Submission

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

Applicants' submission in response to Draft Determination

Public version

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1 Introduction

On 8 July 2010 the Australian Competition and Consumer Commission (**ACCC**) released its draft determination in relation to authorisation applications A19220, A19221, A19222 and A19223 made by the North West Shelf venture participants (**Draft Determination**).

The ACCC proposes to grant authorisation to the North West Shelf (**NWS**) venture participants to:

- jointly market domestic gas (**domgas**) from the NWS Project until 31 December 2015;
- give effect to any new contracts entered into over the proposed period of authorisation for a period not exceeding 5 years from the date of first delivery of gas under new contracts; and
- give effect to existing contracts for their full term, including any extensions.

The NWS venture participants agree with the core ACCC findings that:

1. the WA market is not presently sufficiently mature or liquid to make separate marketing commercially viable for the NWS Project and that the NWS venture participants would face additional commercial risks and costs if they attempted to transition to separate marketing; and
2. an attempted transition to separate marketing at this time would likely result in less domgas being supplied to customers in WA.

The NWS venture participants support the ACCC's conclusion that more domgas supply as a result of continued joint marketing constitutes a significant public benefit.

The NWS venture participants have continuously supplied domgas to the WA market at competitive prices for over 25 years pursuant to joint marketing arrangements. This has provided the State with substantial economic benefits, including security of supply which has fostered significant commercial development. The NWS venture participants agree with the ACCC's finding that the additional domgas likely to be supplied under continued joint marketing will be beneficial to both economic development and employment in WA.

The NWS venture participants also agree with the ACCC's conclusion that there will be minimal public detriment likely to arise from continued joint marketing.

In its draft determination the ACCC has invited the NWS venture participants to provide further information in relation to the appropriate duration of authorisation to give effect to new domgas contracts entered into over the proposed period of authorisation.

The NWS venture participants consider this to be an important matter and are concerned that the proposed period of 5 years is too short and should be substantially increased. In their application the NWS venture participants sought authorisation to give effect to new contracts for a period of 25 years having regard to the Gorgon Determination and potential customer demand.

However, if the ACCC believes that a differential and shorter period should apply, the NWS venture participants consider that authorisation for a period of 15 years to give effect to new contracts is most appropriate to:

- enable the NWS venture participants to be in a position to potentially respond to genuine demand in WA for longer term contracts, thereby underwriting investment in downstream projects;
- ensure that upstream competition between the NWS Project and other rival supply projects is maximised;

- ensure that mid-stream development of the WA domgas market, such as pipeline capacity expansion, can occur to the maximum extent possible; and
- ensure the significant public benefits of the NWS venture participants continuing joint marketing recognised in the Draft Determination, such as security of supply, ongoing investment in the NWS Project and economic development, are realised to the full extent.

Further information in support of a period of authorisation of 15 years to give effect to new contracts is provided in this submission.

Finally, the NWS venture participants also seek a minor clarification to the authorisation that is proposed for the participants in the Incremental Pipeline Joint Venture (**IPGJV**). In their applications for authorisation, the IPGJV participants sought authorisation to give effect to existing domgas contracts for their full term, *including any contracts entered into by the Domgas Joint Venture (**DGJV**) that may be assigned to the IPGJV.*[1] It is not clear from the Draft Determination whether it is proposed that authorisation be granted to the IPGJV in this regard. The NWS venture participants consider that this clarification is uncontroversial, as it will simply ensure there is no 'gap' in the protection afforded to giving effect to the existing DGJV contracts.

2 Duration of authorisation to give effect to new contracts

The NWS venture participants sought authorisation to give effect to domgas contracts entered into during the term of authorisation (or any extensions of such contracts) for a period of up to 25 years from the date of first delivery of gas under those contracts.

The ACCC has proposed to grant authorisation for giving effect to new contracts for 5 years from the date of first delivery of gas under those contracts, but has sought further submissions in this regard.

In particular, the ACCC has noted that whilst it may be desirable to avoid a situation where parties are 'locked in' to longer term, jointly marketed contracts, it is also desirable to enable customers and producers to be able to enter into longer term contracts for gas supply where either or both require sufficient certainty to underwrite investment.

Indeed, significant domgas customers, such as Alcoa, have emphasised the ongoing critical importance of longer term contracts and security of supply to underwrite investment in WA.[2]

The NWS venture participants do not consider that the proposed 5 year period to give effect to new contracts is sufficient to support industry development and does not reflect the actual demand for longer term contracts which is being driven by WA domgas users. The NWS venture participants also consider that authorisation to give effect to new contracts for a period of 15 years is necessary and appropriate to ensure that competition between the NWS joint venture and rival joint venture projects is maximised and that the substantial public benefits of continued joint marketing are realised to the greatest extent possible.

2.1 Substantial demand for contracts longer than 5 years

The ACCC previously concluded in the Gorgon Determination that WA domgas customers were interested in signing 25 year contracts and it was therefore appropriate

[1] Application for Authorisation A91222, Form A, part 2(d), 31 March 2010; Application for Authorisation A91223, Form B, part 2(d), 31 March 2010

[2] Alcoa - record of meeting with ACCC, Monday 31 May 2010

to extend authorisation to give effect to any domgas contracts entered into during the period of authorisation for up to 25 years.[3]

The nature of demand for longer term contracts in WA has not changed since the Gorgon Determination and WA domgas users continue to seek longer term contracts, of significantly greater length than 5 years from the NWS venture participants and other supply projects.

In submissions to the ACCC of 30 April 2010 and 2 July 2010 and during its meeting with ACCC representatives on 31 May 2010, Alcoa, one of the 5 major domgas customers in WA, stated that '*long term contracts are needed to underpin investment*' and that it was '*seeking to re-negotiate contracts for 20 to 25 year timeframes*'.

Consistent with these views, the NWS venture participants have recently received requests and expressions of interests for contracts of between 6 to 20 years duration.

The regular message from many prospective domgas buyers in WA is that they are seeking supply security and longer term contracts.

This supply security is also critical for mid-stream market development and investment, such as pipeline capacity expansions. As the ACCC is aware, the DPB has limited excess capacity and downstream projects have a contractual requirement to enter into gas transportation agreements with a minimum duration of 15 years in order to secure a commitment for pipeline capacity expansion. A downstream project in WA would not ordinarily contract longer term transportation without a substantially similar 'back-to-back' gas supply agreement. An authorisation condition that stifles the potential for longer term contracting from an important supply source, would also inadvertently hinder the interlinking 'step change' market developments that are a feature of the WA domgas market. The NWS venture participants believe that such a restriction would not be in the public interest at this time. (These domgas market features are also discussed in more detail in the Wood Mackenzie expert report).

The NWS venture participants submit there can be no material public detriment associated with the formation of longer term contracts (up to 15 years) in these circumstances. Obtaining necessary supply security via bilateral contracting in the domgas market (which obviously extends beyond the NWS Project) is driven by the considered commercial desires of gas consumers, who recognise they are operating in a largely project-based market.

2.2 Maximisation of competition and public benefits of joint marketing

The NWS venture participants consider that authorisation to give effect to new contracts substantially longer than 5 years is necessary to ensure that competition between rival projects in WA and the public benefits of joint marketing are realised to the maximum extent possible.

In the Gorgon Determination and in the NWS Draft Determination, the ACCC has recognised that the greatest benefits from competition are likely to result from competition between rival projects.[4] In the context of domgas sales, this requires the freedom to compete on key contractual parameters, including contract term.

In short, the NWS venture participants consider that limiting their ability to enter into contracts greater than 5 years duration during the proposed period of authorisation will impair their ability to effectively compete with rival projects that face no such restriction.

The 'unequal' nature of this proposed supply restriction is likely to have a negative impact on competition in the WA market, as it will effectively remove a significant potential

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[3] Draft Determination para 4.326; Determination, Applications for authorisation A91139 – A91161, para 7.288 (**Gorgon Determination**)

[4] Draft Determination, para 4.166; Gorgon Determination para 7.160

source of supply from competing for the longer term contracts that many WA domgas users are seeking.

This means the proposed 5 year limit on authorisation for new contracts will impair the extent to which the recognised public benefits of continued joint marketing are realised. For example:

- any new downstream project that requires supply security for an extended duration to proceed may be unviable because a major potential source of supply has been excluded from the market;
- more generally, it is likely that knowledge of the proposed supply restriction (which applies to only one supply source in WA) will result in less supply options and higher prices for those buyers who require the supply security afforded by longer term contracts; and
- the NWS venture participants will themselves face both a domestic competitive disadvantage in securing contracts and reduced security and certainty in their forward contract position. Such a situation will impair the significant investment decisions that must be made over the next several years to support ongoing domgas supply from the NWS Project and the corresponding economic development that would otherwise result.

2.3 Supply of domgas from NWS Project

In the Draft Determination the ACCC notes that there is some uncertainty about the future levels of supply from the NWS Project.

While it is true that the NWS Project is a mature project and its focus has shifted from expansion to resource recovery, this does not mean that the NWS venture participants will be unable to commit to longer term contracts during the course of the next 5 years.

Investment in smaller undeveloped fields and infrastructure designed to maximise recovery from diminishing larger fields could potentially enable the NWS venture participants to continue offshore production until well past 2020. However, these investment decisions always remain subject to commercial viability, including the ability to underwrite such investment with secure domgas and LNG export contracts.

While it is not possible for the NWS venture participants to precisely determine in advance the duration of contracts that may be formed over the next 5 years, there is clearly at least the potential for the NWS venture participants to actively compete for longer term contracts (with durations longer than 5 years) during the proposed period of authorisation.

The factors that will ultimately determine the duration of new GSAs include:

1. proving of gas reserves;
2. level and success of NWS Project planned investments;
3. gas user requirements;
4. terms and conditions of proposed GSAs; and
5. the value of alternative uses for the gas.

Notwithstanding these inherent market-based uncertainties (which could in combination result in shorter term contracts being formed) the NWS venture participants submit there can be no detriment associated with leaving open the potential for increased Project-based competition for longer term contracts and the material flow-on benefits this would have in supporting market development and investment through the entire gas supply chain (particularly in production, transportation and new downstream projects).

3 Authorisation to give effect to DGJV contracts assigned to IPGJV

The IPGJV participants sought authorisation to give effect to any contracts entered into by the DGJV that may ultimately be assigned to the IPGJV.

It is not clear from the Draft Determination whether the proposed authorisation to give effect to existing contracts for their full term including any extensions includes authorisation for the IPGJV participants to give effect to assigned DGJV contracts.

The internal structure of the NWS Project and the allocation of production entitlements between the DGJV and the IPGJV is explained in paragraphs 2.33 to 2.46 of the Supporting Submission. The DGJV participants are currently contracted beyond the total production entitlement. Once the DGJV production entitlement is exhausted then, pursuant to the arrangements between the DGJV and the IPGJV participants, any ongoing DGJV contracts will need to be assigned to the IPGJV to ensure ongoing supply on the terms and conditions contained in those contracts. The DGJV contracts contain provisions to enable such an assignment.

The NWS venture participants consider that authorisation should be granted to the IPGJV participants to give effect to any DGJV contracts assigned to the IPGJV for the term of those contracts and any extensions. The net public benefits of the IPGJV participants giving effect to such contracts are identical to the net public benefits that would arise from the DGJV participants giving effect to those contracts.