DomGas Alliance

NORTH WEST SHELF GAS: ACCC PROPOSAL AUTHORISE JOINT SELLING

27 July 2010

Key Points

- Business and households face paying an extra $2 billion in gas bills if the ACCC approves joint selling by the NWSJV producers.

- There is overwhelming evidence that separate selling is practical and feasible. Separate selling can only lead to lower gas prices.

- The ACCC appears to rely exclusively on producers' "sky is falling" claims and is not supported on the evidence.

- High gas prices are not being driven by producer costs. According to Woodside's 2009 results, it costs just 55 cents per gigajoule to extract gas and deliver it into a processing plant. Woodside and its NWSJV partners are demanding around $8 per gigajoule from WA consumers.

- The Alliance agrees with the WA Government that requiring the NWSJV producers to sell separately would not threaten investment in the North West Shelf Project or domestic supply.

The ACCC's decision will cost consumers $2 billion a year

The DomGas Alliance is dismayed that the ACCC proposes to allow the six North West Shelf Joint Venture producers to continue to sell as cartel and set prices for consumers.

Given the NWSJV producers control almost 70 per cent of the market, the ACCC's draft decision entrenches the existing duopoly and the immense power of producers. It protects the world's biggest and most profitable oil and gas companies from competition.

ACCC market intervention remains the single biggest barrier to competition in Western Australia. The WA domestic gas market is one of the most uncompetitive in Australia. As a result, wholesale gas prices are up to three times the price in Victoria.

The ACCC's decision comes just months after five of the six NWSJV producers combined together to force a reported 300 per cent price hike on gas retailer Alinta. Woodside has indicated that the NWSJV producers will now seek to apply the price, reportedly $8 per gigajoule, to new or existing contracts.[1]

At the prices being demanded by the NWSJV producers, the State's annual wholesale gas bill is expected to soar from around $1.3 billion to $3.5 billion. Business and households face paying an extra $2 billion in gas bills as a result of the ACCC's decision. This equates to a $2 billion subsidy to major gas producers.

Less competition means higher prices

The ACCC does not consider that WA's high gas prices are due to joint selling and the duopoly market. This is an astounding conclusion and appears at odds with accepted competition theory.

As a general principle, more competition means lower prices; while less competition means higher prices. Joint selling, by reducing the number of competitors from six to one, can only result in higher gas prices.

The ACCC's draft decision appears at odds with its own statements that such arrangements harm consumers, businesses and governments. As the ACCC's website states:

> "Cartels harm the Australian economy and public. Consumers, businesses and even governments can be forced to pay higher prices for goods and services. Cartels also distort economic markets, and serve to slow innovation—after all, companies charging supra-normal prices have little incentive to spend money on research and development."[2]

The ACCC's decision is not supported by the facts and evidence

The ACCC's decision is based on serious errors of fact and does not reflect actual market reality. There is overwhelming evidence that separate selling is practical and feasible in the WA gas market and should be required by the NWSJV producers:

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[1] "This is a huge new revenue exposure for North West Shelf and Woodside and my expectation is that when other new or existing contracts come up for review, there will now be a new price foundation to work from": *WA Business News*, 'Woodside hails new domgas price mark', 24 February 2010, quoting Woodside CEO Don Voelte.

[2] ACCC website, http://www.accc.gov.au/content/index.phtml/itemId/882220, accessed 20 July 2010.

- separate selling of domestic gas already takes place in Western Australia and overseas;

- marketing decisions for domestic gas are already being made separately by the individual NWSJV producers;

- the WA gas market has undergone significant transformation since the 1990s;

- the operational measures for separate selling are well-known and practical; and

- gas balancing and nomination arrangements are already in place in the WA gas market.

The ACCC for example considers that the WA market is not sufficiently mature or liquid to make separate marketing viable. In actual fact, the WA domestic gas market is Australia's largest gas market accounting for almost 40 per cent of Australia's entire domestic gas market. It is a mature, developed market and is bigger than the NSW, ACT and Queensland markets combined.

Producers claim "the sky is falling"

The ACCC's decision appears to rely exclusively on the NWSJV producers' hypothesis that requiring them to compete would threaten investment and gas supply. This amounts to no more than the "sky is falling". In the ACCC and gas producers' circular reasoning, sellers should always be entitled to sell as a cartel as the alternative would be "turning off the tap".

The ACCC is aware that strikingly similar claims were made by NWSJV producers Shell and Chevron in New Zealand, Denmark and Norway. Those fears proved to be misplaced when European and New Zealand competition authorities acted to protect consumers by compelling producers to sell separately. The ACCC should do the same in Australia.

The ACCC ignores the advice of three WA Government Departments

It is disappointing that the ACCC has dismissed the advice of three WA Government departments - the WA Department of Mines and Petroleum, the Department of State Development and the Office of Energy. These agencies have direct, practical understanding of how the WA gas market operates.

The Alliance agrees with the WA Government's assessment that requiring the NWSJV producers to sell separately would not threaten investment in the North West Shelf Project or domestic supply:

> "A decision to authorise joint marketing or not should not affect levels of investment by the NWS project. The domgas plant should be fully depreciated by now and any investment required to ensure sufficient ongoing gas deliverability will be undertaken regardless of this process, as it is required to meet LNG commitments."[3]

Joint selling is a relic of the past. It was put in place 33 years ago to support the initial North West Shelf development at a time when producers were selling to a single monopoly buyer (SECWA).

The project has since grown into one of the most profitable in Australia and producers can sell to over 30 individual customers. The time for protecting the NWSJV partners from competition has long passed.

The ACCC ignores consumers' own views on the benefits and risks consumers are willing to accept

WA gas consumers have repeatedly pleaded with the ACCC that separate selling would deliver more competition and lower prices. No action was taken by the ACCC for over three years despite the ACCC's repeated assurance it was "investigating" consumers' complaints.

The ACCC has now concluded that it is in the "public benefit" of consumers to pay some of the highest prices in Australia for the possibility that current levels of supply are maintained. This is an astonishing approach that ignores consumers' own views on the risks and benefits consumers are willing to accept.

High domgas prices not justified by producer costs

The ACCC considers that "higher costs of exploration and development have driven prices higher". There is little evidence to support these claims. As the WA Government informed the ACCC, the North West Shelf Project is an established project with sunk and already depreciated investment costs.

Furthermore, any rise in production costs come nowhere near justifying the price hikes being demanded by the NWSJV producers. According to Woodside's 2009 company results presentation, gas lifting costs (the cost of extracting gas and delivering into the processing plant) in 2009 was $3.35 per barrel of oil equivalent.[4]

This equates to just *55 cents per gigajoule*.[5]

According to Woodside, while lifting costs rose between 2005 and 2009, they *fell* between 2008 and 2009.

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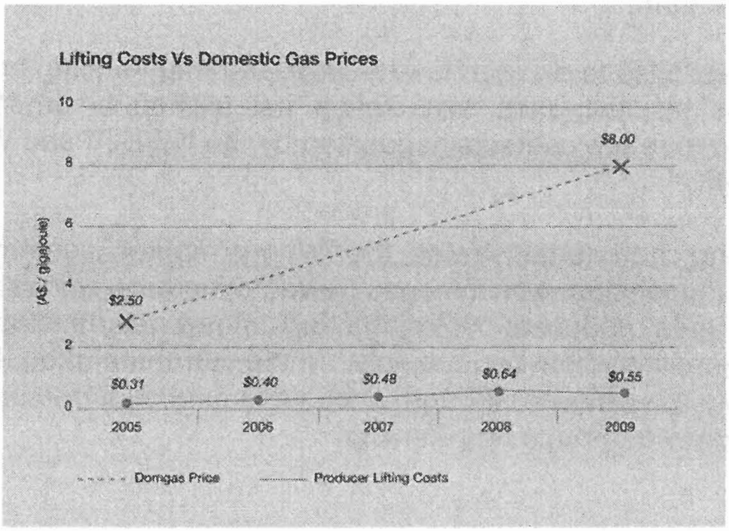
[3] NWS Project applications for authorisation A91220-A91223, Government of Western Australia (WA) Departments – record of meeting, 1 June 2010.
[4] Woodside, *2009 Full Year Results Briefing*, 24 February 2010.
[5] Conversion factor: 1 barrel of oil equivalent (boe) is approximately 6.1 gigajoules (GJ).

At the same time, Woodside and its NWSJV partners have combined together to demand 300 per cent price increases from WA gas consumers. This confirms that WA's gas prices are not being driven by producers' costs but producers' market power.

Chart: Producer lifting costs vs. domestic gas prices



The ACCC's belief in ring-fencing is misplaced

The ACCC considers that the potential for commercially sensitive customer information being shared between competing gas projects in WA could be addressed by "robust ring fencing arrangements". The ACCC's belief in the effectiveness of ring-fencing arrangements is misplaced in this instance.

The ACCC is aware that North West Shelf Gas, the joint marketing body, has no authority to enter into contracts on behalf of the NWSJV partners. Decisions for the supply of gas must be communicated to, and approved by, each of the six NWSJV partners on contract terms and price. Ring-fencing would therefore not prevent:

- price information being communicated to, and known by, those companies;
- price information being disclosed to directors and senior officers;
- directors and senior officers from directly or indirectly influencing marketing staff; or
- the transfer or promotion of marketing staff and the knowledge they retain between projects, or to positions where they could influence pricing decisions affecting different projects.

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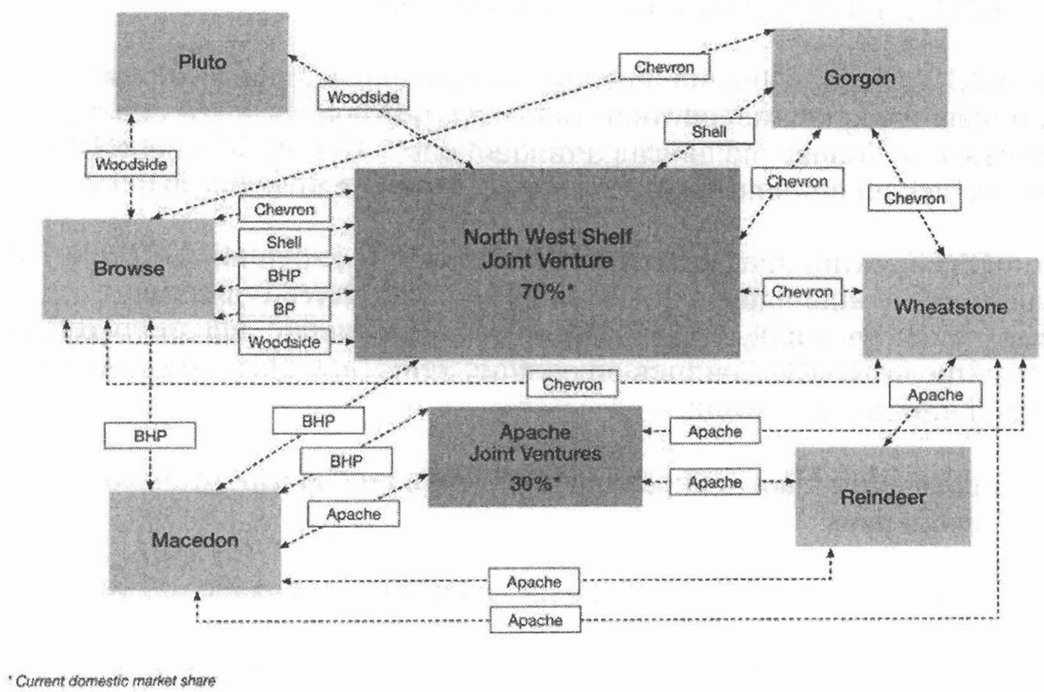
The ACCC would be aware of Woodside CEO Don Voelte's comments that the NWSJV and Woodside would now seek to apply the Alinta price outcome on all future contracts:

> "This is a huge new revenue exposure for North West Shelf and Woodside and my expectation is that when other new or existing contracts come up for review, there will now be a new price foundation to work from."[6]

The ACCC has failed to explain how its proposed ring-fencing arrangements would address this clear price "expectation" established by the Woodside CEO in regard to future contacts negotiated by the NWSJV and Woodside marketing staff.

As the following chart demonstrates, the WA gas market is controlled by a very small producer club with immense power to increase prices or withhold supply. The same producers control the bulk of new gas developments which means no competition between projects. In the current market, lower gas prices can only be achieved through competition and separate selling. It cannot be achieved through ring-fencing.

Chart: WA gas projects



[6] *WA Business News*, 'Woodside hails new domgas price mark', 24 February 2010.

Authorisation should be made conditional on producers delivering the "public benefits" claimed

The NWSJV producers have claimed ACCC authorisation for joint selling would deliver "significant public benefits" in the form of higher domestic gas supply. If these claims were genuine, producers should have no difficulty in committing to delivering these public benefits as a condition for authorisation.

Consumers were therefore surprised by the NWSJV producers and the ACCC's strong opposition to a condition that producers maintain existing levels of supply. Producers either believe the claimed public benefits would eventuate, or they do not. If producers hold such a genuine belief, they should commit to such a condition.

The ACCC is aware that in 1998, the NWSJV producers claimed – and the ACCC accepted – that authorisation would enable it to double domestic supply to 1100 TJ/d through the construction of an additional domestic gas processing train. This commitment was never met despite the ACCC granting authorisation and producers continuing to sell jointly.

The 2020 draft decision would appear to repeat this history to the detriment of consumers. Under the ACCC's proposal, consumers will suffer the immediate detriment of higher prices, with no certainty that the claimed "public benefits" would ever be delivered. The draft decision allows producers to "have their cake and eat it too".