 the North West Shelf venture participants with entitlements to produce domestic gas (**NWS venture participants**) lodged applications numbers A19220, A19221, A19222 and A19223 with the Australian Competition and Consumer Commission (**ACCC**) seeking authorisation to engage in joint marketing of domestic gas (**domgas**) produced from the North West Shelf Project (**Project**) and for ongoing gas supply contract (**GSA**) administration.
- 2 Specifically, the NWS venture participants have sought authorisation to:
- jointly discuss and negotiate common terms and conditions (including price) and the methods by which domgas produced from the Project will be offered for sale by the NWS venture participants;
 - enter into contracts, arrangements and or understandings between the NWS venture participants containing common terms and conditions (including price) upon which domgas produced from the Project will be offered for sale and sold by the NWS venture participants; and
 - give effect to existing and new contracts, arrangements or understandings for the sale of domgas by the NWS venture participants.
- 3 The NWS venture participants have sought authorisation to give effect to existing domgas contracts for the full term of those contracts, to jointly market and enter into new domgas contracts until the end of 2016 and to give effect to domgas contracts entered into during the term of authorisation for a period of up to 25 years from the date of first delivery of gas under those contracts.¹
- 4 The NWS venture participants' detailed analysis in support of its applications for authorisation are set out in a submission to the ACCC dated 31 March 2010 (the **Supporting Submission**) along with associated independent expert reports.
- 5 The ACCC has received submissions from interested parties concerning the NWS venture participants' applications for authorisation. Those interested parties include Alcoa, Synergy, the Domgas Alliance, Rio Tinto and Dr Alan Eggleston, Senator for Western Australia.
- 6 This submission responds to certain issues raised in the Alcoa, Synergy and Domgas Alliance submissions (**Third Party Submissions**) that the NWS venture participants consider to be relevant to the ACCC's consideration of the applications for authorisation.
- 7 However, not all of the statements and assertions set out in the Third Party Submissions are addressed in this response. This does not mean that the NWS venture participants believe these statements and assertions are accurate or relevant. Indeed, much of the information in these submissions (and particularly in the Domgas Alliance submission) is unsubstantiated, presented out of context or simply incorrect.
- 8 The NWS venture participants also note that many of the issues raised in the Third Party Submissions were considered by the ACCC in the recent Gorgon authorisation determination:² particularly in relation to the structural features and recent development of the Western Australian domgas market and the feasibility of attempting separate marketing in this context.

¹ As the ACCC is aware, the applications allow for new GSAs with maximum durations of 25 years. However, this does not imply that all or even most future GSAs will necessarily have 25 year terms. The term of any new GSA will depend on factors such as committable reserves, investment decisions, market conditions and the requirements of the particular buyer in question.

² Chevron Australia Pty Ltd & Ors – Authorisations A91139, A91140, A91160 and A91161, 5 November 2009 (Gorgon determination).

- 9 The NWS venture participants do not consider that the Third Party Submissions have raised any information that calls into question the correctness of the detailed analysis set out in the Supporting Submission and the associated expert reports.
- 10 To the contrary, joint marketing has continuously delivered domgas at competitive prices to the WA market over a sustained period of time. This in turn has delivered many benefits to the WA economy, including the development of important industry in the State. The continuation of joint marketing by the NWS venture participants with authorisation will result in public benefits that outweigh any minimal detriment in all possible counterfactuals. Therefore, authorisation should be granted by the ACCC in the form sought by the NWS venture participants.

2 Proposed conditions on authorisation are unnecessary, unworkable and not in the public interest

- 11 The Third Party Submissions have suggested that the ACCC should impose conditions on any authorisation granted to the NWS venture participants for joint marketing that might effectively introduce a significant new gas regulatory regime over the Project.
- 12 Specifically, it has been submitted that the ACCC should impose conditions that involve:
- a requirement that the NWS venture participants maintain supply to the domestic market at current levels³;
 - a requirement for an annual review process by which the NWS venture participants would have to demonstrate to the ACCC that they are doing everything practicable to market domgas⁴;
 - a requirement that probity auditors oversee NWS venture participants' domgas tendering and sales activities to ensure production facilities are fully utilised⁵;
 - a requirement that the NWS venture participants tie the supply of domgas to the Project reserves or the supply of LNG (meaning that the NWS venture participants would be bound to increase / decrease domgas supply commitments as the resource increases / declines or as LNG production increases / reduces)⁶;
 - a requirement that the NWS venture participants increase domgas plant capacity to 1100 TJ/d through the construction of additional domgas facilities⁷.

2.1 Proposed conditions are unnecessary to satisfy public benefit test

- 13 None of the proposed conditions are necessary to ensure that there are net public benefits from the NWS venture participants continuing joint marketing to 2016, as

³ Alcoa submission to the ACCC on applications for authorisation A91220 – A91223, 30 April 2010 (Alcoa submission), p 2 and 8; Domgas Alliance submission to the ACCC on applications for authorisation A91220 – A91223, 30 April 2010 (Domgas Alliance submission), p 12

⁴ Alcoa submission, p 8

⁵ Synergy submission, p 4

⁶ Alcoa submission, p 2 and 8; Synergy submission to the ACCC on applications for authorisation A91220 – A91223, 30 April 2010 (Synergy submission), p 4

⁷ Domgas Alliance submission, p 11

required under the test for authorisation in the Trade Practices Act 1974 (TPA).⁸ On this basis alone the proposed conditions should not be imposed by the ACCC.

- 14 The evidence provided in the Supporting Submission and associated expert reports establish that continued joint marketing until 2016 would result in net public benefits when compared with any relevant counterfactual, including:
- more domgas being supplied to the Western Australian market;
 - more genuine project-based competition;
 - potentially lower domgas prices; and
 - recognised economic benefits, such as security of supply and increased capital investment.

2.2 Proposed conditions are complex, unworkable and not in the public interest

- 15 As noted in paragraph 2.69 of the Supporting Submission, the amount of domgas the NWS venture participants supply to the WA market in the future will depend on investment decisions (for a mature project with declining reserves) and a range of other factors, including:
- proving of gas reserves;
 - the terms of potential domgas sales;
 - the value of alternative uses for the gas;
 - the increasing costs of producing from diminishing fields (involving investment in compression facilities and additional infrastructure to develop smaller fields); and
 - assessment of regulatory obligations and regulatory risk.
- 16 None of these factors (and how they might interact together in the future) can be accurately predicted over the proposed duration of the authorisations, or over the duration of the GSAs that may be formed over the next several years.
- 17 In this context it is unworkable for the NWS venture participants to commit to supply particular volumes of domgas beyond what is agreed contractually with gas buyers from time to time. It would also be unworkable and extremely complex for the ACCC to determine in advance what the 'correct' or 'optimum' level of domgas production (and inevitably the market price) 'should be' in Western Australia at any given time. Even if this was attempted, a very high risk of regulatory error or failure would arise in trying to set this fixed or base quantity / price restriction. Similarly, attempting to impose and enforce some form of ongoing ACCC review or audit with a view to ensuring that the 'correct' or 'optimum' level of domgas marketing and production had been achieved on an annual basis would give rise to exactly the same concerns.
- 18 Given the maturity of the Project, the NWS venture participants have no plans to expand domgas plant capacity to 1100 TJ/d. In this regard the NWS venture participants note that the submissions made to the ACCC in or around 1997 / 1998 regarding possible domgas plant expansions were completely accurate and genuine at that time. The possible expansion did not occur principally because new GSAs totalling more than 500TJ/d and Heads of Agreement for similar quantities with prospective buyers did not

⁸ In *Re Application by Medicines Australia Inc* [2007] ACompT 4, French J held that the ACCC may impose a condition to reduce public detriment or increase public benefit associated with the proposed conduct in circumstances where the test for authorisation may not otherwise be established (at [133]). Justice French also found that the ACCC's power to impose conditions upon an authorisation is constrained by the subject matter, scope and purpose of the statute (at [129]) and should not be used to construct and impose an ideal or preferred system of self-regulation (at [134]). Similarly, the ACCC *Guide to Authorisation*, March 2007, states that the ACCC will generally only impose conditions to ensure the authorisation test is met or continues to be met over the period of authorisation (at para 5.96).

eventuate. The common theme was that the underlying buyer projects did not proceed due to a lack of funding. The possible expansion was not a condition of the 1998 ACCC authorisation (which lapsed in 2005 in any event) and it forms no part of the current **authorisation** applications. Such capital investment decisions must be made by the NWS venture participants themselves having regard to the usual commercial investment criteria and joint venture investment processes. There is no justification for the ACCC to impose an arbitrary condition of this nature. As noted above, it would be unworkable and extremely complex for the ACCC to determine the 'correct' or 'optimum' amount and nature of domgas infrastructure investment in Western Australia.

- 19 For the reasons set out above, it is far from clear that having the ACCC involved in engineering 'optimum' levels of production / price and investment in the domgas market would achieve a better public interest outcome than allowing participants to make these decisions themselves having regard to **ordinary** market forces. These issues go well beyond the scope of the authorisation applications and the TPA authorisation process. Attempting to construct and impose such conditions would fundamentally change the NWS venture participants' business in Western Australia and would impose an unjustified burden upon them.
- 20 However, what can be accurately assessed by the ACCC at this time is that there is likely to be more domgas supply and more investment in relevant infrastructure associated with the Project under continued joint marketing with ACCC authorisation than under any other possible counterfactual for the detailed reasons set out in the Supporting Submission and the associated expert reports. The proposed conditions do not alter or assist this public benefit analysis.
- 21 Finally, the NWS venture participants note that they have always met, and will continue to meet, all of the legislative requirements to service the domgas market. For the Project these substantial historical and ongoing requirements are set out in the Ratified State Agreement, as explained in the Supporting Submission. The NWS venture participants are also continuing to service domestic buyers by marketing new volumes of domgas.

3 WA parliamentary inquiry into gas prices should not affect ACCC determination timeline

- 22 On 20 April 2010 the Western Australian Economics and Industry Parliamentary Committee commenced a parliamentary inquiry into the price of domgas in Western Australia (**the Inquiry**). The Inquiry is currently scheduled to deliver a report by 28 February 2011.
- 23 The Domgas Alliance has submitted that the ACCC should delay its determination of the NWS venture participants' authorisation applications until completion of the Inquiry.⁹
- 24 The NWS venture participants confirm their request for the ACCC to undertake its assessment of their applications in accordance with usual ACCC processes and within the timelines set out in the TPA. As the national competition authority the ACCC is well placed to make this determination and the ACCC has access to the information it needs to make the public benefit assessment required.

4 Separate marketing of incremental volumes infeasible and not in the public interest

- 25 Synergy submits that:

⁹ Domgas Alliance submission, p 10

- the NWS venture participants will be marketing incremental volumes of gas of around 100TJ/d for 6 years; and
- the NWS venture participants should be 'required' to separately market these incremental volumes of gas.

26 In response, the NWS venture participants note the following:

26.1 Firstly, while the NWS venture participants will continue to market domgas during the relevant period, it is not accurate to state that the NWS venture participants will be marketing incremental volumes of gas of around 100 TJ/d for 6 years under the proposed authorisations. As noted in Section 2 above, it is not possible to accurately predict the domgas volumes that the NWS venture participants will produce, market or sell during the period of authorisation (although domgas plant capacity does provide an implicit upper limit for production).

26.2 Secondly, the costs and risks that would arise for the NWS venture participants in attempting to transition to separate marketing for incremental volumes up to plant capacity are very high and the analysis set out in the Supporting Submission continues to apply. For incremental sales there will be six NWS venture participants involved, and attempting to achieve alignment in terms of share of production and reserves, access to production facilities and approval for future investments proposals will be virtually impossible under separate marketing. For example, even assuming that a gas balancing agreement was agreed and workable (which it is not), if one venturer sought to sell 30% of available incremental capacity in its own right, the other five would not be able to balance a volume exposure of this size over the duration of the GSA (because, as group of six, the NWS venture participants obviously cannot market more than 100% of available capacity). The costs and risks are further compounded by the increasing reserves risk for each individual NWS venture participant as the amount of provable / deliverable gas available from the Project, and thus the future incremental marketing opportunities, becomes increasingly uncertain, costly and dependent on future joint investment decisions (as described in more detail in paragraphs 7.47 – 7.49 of the Supporting Submission).

26.3 Thirdly, the NWS venture participants reiterate the three possible counterfactuals if authorisation is not granted (in whole or in part):

- i continue joint marketing, notwithstanding any regulatory uncertainty; or
- ii attempt to transition to separate marketing; or
- iii consider lower risk / cost alternatives, such as focussing on export opportunities.

If authorisation is not granted for incremental marketing the most likely outcome under any of these counterfactuals is lower volumes of incremental domgas supply and reduced incentives to make the investments necessary to shore up the reserves for these future sales. Again, the detailed public benefit analysis set out in the Supporting Submission is applicable to both incremental and 'base load' GSAs.

5 Update on WA domgas market

GSEMC recommendations

- 27 Synergy has submitted that implementation of the recommendations of the Gas Supply and Emergency Management Committee (**GSEMC**) are underway.¹⁰
- 28 In short, the GSMEC recommendations regarding the possible establishment of a gas bulletin board and a short term trading market have not been implemented and there are no firm timelines for their implementation. In December 2009, the Western Australian state government commenced a public consultation process on its Strategic Energy Initiative (**SEI**), including consultation on the recommendations of the GSEMC. Public consultation is scheduled to close in June 2010 with development of the SEI not expected to be complete until the end of 2010.
- 29 Furthermore, as the NWS venture participants noted in the Supporting Submission, even if the relevant GSEMC recommendations are ultimately supported (in whole or in part) it will be some time before the implementation of any potential gas bulletin board or short term market in Western Australia would have a material impact on the structure and operation of the gas market given the underlying 'lumpiness' of domgas demand and market development.

DBNGP expansion

- 30 The NWS venture participants note the current Stage 5B expansion of the DBNGP, which is expected to increase the capacity of the pipeline by approximately 110 TJ/d.
- 31 This expansion does not alter the fact that the DBNGP is a gas transportation pipeline and not a commercial gas storage facility. The park and loan service available on the pipeline, which allows relatively small daily pipeline flexibilities for individual users, must be viewed in this context. The DBNGP is unable to store significant volumes of gas for the NWS venture participants for an extended period or to otherwise operate as a commercial storage facility.

WA gas market continues to lack features necessary for separate marketing

- 32 The detailed analysis in the Wood Mackenzie *Western Australia Gas Market Study* (which also closely mirrors the considered views of the ACCC in the Gorgon determination regarding market structure) demonstrates that the WA gas market has only developed marginally since 1998 and lacks the structural features necessary to support separate marketing by the NWS venture participants at this time.

6 NWS Project gas balancing arrangements do not exist

- 33 The Domgas Alliance has suggested that operational measures necessary for separate selling of domgas are already in place within the Project.¹¹
- 34 This submission is incorrect. There are no gas balancing arrangements in place within the Project. There are also no accounting or other mechanisms in place that could readily be adapted to allow for separate sales of domgas.
- 35 Some gas supplies do occur between the two NWS joint ventures that currently supply domgas – the IPGJV and the DGJV – as necessary to meet contractual commitments. However, this supply is effectively a sale of gas between the two domgas joint ventures that occurs in accordance with the underlying joint venture participating interests and

¹⁰ Synergy submission, p 3

¹¹ Domgas Alliance submission, Appendix, p 20

does not involve any gas balancing arrangement as between the individual NWS venture participants. The intra-venture arrangements for the Project are described in paragraphs 2.43 – 2.46 of the Supporting Submission.

7 Alinta contract price review pursuant to independent arbitration and subsequent negotiation (facilitated by a joint approach)

- 36 The Domgas Alliance makes several unfounded claims in relation to the outcome of the recent contract price arbitration between Alinta and the NWS venture participants and the impact this is incorrectly suggested to have on the domgas market.¹² For example, the Domgas Alliance wrongly alleges that the “NWSJV producers combined together to force a reported 300 per cent price rise on Alinta”.¹³
- 37 Whilst the specific details of the final arbitrated outcome and the NWS venture participants’ subsequent negotiated settlement with Alinta are confidential, the NWS venture participants can disclose the following facts:
- The independent price arbitration occurred pursuant to a pre-existing price review clause contained in the Alinta GSA. The price review clause could be triggered by either party and allowed the price to be re-set in line with prevailing market prices.
 - When a market price could not be agreed between the parties under the terms of the GSA, the matter was referred to an independent arbitrator (the former High Court Justice, the Honourable Michael McHugh).
 - Following an extensive process in which the parties made detailed submissions, the independent arbitrator determined a market price for the contract.
 - At the time of the arbitration outcome there was genuine concern around Alinta’s financial and commercial commitments and its ability to continue trading. However, in order to support Alinta as a going concern, the NWS venture participants *voluntarily* jointly agreed a pricing arrangement materially lower than the independently arbitrated price. This resulted in the NWS venture participants sacrificing a substantial sum of future revenue and Alinta was able to continue its important business in Western Australia.
- 38 In reality, the Alinta price arbitration process is not an example of joint marketing at all – it is an example of joint GSA administration. It is a good example that again demonstrates the very significant public benefits that will continue to arise from this conduct. Consider the two key outcomes of this instance of joint contract administration:
- firstly, a single price arbitration process. It is difficult to see why, for example, the possibility of multiple separate price arbitrations with Alinta would improve the process or the arbitrated outcome; and
 - secondly, a jointly negotiated pricing arrangement with Alinta materially lower than the independently arbitrated price. If joint contract administration is not authorised, such an outcome would be considerably more difficult to achieve through bi-lateral negotiations between Alinta and each of the relevant NWS venture participants. This was a very complex series of negotiations that also involved financiers and customers.

¹² Domgas Alliance submission, pp 3, 5, 9; Domgas Alliance submission, Appendix, pp 11, 14, 16, 17, 19.

¹³ Domgas Alliance submission, pp 3, 5; Domgas Alliance submission, Appendix, p 19

8 Ring fencing between rival projects

- 39 The Domgas Alliance and Synergy have submitted that cross-ownership between different gas projects in Western Australia creates transparency of pricing and reduces competition.¹⁴
- 40 The NWS venture participants reject outright any suggestion that gas producers in Western Australia share competitively sensitive information or have been coordinating marketing across competing projects. As the ACCC is aware, the NWS venture participants have always taken their obligations under the TPA very seriously.
- 41 The NWS venture participants consider that there is a very low risk that competitively sensitive information would be 'shared' between rival projects due to safeguards put in place by the NWS venture participants to ensure compliance with the TPA. However, to further minimise any such risk, the NWS venture participants with a rival project in Western Australia have either implemented, or are in the process of implementing, the ring fencing arrangements provided as Attachment 6 to the Supporting Submission. These arrangements are consistent with the ring fencing protocol accepted by the ACCC as part of the Gorgon determination.
- 42 The NWS venture participants submit that these arrangements adequately address the concerns raised by interested parties in relation to the potential for transparency of competitively sensitive information across rival projects.

9 Unfounded allegations of anti-competitive conduct

- 43 The Domgas Alliance makes unsubstantiated and unfounded claims that the NWS venture participants, and other gas producers in Western Australia, have engaged in anti-competitive conduct. These claims include:
- gas producers in Western Australia appear to be coordinating gas marketing across projects by ensuring that any marketing from a given project occurs sequentially so as to limit competition¹⁵;
 - major gas producers in Western Australia have been deliberately withholding domgas supply and "targeting" particular customers to drive up market prices¹⁶; and
 - the NWS venture participants forced a 300% price increase on Alinta through a "coordinated abuse of market power"¹⁷.
- 44 The NWS venture participants absolutely reject these unsubstantiated and unfounded allegations and reiterate that they have not engaged in any anti-competitive conduct and take their obligations under the TPA very seriously.

¹⁴ Domgas Alliance submission, Appendix , p 8, 20; Domgas Alliance submission, Appendix, p 3, 9, 12 ; Synergy submission, p 4

¹⁵ Domgas Alliance submission, p 3; Domgas Alliance submission, Appendix, p 9

¹⁶ Domgas Alliance submission, p 4

¹⁷ Domgas Alliance submission, Appendix, p 14