



Australian
Competition &
Consumer
Commission

Determination

Applications for authorisation

lodged by

**BHP Billiton Petroleum (North West Shelf) Pty Ltd, BP
Developments Australia Pty Ltd, Chevron Australia Pty Ltd,
Japan Australia LNG (MIMI) Pty Ltd, Shell Development
(Australia) Pty Ltd and Woodside Energy Ltd**

in respect of

**joint marketing activities for the sale of domgas in Western Australia from
the North West Shelf Project and to administer existing gas supply contracts**

Date: 8 September 2010

Authorisation no.: A91220,
A91221, A91222, A91223

Public Register no.: C2010/344

Commissioners: Samuel
Kell
Court
Dimasi
Walker

Summary

The ACCC grants authorisation to the North West Shelf (NWS) joint venture participants with entitlements to produce domestic gas (domgas) to engage in joint marketing of domestic gas produced from the NWS Project, and for the administration of ongoing gas supply contracts.

The ACCC grants authorisation to the NWS joint venture participants to:

- jointly market 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 15 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 authorisation is conditional upon the NWS joint venture participants adhering to a ring fencing protocol and appointing an independent auditor to oversee and report on compliance with that protocol.

The applications for authorisation

On 31 March 2010 the NWS joint venture participants lodged applications for authorisation A91220–A91223 with the ACCC. The North West Shelf participants are:

- BHP Billiton Petroleum (North West Shelf) Pty Ltd
- BP Developments Australia Pty Ltd
- Chevron Australia Pty Ltd
- Japan Australia LNG (MIMI) Pty Ltd
- Shell Development (Australia) Pty Ltd and
- Woodside Energy Ltd (hereafter referred to as the Applicants).

In particular, the Applicants seek authorisation to:

- jointly discuss and negotiate common terms and conditions (including price) and the methods by which domgas produced from the NWS Project will be offered for sale by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture
- enter into contracts, arrangements or understandings between the NWS joint venture participants containing common terms and conditions (including price) upon which domgas produced from the NWS Project will be offered for sale and sold by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture and
- give effect to existing and new contracts, arrangements or understandings for the sale of domgas by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture.

The NWS Project is a large domgas and liquefied natural gas (LNG) development in the Carnarvon Basin, located off the north west coast of Western Australia. The NWS Project is a mature project, with existing reserves having been in production for over 25 years.

The project's onshore Karratha gas processing facility currently has a maximum committable capacity of approximately 600 terajoules of domgas per day and currently supplies around 65 per cent of Western Australia's domgas supply. The focus of investment in the NWS Project has shifted from expansion to maintaining deliverability and resource recovery.

History of joint marketing from the NWS Project

Domgas from the NWS Project has been jointly marketed, through North West Shelf Gas Pty Ltd, for around 25 years. Over that time, the ACCC (and its predecessor, the Trade Practices Commission) has authorised joint marketing from the NWS Project. The most recent of these authorisations, granted to the Incremental Pipeline Gas Joint Venture in 1998, lapsed in 2005. In March 2008, the ACCC revoked the original 1977 joint marketing authorisation, at the request of North West Shelf Gas Pty Ltd.

Gorgon Gas Project authorisation

In November 2009 the ACCC granted conditional authorisation to the Gorgon joint venture partners (Chevron Australia Pty Ltd, Chevron (TAPL) Pty Ltd, Mobil Australia Resources Company Pty Ltd and Shell Development (Australia) Pty Ltd) to jointly market their gas entitlements from the Gorgon Project for supply in Western Australia until 31 December 2015 (the 'Gorgon Determination'). The Gorgon Project is scheduled to commence domgas production in the second half of 2015. Authorisation was also granted to the Gorgon Applicants to give effect to any agreements entered into during the period of authorisation for a period not exceeding 25 years from the date of first delivery of gas from the Gorgon Project.

In its Gorgon determination, the ACCC noted that since its 1998 decision concerning the NWS Project, the Western Australian natural gas market has experienced marginal development and that separate marketing is still practically difficult with substantial commercial risk.

A further outline of the Gorgon authorisation applications and the ACCC's assessment of this matter is provided in Chapter 3 of this determination.

The NWS Project joint marketing arrangements – balance of public benefits and detriments

Without authorisation of the proposed NWS Project joint marketing arrangements, the ACCC is of the view that the Applicants would be likely to:

- continue to jointly give effect to existing domgas contracts (the majority of which were entered into under previous authorisations) and
- attempt to separately market incremental volumes.

However, the ACCC considers that separate marketing of domgas does not appear to be commercially feasible for incremental volumes from the NWS Project even though it might be practically possible in Western Australia.

In an illiquid and immature market, the ACCC is of the view that attempting to separately market these incremental volumes is likely to result in additional commercial risk to the

Applicants due to the need to establish and manage balancing obligations. Increased risks and costs could potentially result in a lower volume of domgas being supplied from the NWS Project than would be the case under joint marketing due to the possible deferral or withdrawal of planned investment to enable future domgas volumes.

The ACCC therefore considers the NWS Project joint marketing of the incremental domgas volumes is likely to result in the supply of higher domgas volumes to the Western Australian market than would be the case under separate marketing.

Given the current demand and supply imbalance in Western Australia, the ACCC considers the supply of higher domgas volumes constitutes a significant public benefit.

Overall, the ACCC considers that the proposed joint marketing of domgas from the NWS Project is unlikely to give rise to significant public detriments. The ACCC considers that the level of competition in domgas supply in Western Australia over the next 5 years (after which, new gas fields are scheduled to commence production) is not likely to be significantly different if domgas from the NWS Project is jointly or separately marketed.

The ACCC maintains its view that the level of competition, and hence domgas prices in Western Australia, is more impacted by the overall level of gas supply than whether domgas is jointly or separately marketed. In particular, the ACCC notes that were the NWS joint venture partners to attempt to separately market, the decisions about the timing and volume of gas supply would still be made by the partners jointly.

The ACCC considers that along with individual producers' investment decisions and the level of demand in the market, the overall level of domgas supply is partly influenced by acreage management and retention lease policies.

The ACCC acknowledges that prices for new domgas contracts have risen sharply from the long term average in WA in recent years and are higher than prices in the eastern states. However, the ACCC does not consider that this differential and the increase in price is a result of the joint marketing from WA domgas projects. Rather the strong demand for energy from the resources sector, the LNG export component of the WA gas industry, the constrained choice of energy options facing WA mining projects and the increasing cost of exploration and development appear to be driving the increased prices and the difference with the eastern states.

The ACCC rejects the assertion that authorisation of joint marketing by the NWS Project will result in significantly higher gas prices in Western Australia. Gas has always been jointly marketed in Western Australia by the NWS Project - including when gas was being sold for an extended period of time at historically low prices.

In the current market circumstances, the ACCC considers that joint or separate marketing by the NWS Project in and of itself is unlikely to have a significant impact on gas prices in Western Australia.

However, the ACCC recognises the potential for anti-competitive detriment to arise if confidential gas marketing and sales information were transferred between producing joint ventures in Western Australia. The ACCC considers this potential concern can be substantially mitigated by effective ring fencing arrangements. Accordingly, the ACCC grants authorisation conditional upon the Applicants adhering to the Ring Fencing Protocol (provided at Attachment 6 to the supporting submission to the current applications for authorisation) and appointing an independent auditor to oversee and report on compliance with that protocol. The proposed conditions of authorisation are consistent with those imposed by the ACCC in the Gorgon Determination.

Certain interested parties also submit that any authorisation of the NWS Project joint marketing arrangements should include conditions of authorisation aimed at securing future domgas supply from the project – for example, making authorisation conditional upon the Applicants maintaining existing levels of domgas supply for the life of the NWS Project or for the duration of any authorisation period.

However, the ACCC considers that decisions regarding optimal supply volumes from the NWS Project are more efficiently left to the Applicants to determine, rather than by regulatory intervention. Further, the ACCC considers that imposing domestic supply obligations on the Applicants (with associated necessary investment) would be outside the scope of the authorisation process and as such, does not intend to impose such conditions.

Therefore, the ACCC considers that overall, subject to the Ring Fencing Protocol conditions, the public benefits likely to result from the NWS Project joint marketing arrangements are likely to outweigh the public detriment.

Length of authorisation

As previously recognised by the ACCC, the Western Australian domgas market has not significantly developed over the past decade to enable commercially viable separate marketing of the NWS Project's incremental gas volumes. However, this does not necessarily indicate that the Western Australian domgas market will not sufficiently develop in the medium term.

Consistent with the Gorgon Determination, the ACCC is not satisfied that a longer period of authorisation (beyond 2015) is in the public interest, particularly due to the possible commencement of a number of new domgas projects in Western Australia in the coming five years.

The ACCC views the expected commencement of new domgas supplies in Western Australia as an opportunity for the market to develop. This makes 2015 a sensible time to review whether it is commercially viable for domgas in Western Australia to be separately marketed.

Therefore, the ACCC grants conditional authorisation to the NWS Applicants to jointly market domgas from the NWS Project and enter into gas supply agreements until 31 December 2015.

Further, the ACCC grants conditional authorisation to the Applicants to give effect to any domgas supply agreements which existed at the time the current applications for authorisation were lodged for their full term, including any extensions.

With regard to giving effect to new domgas contracts entered into during the proposed period of authorisation, the ACCC notes there appears to be some uncertainty between the duration of contracts that customers may seek to negotiate (namely, up to 25 years) and the Applicants'

ability or willingness to sign contracts with 25 year terms. Indeed, the Applicants advise that, at this stage, future gas supply agreements will not necessarily have 25 year terms.

Unlike the Gorgon Project, the ACCC notes that the NWS Project is a mature project, with existing reserves having been in production for over 25 years, Future NWS Project domgas sales agreements are expected to be for incremental volumes only.

In its draft determination, the ACCC expressed concern that gas buyers not be tied into unnecessarily long jointly marketed contracts and proposed to authorise the parties to give effect to sales contracts for up to 5 years - but sought the views of the Applicants and interested parties on the appropriate duration.

Both the Applicants and some gas buyers responded that 5 years was too short - with buyers often needing 10-15 year gas supply contracts to match up with financing arrangements for new projects and/or pipeline transportation contracts.

Consequently, the ACCC extends authorisation to the Applicants to give effect to contracts entered into during the term of the authorisation for the sale of domgas by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture, for a period not exceeding 15 years from the date of first delivery of gas.

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List of abbreviations

ACCC	Australian Competition and Consumer Commission
The Act	<i>Trade Practices Act 1974</i>
AER	Australian Energy Regulator
DBNGP	Dampier to Bunbury Natural Gas Pipeline
Domestic JV	Domestic Gas Joint Venture
domgas	Domestic natural gas
DUC	Danish Underground Consortium
EC	European Commission
ERA	Economic Regulation Authority (WA)
GBA	Gas Balancing Agreement
GBB	Gas Bulletin Board
GFU	Norwegian Gas Negotiation Committee
GJ	Gigajoule
Gorgon Applicants	Chevron Australia Pty Ltd; Chevron (TAPL) Pty Ltd; Mobil Australia Resources Company Pty Ltd; and Shell Development (Australia) Pty Ltd
GSA	gas sales agreement
Gorgon Determination	ACCC Determination in relation to applications for authorisation (A91139–A91140 and A91160–A91161) lodged by the Gorgon Applicants, 5 November 2009.
GSEMC	Gas Supply and Emergency Management Committee
Incremental JV	Incremental Pipeline Gas Joint Venture
Karratha Plant	Karratha Gas Plant
MIMI	Japan Australia LNG (MIMI) Pty Ltd
LNG	Liquefied natural gas
NWS Agreement	North West Shelf Project Agreement
NWSG	North West Shelf Gas Pty Ltd
NWS Project	North West Shelf Project
NWS State Agreement	<i>North West Gas Development Agreement (Woodside) Agreement Act 1979 (WA)</i>
PJ	Petajoule
SECWA	State Energy Commission of Western Australia
PNG Applicants	ExxonMobil Group; Oil Search Group; Mineral Resources Development Ltd; Merlin Petroleum Company; and AGL Gas Developments (PNG) Ltd
TJ	Terajoule
TPC	Trade Practices Commission

1. The applications for authorisation

1.1. On 31 March 2010 the North West Shelf joint venture participants lodged applications for authorisation A91220–A91223 with the ACCC.

1.2. The North West Shelf participants are:

- BHP Billiton Petroleum (North West Shelf) Pty Ltd
- BP Developments Australia Pty Ltd
- Chevron Australia Pty Ltd
- Japan Australia LNG (MIMI) Pty Ltd
- Shell Development (Australia) Pty Ltd and
- Woodside Energy Ltd (hereafter referred to as the Applicants).

1.3. Authorisation is a transparent process where the ACCC may grant immunity from legal action for conduct that might otherwise breach the *Trade Practices Act 1974* (the Act). The ACCC may ‘authorise’ businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment. The ACCC conducts a public consultation process when it receives an application for authorisation, inviting interested parties to lodge submissions outlining whether they support the application or not. Further information about the authorisation process is contained in [Attachment A](#).

1.4. A chronology of the significant dates in the ACCC’s consideration of these applications is contained in [Attachment B](#).

1.5. Application A91220 was made under:

- section 88(1) of the Act to make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act and
- section 88(1A) of the Act to make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.

1.6. Application A91221 was made under:

- section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act and
- section 88(1A) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

1.7. Application A91222 was made under:

- section 88(1) of the Act to make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act and
- section 88(1A) of the Act to make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.

1.8. Application A91223 was made under:

- section 88(1) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act and
- section 88(1A) of the Act to make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).

1.9. In particular, the Applicants seek authorisation to:

- jointly discuss and negotiate common terms and conditions (including price) and the methods by which domestic gas (domgas) produced from the North West Shelf Project will be offered for sale by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture
- enter into contracts, arrangements or understandings between the North West Shelf joint venture participants containing common terms and conditions (including price) upon which domgas produced from the North West Shelf Project will be offered for sale and sold by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture and
- give effect to existing and new contracts, arrangements or understandings for the sale of domgas by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture.

1.10. The applications for authorisation relate to domgas sales only. The Applicants request that separate authorisations be granted to both the Domestic Gas Joint Venture (Domestic JV) and the Incremental Pipeline Gas Joint Venture (Incremental JV) in recognition of the different participating interests in each of those joint ventures.

1.11. The Applicants also advise that it is presently anticipated that future domgas contracts will be formed by the participants in the Incremental JV.

Duration of authorisation sought

- 1.12. The Applicants seek authorisation to jointly market and enter into domgas contracts until the end of 2016 (or at least until the end of 2015) to provide regulatory certainty to allow them to underwrite investment decisions to maintain capacity and deliverability for the production of domgas to be marketed by the Incremental JV participants.
- 1.13. In addition, the Applicants seek authorisation to give effect to:
- existing domgas contracts for the full term of those contracts (including any extensions) and
 - 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 the first delivery of gas under that contract.

2. Draft determination

- 2.1. Section 90A(1) requires that before determining an application for authorisation the ACCC shall prepare a draft determination.
- 2.2. On 8 July 2010 the ACCC released a draft determination proposing to grant conditional authorisation to the Applicants to:
 - jointly market 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.
- 2.3. The ACCC's draft determination proposed to grant authorisation conditional on the Applicants adhering to a ring fencing protocol and appointing an independent auditor to oversee and report on compliance with that protocol.
- 2.4. A pre-decision conference was not requested in relation to the draft determination.
- 2.5. A copy of the draft determination may be obtained from the authorisations register on the ACCC's website (www.accc.gov.au/AuthorisationsRegister) and by following the links to this matter (North West Shelf Project).

3. Background to the applications

The Applicants¹

- 3.1. All of the Applicants, except for Japan Australia LNG (MIMI) Pty Ltd ('MIMI'), were participants in the North West Shelf Project's (NWS Project) original gas production joint venture – namely, the Domestic JV. MIMI joined the NWS Project in 1985 after investing in the project's LNG export phase. Subsequently, MIMI acquired a participating interest in future domgas production and sales.
- 3.2. Table 2.1 outlines the Applicants' interests in the NWS Project's Domestic JV and Incremental JV.

Table 2.1: participating interests in the NWS Domestic JV and Incremental JV²

Party	Domestic JV (%) – 1979	Incremental JV (%) – 1995
Woodside	50	16 ^{2/3}
Shell	8 ^{1/3}	16 ^{2/3}
BHP Billiton	8 ^{1/3}	16 ^{2/3}
BP	16 ^{2/3}	16 ^{2/3}
Chevron	16 ^{2/3}	16 ^{2/3}
MIMI	n/a	16 ^{2/3}

- 3.3. An overview of each of the Applicants' businesses follows.

Woodside Energy Ltd

- 3.4. Woodside Energy Ltd (Woodside) is a participant in the NWS Project, as well as the delegated operator of the project.
- 3.5. Woodside is Australia's largest publicly traded oil and gas exploration and production company. Its other relevant domestic interests include:
- a 90 per cent operating interest in the Pluto LNG Project near Karratha (Western Australia)
 - a 33.44 per cent operating interest in the Sunrise LNG development in the Timor Sea
 - an operator and an interest in the Browse LNG Development in northern Western Australia and

¹ Unless stated otherwise, the information appearing under this heading was obtained from the supporting submissions to the applications for authorisation A91220–A91223, 31 March 2010, pages 8-9.

² The Applicants supporting submission to the applications for authorisation A91220–A91223, 31 March 2010, page 12.

- offshore exploration in the north west of Australia.

BHP Billiton Petroleum (North West Shelf) Pty Ltd

3.6. BHP Billiton Petroleum (North West Shelf) Pty Ltd is a wholly owned subsidiary of BHP Billiton Petroleum International Pty Ltd, an international oil and gas exploration and production company owned by BHP Billiton Limited.

3.7. BHP Billiton's other relevant interests in Australia include:

- the Bass Strait oil and gas production joint venture, located off the south east coast of Australia
- a 45 per cent operating interest in the Griffin Venture (in the Carnarvon Basin off the coast of Western Australia), which has recently ceased production
- a 90 per cent operating interest in the Minerva offshore gas venture, located in the Otway Basin (Victoria)
- a 50 per cent operating interest in the Stybarrow venture, producing oil and gas from fields in the Exmouth sub-basin (offshore Western Australia)
- a 71 per cent operating interest in the Pyrenees venture, producing oil and gas from fields in the Exmouth sub-basin (offshore Western Australia)
- a 71 per cent operating interest in the Macedon joint venture with Apache, located off the north coast of Exmouth (Western Australia)
- an interest in the Browse LNG joint venture off the northern coast of Western Australia and
- a 50 per cent interest in the Scarborough gas field, a potential LNG development, and 100 per cent interest in the nearby Thebe discovery (north west coast of Western Australia).

BP Developments Australia Pty Ltd

3.8. BP Developments Australia Ltd (BP Developments) is part of the BP group of companies, one of the world's largest energy companies. BP Developments is involved in the exploration for and production of oil, natural gas, and the refining, transportation and marketing of petroleum and lubricant products.

3.9. BP Developments other relevant interests in Australia are:

- a stake in the Browse LNG joint venture off the northern coast of Western Australia and
- the Io gas field, which is located in the Greater Gorgon development area off the coast of Western Australia.

Chevron Australia Pty Ltd

- 3.10. Chevron Australia Pty Ltd is a wholly-owned subsidiary of the Chevron Corporation. Chevron Corporation was formed by the merger of Chevron and Texaco in 2001.
- 3.11. Chevron's other relevant interests in Australia include:
- a 50 per cent operating interest in the Gorgon Project, located off the northwest coast of Western Australia (due to commence domgas supply in or around 2015)
 - the wholly-owned Wheatstone LNG project and domgas operation near Onslow (onshore Western Australia)
 - an interest in the Browse LNG joint venture off the northern coast of Western Australia and
 - offshore exploration in the north-west of Australia.

Japan Australia LNG (MIMI) Pty Ltd

- 3.12. MIMI is an Australian company owned equally by Mitsubishi Corporation and Mitsui & Co Ltd. As noted above, MIMI was formed to participate in the NWS Project and has no other relevant oil and gas business interests in Australia.

Shell Development Australia Pty Ltd

- 3.13. Shell Development (Australia) Pty Ltd (Shell) is a member of the Royal Dutch/Shell group of companies, one of the world's largest energy companies.
- 3.14. Shell's other relevant interests in Australia include:
- a 25 per cent interest in the Gorgon Project (due to commence domgas supply in or around 2015)
 - an interest in the Browse LNG joint venture off the coast of Western Australia
 - a 100 per cent interest in the Prelude and Concerto fields located in the Browse Basin (offshore Western Australia)
 - interests in the Sunrise (26.6 per cent) and Evans Shoal (25 per cent) gas fields in the Bonaparte Basin off the north-west coast of Australia
 - a 33 per cent interest in the Iago and Clio fields
 - interests in a potential project to convert coal bed methane to LNG in Queensland and
 - offshore exploration in the north-west of Australia.

The NWS Project³

- 3.15. The NWS Project accounts for more than 40 per cent of Australia's total oil and gas production.
- 3.16. The NWS Project involves exploration, production and processing of hydrocarbons in the Carnarvon Basin. The Carnarvon Basin is located off the north west coast of Western Australia, approximately 125km north west of Karratha.
- 3.17. The NWS Project comprises both offshore and onshore facilities, which are operated by Woodside Energy Ltd. Gas is currently produced from a number of fields in the project area – including North Rankin, Goodwyn, Perseus, Angel Searipple, Echo/Yodel and associated gas from the Wanaea, Cossack, Lambert and Hermes fields. An overview of the NWS Project's facilities follows:
- **Offshore** facilities – three deep sea platforms and associated infrastructure which is capable of producing a total of more than 100 000 tonnes of gas per day.
 - **Onshore** facilities – gas extracted offshore is transported onshore via two sub-sea pipelines to the Karratha Gas Plant (the Karratha Plant). The Karratha Plant processes:
 - LNG for international export
 - domestic natural gas ('domgas') for supply to Western Australia
 - LPG and
 - condensate (a by-product of natural gas).
- 3.18. The Karratha Plant has a maximum committable capacity of approximately 600 TJ (equal to 12 000 tonnes) of domgas per day and 52 000 tonnes of LNG per day. Following processing, domgas is supplied to the Dampier to Bunbury Natural Gas Pipeline and the Pilbara Pipeline for transportation to customers. LNG is exported via ship.
- 3.19. Natural gas and condensate reserves were discovered by the initial five NWS Project participants in 1970. The project was then developed in two stages:
- the production of domgas for supply to the Western Australian domestic market – commenced in 1984 and
 - the production of LNG for export – commenced in 1989 with a shipment to Japan.
- 3.20. When the NWS Project started, the original NWS Project participants entered into a 20 year gas supply agreement with the Western Australian government-owned utility, State Energy Commission of Western Australia (SECWA). In 1994 the SECWA contract was disaggregated into separate Domestic JV contracts with five major customers.

³ The information appearing under this heading was obtained from the supporting submission to the applications A91220–A91223, 31 March 2010, pages 6-16.

Domgas production

- 3.21. The structure of the NWS Project is governed by the North West Shelf Project Agreement (the 'NWS Agreement'). The NWS Agreement establishes two joint ventures for the production of domgas, namely:
- the Domestic JV – comprised of the original five NWS venture participants and
 - the Incremental JV – comprised of the original NWS venture participants and MIMI.
- 3.22. The Domestic JV consists of the following parties:
- BHP Billiton Petroleum (North West Shelf) Pty Ltd
 - BP Developments Australia Pty Ltd
 - Chevron Australia Pty Ltd
 - Shell Development (Australia) Pty Ltd and
 - Woodside Energy Ltd
- 3.23. The Incremental JV was created in the 1990's to sell additional domgas (beyond that which was already committed under the initial 20 year gas supply agreement with SECWA) and to recognise MIMI's new participation in the NWS Project.
- 3.24. As the Domestic JV has fully contracted its production entitlements under existing domgas contracts, the Applicants advise that any future sales of NWS Project domgas are likely to be made by the Incremental JV.
- 3.25. The NWS Agreement also specified a daily production limit for the Domestic JV – currently 414 TJ/day. The Applicants advise that gas supply requirements under existing Domestic JV contracts often exceed this daily production limit. Therefore, to ensure that Domestic JV customers receive uninterrupted supply at agreed prices and conditions, the Domestic JV and Incremental JV participants entered into a Production Transfer Agreement. Under this agreement, the Domestic JV participants effectively purchase any shortfall (that is, the amount exceeding 414 TJ/day) from the Incremental JV participants.

Joint marketing domgas from the NWS Project

- 3.26. While the NWS Agreement provides that the Applicants have the right to own, take and separately dispose of their production entitlements, the Applicants have always elected to jointly market their domgas entitlements. In this regard, a marketing agency, North West Shelf Gas Pty Ltd (NWSG) was established to undertake the following activities:
- market domgas produced by the Domestic JV and the Incremental JV to customers in Western Australia and
 - administer existing domestic gas sales agreements.

- 3.27. NWSG is staffed by representatives from all of the NWS Project participants. It is NWSG's role to identify opportunities to sell domgas and to recommend terms and conditions, including prices, for consideration by the NWS Project participants. However, NWSG does not have the authority to commit the participants to particular terms and conditions.
- 3.28. NWSG adopts the following processes when negotiating domestic gas sales agreements:
- the relevant NWS Project participants collectively negotiate and agree all of the terms and conditions, including price, for supply of gas to the prospective buyers identified by NWSG
 - the buyer contracts individually with each relevant NWS Project participant in respect of its proportionate share of the delivered domgas (namely, each Applicants' percentage interest in the Domestic JV or Incremental JV)
 - the separate gas sales agreements between the buyer and each NWS Project participant are consolidated into a single document
 - the domgas made available to a buyer under the gas sales agreement is delivered in a common and comingled stream and
 - NWSG invoices the buyer on behalf of the each of the NWS Project participants.
- 3.29. For existing contracts, NWSG receives nominations from customers for the amounts of gas they require on a particular day. This information is then provided to Woodside (the NWS Project's operator), which determines the total amount of domgas to be produced and processed by the NWS Project. NWSG also assists Woodside with planning and forecasting for the Karratha Plant.
- 3.30. Further, the Applicants advise that a small number of the Domestic JV's longer term contracts contain price review clauses. In this regard, NWSG is also involved in facilitating negotiations between the Applicants and their customers during price review processes. Disputes about price review amounts are generally resolved via an independent arbitration process.

Current domgas customers

- 3.31. The **Domestic JV** supplies the following five major customers, largely under restatements of the original SECWA contract:
- Alcoa
 - Alinta
 - BHP Billiton
 - Hamersley Iron and
 - Verve.

- 3.32. The ACCC understands that over 90 per cent of the NWS Project's available domgas production capacity is used to meet the requirements of these above customers.
- 3.33. The **Incremental JV** has made some short sales of domgas where small amounts of capacity exceeding the Domestic JV commitments have become available. The Applicants advise that opportunities for the Incremental JV to sell new quantities of domgas will increase as the Domestic JV contracts fall away and plant capacity becomes available.

Ongoing investment and gas reserves in the NWS Project

- 3.34. The Applicants advise that total investment in the development and expansion of the NWS Project to date has totalled more than AUD\$27 billion.
- 3.35. The NWS Project is a mature project, with existing reserves having been in production for over 25 years. Based on the current understanding of the field's subsurface, the Applicants submit that there is limited scope for adding incremental reserves through exploration. As such, the Applicants consider that any future discoveries within the NWS Project area are expected to be relatively minor.
- 3.36. Therefore, the Applicants advise that the focus of investment in the NWS Project has shifted from expansion to maintaining deliverability and resource recovery. In particular, investment is now directed towards exploration and offshore infrastructure intended to secure gas flows from diminishing fields as well as the smaller undeveloped fields to maximise the life of the project.
- 3.37. Regarding the level of investment, the Applicants advise that as the NWS Project matures, the difficulty and cost of extracting gas from existing reserves increases. Therefore, simply maintaining production at existing levels (without any expansion) will require significant ongoing investment.
- 3.38. In this regard, one key development project to be undertaken in order to maintain production over the remaining life of the project is the North Rankin Redevelopment Project (NR2). At a cost of around AUD\$5 billion, NR2 will involve the installation of a second deep-sea platform with compression to enhance offshore deliverability and access reserves. The Applicants advise that reliable production from NR2 is expected to commence in 2013 and that it will enable them to recover remaining low pressure gas from some of the NWS Project's fields and help to satisfy both existing and future domgas customer commitments.

Future domgas supply

- 3.39. The Applicants advise that future domgas production and sales from the NWS Project could come from either:
- the residual reserves (that is, those reserves not subject to a state obligation) allocated to the Incremental JV or

- potentially, extended interest gas which would be allocated to the future Extended Interest Joint Venture⁴ – the Extended Interest Joint Venture is a potential joint venture that may be formed in the future, following China National Offshore Oil Corporations Ltd’s investment in the NWS Project in 2004.
- 3.40. Further, the Applicants advise that the extent to which the Incremental JV or the Extended Interest Joint Venture will be able to supply the domestic market in the future is dependent on investment decisions and will involve the Applicants assessing a range of factors, including:
- proving of gas reserves
 - the terms of potential domgas sales
 - the value of alternative uses for the gas (such as LNG)
 - 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.

The NWS State Agreement⁵

- 3.41. The five original NWS Project participants entered into an agreement with the Western Australian government in 1977 – this agreement was legislated as the *North West Gas Development Agreement (Woodside) Agreement Act 1979 (WA)* (hereafter referred to as the ‘NWS State Agreement’).
- 3.42. The NWS State Agreement imposed specific supply obligations on the NWS Project participants, namely:
- 5064 PJ of NWS Project gas for delivery and use in Western Australia (including the 20 years of supply to SECWA) and
 - approximately 7560 PJ of NWS Project gas for export to satisfy initial LNG contracts.
- 3.43. The Applicants advise that the domgas obligation will be satisfied under existing NWS Project contracts by around 2014. The initial quantity of LNG for export has already been delivered.
- 3.44. While residual quantities of gas produced by the NWS Project in excess of the domgas and export obligation amounts are not subject to specific state requirements, the NWS State Agreement sets additional obligations on the Applicants. In particular, the Applicants submit they are required to:

⁴ Due to uncertainties regarding the future marketing of domgas by the Extended Interest Joint Venture, it is not an applicant for the current applications for authorisation A91220–A91223.

⁵ The information appearing under this heading was obtained from the supporting submission to the applications A91220–A91223, 31 March 2010, pages 12-13.

- keep the relevant state Minister informed of their proposed arrangements for the utilisation of gas produced during the years 2010 to 2034 and
- consult with the Minister prior to entering into any arrangements for the sale, use, supply or export of natural gas and to reach agreement with the Minister on the requirements of the state and the manner in which they will be met.

The Western Australian domgas industry

3.45. The Western Australian domgas industry sits apart from the rest of Australia as there are currently no pipelines enabling domgas supply either to or from the eastern states. In addition, the Western Australian electricity industry does not have physical interconnection or governance linkages with the National Electricity Market. The Western Australian electricity industry is linked to the domgas industry as currently 60 per cent of installed generation capacity is fuelled by domgas.⁶

Upstream gas sector

3.46. For the year to 30 June 2009, the Western Australian gas industry produced approximately 1095 PJ (natural gas and LNG combined). This compares to total Australian natural gas production for the same period of 1780 PJ.⁷

3.47. Approximately two thirds of Western Australia's production for the year ended 30 June 2009, or 766 PJ, was exported as Liquefied Natural Gas (LNG).⁸ Consequently, approximately 329 PJ (or on average 901 TJ/day) was produced as domgas and supplied into the Western Australian market.⁹

3.48. The majority of domgas production in Western Australia, close to 97 per cent, presently comes from the Carnarvon Basin located in the north west of the state, which is approximately 1300 km from Perth.¹⁰ The remainder is produced from the Perth Basin. Domgas produced from the Carnarvon Basin is essentially processed from two facilities – namely, the NWS Project's Karratha facility and the Apache Energy managed Varanus Island facility. Figure 2.1 illustrates the location of Western Australia's significant oil and gas fields, including the various natural gas pipelines, as at 31 March 2010.

3.49. The NWS Project supplies approximately 600 TJ/day of domgas, or approximately 65 per cent of total supply in Western Australia.¹¹ The NWS Project's Karratha domgas facility is theoretically running close to capacity. However, in the middle of 2008 production was able to be temporarily increased to above 700 TJ/day to compensate for lost supply following the Varanus Island explosion.¹² The ACCC considers this reflects a level of plant redundancy at the Karratha Plant to provide what the Applicants view as an appropriate level of supply security.

⁶ Australian Energy Regulator, *State of the Energy Market 2008*, 20 November 2008, page 224.

⁷ Australian Energy Regulator, *State of the Energy Market 2009*, page 226.

⁸ Ibid.

⁹ Ibid

¹⁰ Australian Energy Regulator, *State of the Energy Market 2008*, 20 November 2008, page 224.

¹¹ North West Shelf Gas, *North West Shelf Venture Fact Sheet*, www.nwsg.com.au.

¹² Woodside Petroleum Ltd, *Half Year Report*, 30 June 2008, page 3.

- 3.50. The Apache Energy managed Varanus Island facility sources gas from two joint ventures, Harriet and John Brookes. The Harriet joint venture produces approximately 95 TJ/day and the John Brookes joint venture produces approximately 245 TJ/day.¹³ In total, the Varanus Island facility represents approximately 30 – 35 per cent of Western Australia’s domgas production. The ownership structure of the Varanus Island joint ventures is outlined at tables 2.2 and 2.3 below.

Table 2.2 – Harriet joint venture ownership structure¹⁴

Company	Ownership (%)
Apache Energy	68.50
Kufpec Australia	19.28
Tap Oil	12.22

Table 2.3 – John Brookes joint venture ownership structure¹⁵

Company	Ownership (%)
Apache Energy	55
Santos	45

- 3.51. Less than five per cent of Western Australia’s total domgas supply comes from fields in the Perth Basin, such as AWE Ltd’s Dongara and Woodada fields.¹⁶

Domgas shipment

- 3.52. The supply of domgas from producers to customers in Western Australia is facilitated through shipment via a series of pipelines.
- 3.53. The Dampier to Bunbury Natural Gas Pipeline (DBNGP) is the largest of Western Australia’s gas pipelines, with a current capacity of 785 TJ/day. It runs almost 1600 km, transporting gas from the Carnarvon region to customers in south west Western Australia. The firm full haul capacity of DBNGP is fully contracted under pre-existing contracts until 2019, with options potentially extending this to 2029.¹⁷ The capacity of DBNGP is presently being expanded and by early 2010 will have a firm full haul capacity of 840 TJ/day.
- 3.54. The Goldfields Gas Pipeline transports gas from the Carnarvon region to customers in the Pilbara and Eastern Goldfields regions. It has a current capacity of 130 TJ/day.¹⁸
- 3.55. The Parmelia Gas Pipeline transports gas from the Perth Basin to industrial customers in the wider Perth region. It has a capacity of 65 TJ/day. The pipeline includes the Mondarra storage facility, which is the largest storage available in Western Australia. Mondarra currently has a capacity of approximately 12 TJ/day.¹⁹

¹³ http://www.apachecorp.com/Operations/Australia/Varanus_Island/index.aspx and Tap Oil, *Quarterly Report for the Quarter Ended 30 June 2009*.

¹⁴ Tap Oil Ltd, *ASX Announcement: Harriet Joint Venture Production Rates Increase*, 29 April 2009.

¹⁵ <http://www.santos.com/activities-browser/production-processing/john-brookes.aspx>

¹⁶ The Senate – Standing Committee on Economics, *Matters relating to the gas explosion at Varanus Island, Western Australia*, December 2008, page 37.

¹⁷ Submission from DBNGP (WA) Transmission Pty Ltd in relation to the Gorgon Project applications for authorisation (A91139-A91140 and A91160-A91161), 5 June 2009, page 2.

¹⁸ Goldfields Gas Transmission website, <http://www.ggt.com.au/html/02doi2.htm>.

¹⁹ Office of Energy (WA), *Energy Update*, 24 June 2008.

- 3.56. The Pilbara Pipeline System, located adjacent to the Carnarvon Basin, is interconnected with the DBNGP and incorporates the Pilbara Energy Pipeline. The Pilbara Pipeline System has an uncompressed capacity of 186 TJ/day.²⁰
- 3.57. The Telfer Pipeline System runs 488 km and transports gas from Port Headland to mine sites.
- 3.58. The DBNGP and Goldfields Gas Pipeline are known as ‘covered pipelines’, in that they are regulated by the Economic Regulation Authority (WA) (the ‘ERA’) under the *Gas Pipelines Act 1998* (WA), which implements the National Third Party Access Code for Natural Gas Pipeline Systems (the Code). As covered pipelines, DBNGP and Goldfields Gas Pipeline must make publically available an access arrangement approved by the ERA. The access arrangement must include a policy on services offered, a reference tariff and a benchmark tariff and an expansion policy. For example, the DBNGP Standard Shipper Contract prescribes that it must expand for demand increments of 10 TJ/day.²¹

Domgas purchasers

- 3.59. Domgas consumption in Western Australia is dominated by industrial usage (58 per cent of supply) and electricity generation (29 per cent of supply).²² Approximately 60 per cent of electricity generation capacity in Western Australia is fuelled by natural gas.²³ Five large customers (Alcoa, Verve Energy, Alinta, BHP Billiton and ERM Power) take approximately 90 per cent of Western Australia’s domgas supply,²⁴ with Alcoa the largest customer taking approximately 25 per cent.²⁵

Gas prices in Western Australia

- 3.60. The ACCC notes that there is little price transparency in the Western Australia gas market and average prices which are often quoted are likely to be significantly affected by long term, high volume contracts. The Office of Energy’s (WA) Gas Tariffs Review, released in June 2009, noted that prices are moving sharply away from historical prices that were around \$2.50 per GJ earlier this decade.²⁶
- 3.61. Further, utilising information prepared for it by ACIL Tasman, the Office of Energy (WA) noted that based on the long run marginal cost of gas in Western Australia from the Reindeer Project, its analysis indicated a gas commodity price between \$6.50/GJ and \$8.50/GJ.²⁷

²⁰ <http://www.epicenergy.com.au/index.php?id=30>

²¹ Submission from DBNGP (WA) Transmission Pty Ltd in relation to the Gorgon Project applications for authorisation (A91139-A91140 and A91160-A91161), 5 June 2009, page 5.

²² Australian Petroleum Production and Exploration Association (APPEA), *Submission to the Gas Supply Emergency Management Review Committee*, May 2009.

²³ Australian Energy Regulator, *State of the Energy Market 2008*, 20 November 2008, page 224.

²⁴ The supporting submission to the applications ofr authorisation A91220–A91223, 31 March 2010, page 15.

²⁵ The supporting submission to the Gorgon Project’s applications for authorisation A91139-A91140 & A91160-A91161, 20 May 2009, page 23.

²⁶ Office of Energy (WA), *Gas Tariffs Review Interim Report*, June 2009, page 14.

²⁷ *Ibid*, page 15.

- 3.62. The Australian Energy Regulator (AER) notes in its *Energy Market Report 2008* that the Western Australian gas market:

...has experienced considerable tightening since 2006, with rising production costs and strong domestic demand occurring at a time when most producers have fully contracted their developed reserves. In addition, Western Australia's LNG export capacity makes the domestic market relatively sensitive to international energy prices, which have increased significantly since 2005.

In combination, these factors have led to a substantial rise in domestic prices in Western Australia, with some contracts in 2007 being negotiated at around \$7 per gigajoule compared to typical prices of around \$2.50 earlier in the decade.²⁸

- 3.63. The Department of Mines and Petroleum (WA) reported in its *Statistics Digest* in April 2010, that the average price for domgas in Western Australia in the December quarter of 2009 was approximately \$3/GJ. The same publication noted that this price was well below domestic gas prices in Europe, the United Kingdom and the United States.²⁹
- 3.64. By way of further international comparison, the ACCC notes that the Energy Information Administration (US) reported the Henry Hub price as \$US 5.13 per million British Thermal Units for natural gas, as of 16 June 2010.³⁰ This equates to approximately \$AUD 5.54 /GJ. The Henry Hub is physically located in Louisiana (USA) and is the pricing point for gas futures contracts on the New York Mercantile Exchange. It is generally considered that the Henry Hub price is a good benchmark of the spot price for natural gas in North America.

Western Australia's future domgas supply and reserves

- 3.65. In September 2006, the Office of Energy (WA) reported that Western Australia holds approximately 80 per cent of Australia's natural gas reserves.³¹ In total, it is estimated that there is 112 trillion cubic feet of natural gas reserves in Western Australia. The majority is estimated to be held in the Carnarvon Basin (80 trillion cubic feet), followed by the Browse Basin (30 trillion cubic feet) and the Bonaparte Basin.
- 3.66. In October 2006, the Western Australian Government introduced a policy to reserve gas from LNG projects for domestic purposes. The intention of the domestic gas reservation policy is to set aside 15 per cent of gas available from any future offshore gas developments in order to secure Western Australia's future energy supplies.³² Each gas project seeking to establish processing facilities on Western Australian territory must negotiate with the government the quantity and delivery timetable and flexibility of the domestic obligation as a condition of land access for processing facilities.³³

²⁸ Australian Energy Regulator, *State of the Energy Market 2008*, 20 November 2008, page 231.

²⁹ The Department of Mines and Petroleum (WA), *Statistics Digest 2009*, April 2010, page 13.

³⁰ Energy Information Administration, *Natural Gas Weekly Update*, 16 June 2010.

³¹ Office of Energy (WA), *Gas Reserves*, September 21 2006.

³² WA Premier Media Statement, *State Government's domestic gas reservation policy released*, 12 October 2006.

³³ Allen Consulting Group, *Report to the ACCC: Gorgon Gas Project Joint Venture Application for Authorisation of Joint Marketing*, 24 July 2009, page 9.

- 3.67. There are a number of new gas projects in Western Australia currently scheduled to commence production in the next five years or so. The Gorgon Project is forecast to commence domgas supply in the second half of 2015. The Reindeer project (domgas only) which is a joint venture between Apache Energy and Santos, will process domgas through the Devil Creek processing facility. Devil Creek will initially produce 110 TJ/day, with a capacity increasing to 220 TJ/day.³⁴
- 3.68. In addition, BHP Billiton has recently indicated that it is intending to reach a final investment decision on its Macedon joint venture with Apache Energy in mid 2010.³⁵ The Macedon Project is likely to be domgas only with a capacity of approximately 210 TJ/day, with production forecast to commence in 2013.³⁶ In November 2009, the WA Parliament passed the *Gas Supply (Gas Quality Specifications) Act 2009* (WA), which is intended to encourage gas producers to develop fields containing broader specification gas (such as Macedon) by reducing the required gas processing costs.
- 3.69. Santos and Apache Energy announced in August 2010 their intention to develop the Halyard and Spar fields for domgas delivery from mid 2011. Production is forecast to commence at 50 TJ/day with a potential increase to above 100 TJ/day from 2013 depending on the outcome of appraisal wells at the Spar 2 field. The proposed domgas production will be processed through the existing Varanus Island facilities.³⁷
- 3.70. In addition to the projects noted above, a number of developments are tentatively forecast to either commence production of domgas in 2015, or shortly after:
- Pluto (Woodside) – LNG production forecast to commence in 2010 with possible domgas supply from 2015.³⁸
 - Wheatstone (Chevron) – possible domgas supply of 250 TJ/day from 2016.³⁹
 - Scarborough (BHP Billiton & Exxon Mobil) – currently in a feasibility study, possible production post 2015.⁴⁰
 - Additional domgas production from the North West Shelf joint venture.⁴¹
- 3.71. On 22 October 2009 Apache Energy and KUFPEC announced that it would supply gas from its Julimar and Brunello fields to Chevron's Wheatstone field in return for a 25 per cent stake in the Wheatstone LNG Project. Wheatstone's first phase will consist of two LNG trains with a combined capacity of 8.6 million tonnes per year with a Final Investment Decision expected in 2011.⁴²

³⁴ Apache Energy Media Release, *Groundbreaking signals commencement of new WA domestic gas hub*, 15 September 2009.

³⁵ BHP Billiton, *Petroleum Briefing*, 24 May 2010.

³⁶ Ibid.

³⁷ Santos ASX/Media Release, *Santos and Apache development a major boost for Western Australian domestic gas supply*, 30 August 2010.

³⁸ WA Premier Media Statement, *Woodside commits to domestic gas reservation policy*, 8 December 2006.

³⁹ <http://www.chevron.com/countries/australia/wheatstone/>

⁴⁰ http://www.exxonmobil.com/Australia-English/PA/about_what_wa_scarb.aspx

⁴¹ The Department of Mines and Petroleum (WA), *Petroleum in Western Australia*, April 2009, page 23.

⁴² Apache Energy Media Release, *Apache, KUFPEC to Join Chevron's Wheatstone LNG Project in Australia*, 22 October 2009.

- 3.72. Commitments under Western Australia's domestic gas reservation policy have been made in relation to the Gorgon, Pluto and Wheatstone projects. The price of gas sold into the domestic market is to be determined through commercial arrangements between gas buyers and sellers. In a report prepared by EnergyQuest within the AER's 2009 State of the Energy Market Report, it was considered that domestic gas prices for these new projects are likely to provide returns comparable to the gas price producers can obtain from LNG.⁴³

Government and parliamentary inquiries concerning domestic gas supply

Current inquiry into domestic gas prices in Western Australia

- 3.73. On 20 April 2010 the Western Australian Legislative Assembly referred the following terms of reference to the Economics and Industry Standing Committee:
- That the Committee specifically investigate:
- (a) the price of gas for customers throughout Western Australia
 - (b) the comparison of the price of gas with other states, especially Victoria, and whether there is a significant price differential and, if so, why; and
 - (c) the contrast between domestic gas prices in Western Australia and international LNG prices and the LNG contracts that govern these international prices.
- 3.74. Under the terms of reference, the committee is directed to make recommendations on any measures that could be implemented to reduce the price of gas in Western Australia.
- 3.75. The committee was originally requested to report by 30 September 2010. On 6 May 2010 Parliament agreed to extend the tabling date for the inquiry report to 28 February 2011.

2008 inquiry into the NWS Project's joint marketing arrangements

- 3.76. On 25 September 2008 the Senate referred the following matter to the Standing Committee on Economics for inquiry and report:
- The joint marketing arrangements on the North West Shelf project and their impact on competition in the upstream gas market and on prices paid by consumers.⁴⁴
- 3.77. In its December 2008 report, the committee concluded that it had not received substantive evidence to allow it to make a recommendation at that point in time. In particular, the committee noted there are contradictory views in relation to joint marketing arrangements for the NWS Project:
- On the one hand there is the argument that these arrangements have set a price floor for gas and have stunted the competitive development of the Western Australian gas market. On the other is

⁴³ Australian Energy Regulator, *State of the Energy Market 2009*, a report by EnergyQuest (*Australia's natural gas markets: connecting with the world*), page 31.

⁴⁴ The Senate Standing Committee on Economics, *Joint marketing arrangements on the North West Shelf project*, December 2008, page 1.

the argument that the market is still developing and that the substantial capital investment for these large scale projects would not be feasible under separate selling arrangements.⁴⁵

3.78. In a minority report, the Coalition members of the committee noted that:

...while philosophically subscribing to the concept of the desirability of competition in markets producing the best outcome for consumers, ...the special features of the WA gas market at this stage of its development mean that requiring the members of the North West Shelf Joint Venture separately market gas would not necessarily result in the desired outcome of competition driven price reduction.⁴⁶

Inquiry into the 2008 Varanus Island explosion

3.79. On 3 June 2008 a series of explosions at the Varanus Island processing facilities cut all of its domgas production, reducing domgas supply in Western Australia by approximately 30 – 35 per cent. Partial production resumed in August 2008, with full production reported to have recommenced in June 2009.⁴⁷

3.80. In August 2008, the Senate referred a number of matters pertaining to the Varanus Island explosions and subsequent cut in supply to the Standing Committee on Economics for inquiry and report. The report was handed down in December 2008. In considering the issue of energy security and diversifying sources of energy in Western Australia, the report concluded:

Energy supplies in Western Australia are prone to serious dislocation due to the lack of a mature, diverse and competitive market. This situation, coupled with limited supply capabilities, leaves the Western Australian community and industry prone to severe dislocations as a result of plant or pipeline failure.⁴⁸

3.81. On 13 October 2009 the Western Australian Government tabled the Gas Supply and Emergency Management Committee's (GSEMC) Report to Government. The GSEMC was established following the Varanus Island incident and a short shutdown of the North West Shelf's Karratha Plant in January 2008. The GSEMC was to review and provide advice to the Western Australian Government on the state's gas security, gas supply disruption management and mitigation options in the event of a gas supply disruption. In its report to Government, the GSEMC recommended possible mitigation measures in the event of a disruption, including:

- providing incentives for electricity generators to install or retrofit dual-fuel generation capacity and maintain an adequate strategic stock of diesel to meet abnormal fuel requirements and
- additional gas storage capacity capable of withdrawal rates of between 35 TJ/day and 100 TJ/day from a gas reservoir, such as Mondarra, and additional interconnection of the Parmelia Pipeline and the DBNGP.⁴⁹

⁴⁵ Ibid, page 13.

⁴⁶ The Senate Standing Committee on Economics, *Joint marketing arrangements on the North West Shelf project*, Coalition Senator's Minority Report, December 2008, page 15.

⁴⁷ Sydney Morning Herald, *Varanus at full capacity*, 29 June 2009.

⁴⁸ The Senate – Standing Committee on Economics, *Matters relating to the gas explosion at Varanus Island, Western Australia*, December 2008, pages 51-52.

⁴⁹ Office of Energy (WA), Gas Supply and Emergency Management Committee – Report to Government, September 2009, page 5.

- 3.82. In its report to Government, the GSEMC further recommended measures to improve reliability and competitiveness of domestic gas supply in Western Australia, including:
- implementation of a Gas Bulletin Board (GGB), including a non-compulsory facilitated trading market that provides for offers to sell and buy on standard transport and commodity contracts and
 - further consideration be given to a compulsory Short Term Trading Market following a review of the operation of the Western Australian GGB and the gas market experiences in other Australian jurisdictions.⁵⁰

Productivity Commission review of the Regulatory Burden on the Upstream Petroleum (Oil and Gas) Sector

- 3.83. In 2008, the Productivity Commission was requested to undertake a study on the regulation of crude oil and natural gas projects that involve more than one jurisdiction.
- 3.84. In its report of 30 April 2009, the Productivity Commission made a number of recommendations relating to the regulation of the upstream oil and gas industry, including the granting and renewal of retention leases.⁵¹
- 3.85. Retention leases in Australian offshore waters were originally introduced in 1985 to:
- provide for the granting and retention of leases over currently non-commercial discoveries. Retention leases will allow explorers to retain tenure over discoveries until they become commercial and should provide an additional measure of encouragement for companies exploring in deep water or gas prone areas.⁵²
- 3.86. An application for a retention lease has to satisfy two criteria:⁵³
- the discovery is not commercially viable at the time of the application and
 - it is likely to be commercially viable within 15 years when the application is submitted.
- 3.87. If an application for the grant of a retention lease is refused because the recovery of the petroleum is found to be commercially viable, the titleholder has until the exploration permit expires to apply for a production licence. If an application for the renewal of a retention lease is refused because the recovery of the petroleum is found to be commercially viable, the titleholder has 12 months to apply for a production licence.⁵⁴
- 3.88. Since 1985, 70 per cent of retention leases granted have been offshore from Western Australia, and 80 per cent of retention leases are held over gas fields.⁵⁵

⁵⁰ Office of Energy (WA), Gas Supply and Emergency Management Committee – Report to Government, September 2009, page 5.

⁵¹ Productivity Commission Research Report, *Review of regulatory burden on the upstream petroleum (oil and gas) sector*, April 2009, page XLV.

⁵² Australian Government Department of Resources, Energy and Tourism, *Review of policy relating to the grant and renewal of retention leases – options paper – 12 June 2009*, page 3.

⁵³ Ibid, page 4.

⁵⁴ Ibid.

⁵⁵ Ibid, page 5.

3.89. Regarding retention leases, the Productivity Commission noted in its 2009 report that:

There has been some pressure to make commerciality tests more rigorous, especially for gas reserves, in order to increase domestic gas supplies. In the extreme, lease holders might be compelled to commence production or lose the resource title, regardless of differing views about commerciality (a strict ‘use it or lose it’ test).

Yet various reviews have not found any significant market failure justifying action to compel lease holders to sell or develop gas reserves – for example, competition was found adequate to ensure that individual businesses do not have an incentive to hoard reserves in order to influence prices. So it could be expected that companies generally will develop or on-sell their discoveries when they see the prospect of an adequate commercial return.⁵⁶

3.90. The Productivity Commission made the following recommendation concerning retention leases:

To promote regulatory certainty, governments should clarify and clearly articulate the objective/s and make transparent the criteria and processes used in both approving initial retention leases and renewing existing retention leases. In considering any changes to the retention lease system, governments should:

- assess the costs and benefits (including the possible effects on incentives to explore for petroleum, and any likely gas supply outcomes)
- ensure the costs of intervention are the minimum necessary to achieve the governments’ objectives
- consider more objective tests of commerciality, such as auction mechanisms, where disagreements about commercial assessment arise, to avoid inadvertent expropriation of exploration investments.

3.91. On 12 June 2009 the Australian Government Department of Resources, Energy and Tourism issued an options paper regarding the review of the policy relating to the grant and renewal of retention leases. For the purpose of generating discussion, this paper canvassed options related to how the granting and renewal of retention leases can be improved in a way which would have a positive impact on oil and gas exploration and development in Australia.

Previous gas joint marketing ACCC authorisations

3.92. The ACCC has previously considered a number of applications for authorisation from gas joint ventures relating to joint marketing. Two of these concerned the North West Shelf Project and one related to the Papua New Guinea Gas Project. The most recent ACCC gas joint marketing authorisation decision relates to the Gorgon Gas Project. These matters are described below.

⁵⁶ Australian Government Productivity Commission, *Review of regulatory burden on the upstream petroleum (oil and gas) sector*, April 2009, page xxix.

Gorgon authorisation (A91139-A91140 & A91160-A91161)

- 3.93. On 5 November 2009 the ACCC granted conditional authorisation to the Gorgon JV partners (Chevron Australia Pty Ltd, Chevron (TAPL) Pty Ltd, Mobil Australia Resources Company Pty Ltd and Shell Development (Australia) Pty Ltd – the ‘Gorgon Applicants’) to jointly market their gas entitlements from the Gorgon Project for supply in Western Australia until the end of 31 December 2015. Authorisation was also granted to the Gorgon Applicants to give effect to any agreements entered into during the period of authorisation for a period not exceeding 25 years from the date of first delivery of gas from the Gorgon Project.
- 3.94. The Gorgon Project is a large LNG and domestic gas development off the north west coast of Western Australia, which is forecast to commence domgas production in the second half of 2015. Under the State Agreement with the Western Australian Government, the Gorgon Project is required to supply 2000 PJ of natural gas over the life of the Gorgon Project into Western Australia.
- 3.95. In the Gorgon Determination, the ACCC noted that since its 1998 decision concerning the NWS Project (see paragraphs 3.113 – 3.115 below), the Western Australian natural gas market has experienced marginal development and that separate marketing is still practically difficult with substantial commercial risk.⁵⁷
- 3.96. In particular, the ACCC noted that the Western Australian natural gas market still has a relatively small number of suppliers, purchasers and gas transport options. Further, the preference of the majority of suppliers, purchasers and pipeline operators is to sign long term gas supply contracts. This has resulted in a market which is contract based or ‘lumpy’, where demand and supply moves in significant steps or increments. In the ACCC’s view, this appeared to have limited the extent to which parties in the market are able to engage in secondary trading and has discouraged the development of significant gas storage – being key prerequisites for separate marketing to be viable.⁵⁸
- 3.97. In the Gorgon Determination, the ACCC also noted that almost all domestic natural gas production in Western Australia currently occurs from the NWS and Varanus Island (Harriet and John Brookes) joint ventures. The ACCC considered that joint marketing by the Gorgon joint venture would be in the public interest by enabling a significant new source of gas supply for Western Australia. The ACCC was of the view that joint marketing was likely to enable domgas production from the Gorgon Project to commence at an earlier date and at higher volumes than if the Gorgon producers separately marketed.

⁵⁷ ACCC Authorisation Determination, *the joint marketing and sale of natural gas from the Gorgon Gas Project for supply in Western Australia*, 5 November 2009, page ii.

⁵⁸ *Ibid*, pages ii-iii.

- 3.98. More broadly, the Gorgon Determination also outlined the ACCC's view that the Western Australian natural gas market is likely to have high levels of concentration in field ownership in the short to medium term. Further, the timing and volume of gas supply will be determined by the production joint venture, regardless of whether that gas is subsequently marketed jointly or separately. In these circumstances, the Gorgon Determination highlighted that the greatest benefits from competition are likely to result from competition between projects as opposed to between individual joint venture partners in the Gorgon Project. Further, the ACCC considered that the price of natural gas in Western Australia is likely to be more significantly influenced by the overall volume of gas supply, rather than whether that gas is jointly or separately marketed.
- 3.99. Further, the ACCC considered that once the Gorgon parties are producing jointly – including making decisions about production levels and timing – joint marketing is unlikely to lead to higher prices compared to separate marketing. In fact, the ACCC concluded in the Gorgon Determination that due to the lower risks and costs compared to separate marketing, in those circumstances it may lead to lower prices depending on the level of competition from other sellers.
- 3.100. To address concerns from interested parties that commercially sensitive information obtained from customers by the Gorgon partners may be transferred to and used by competing parties or projects in Western Australia, the ACCC decided to impose conditions aimed at ensuring that a robust ring fencing regime is in place.
- 3.101. The ACCC's 2009 Gorgon authorisation was time limited, to take account of the possibility that the Western Australian market may mature sufficiently to enable separate marketing from the end of 2015.

Previous NWS Project authorisations

Authorisation A18492 - 1977

- 3.102. In February 1977, the Trade Practices Commission (TPC) granted authorisation (A18492) to the parties in the North West Shelf joint venture (namely, the Domestic JV participants) to discuss and agree the common terms and conditions upon which natural gas will be offered for sale. At the time of authorisation, the NWS Project was in a developmental stage and had not yet commenced production of natural gas for supply into Western Australia.
- 3.103. In granting the authorisation, the TPC concluded that the benefits to flow from the NWS Project, such as lower fuel costs and energy self sufficiency, were dependent on the joint venture arrangements.⁵⁹ Alternatively, the project was unlikely to proceed without the joint venture arrangements. The authorisation was granted without a time limit.
- 3.104. In September 1980, the North West Shelf joint venture partners entered into gas supply contracts with the former SECWA to supply approximately 414 TJ/day of gas over a 20 year period from 1985 to 2005.

⁵⁹ Australian Competition and Consumer Commission Authorisation Determination, *Woodside Petroleum Development Pty Ltd A18492*, 15 February 1977, page 11.

- 3.105. On 14 December 2007 North West Shelf Gas Pty Ltd (NWSG) requested that the ACCC revoke its 1977 NWS Project authorisation (A18492). The NWSG requested the revocation on the basis that there was no need for immunity under the Act, as the conduct for which authorisation was originally granted would not be in breach of the Act. The ACCC revoked the 1977 authorisation (A918492) on 5 March 2008.
- 3.106. The ACCC noted in its accompanying News Release that the joint venturers intended to continue to jointly market gas produced from the project.⁶⁰

Authorisation A90624 - 1998

- 3.107. In September 1997, the participants in the NWS Project (Woodside Energy Ltd, Shell Development (Australia) Pty Ltd, BHP Billiton Petroleum, BP Developments Australia Pty Ltd, Chevron Australia Pty Ltd and MIMI – namely, the Incremental JV) lodged application for authorisation A90624. The Applicants sought authorisation to discuss and agree together the common terms and conditions, including price, at which gas produced together under the NWS Project will be offered for sale to customers and to discuss and agree on methods for the marketing and sale of such gas.
- 3.108. The application concerned a proposed expansion of gas processing facilities for supply into Western Australia. At that time, the Applicants were proposing to double domestic production capacity of the NWS Project from 550 TJ/day to 1 100 TJ/day.
- 3.109. The 1997 authorisation application was for conduct that was almost identical to that authorised in 1977, with the exception that it also included MIMI. In the application, the Applicants stated that the 1977 authorisation still applied to their activities and if approved, the 1998 authorisation would operate side by side with the existing authorisation.⁶¹ MIMI was to become a partner in the domestic component of the NWS Project under the proposed expansion.
- 3.110. The applicants argued that joint marketing was integral to the project and that the proposed expansion may not proceed without authorisation. The applicants further argued that a number of public benefits would flow from the proposed expansion such as greater efficiency, business and employment opportunities, import replacement, export enhancement and increased international competitiveness. Finally, the applicants considered that separate marketing was not feasible at the time in the Western Australian market.⁶²
- 3.111. A number of interested parties opposed the authorisation arguing in broad terms that the gas market in Western Australia had matured sufficiently since 1977 to support the NWS Project's proposed expansion with separate marketing.⁶³ Further, some interested parties claimed that separate marketing would increase competition and lower prices.

⁶⁰ ACCC News Release, *ACCC revokes North West Shelf Gas joint marketing authorisation*, 6 March 2008.

⁶¹ Australian Competition and Consumer Commission Authorisation Determination, *North West Shelf Project A90624*, 29 July 1998, page 6.

⁶² ACCC Authorisation Determination, *North West Shelf Project A90624*, 29 July 1998, page iv.

⁶³ *Ibid*, pages 30 – 31.

- 3.112. In considering the application, the ACCC concluded that, where possible, separate marketing is the preferred method of supplying gas to domestic markets. By having a large number of separate marketers, the expectation is that the market would be more competitive. In its 1998 NSW Project determination, the ACCC noted the examples of the US and UK domestic gas markets, where the production and delivery of gas is separate from contractual sales, as evidenced by active secondary markets and the presence of a large number of customers, producers and aggregators.⁶⁴
- 3.113. However, the ACCC concluded that the Western Australian market demonstrated few of the features that were evident in overseas markets that appeared to be prerequisites for separate marketing to be commercially feasible. The Western Australian market was characterised as a contract or project market, where gas is only produced to meet specific, and often long-term, contractual obligations.⁶⁵
- 3.114. The ACCC's 1998 NWS Project determination noted that the greater the number of features from the following list that are developed, the greater the likelihood that separate marketing would become viable in Western Australia:
- a significant increase in the number of customers
 - the entry of new competitive suppliers
 - additional transport options
 - storage
 - the entry of brokers/aggregators
 - the creation of gas-related financial markets and
 - the development of significant short term and spot markets.⁶⁶
- 3.115. The ACCC noted in its 1998 determination that in order for it to conclude that separate marketing was feasible it would need to demonstrate that the practical problems identified by the applicants in an environment of few producers and buyers, long term contracts and no active spot/secondary market, could be overcome. The ACCC further noted that no submissions opposing authorisation provided satisfactory evidence as to how these practical problems could be addressed.⁶⁷
- 3.116. The ACCC granted authorisation on 29 July 1998 for seven years, with authorisation extended to give effect to any contracts entered into during that time for up to 20 years. In all circumstances the authorisation was to expire in 2018.
- 3.117. The 1998 NWS Project authorisation (A90624) granted to the Incremental JV lapsed in 2005, and the parties did not reapply for authorisation.

⁶⁴ Ibid, pages iv –v.

⁶⁵ Ibid.

⁶⁶ ACCC Authorisation Determination, *North West Shelf Project A90624*, 29 July 1998, pages iv –v.

⁶⁷ ACCC Authorisation Determination, *North West Shelf Project A90624*, 29 July 1998, page vi.

- 3.118. A copy of the ACCC's 1998 determination and the NWS Project's application is available from the authorisations register on the ACCC's website (www.accc.gov.au/AuthorisationsRegister) and searching by 'A90624'.

PNG Gas Project 2006 authorisation (A40081)

- 3.119. In December 2004, the participants in the PNG Gas Project (ExxonMobil Group, Oil Search Group, Mineral Resources Development Ltd, Merlin Petroleum Company and AGL Gas Developments (PNG) Ltd) (the PNG Applicants) sought authorisation for the joint marketing and sale of natural gas into Queensland. The gas was to be transported to Australia via a pipeline constructed from PNG to Queensland. At the time of the application the PNG Project was solely a domgas venture.
- 3.120. In their submissions, the PNG Applicants contended that they needed the legal certainty of authorisation prior to committing to the project. Further, the PNG Applicants said they would not proceed with the project in the foreseeable future without authorisation.⁶⁸ The PNG Applicants added that the PNG Project would result in considerable public benefits, such as greater competition in the Queensland market and lower wholesale gas prices, with no public detriment.⁶⁹
- 3.121. A number of interested party submissions raised concerns that the conduct would result in the PNG joint venture dominating the Queensland market and limit growth in the coal seam methane gas industry.⁷⁰ Further concerns were raised that joint marketing may limit the ability of customers to negotiate on price and conditions resulting in a loss of dynamic efficiencies. Finally, interested parties were concerned that customers' commercially sensitive information obtained under joint marketing may be inappropriately used by joint venture partners that had interests in other Australian gas projects.⁷¹
- 3.122. At the time the ACCC was considering this matter, approximately 93 per cent of gas production in the eastern states of Australia came from the Cooper Basin and the Gippsland Basin. Further, the ACCC's determination noted that BHP Billiton, ExxonMobil and Santos controlled approximately 90 per cent of the gas reserves in eastern Australia.⁷²
- 3.123. In its 2006 PNG Project determination, the ACCC noted that gas exploration and production in Australia has generally been undertaken by joint ventures, principally as a mechanism to share costs and risk. The determination further adds that joint venture partners have tended to prefer to jointly market the gas produced from the projects.⁷³

⁶⁸ ACCC Authorisation Determination, *PNG Gas Project A40081*, 3 May 2006, page 67.

⁶⁹ Ibid, page 39.

⁷⁰ Ibid, page 56.

⁷¹ Ibid.

⁷² Ibid, page 19.

⁷³ Ibid, page 26.

- 3.124. While the PNG Applicants indicated that their preference would be to separately market the gas produced from the PNG Project, the illiquid and shallow dynamics of the eastern Australian energy market did not in their view make it viable, necessitating joint marketing. The PNG Applicants noted that where separate marketing did occur in Australia, it was limited to small gas fields or where a vertically integrated joint venturer can supply itself with gas produced from the field.⁷⁴
- 3.125. The ACCC in its 2006 determination accepted that the PNG Project was likely to not proceed under separate marketing arrangements. However, the ACCC did not accept that separate marketing would be infeasible for the life of the project.⁷⁵ Further, while the ACCC expressed uncertainty that separate marketing would lead to lower prices, it did consider that it may add value and lead to enhanced dynamic efficiency, particularly through the negotiation of individual conditions with individual producers.⁷⁶
- 3.126. The ACCC granted authorisation to the PNG Applicants in May 2006 for a period of 16 years. The ACCC considered that substantial public benefits would arise as a result of the PNG Project proceeding. The ACCC noted that while the project would enjoy a large share of the Queensland market it would be competitively constrained by developments in coal seam methane.⁷⁷
- 3.127. The PNG Applicants had sought authorisation for the term of the project. However, the ACCC concluded that over time, market characteristics were likely to change that would enable separate marketing with its associated benefits.
- 3.128. In order to address concerns from interested parties about the treatment of commercially sensitive information, the PNG Applicants' ring fencing arrangements formed part of the authorisation. In particular, the ring fencing arrangements required the PNG Applicants to provide an annual statement as to the nature of the ring fencing arrangements signed by the CEO and one director of each applicant and a commitment to report any breaches of the ring fencing arrangements to the ACCC.
- 3.129. In February 2007, it was announced by the PNG Gas Project partners that the plan to build a pipeline to supply natural gas to Queensland would be abandoned in favour of an LNG processing hub.⁷⁸
- 3.130. A copy of the ACCC's 2006 PNG determination and the PNG Project's application for authorisation is available from the authorisations register on the ACCC's website (www.accc.gov.au/AuthorisationsRegister) and searching by 'A40081'.

⁷⁴ ACCC Authorisation Determination, *PNG Gas Project A40081*, 3 May 2006, page 30.

⁷⁵ Ibid, page 35.

⁷⁶ Ibid, page 36.

⁷⁷ Ibid, page 6.

⁷⁸ International Herald Tribune, *Papua New Guinea gas pipeline plan dropped*, 1 February 2007.

4. Submissions received by the ACCC

- 4.1. The ACCC tests the claims made by the applicant in support of an application for authorisation through an open and transparent public consultation process. To this end the ACCC aims to consult extensively with interested parties that may be affected by the proposed conduct to provide them with the opportunity to comment on the application.
- 4.2. Broadly, in the current applications, the Applicants submit that separate marketing is still not commercially feasible in Western Australia. The Applicants submit that the necessary market features (previously identified by the ACCC in 1998, and again in 2009) have not developed in Western Australia in a material way – particularly the implementation of gas balancing arrangements.⁷⁹
- 4.3. Further, the Applicants submit that joint marketing has continuously delivered domgas at competitive prices to the Western Australian market over a sustained period of time. Due to the commercial infeasibility of separate marketing, the Applicants consider that the arrangements for which authorisation is sought will result in significant public benefits, namely:
- more domgas being supplied to the Western Australian market than would be available under attempted separate marketing
 - more competition than would exist under attempted separate marketing
 - potentially lower prices, or at least prices that are not higher, than would result under separate marketing and
 - recognised economic benefits, such as security of supply (including prompt emergency supply) and increased capital investment.⁸⁰

Initial consultation

- 4.4. Upon receipt of the applications, the ACCC invited submissions from around 80 interested parties potentially affected by the applications, including customers, industry associations and relevant government departments. The ACCC also held a number of meetings with interested parties in Perth.
- 4.5. In response to the request for submissions, the ACCC received six public submissions from the following interested parties:
- Alcoa World Alumina Australia (Alcoa)
 - Domgas Alliance
 - Synergy
 - Rio Tinto

⁷⁹ The Applicants' supporting submission to the applications for authorisation A91220-A91223, 31 March 2010, page 4.

⁸⁰ Ibid, pages 4–5.

- Dr Alan Eggleston, Senator for Western Australia
 - Chevron Australia Pty Ltd, Chevron (TAPL) Pty Ltd, Mobile Australia Resources Company Pty Limited and Shell Development (Australia) Pty Ltd (the joint venturers in the Gorgon Gas Project).
- 4.6. The Applicants also provided a public submission in response to the issues raised in interested party submissions.
- 4.7. The views of the Applicants and interested parties prior to the release of the draft determination are outlined in Chapter 5 of this determination.

Post draft determination

- 4.8. Upon the release of the draft determination, the ACCC wrote to 14 interested parties and the Applicants to seek their views on the proposed conditional grant of authorisation. The Domgas Alliance and Rio Tinto provided interested party submissions.
- 4.9. **The Domgas Alliance** strongly opposes the ACCC's proposal in the draft determination to grant conditional authorisation. It maintains that separate marketing is practical and feasible in WA and that it would result in lower prices.
- 4.10. **Rio Tinto**, as expressed in its initial submission, is in principle opposed to joint marketing. However, Rio Tinto again affirms that it would be concerned if the ACCC authorisation process caused a delay or deferment of the marketing and sale of domgas from the NWS Project. Rio Tinto also sought clarity from the ACCC on the criteria it would apply in considering future applications for authorisation of joint marketing arrangements from WA domgas projects.
- 4.11. The Applicants and interested parties were provided with an opportunity to call a conference following the release of the ACCC's draft determination. No party requested a conference.
- 4.12. The views of the Applicants and interested parties are further outlined in the ACCC's evaluation of the NWS Project joint marketing activities in Chapter 5 of this determination. Copies of public submissions and records of meetings held with interested parties may be obtained from the ACCC's website (www.accc.gov.au/AuthorisationsRegister) and by following the links to this matter.

5. ACCC evaluation

5.1. The ACCC's evaluation of the NWS Project joint marketing arrangements is in accordance with the tests found in:

- section 90(8) of the Act which states that the ACCC shall not authorise a proposed exclusionary provision of a contract, arrangement or understanding, unless it is satisfied in all the circumstances that the proposed provision would result or be likely to result in such a benefit to the public that the proposed contract, arrangement or understanding should be authorised.
- sections 90(6) and 90(7) of the Act which state that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:
 - the provision of the proposed contract, arrangement or understanding in the case of section 90(6) would result, or be likely to result, or in the case of section 90(7) has resulted or is likely to result, in a benefit to the public and
 - that benefit, in the case of section 90(6) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision was given effect to, or in the case of section 90(7) has resulted or is likely to result from giving effect to the provision.
- sections 90(5A) and 90(5B) of the Act which state that the ACCC shall not authorise a provision of a proposed contract, arrangement or understanding that is or may be a cartel provision, unless it is satisfied in all the circumstances that:
 - the provision, in the case of section 90(5A) would result, or be likely to result, or in the case of section 90(5B) has resulted or is likely to result, in a benefit to the public and
 - that benefit, in the case of section 90(5A) would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement were made or given effect to, or in the case of section 90(5B) outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result from giving effect to the provision.

5.2. For more information about the tests for authorisation and relevant provisions of the Act, please see [Attachment C](#).

5.3. The proposed joint marketing activities of both the Domestic and Incremental JV's from the NWS Project are considered jointly below.

Area of competition

- 5.4. The first step in assessing the effect of the conduct for which authorisation is sought is to consider the relevant area of competition affected by that conduct.
- 5.5. The Applicants note that in previous matters the ACCC has considered the relevant area of competition to be the wholesale market for the domestic supply of gas in Western Australia or the south west region of Western Australia. The Applicants consider that arguably there is a broader energy market which encompasses gas and other fuels such as coal and oil. Nonetheless, for the purpose of these applications the Applicants adopt the previous market definition, namely the Western Australian domgas market.
- 5.6. No interested parties specifically addressed the issue of market definition in their submissions.
- 5.7. The ACCC notes that the supply of domgas in Western Australia is currently restricted to production from within the State. There are currently no pipelines connecting Western Australia to gas production in the eastern States and in addition there are no facilities that would enable the importation of LNG and its subsequent re-gasification in Western Australia. The Western Australian electricity market is also not connected to the National Electricity Market.
- 5.8. As explored later in this chapter with respect to domgas prices, the ACCC considers that there is a degree of substitution between domgas and diesel for power generation in Western Australia. In particular, remote resource developments in Western Australia will in most cases have a choice of diesel or if physically available, domgas, for energy generation at the mining sites. These mining sites often have their own energy generation units due to a requirement for relatively large electricity loads associated with the extraction and processing of minerals.
- 5.9. The feasibility of utilising domgas will be strongly influenced by the ability to access pipelines and the prevailing price of diesel compared to contracted domgas. The ACCC is of the view that mining sites that have access to existing pipelines will have a strong incentive to utilise domgas over diesel. In particular, domgas has, in the past, been able to provide long term energy security at relatively stable prices that can be matched against a resource's development profile.
- 5.10. Additionally, the ACCC considers that large domgas customers in the south west of Western Australia, such as electricity generators, may over time have the option of substituting domgas in respect of new generation investment for other energy options, in particular coal.

- 5.11. The ACCC notes recent academic research that concludes that an estimated increases in the price of domgas in Western Australia, from \$3.20/GJ in 2005 to around \$7/GJ in 2009, is making prospective investment in natural gas combined cycle electricity generation unviable. In particular, the paper considers that if the domgas price is maintained at \$7/GJ (or higher), future investment in electricity generation Western Australia will be focused on coal.⁸¹
- 5.12. However, for existing base load power generation assets, there exists significant costs and difficulties in retrofitting these plants to utilise another energy source. As demonstrated in the Varanus Island disruption in 2008, some electricity generation was able to be transferred from gas to diesel and coal, however there continued to be significant supply disruptions.⁸²
- 5.13. The ACCC is of the view that while there is a degree of substitution between domgas and other energy sources, it is not particularly strong in the short to medium term. For the purpose of assessing these applications, the ACCC considers the relevant area of competition affected by the proposed conduct is the wholesale supply of domgas in Western Australia.

The counterfactual

- 5.14. The ACCC applies the ‘future with-and-without test’ established by the Tribunal to identify and weigh the public benefit and public detriment generated by conduct for which authorisation has been sought.⁸³
- 5.15. Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the ‘counterfactual’.
- 5.16. The Applicants submit that if authorisation is denied by the ACCC, then there are three possible counterfactuals:
- 1) continue joint marketing of domgas without authorisation, notwithstanding the significant regulatory costs and uncertainty this would bring or
 - 2) consider lower risk alternatives, such as focussing on export opportunities or
 - 3) attempt to transition the NWS Project to separate domgas marketing.

⁸¹ Simshauser, P and Wild, P ‘The Western Australian Power Dilemma,’ *Australian Economic Papers*, Vol. 48, No. 4, December 2009, pages 342-369.

⁸² The Senate (Cth) – Standing Committee on Economics, *Matters relating to the gas explosion at Varanus Island, Western Australia*, December 2008, page 38.

⁸³ *Australian Performing Rights Association* (1999) ATPR 41-701 at 42,936. See also for example: *Australian Association of Pathology Practices Incorporated* (2004) ATPR 41-985 at 48,556; *Re Media Council of Australia* (No.2) (1987) ATPR 40-774 at 48,419.

- 5.17. The three potential counterfactuals canvassed by the Applicants are considered below. However, as with its assessment in the Gorgon Determination, the ACCC considers that the key issue in forming a view of the relevant counterfactual for these applications is the commercial viability of separate marketing in the Western Australian domgas market.

Continue joint marketing

Applicants' submission

- 5.18. The Applicants submit that based on their assessment that joint marketing is unlikely to lessen competition in the Western Australian domgas market, the NWS partners may elect to continue joint marketing. Nonetheless, the Applicants recognise that continuing joint marketing without authorisation may potentially result in a high administrative burden and greater uncertainty through having to respond to issues such as regulatory enquiries.
- 5.19. The Applicants are of the view that managing these processes is likely to result in considerable costs for the joint venture partners. The Applicants anticipate that these costs may increase over the next five years due to the ACCC's view expressed in the Gorgon Determination that the market may develop during this period.

ACCC's view

- 5.20. None of the interested parties specifically addressed the Applicants' proposed counterfactual of continuing to jointly market without authorisation.
- 5.21. The ACCC notes that the Applicants have been conducting joint marketing and selling of incremental volumes of domgas from the NWS Project without authorisation for a number of years. In addition, the Applicants have continued to manage and give effect to existing contracts during this period.
- 5.22. The ACCC is of the view that should authorisation be denied, the Applicants would be likely to continue to jointly manage and give effect to existing contracts. The ACCC notes that the majority of domgas capacity is utilised in meeting existing contracts that are derived from the original SECWA contract that commenced in 1985 and was disaggregated in 1994. The ACCC understands that supply under these contracts from the Domestic JV will conclude by 2017 with some contracts continuing to be supplied by the Incremental JV until 2020.⁸⁴
- 5.23. The ACCC considers that the Applicants would be unlikely to be prepared to bear the administrative burden to renegotiate these contracts or attempt to assign them to an individual joint venture partner. Additionally, the ACCC notes the volume of domgas supplied under some of these contracts is likely to be of a size that would necessitate the assigning to two or more partners resulting in a greater level of complexity. Finally, the ACCC is not satisfied that the customers themselves would necessarily wish to have these long term contracts renegotiated or assigned to separate joint venture partners, with the additional uncertainty and costs this would likely bring.

⁸⁴ The Applicants' supporting submission to applications for authorisation A91220-3, 31 March 2010, page 13.

- 5.24. The ACCC further considers that giving effect to existing contracts would in most cases not involve the Applicants undertaking marketing or selling activities. Rather it would be the administration of the terms and conditions of the contracts, such as the delivering of the contracted domgas volumes. The administering of these contracts would also include, where applicable, exercising price review clauses.
- 5.25. While the Applicants may engage in joint marketing of the additional incremental domgas volumes from the NWS Project without authorisation, the ACCC notes the Applicants concern about the uncertainty and additional risks and costs that are likely to come from the increased regulatory exposure. The ACCC therefore considers that were authorisation to be denied, the joint venture partners are not likely to engage in joint marketing of the incremental volumes of domgas.

Lower risk alternatives, such as focussing on export opportunities

Applicants' submission

- 5.26. The Applicants also canvass that if authorisation of domgas joint marketing arrangements is denied by the ACCC, consideration would be given to dedicating greater amounts of gas produced from the NWS Project for export as LNG.
- 5.27. The Applicants submit that this potential counterfactual is not desirable for the joint venture partners and recognise that the LNG processing facilities at the Karratha plant are operating at maximum capacity and that placing reserves earmarked for domgas production into LNG production will result in deferred revenues. However, the Applicants are of the view that this option has the following potential attractions:
- reduction of the costs and risks inherent in continuing to joint marketing without authorisation or attempting to transition to separate marketing and
 - a reduced risk of inquiries or enforcement action under the Act.
- 5.28. The Applicants note that this option could only be pursued after discussions with the Western Australian Government. The Applicants submit that under this counterfactual, current domgas contracts would continue to be administered but that it would be future new or recontracting volumes of gas that would potentially be reduced.

Interested party submissions

- 5.29. The Domgas Alliance submits that the proposed counterfactual that the Applicants would divert domgas reserves towards LNG production were authorisation denied is unlikely. In particular, the Domgas Alliance notes that the NWS State Agreement provides a mechanism for the Western Australian Government to enforce continuing gas supply. It goes on to submit:

Even if the NWSJV producers satisfy their original domestic supply obligations by 2014, this does not extinguish the State's power to ensure priority of domestic supply over the renewal of existing LNG contracts or the entering into of new LNG contracts.⁸⁵

⁸⁵ Submission from Domgas Alliance, 30 April 2010, page 10.

- 5.30. Alcoa is of the view that were the Applicants to divert domgas reserves toward LNG production in the event that authorisation is denied, then this will lead to lower market supply and corresponding higher prices. Alcoa submits that the Applicants incentive to divert domgas production into LNG streams will be increased in a situation where LNG prices increase markedly.

ACCC's view

- 5.31. The ACCC notes the Frontier Economics report prepared for the Applicants that explores the option of selling domgas reserves as LNG production. In particular, the report indicates that the LNG infrastructure is at capacity until approximately 2023:

...the willingness of the [Incremental JV] to sell domestic gas will depend on the other options available to JV participants: the other option for JV participants is likely to be leaving gas under the sea and selling it in the form of LNG in 2024 or later.⁸⁶

- 5.32. As a consequence, were the Applicants to decide that absent authorisation they would divert reserves they would otherwise sell as domgas into the LNG streams, then this gas would not be able to be sold until after 2023. The ACCC understands that the LNG plant remaining at capacity until 2023 is conditional on future investments proceeding as currently planned.

- 5.33. As the Applicants acknowledge, there is an opportunity cost in 'leaving in the ground' these volumes. This is magnified by the length of time, ten to twelve years, between any decision to cease or reduce selling future domgas volumes and when those volumes could be utilised as LNG. Predictions about realised LNG prices for supply from 2023 would be highly uncertain over such a lengthy timeframe. This is acknowledged in the Frontier Economics report prepared for the Applicants:

If one compares entering into a contract to sell domestic gas at a certain price now with the uncertain revenue to be got from converting the offshore gas to LNG and selling it in 2024, the opportunity cost of processing and selling domestic gas today would be significantly less than \$2.52 per GJ.⁸⁷

- 5.34. On the other hand, there appears to be evidence that domgas prices will continue to be strong as the tight supply/demand balance persists in Western Australia at the same time as when these incremental volumes are currently planned to be marketed and delivered.

- 5.35. The ACCC is not able to form a view on whether the Western Australian Government is able to prevent the Applicants from diverting incremental volumes from domgas reserves into future LNG production.

- 5.36. The ACCC is of the view that the Applicants have a strong financial incentive to attempt to market and sell these future incremental volumes as domgas over the option of diverting the volumes into future LNG production. The ACCC therefore considers that were authorisation denied, it would be unlikely that the Applicants would divert incremental volumes of domgas into future LNG production.

⁸⁶ Frontier Economics, *Joint marketing of NWS domestic gas*, 31 March 2010, page 16.

⁸⁷ *Ibid*, page 12.

Transition to separate marketing

- 5.37. As concluded previously, the ACCC is of the view that if it denies authorisation of the NWS Project joint marketing arrangements, then the Applicants would be likely to continue to jointly give effect to existing contracts but would be unlikely to jointly market incremental volumes. Additionally, the ACCC considers that should authorisation be denied, it would be unlikely that the Applicants would divert earmarked domgas reserves into future LNG production. The natural extension of these conclusions is that the Applicants would, absent authorisation, attempt to transition to separate marketing for the incremental volumes.
- 5.38. The Applicants acknowledge that a denial of authorisation may force them to consider implementing separate marketing. However, the Applicants strongly maintain it is not currently commercially feasible to transition the NWS Project to separate marketing. Further, the Applicants argue that any attempt to separately market from the NWS Project will result in higher costs and risks for the participants.
- 5.39. The key consideration for the ACCC in assessing this counterfactual is the commercial viability of separately marketing the NWS Project's incremental volumes in the Western Australian domgas market and the potential implications of this level of viability on the actions of the Applicants.
- 5.40. The ACCC notes that the Applicants and interested parties have broadly considered the following issues in addressing the viability or otherwise of separate marketing in the Western Australian domgas market:
- structure of Western Australian domgas market
 - gas balancing arrangements in the Western Australian domgas market
 - nature of the NWS Project
 - separate marketing from other Western Australian gas fields
 - the Pohokura gas field in New Zealand and
 - the Denmark and Norway examples.

Structure of Western Australian domgas market

Applicants' submission

- 5.41. The Applicants note the ACCC's conclusion in its consideration of the Gorgon authorisation application that the Western Australian domgas market has only developed marginally since 1998, and lacks the features necessary to support separate marketing. In addition, the Applicants engaged Wood Mackenzie to assess the development of each of the key market features considered by the ACCC in the 1998 NWS authorisation as being necessary to facilitate separate marketing. Wood Mackenzie's findings, as noted by Applicants, are provided below:
- Similar concentration of major buyers with the majority of gas still purchased by only five customers.

- Similar concentration of major suppliers with the majority of gas still supplied by the NWS Project and the Apache joint ventures.
- Increased capacity on transport infrastructure but the number of pipelines has not materially changed and the key pipelines are fully contracted.
- No material change in the level of storage with only one small facility with a capacity of 12 – 15 TJ/day.
- Modest progress in the introduction of brokers/aggregators and an immature trading market.
- No gas related financial markets exist in Western Australia.
- Short term/spot markets are very modest and considered immature.

5.42. The Applicants go on to note Wood Mackenzie’s finding that new demand in Western Australia is characteristically ‘lumpy’. This is attributed to it being predominantly project-based. To meet these new incremental domgas volumes, additional investment in gas transportation is required and new gas supply and processing facilities are also needed.

Interested party submissions

5.43. Synergy submits that the Western Australian domgas market has undergone significant reforms since the ACCC’s 1998 NWS determination. These developments include that there are now 30 customers that purchase gas directly from producers and there has also been an increase in retailers such as Alinta selling gas to consumers. Additionally, there has been an increase in gas demand, additional transportation and storage, such as Mondara, and greater connectivity between pipelines. Finally, Synergy notes that there are a number of brokers and gas aggregators and that short term and long term trading of gas on informal secondary markets is common.

5.44. Synergy also notes the recommendations made to the Western Australian Government in September 2009 from the Gas Supply and Emergency Management Committee as demonstrating the maturity of the Western Australian domgas market. These recommendations included the establishment of a permanent Gas Bulletin Board (GBB), the implementation of a Gas Statement of Opportunities to provide long term gas supply and demand forecasts and the consideration of a short term trading market to facilitate the trade of gas contracts.

5.45. The Domgas Alliance also considers that the Western Australian domgas market has the necessary structural features to enable viable separate marketing from the NWS Project. It notes the relative size of domgas consumption compared to Eastern states, and that since the 1990s, the Western Australian domgas downstream market has undergone extensive reform. As with Synergy, the Domgas Alliance further notes that there are now around 30 customers that purchase directly from producers, compared to the previously single vertically integrated purchaser, SECWA.

- 5.46. The Domgas Alliance submits that there is now a high level of sophistication in trading of gas volumes between gas users, despite no formal market being established. NWS Project domgas customers can trade gas either physically or with swaps in any part of the system. In particular, the alliance notes the exchange that facilitates gas trades on the DBNGP. The Domgas Alliance also notes the work being done by the Western Australian Government to expand short term trading through the development of a GBB.
- 5.47. The Domgas Alliance argues that there exists well developed gas storage in the Western Australian domgas market to enable balancing arrangements. In particular, the Domgas Alliance refers to the storage arrangements on the DBNGP and the planned expansion of APA Group's Mondarra storage facility.
- 5.48. Senator Dr Alan Eggleston submits in respect of market features faced by the NWS Project:
- ...the Western Australian domgas market is small, relatively immature and subject to 'lumpy' step changes in both supply and demand.⁸⁸
- 5.49. In a meeting with ACCC staff prior to the release of the draft determination, representatives of various Western Australian government departments made the following comments with regard to the development of certain market characteristics:
- The WA Government is exploring the establishment of a Gas Bulletin Board towards the end of 2010. There may be a move at a later date to establish a formal domgas trading market.
- There is additional investment in domgas storage planned in the WA market. Further, current and future developments with respect to gas fired peaking electricity plants will provide additional liquidity to the domgas market.⁸⁹
- 5.50. The Domgas Alliance, in its submission following the draft determination, again strongly asserts that there is overwhelming evidence that separate selling is practical and feasible in WA. Namely, that separate selling already takes place in WA, marketing decisions are already being made separately by the Applicants, the WA market has undergone significant development and the operational and balancing arrangements to necessitate separate marketing are known or are already in place. Additionally, the Domgas Alliance notes that the WA domgas market accounts for 40 per cent of Australia's domgas production and considers that this demonstrates that the market is mature and developed.
- 5.51. Rio Tinto in a submission following the draft determination considered that the ACCC should address the following two issues in its final determination:
1. The criteria that will be generally applied by the ACCC in considering applications for authorisation for joint marketing by WA domgas greenfield and existing projects such that customers are better able to judge whether joint marketing is likely to be approved or rejected.

⁸⁸ Submission from Senator Eggleston (WA), 4 May 2010.

⁸⁹ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

2. Provision of additional advance notice of the outcome from the next review thereby providing market participants with more certainty and allowing additional time to put alternative processes in place, assuming the NWSG joint marketing arrangements are to be unwound in the future.⁹⁰

Applicants' further submissions

- 5.52. In response to interested parties, the Applicants note that the recommendations of the Gas Supply and Emergency Management Committee (GSEMC), such as the establishment of a GBB, have yet to be implemented. The Applicants further argue that the DBGNP is a gas transportation pipeline and not a commercial gas storage facility, as it is unable to store significant volumes of gas for a significant period of time.
- 5.53. The Applicants in a submission following the release of the draft determination, agreed with the ACCC's view in the draft determination that the WA market is not sufficiently mature or liquid to enable commercially viable separate marketing from the NWS Project. In addition, the Applicants also agreed that an attempted transition to separate marketing would likely result in less domgas being supplied.

ACCC's view

- 5.54. The ACCC acknowledges that there has been some development of the features of the Western Australian domgas market since 1998. However, as considered in the Gorgon Determination, the ACCC is of the view that this development has only been marginal and that the Western Australian domgas market continues to lack the necessary features that would enable the partners in a project such as the NWS Project to attempt to transition to commercially viable separate marketing.
- 5.55. The ACCC remains of the view that the long-term contractual or 'lumpy' nature of the Western Australian domgas market, where domgas demand and supply does not move in steady increments but rather significant steps, is significant in the slow development of some necessary features for separate marketing, such as a formal spot market. The lack of a transparent trading exchange or spot market prevents price and volume discovery. Further, it hampers the development of financial markets that would enable both purchasers and producers to manage risk through activities such as hedging.
- 5.56. Additionally, the development of large storage facilities that are not contracted to a single entity would be encouraged by greater liquidity in secondary trading that would come through shorter contract terms. Storage and secondary markets enable parties to manage the commercial risks of only a limited contracted volume at a certain price.
- 5.57. However, the ACCC recognises that there are characteristics of the Western Australian domgas market that have encouraged its long term contractual nature. In particular, the strong resource and heavy industry component of energy use in Western Australia has meant that entities bringing a new or additional development online have tended to prefer energy contracts that match the payback period or resource depletion timeframes of a particular project. Energy is often a key component of these projects, and having supply certainty for this input would be a consideration in making an investment decision.

⁹⁰ Submission from Rio Tinto, 6 August 2010.

- 5.58. Further, the ACCC is of the view that increasing uncertainty about future Western Australian domgas supplies may incentivise domgas purchasers to enter into long term contracts. A customer that considers that it may not be able to recontract the necessary volumes at the conclusion of a contract period may seek to sign contracts for as long as required or can be obtained. On the other hand, a customer that is confident about the availability of necessary volumes in the future may be more inclined to sign contracts of a shorter duration.
- 5.59. Nonetheless, the ACCC considers that there exists potential for the Western Australian domgas market to develop in the next five years. The introduction of new sources of supply from different joint ventures such as Gorgon, Macedon and Reindeer will diversify options for supply and may potentially encourage customers to enter into shorter contract durations.
- 5.60. Further, the ACCC notes recent and future investment in additional gas powered electricity peaking stations, such as Perth Energy's 120 MW Kwinana Swift Power Station, that are broadly used for times of high electricity demand and to manage an increasing renewable energy load. Peaking generation creates greater liquidity, secondary trading and additional storage as these power stations need to be able to access gas at relatively short notice.
- 5.61. The ACCC is of the view that the measures to be implemented by the Western Australian Government stemming from the GSMEC recommendations will add to the potential development of the Western Australian domgas market. In particular, the introduction of a formal GBB and a potential secondary trading market will assist in price discovery and create demand for associated financial products. However, the ACCC notes that there is currently no clear timeframe for the implementation of these measures.
- 5.62. The ACCC notes Rio Tinto's request that the ACCC publish the criteria by which it will evaluate possible future applications for joint marketing by WA domgas joint ventures. The ACCC assesses applications for authorisation on a case by case basis however, this determination, along with the 2009 Gorgon Gas Project authorisation, could be broadly considered as an indication of the factors the ACCC would consider in future applications.
- 5.63. With respect to Rio Tinto's request that advance notice of the outcome of the next authorisation application be provided to the industry, the ACCC does not consider it appropriate to provide an indication or forewarning of an authorisation decision. However, were the ACCC to find in considering a future application that separate marketing in WA is commercially feasible it may be appropriate for a transition period to be provided to enable market participants to adjust and put in place the necessary arrangements.

Gas balancing arrangements

- 5.64. Gas balancing agreements (GBAs) are entered into between partners in a gas producing joint venture when they are separately selling their entitlements. GBAs are designed to permit individual partners to sell or supply gas to the market in different percentages ('lift') than they are nominally entitled to under their ownership shares. An 'overlifting' party is one that takes more than its ownership share of production while an 'underlifting' party is one that takes less than its ownership share of production over a given period of time. The GBAs contain makeup provisions that enable the 'underlifting' party to be repaid in most cases either financially or with physical gas. The intention of the GBA is to ensure that all partners in the joint venture ultimately obtain a value for their gas proportional to their percentage share of the reserves.

Applicants' submission

- 5.65. The Applicants recognise that were they to attempt to separately market, then a GBA would need to be in place to manage the imbalances that would likely arise. However, the Applicants are of the view that due to the current structure of the Western Australian domgas market, the viability of implementing a GBA for the NWS Project is undermined. The Applicants refer to a report prepared for them by Mr James Jenson to argue that in Western Australia it is very difficult to implement the compensation components of a GBA, such as cash or in-kind balancing.
- 5.66. In particular, the Applicants point to the 'lumpiness' of the Western Australian domgas market, no effective spot or secondary market and a lack of storage facilities as preventing the commercially viable implementation of a GBA.
- 5.67. The Applicants argue that the 'lumpiness' of the market, where demand and supply move in step changes, will likely give rise to large and persistent imbalances. That is, a particular joint venture partner is more likely to carry sustained under-produced balances for an extended period of time as it is not able to find a customer to match its production share. In contrast, in a liquid market such as the US or UK, where there are a large number of buyers and storage, a producer would be able to ensure that any imbalances are small and short term only.
- 5.68. The Applicants are of the view that without an effective short term/spot market there is no mechanism that will enable price discovery or the physical clearing of short term gas imbalances. The Applicants point to the Alinta Sales price arbitration process as indicating the difficulty that exists in establishing a market price in Western Australia. Further, the Applicants acknowledge that some short term trading occurs through the DBP Transmission managed Inlet Traders service but this mechanism is only available to existing DBNGP users to assist with short term gas supply and imbalance needs and does not constitute a transparent spot market.

- 5.69. The Applicants are of the view that significant commercial gas storage is critical to enable a commercially functioning GBA. In particular, it allows a joint venture participant to defer a component of its production share that it has not entered into a gas supply contract at the time the gas is produced. The Applicants note that the Mondarra facility is the only storage development to emerge in Western Australia since 1998. Mondarra is considered to offer only modest storage potential with a capacity of two per cent of total average daily market volume, which is currently fully contracted. The Applicants do not consider that the short term storage or imbalance flexibilities offered on the DBNGP are able to store large volumes of gas for an extended period of time.
- 5.70. The Applicants argue that it is not commercially feasible to balance domgas against the LNG market and further note that the NWS partners have never separately marketed their LNG entitlements.
- 5.71. The Applicants are of the view that the difficulties posed by attempting to implement a GBA are magnified by the age and complexity of the Project, in particular the reserves uncertainty. In this case there is an increased possibility that an ‘underlifting’ partner with a large and prolonged imbalance will never be repaid their borrowed gas if reserves do not perform as expected.
- 5.72. The Applicants argue that as imbalances would not be able to be repaid in-kind, that is with gas, they would have to settle through cash balancing. As noted previously, the Applicants are of the view that there is no transparent price system through which to establish a market price. As such, the Applicants, with reference to Mr Jensen’s report, canvass three possible cash balancing options and identify potential flaws with them:
- 1) Prices achieved by the ‘overlifter’. This approach is unlikely to produce a more competitive outcome than joint marketing, as the joint venture partners would have no incentive to bid against each other.
 - 2) Internally negotiated prices. Settlements would be negotiated prior to sales. However this would be likely to produce a similar price outcome as joint marketing.
 - 3) Independent benchmarks. An example of a price benchmark through which a balancing price could be set would be the export price of LNG. This would significantly distort the development of the domgas market and would not result in a more competitive environment.
- 5.73. In conclusion, the Applicants submit that the inability to find balance outlets for individual production entitlements under a GBA will likely result in large and persistent production imbalances, increased costs and place future investment and domgas production at risk.

Interested party submissions

- 5.74. Synergy notes the ACCC’s consideration in the Gorgon Determination that without a functioning secondary market and significant storage, there would exist high commercial risk to parties entering a GBA. However, Synergy argues that as the NWS partners will be marketing incremental volumes that are understood to be approximately 100 TJ/day for six years, and that these small volumes will reduce the risks associated with separate marketing and GBAs.

- 5.75. Synergy is also of the view that given that each joint venture partner is a highly skilled and profitable multinational company, they have the necessary commercial skills to successfully negotiate separate contracts and handle the accompanying issues.
- 5.76. As noted above, the Domgas Alliance submits that the Western Australian domgas market does have the necessary features, such as storage and trading, to enable the Applicants to separately market and manage issues such as GBAs. The Domgas Alliance also expresses the view that the necessary accounting and joint venture management features exist at the NWS to enable the balancing issues associated with separate marketing to be resolved.

Applicants' further submission

- 5.77. The Applicants dispute Synergy's submission that as the volumes of incremental gas to be marketed are likely to be relatively small then this will enable separate marketing. Firstly, the Applicants submit that it is not possible to accurately predict the domgas volumes that will be available to be marketed in any authorisation period. Secondly, they argue that the costs and risks of transitioning to separate marketing for these incremental volumes will be high.
- 5.78. The Applicants reiterate that achieving alignment in terms of share of production, reserves and future investment decisions will almost be impossible under separate marketing of the incremental volumes. In addition, entering a workable GBA is complicated by the increasing reserves risk from the NWS Project, which makes future incremental volume marketing opportunities more uncertain.

ACCC's view

- 5.79. The ACCC remains of the view expressed in the Gorgon Determination that without significant risk mitigation measures, such as long term trading and formal spot/secondary markets, there exists commercial risks for domgas joint venture partners to enter into a GBA in the Western Australian domgas market. The ACCC considers that these risks are magnified by the structure of the NWS joint ventures and the marketing of the incremental volumes.
- 5.80. In particular, the ACCC accepts that the long term contractual nature of the Western Australian domgas market combined with the increasing reserves uncertainty associated with the NWS fields means that in-kind balancing would be unlikely to be commercially feasible. In addition, cash balancing would be highly problematic in the current Western Australian domgas market where there is no functioning spot market or transparency on pricing levels. This is reflected in the lengthy price arbitration process between Alinta and the NWS partners.
- 5.81. The ACCC notes the observations of Mr Jensen that even in the deeply liquid and price transparent US market, producers prefer not to engage in cash balancing. In the Western Australian domgas market, NWS partners would find it very difficult to reach an agreeable financial settlement under a GBA.

- 5.82. For example, a NWS partner that has ‘overlifted’ its production share to enter into a long-term contract would eventually have to balance with the ‘underlifter(s)’. With in-kind balancing problematic due to reserves risk, a financial settlement would be the likely solution. The base of the financial settlement would be contentious: should it be referenced to the price of the long term contract; the price that the ‘underlifter’ could now obtain for those volumes; or some other prevailing market price? In an illiquid market, such as Western Australia, without appropriate financial hedging instruments, partners that take production above their entitlements to secure contracts, will potentially be exposed to financial risk. For example, in the event that the domgas price appreciates in the intervening period and the ‘overlifter’ is required to balance with reference to the price the ‘underlifter’ could now obtain, the ‘overlifter’ would then be exposed to payments above the price it was receiving from the contract.
- 5.83. The ACCC considers this example demonstrates some of the inherent commercial risks that would arise when entering into GBAs in a market such as Western Australia. These risks are such that the partners may not be willing to compete with each other for contracts above their entitlements and may result in unproduced shares such that the total domgas supply is lower. Further, it may lead the Applicants to defer or not proceed with additional investments needed to bring future additional incremental volumes to market. That is, the Applicants may supply domgas volumes to the market at levels lower than would be the case under joint marketing.
- 5.84. However, the ACCC is of the view that these risks are unlikely to be as high as those faced by the Gorgon Gas Project partners were they to attempt to separately market, which were identified by the ACCC in its 2009 determination. In particular, the Gorgon Gas Project is a greenfields development, which requires a substantial investment to establish the necessary domgas processing facilities and infrastructure. The North West Shelf, in comparison, has had the necessary domgas infrastructure in place and operating for a number of years with a demonstrated history of domgas deliverability and performance. Future investment will generally be associated with maintaining deliverability and these investments will in part be supported by the LNG component of the project.
- 5.85. Further, the ACCC acknowledges that the current strength of demand and concern about future supply in the Western Australian domgas market reduces somewhat the risks associated with the Applicants entering GBAs for the incremental volumes. In particular, the environment indicates that the individual partners should be confident that they could enter into gas sales agreements for their individual production shares, or lifting profiles, were they to separately market.
- 5.86. However, the ACCC remains of the view that the nature of the Western Australian domgas market would lower the likelihood for the individual partners to compete with each other for contracts above their lifting profiles due to the risks associated with balancing any ‘overlift’ at the end of the period.
- 5.87. The ACCC accepts that the risks associated with entering into a GBA were the joint venture partners to separately market are magnified by particular features of the NWS Project. These features are explored further below.

Nature of the NWS Project

Applicants' submission

- 5.88. The Applicants consider that an attempt to transition a development of the size, age and complexity of the NWS Project to separate marketing would be likely to result in large and ongoing costs. In addition, these costs are magnified as the NWS Project enters a declining phase, with the profile of gas being uneven in terms of duration and rate.
- 5.89. The Applicants submit that in addition to an attempt to put in place GBAs, a move to separate marketing would also potentially involve revisiting and unravelling the joint venture agreements. In this respect, the Applicants note that the Project comprises six production joint ventures across twenty one fields and issues such as integrated resource optimisation and integrated development plans would need to be potentially revised.
- 5.90. The Applicants further note that in a joint marketing environment, investment decisions are underpinned by joint marketing activities, such that each partner will realise the same sales return at the same time from downstream contracts. The Applicants argue that in a separate marketing environment, it is likely that not all joint venture partners will be able to monetise gas sales agreements in unison for their full entitlement of gas. The Applicants submit this may delay or frustrate the joint venture partners reaching decisions about future investment and ongoing maintenance decisions required to maintain the NWS Project's current levels of domgas supply.
- 5.91. The Applicants also consider that an attempt to transition to separate marketing may give rise to protracted legal disputes as partners' interests fall out of alignment, such as with the signing of a new gas supply contract. In addition, the Applicants note a number of other issues such as resolving transportation constraints, increased transaction costs and dealing with liquids produced, as indicating the inherent complexity that exists with any attempt to move to separate marketing.

Interested party submissions

- 5.92. The Domgas Alliance argues that the operational measures to enable separate marketing from the NWS Project are already in place. Additionally, the Domgas Alliance asserts that already, through the NWSG joint selling role, there are already mechanisms to allocate gas for production shares between the different joint ventures and by individual partners within the ventures.
- 5.93. The Domgas Alliance also submits that:

...the joint venture accounting arrangements are currently sophisticated enough to separately account for individual JV participant entitlement to four different product streams – the domestic gas stream (comprising Domgas Venture and Incremental JV), the LNG stream, LPG's and the liquids/condensate stream.

The Alliance understands that LPG's, liquids and condensate are already being sold separately by the NWSJV participants in relation to their respective shares of production.⁹¹

⁹¹ Submission from the Domgas Alliance, 30 April 2010, page 22.

Applicants' further submission

- 5.94. The Applicants dispute that the necessary operational measures to enable separate marketing are already in place at the NWS. In particular, the Applicants submit that there are no accounting or other mechanisms that could be tailored to allow separate marketing. The Applicants acknowledge that some gas is supplied between the Incremental and Domgas JV's but that is, in effect, a sale and that no gas balancing arrangements exist to facilitate this.

ACCC's view

- 5.95. The ACCC accepts that the complex nature of the NWS Project joint ventures will increase the costs associated with any attempt to transition to separate marketing. In particular, attempts to put in place the necessary legal framework, such as GBAs, would likely be time consuming and costly with six joint venture partners and differing interrelationships with certain fields and production streams.
- 5.96. As noted previously, the ACCC also considers that increasing reserves risk at the NWS Project where future production streams are highly uncertain, adds additional risk to any attempt by the Applicants to transition to separate marketing for the incremental volumes.
- 5.97. The ACCC acknowledges that there would be additional costs arising from all of the partners establishing the necessary resources to separately market. While the ACCC notes that this may not be high for some joint venture partners that already have a significant presence in the Western Australian market, for those that do not this may be considered an additional impediment and risk associated with separate marketing. This may be magnified by the fact that future marketing will only be of incremental volumes. These volumes, while collectively significant, when broken into the individual production shares may not justify a partner that does not have a large presence in the Western Australian domgas market establishing the necessary separate marketing personnel and infrastructure.
- 5.98. The ACCC is concerned that these risks in unison will act as a disincentive for the Applicants to make the additional investments to bring future domgas production online. Further, the Applicants may supply lower volumes than would be the case under joint marketing and potentially at higher prices as a result of these risks.

Separate marketing from other Western Australian gas fields

- 5.99. The Applicants acknowledge that there have been instances of separate marketing in Western Australia, such as small volumes from the John Brookes field, and that some limited separate marketing may occur in the future. Nonetheless, the Applicants are of the view that the vast majority of sales of domgas in Western Australia have been via joint marketing. Further, the Applicants argue that these examples do not indicate that separate marketing of domgas would be commercially feasible for the NWS Project.
- 5.100. In addition, the Applicants submit that the feasibility of separate marketing must take into account the following project specific factors:
- the number of joint venture partners involved
 - the technical complexity of the joint venture arrangements

- the size and age of the project and
- the nature and significance of ongoing investments required to develop reserves.

Interested party submissions

5.101. The Domgas Alliance argues that the evidence that major producers sell separately in Western Australia indicates the commercial feasibility of separate marketing from the NWS Project. It notes that Apache Energy and Santos have been separately selling gas from the John Brookes field and provides the example of Santos announcing in April 2010 that it had separately entered into a gas supply agreement with Wesfarmers Energy for 60 PJ over five years.

ACCC's view

- 5.102. The ACCC notes that Santos and Apache Energy are separately marketing some of their domgas entitlements from the John Brookes field. However, the ACCC further notes that Santos appears to be the only partner actively marketing, most recently with the announcement in April 2010 that it would supply Wesfarmers over five years.⁹²
- 5.103. The ACCC accepts that the majority of domgas that has been marketed in Western Australia has been jointly marketed with John Brookes appearing to be the only significant domgas field in Western Australia where the partners are engaged in a degree of separate marketing. The Harriet Joint Venture, which is also managed by Apache Energy, is jointly marketed and the Reindeer field that is forecast to commence production in 2011 appears to have so far been jointly marketed. The ACCC is not aware of any publicly available information on the marketing intentions of the prospective Wheatstone and Macedon projects.
- 5.104. The ACCC notes that Apache and Santos appear to have jointly marketed the majority of domgas volumes from John Brookes and appear to be jointly marketing all of the Reindeer reserves. The ACCC is of the view that this appears to indicate a preference for joint marketing and that the incidents of separate marketing have come about due to specific circumstances associated with the decline of the East Spar field and subsequent rapid development of John Brookes in 2004/5.
- 5.105. The separate marketing undertaken by the John Brookes partners indicates that it is practically possible in certain circumstances to separately market domgas in the Western Australian market. However, the ACCC is not satisfied that it necessarily indicates that it is commercially viable for the Applicants to undertake separate marketing of incremental volumes from the NWS Project. The complexity of the NWS Project is of a greater nature than John Brookes where there are only two partners, Apache Energy and Santos. In addition, the NWS Project is entering into a period of reserves uncertainty where it would prove difficult for partners to under or overlift with certainty that imbalances could be resolved through in-kind settlement. Difficulties with financial settlement are also previously discussed at paragraphs 5.80 – 5.82.

⁹² Santos ASX/Media Release, *Santos signs Gas Sale and Purchase Agreement with Wesfarmers*, 13 April 2010.

Pohokura gas field

- 5.106. In the Gorgon Determination, a number of interested parties raised the example of the Pohokura gas field in New Zealand as demonstrating the feasibility of separate marketing in a market comparable to Western Australia.
- 5.107. In December 2002, the Pohokura gas field joint venture partners (Shell, OMV and Todd) sought authorisation from the New Zealand Commerce Commission for joint marketing and selling activities from the field. Authorisation was granted in September 2003, however it was subsequently revoked in June 2006. The revocation was broadly prompted by the Pohokura partners informing the New Zealand Commerce Commission that joint marketing arrangements had not been able to be agreed on, and that the partners would now engage in separate marketing.
- 5.108. Additional background information about the Pohokura matter is available from the ACCC's Gorgon Determination.⁹³
- 5.109. The ACCC concluded in the Gorgon Determination that while Pohokura demonstrated that separate marketing is possible in a relatively immature market, it was not directly comparable to the Gorgon Project. In particular, Pohokura was a relatively technically straightforward project to bring into supply in comparison to the complexity of Gorgon. Additionally, the ACCC was of the view that the Gorgon partners would face a higher investment risk profile than was the case with Pohokura due to the relatively more uncertain demand profile in Western Australia.
- 5.110. Further, the ACCC noted that the partners in the Pohokura joint venture appeared to be experiencing significant problems managing the arrangements associated with separate marketing and that litigation was occurring between the Pohokura partners over how balancing was to be managed.⁹⁴

Applicants' submission

- 5.111. The Applicants note the ACCC's views in the Gorgon Determination with regard to the Pohokura example. The Applicants maintain that the Pohokura partners have not been able to negotiate and agree on gas balancing arrangements and have been in litigation since 2006 in relation to the project's arrangements.
- 5.112. In addition, the Applicants argue for the following reasons that transition to separate marketing for the NWS Project would be far more complex and risky:
- the number of joint venture partners involved, each additional party adds to the complexity and litigation risks associated with entering a GBA
 - the NWS Project consists of six inter-related ventures (two of which produce domgas) that have different participating interests and

⁹³ ACCC Authorisation Determination, *the joint marketing and sale of natural gas from the Gorgon Gas Project for supply in Western Australia*, 5 November 2009, Attachment F.

⁹⁴ The Gorgon Project Applicants' submission, 31 July 2009, page 17.

- the size and age of the Project, in particular with regard to reserve risks. Putting in place a GBA at the start of a small project would be far easier than the NWS partners trying to do so across 25 years of operation.

Interested party submissions

- 5.113. The Domgas Alliance again draws attention to the Pohokura gas field in New Zealand to argue that separate selling is practical and commercially feasible in Western Australia. The Domgas Alliance notes that the Pohokura partners had argued in their application that separate selling was not feasible in New Zealand, including referencing the ACCC's 1998 NWS determination. The Domgas Alliance considers that these claims were subsequently disproved when they began separately selling domgas with no delay to production or supply.
- 5.114. The Domgas Alliance goes on to argue that the ACCC, in its Gorgon Determination, may have been misinformed about the nature of the litigation occurring between the Pohokura partners, and was wrong to conclude that this reflected the risks of separate marketing. In particular, the Domgas Alliance is of the view that the disputes appear to be concerned with Shell having operational control of the Pohokura plant, the rate of gas production and Todd's rights as a minority joint venture partner.
- 5.115. The partners in the Gorgon Gas Project provided a submission on 28 May 2010 refuting the Domgas Alliance's view on the consideration of Pohokura in the Gorgon Determination:

This allegation is completely without foundation. It is based on selective information relating to other actions associated with Pohokura that are not directly related to separate marketing, and ignores the significant dispute recently heard by the New Zealand High Court which centres on matters of specific relevance to gas balancing.⁹⁵

ACCC's view

- 5.116. The ACCC remains of the view that separate marketing by the joint venture partners in the Pohokura gas field in New Zealand demonstrates that separate marketing can be practically implemented in an immature market. However, the ACCC considers that the past and present litigation between the joint venture partners does reflect, to some extent, the difficulties presented by separate marketing in such a market.
- 5.117. The ACCC is satisfied that a component of the litigation that has occurred relates to the inability of the joint venture partners to reach a gas balancing agreement. In particular, the most recent disputes are related to the field's Offtake Rules that award to Shell the position as operator and assessor of the reserves.⁹⁶ Broadly, Todd considers that the Offtake Rules are restricting it from extracting a full share of gas from the reserves per annum. The ACCC is of the view that this dispute appears to centre on the lack of a functioning GBA between the partners that would enable separate partners to lift above their production share.

⁹⁵ The Gorgon Gas Project joint venture partners, submission on applications for authorisation A91220-A91223, 28 May 2010, page 1.

⁹⁶ TODD POHOKURA LIMITED V SHELL EXPLORATION NZ LIMITED AND ANOR HC WN CIV 2006 485 1600 [2009] NZHC 1013 (12 August 2009).

- 5.118. The ACCC notes that the New Zealand High Court in July 2010 dismissed a lawsuit brought by Todd that claimed Shell and OMV had colluded to restrict gas and oil produced from the Pohokura gas field. In particular, it was found that Todd was unable to demonstrate that the Offtake Rules were intended to lessen competition or had that effect.⁹⁷
- 5.119. As noted above, the ACCC accepts that a larger number of partners in a particular joint venture will add to the complexity associated with reaching agreement on the arrangements to manage separate marketing. In particular, the potential for imbalances in lifted production shares are naturally greater when there are a higher number of partners. To the extent that this will lead to disputes between the partners, the ACCC is of the view that this is more likely in a joint venture with five or six partners such as with the NWS than in a smaller joint venture such as Pohokura.

Denmark and Norway

Domgas Alliance submission

- 5.120. The Domgas Alliance notes that in 2002 and 2003, European competition authorities compelled natural gas joint marketing groups in Norway and Denmark to separately sell their production shares. With regard to joint marketing from the NWS Project, the Domgas Alliances argues that it is:

...illogical that they continue to engage in conduct in Australia that they are prohibited from engaging in elsewhere in the world.⁹⁸

- 5.121. More specifically, the Domgas Alliance submits that in 2003 the Danish and European competition authorities concluded an investigation into the joint marketing of natural gas by the Danish Underground Consortium (DUC), which was composed of Shell, ChevronTexaco and A.P Møller. The investigation was settled by the partners agreeing to separately market their gas and to further commit to supply additional gas volumes over the following five years. The Domgas Alliance considers that the investigation and settlement recognises that the effect of joint selling in Denmark had been a reduction in supply and competition.
- 5.122. The Domgas Alliance also notes the European Commission's (EC) investigation and subsequent settlement of the Norwegian Gas Negotiation Committee (GFU) in 2001 and 2002. The GFU, comprising a large number of gas producers, jointly negotiated the vast majority of gas sales from Norway to the European Union. Under the settlement with the EC, the gas producers agreed to commence separate marketing and provide additional gas volumes to the EU.

ACCC's view

- 5.123. The Applicants did not address the Norwegian and Danish cases in their additional submission in response to issues raised by interested parties.

⁹⁷ TODD POHOKURA LIMITED V SHELL EXPLORATION NZ LIMITED HC WELLINGTON CIV 2006-485-1600 [2010] NZHC 1134 (13 July 2010)

⁹⁸ Submission from the Domgas Alliance, 30 April 2010, page 26.

- 5.124. The ACCC is of the view that the Norwegian and Danish examples, while demonstrating that joint marketing and selling may result in sub optimal competitive outcomes in a relatively mature and liquid market, are not directly applicable to the joint marketing of the NWS Project's incremental domgas volumes in Western Australia. In particular, the ACCC considers that the European gas trading environment in the period 2002–03 was characterised by a number of highly interdependent regional and national markets and appeared to have the features to enable commercially viable separate marketing.
- 5.125. There appears to have been a significant level of gas storage available in Europe at the time of these settlements. One estimate indicates that in 2002 the level of gas storage in Europe was roughly equivalent to one third of production.⁹⁹ In addition, there was well developed formal secondary trading markets at a number of virtual or physical hubs. One publication estimates that at the Zeebrugge hub in Belgium, the traded volumes in 2002 were equivalent to twice Belgium gas consumption, or 10 per cent of European consumption.¹⁰⁰
- 5.126. Finally, the ACCC notes that the European environment had the added dimension of a number of LNG facilities that enabled the importation of natural gas from international regions that are not connected by pipeline infrastructure.
- 5.127. The ACCC is also of the view that the specifics of the joint marketing arrangements in these European examples are not directly comparable to the NWS Project. In particular, in Norway the joint marketing by the GFU covered a number of gas producing fields, predominantly from the North Sea, that were controlled by different entities or joint ventures and were processed through a number of separate processing facilities. On the other hand, the NWS Project is an individual project in the broader Western Australian domgas market that is processed through a single processing facility.
- 5.128. The ACCC acknowledges that the DUC is comparable to the NWS Project, in the sense that it is an individual joint venture processing gas from a group of fields. However, the ACCC notes that a central focus of the investigations was the relationship between the DUC and the state owned energy purchaser DONG, under which the DUC was obliged to offer their entire gas production to DONG. These volumes were on-sold by DONG and were sufficient to supply the entire Danish demand and additional volumes into Sweden and Germany. An aspect of this relationship was the requirement for DONG to report to the DUC partners the volumes sold to certain categories of customers.¹⁰¹
- 5.129. Conversely, the NWS Project, while currently the majority supplier of Western Australian domgas, does not sell to a single entity but rather a number of individual organisations, both state and privately owned.

⁹⁹ Clingendael International Energy Programme, 'The European Market for Seasonal Storage', February 2006, page 11.

¹⁰⁰ Kingston Energy Consulting, 'Is the European Gas Market Ready for 2007?', December 2003, page 4.

¹⁰¹ European Commission Press Release, *Commission and Danish competition authorities jointly open up Danish gas market*, 24 April 2003.

- 5.130. The ACCC accepts that the European gas environment is not as liquid or mature as that in the United States. The EC and individual countries continue to pursue reforms that are intended to create a more liberal whole of Europe gas market. One of the issues of focus has been the tendency for industry participants to enter into long term contracts. The ACCC notes that between 2006 and 2008 the German competition authority initiated proceedings against 15 national regional gas transmission companies for entering into long term gas supply contracts. As a result of the proceedings, the companies, amongst other actions, were required to limit the duration of contracts and remove clauses against resale restrictions in the gas supply contracts. The German competition authority concluded in June 2010 that the end of the practice of long term contracts had resulted in greater competition and product diversity.¹⁰²
- 5.131. As noted in the public detriment section later in this chapter of the determination, the ACCC does not consider that the joint marketing of the NWS Project's incremental volumes is likely to materially prevent the Western Australian gas market from developing further over the next 5 years. Rather, the introduction of new sources of domestic supply, market developments such as a formal trading market and a potential move to shorter term contracts may enable the market to develop such that viable separate marketing of the incremental domestic volumes from the NWS Project may be possible.

ACCC conclusion on the most likely counterfactual

- 5.132. Based on the above, the ACCC is of the view that were authorisation denied then the Applicants would be likely to continue to jointly give effect to existing domestic contracts. However, the ACCC does not consider it likely that the Applicants would jointly market the incremental volumes absent authorisation.
- 5.133. Noting the length of time before there is spare capacity in the LNG plant and the current strength of the Western Australian domestic market, the ACCC does not consider it likely that the Applicants would divert incremental domestic reserves into future LNG production were authorisation denied.
- 5.134. The ACCC is of the view that were authorisation denied, the Applicants would attempt to transition to separate marketing of the incremental volumes. The ACCC considers that it is not likely to be currently commercially feasible for the Applicants to separately market the incremental volumes from the NWS Project, even though it might be practically possible in the Western Australian domestic market.
- 5.135. The ACCC is of the view that attempting to separately market these incremental volumes is likely to result in additional commercial risk due to managing balancing obligations in such an illiquid and immature market. The ACCC is concerned that the increased risks would potentially result in a lower volume of domestic gas being supplied from the NWS Project than would be the case under joint marketing and the possible deferral or withdrawal of planned investment to enable future domestic volumes.

¹⁰² Bundeskartellamt, *Press Release: Substantial improvement of competition conditions in gas distribution sector*, 15 June 2010.

Public benefit

5.136. Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.¹⁰³

5.137. As noted in the counterfactual section of this determination, the Applicants and some of the interested parties have differing views on whether separate marketing of domgas from the NWS Project is commercially viable in the Western Australian market. These views have shaped their submissions on the public benefits of the proposed arrangements.

5.138. As noted previously, the ACCC considers that absent authorisation, the Applicants would be likely to continue to jointly give effect to existing domgas contracts but would attempt to transition to separate marketing for the incremental domgas volumes. Consequently, the ACCC has focused its assessment on the Applicants' claimed public benefits relating to this counterfactual. The ACCC considers that an analysis of the Applicants' claimed public benefits and interested parties views on them can be categorised under the following issues:

- volume of domgas supply
- level of competition
- price of domgas sales and
- economic development.

Volume of domgas supply

Applicants' submission

5.139. The Applicants note the NWS Project's importance in bringing domgas supply to the Western Australian market and consider that the NWS Project's central role will continue until at least 2015 when the Gorgon Gas Project commences production. The Applicants, noting a report prepared for them by Frontier Economics, argue that it is likely that less domgas will be supplied into the Western Australian market under separate marketing from the NWS Project than would be the case under joint marketing. The Applicants are of the view that a continuation of this supply is an important public benefit that stems from joint marketing.

5.140. The Applicants identify the following reasons, that were explored in greater detail in the counterfactual section, as to why domgas volumes would be lower under separate marketing:

- the costs and risks of the Applicants entering into GBAs and

¹⁰³ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677. See also *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242.

- potential for divergent investment incentives between the individual Applicants that would affect joint decisions on investment with resulting impacts on future domgas supply.
- 5.141. The Applicants argue that joint marketing allows them to more effectively resolve issues that arise from capacity constraints. The Applicants are of the view that under separate marketing the inability of one venture participant to obtain access to necessary infrastructure could result in disagreement over joint production decisions resulting in reduced or delayed downstream supply.
- 5.142. The Applicants use the example of the NWS Project's response to the Varanus Island explosion in 2008 to argue that joint decision making and alignment of interests gives rise to supply benefits. In particular, under joint marketing the partners were able to quickly agree to operate the Karratha plant at above long term sustainable capacity and provide corresponding additional gas supply agreements. The Applicants argue that this may not have been possible under separate marketing when each individual partner has separate incentives.

Interested party submissions

- 5.143. A number of interested parties have addressed the issue of domgas supply in their submissions. Interested parties are broadly of the view that one of the major issues facing the Western Australian domgas market is the potential shortage of domgas supply in the medium to long term.
- 5.144. Alcoa submits that between 2010 and 2015 new domgas supply will not be sufficient to meet new demand for domgas and contracts that are rolling off, with a shortfall of at least 160 TJ/day. Alcoa is of the view that this will result in:
- ...a significant impact on the economy by delaying projects and potentially threatening the viability of existing businesses and industries.¹⁰⁴
- 5.145. Rio Tinto also expressed concern about supply diversity and flexibility in the Western Australian domgas market and submits:
- Rio Tinto would, however, be deeply concerned in this particular case if the ACCC's decision making process caused a protracted delay or deferment of the marketing of gas by the North West Shelf Project Partners. Given the current lack of supply diversity and flexibility in the Western Australian domestic gas market, this could have a significant impact on the State's mineral production and consequently the State and national economy.¹⁰⁵
- 5.146. The Domgas Alliance disputes that a grant of authorisation will result in increased domgas supply to Western Australia. The Domgas Alliance notes that as a part of the 1998 authorisation process, the NWS partners submitted that they intended to increase the capacity of the domestic gas processing infrastructure to 1 100 TJ/day with a corresponding lift in domgas supply. The Domgas Alliance notes that despite the grant of authorisation this proposed expansion never occurred.

¹⁰⁴ Submission from Alcoa 30 April 2010 page 4.

¹⁰⁵ Submission from Rio Tinto, 3 May 2010, pages 1–2.

- 5.147. In a meeting with ACCC staff, representatives of various Western Australian government departments made the following comments on the importance of supply from the NWS Project:

The WA domgas market is likely to experience a tight demand/supply balance until at least the end of 2015.

Demand for domgas is likely to remain high in the foreseeable future with a number of new customers likely to require substantial supply. In particular, mining projects in most cases have the option of sourcing their energy from either diesel or domgas. With diesel currently at about \$18/GJ, domgas is a viable source of energy for these projects even at the current high price levels.¹⁰⁶

- 5.148. Finally, a number of interested parties also submit that should the ACCC decide to grant authorisation to the NWS Project joint marketing activities, authorisation should be subject to a range of conditions aimed at securing supply of future domgas volumes from the project. The ACCC does not consider imposing such conditions of authorisation is appropriate. The views of interested parties, the Applicants and the ACCC on this issue are outlined in further detail from paragraph 5.302 of this determination.

ACCC's view

- 5.149. The ACCC recognises that the issue of current and future domgas supply certainty is a crucial concern for customers. In particular, the ACCC notes that the NWS Project has for a period of 25 years provided a high degree of supply certainty that has underpinned investment in Western Australia in gas fired electricity generation and energy intensive heavy industry such as aluminium processing. Until the introduction of supply from the Gorgon Project in 2015/16, the NWS Project is likely to continue to constitute a substantial proportion of domgas supply.
- 5.150. The ACCC notes the most recent ABARE publication on Australian energy projections that Western Australia's gross electricity output is forecast to increase by 59 per cent between 2007/8 and 2029/30. ABARE forecasts that this expansion will be driven by gas fired generation, which is estimated to grow by two per cent a year.¹⁰⁷
- 5.151. The ACCC further notes that electricity generation is only one aspect of the demand scenario and that significant future demand can be expected from the mining and resources sector in Western Australia. For example, ABARE in a separate publication, estimates as of April 2010 that there are 21 separate mining projects in Western Australia at an advanced stage of development.¹⁰⁸ However, the ACCC recognises that the impact of the global financial crisis and the corresponding softening of commodity prices is likely to result in growth in energy demand from the resources sector not matching the level that was experienced during the boom period of 2005-2008.

¹⁰⁶ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

¹⁰⁷ ABARE, *Australian energy projections to 2029-30*, March 2010, page 32.

¹⁰⁸ ABARE, *Mineral and energy – Major development projects – April 2010 listing*, May 2010, page 8.

- 5.152. The ACCC notes the report prepared by Economics Consulting Services for the Domgas Alliance, that there exists a potential shortfall in domgas supply at both 2015 and 2020 of up to 600 TJ/day.¹⁰⁹
- 5.153. The ACCC acknowledges that with the NWS Project entering a period of reserves uncertainty and potentially declining production, the role the project can play in meeting this growing demand for domgas in Western Australia is unclear. Additionally, while the Reindeer domgas project and potentially the Macedon development will be welcome additional supply sources in the period until 2015/16, they are unlikely to fundamentally ease the expected excess demand scenario in the Western Australian domgas market.
- 5.154. The ACCC accepts that joint marketing from the NWS Project facilitates a unified and rapid response to a broader market crisis, such as the Varanus Island disruption. The ACCC is of the view that under separate marketing the ability to agree to run the gas processing facilities at above capacity and for each of the joint venture partners to separately enter into corresponding emergency gas contracts would be highly complex and endanger a timely response to such an extraordinary event.
- 5.155. In this context, the ACCC is of the view that the ability for additional supply of domgas from the NWS Project, above what would be provided under separate marketing, constitutes a public benefit. As explored further in the counterfactual section of this chapter, the ACCC is of the view that the Western Australian domgas market does not currently have the necessary market features to support commercially viable separate marketing of the NWS Project's incremental domgas volumes.
- 5.156. In particular, the ACCC considers that there would likely exist significant commercial risks in entering the necessary GBAs to facilitate separate marketing without features such as an active secondary trading market with associated financial products and deep and liquid storage options. The ACCC is of the view that these risks may be such that one or more partners would consider deferring supplying all or part of their share of production until appropriate mechanisms or market conditions enabled separate marketing.
- 5.157. Additionally, these risks and the potential for deferral of supply and consequently differing revenue and return profiles between the partners has the potential to alter decisions on future investment decisions. In particular, the ACCC is concerned that the heightened risks associated with separate marketing may increase the possibility that the Applicants will not agree or proceed with future investment to maintain and increase domgas supply.
- 5.158. The ACCC acknowledges that planned investments such as the North Rankin redevelopment, which will improve natural gas deliverability to processing facilities through further compression, will also benefit LNG production. Nonetheless, the ACCC considers that the domgas component or share of such an investment should be considered as a separate and distinct decision by the Applicants.

¹⁰⁹

Economics Consulting Services, *Report for the Domgas Alliance: Western Australia Natural Gas Demand and Supply – A Forecast*, June 2010, page 26.

- 5.159. Joint marketing on the other hand is likely to mitigate these risks and increase the likelihood that each of the Applicants' production shares are supplied in full to the market. Further, the reduction of these risks is likely to increase the potential for future investment to enable the maintenance of domgas supplies or additional incremental domgas volumes.
- 5.160. The ACCC considers that the joint marketing of the incremental volumes from the NWS Project by the Applicants is likely to enable the supply of domgas volumes at levels higher than would be the case under separate marketing, which is a public benefit. Given the current demand and supply imbalance in Western Australia, the ACCC considers this constitutes a significant public benefit.

Level of competition

Applicants' submission

- 5.161. The Applicants submit that joint marketing of the NWS Project domgas volumes will result in greater competition than would be the case under separate marketing. In particular, the Applicants note the following ACCC conclusions in the Gorgon Determination to argue that the greatest benefits of competition occur between projects:
- the high concentration of parties producing domgas in Western Australia will remain regardless of joint or separate marketing
 - the timing and volume of domgas supply will be determined jointly, regardless of whether that gas is subsequently marketed jointly or separately
 - the price of domgas, in the current Western Australian market environment, is likely to be significantly influenced by the volumes of gas available rather than joint or separate marketing
 - under separate marketing the venture partners will have the same production costs and
 - due to the difficulties of negotiating GBAs, the Applicants would have little incentive to compete with each other for market share.

Interested party submissions

- 5.162. Synergy notes that currently approximately 98 per cent of the Western Australian domgas market is supplied from two joint ventures. Synergy is of the view that these joint ventures hold significant market power and the ability to control domgas supply, and in addition there are:

...no incentives for them to compete effectively, hence competition is reduced and the cost of gas to domestic consumers is ultimately increased.¹¹⁰

¹¹⁰ Submission from Synergy, 30 April 2010, page 3.

- 5.163. The Domgas Alliance is broadly of the view that joint marketing, rather than increasing competition in the Western Australian domgas market, reduces customer choice and the potential for competitive behaviour amongst the individual partners. The Domgas Alliance submits:

Joint selling reduces the number of interested parties competing with each other from six to one. Customers are forced to negotiate with a combined entity as opposed to dealing separately with individual sellers offering the lowest possible price.¹¹¹

- 5.164. The Domgas Alliance goes on to argue that joint selling limits customer choice over terms and conditions. The Domgas Alliance claims that the NWS partners do not typically supply customers of less than 15 TJ/day. In addition, the Domgas Alliance is of the view that domgas suppliers in Western Australia have shortened contract terms despite customers' preference for contract duration of 15 – 20 years. The Domgas Alliance contrasts the situation in the Western Australian domgas market with the international LNG market, where customers enjoy greater competition and long term contracts.

- 5.165. Rio Tinto submits that it is supportive of full competition and:

...in principle, is opposed to joint marketing of gas beyond such period as might otherwise be warranted to ensure that a Greenfield development proceeds; for example, the term of any project financing necessary to support the development where external lenders require greater certainty as the early cash-flows of the project.¹¹²

- 5.166. Further, representatives of various Western Australian government departments made the following comment in a meeting with the ACCC concerning competition in the Western Australian domgas market:

Changes to the current processes for acreage management and retention leases may be more important in promoting competition in and supply of domgas in WA than separate marketing of gas.

Nevertheless, consideration should be given to at some stage to a transition to separate marketing.¹¹³

ACCC's view

- 5.167. The ACCC is of the view that in a liquid and mature market, separate marketing from domgas joint ventures is likely to result in competitive benefits to domgas customers in the form of lower prices and more flexible terms and conditions. However, as explored in the counterfactual section of this chapter, the ACCC does not consider that the Western Australian market has the necessary market features of a mature market which would enable commercially viable separate marketing of the NWS Project's incremental domgas volumes.

¹¹¹ Submission from Domgas Alliance, 30 April 2010, page 10.

¹¹² Submission from Rio Tinto, 3 May 2010 page 1.

¹¹³ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

- 5.168. The ACCC notes that even if the Applicants attempted to transition to separate marketing, they would still share a common cost base for their share of production with all other joint venture partners. The ACCC accepts the Applicants' submission that this share of production costs forms a significant component of the marginal cost of domgas supply.
- 5.169. The ACCC further notes that should the NWS joint venture partners attempt to separately market, the decisions about the timing and volume of gas supply would still be made by the partners jointly.
- 5.170. Noting the above, and the difficulties in establishing a viable GBA in a market such as Western Australia, the ACCC is not satisfied that the Applicants would have an incentive to compete for market share under separate marketing. A joint venture partner that had taken more of its production share through competing with its partners will ultimately have to provide compensation through in-kind or cash balancing. As demonstrated in the counterfactual section, such compensation measures would be extremely difficult in the Western Australian domgas market and with a project that has reserves uncertainty such as the NWS Project.
- 5.171. As noted in the Gorgon Determination, the ACCC is of the view that the high concentration of parties producing domgas in Western Australia will remain regardless of whether they separately or jointly market. As this is likely to be the case in the short to medium term with incumbents such as BHP Billiton (Macedon) and Apache and Santos (Reindeer) bringing on prospective fields, the ACCC considers that the best potential for competition in the Western Australian domgas market is between joint ventures.
- 5.172. The ACCC notes that the NWS Project has partners that are members of other Western Australian domgas joint ventures. For example, Shell and Chevron are members of the Gorgon Project and BHP Billiton is the majority partner in the proposed Macedon project.
- 5.173. However, the ACCC is satisfied that the Applicants do have an incentive to compete with other joint ventures. In particular, the ACCC notes that BP Developments, MIMI and Woodside Energy are currently not members of an announced or pending domgas development. The ACCC considers that the presence of these partners will assist in ensuring that the joint venture will compete for gas contracts.
- 5.174. The ACCC notes that the Applicants have indicated that they recently failed to secure a gas supply agreement with Wesfarmers. The Applicants are of the view that this is evidence of competition in the market.¹¹⁴ The ACCC acknowledges that Santos appears to have secured this contract with Wesfarmers through its separate marketing of some of its production entitlement from the John Brookes joint venture.¹¹⁵ Nonetheless, the ACCC is of the view that this indicates that there is currently a degree of competitive tension in the Western Australian domgas market, both between joint ventures and between joint ventures and parties separately marketing.

¹¹⁴ Record of meeting between ACCC and the Applicants, 31 May 2010.

¹¹⁵ Santos ASX/Media Release, *Santos signs Gas Sale and Purchase Agreement with Wesfarmers*, 13 April 2010.

- 5.175. The ACCC considers that joint marketing of the NWS Project's incremental domgas volumes may result in some marginal competitive benefit. In particular, joint marketing will potentially enable the Applicants to supply more domgas than would be the case under separate marketing, which will enable the Applicants to compete more effectively in a market that is characterised by relatively large contract volumes.
- 5.176. However, as explored further in the public detriment section of this chapter, the ACCC is of the view that the level of competition in domgas supply in Western Australia over the next 5 years (after which, new gas fields are scheduled to commence production) is not likely to be significantly different if domgas from the NWS Project is jointly or separately marketed.

Price of domgas

Applicants' submission

- 5.177. The Applicants reiterate their views, as expressed in the counterfactual section of this determination, that under separate marketing the NWS partners are likely to face significantly higher costs. The Applicants note the findings of Frontier Economics that the price of gas under separate marketing would be affected by the increased costs of supply associated with the negotiation and implementation of the necessary balancing arrangements. However, the Applicants note that Frontier Economics also concluded that the effect on price was unable to be determined.
- 5.178. The Applicants argue that as joint marketing will result in reduced costs, increased supply and competition between projects there is likely to be public benefits associated with the possibility of lower prices. Having said this, the Applicants acknowledge that the precise price effects are difficult to calculate.

Interested party submissions

- 5.179. The Domgas Alliance considers that a result of the lack of competition created by joint marketing is that it enhances the market power of the producers and creates a minimum floor price for domgas. The Domgas Alliance goes on to claim that the Alinta price outcome demonstrates the market power conveyed by joint marketing and submits:

If the NWSJV participants are required to sell separately and compete with each other to offer the lowest possible price, outcomes such as the reported 300 per cent Alinta price increase would likely not occur.

Separate selling would also limit the ability of the same producers to combine together to impose any price outcome such as a "benchmark" price for the WA domgas market.¹¹⁶

- 5.180. The views of interested parties in relation to the impact of joint marketing on domgas prices in Western Australia are explored more fully in the public detriment section of this chapter.

¹¹⁶ Submission from the Domgas Alliance, 30 April 2010, page 14.

Applicants' further submission

- 5.181. The Applicants in their additional submission in response to the interested party views, address the issue of the Alinta price arbitration and argue that the Domgas Alliance's claim that a 300 per cent price rise was forced on Alinta are incorrect. In addition, the Applicants submit:

...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.¹¹⁷

ACCC's view

- 5.182. The ACCC accepts that there would be some costs associated with each of the six joint venture partners establishing the necessary marketing resources to conduct separate selling in Western Australia. For a partner such as MIMI, which does not have a significant presence in the Australian petroleum industry, these costs may be high relative to the other established partners. Nonetheless, the ACCC is of the view that these costs for experienced international petroleum companies would not be significant in comparison to the costs of domgas production and transportation.
- 5.183. The ACCC also considers that there is the potential for transaction costs and risks associated with entering into separate marketing and the corresponding GBAs for the NWS Project's incremental volumes in the current illiquid Western Australian domgas market. As these incremental volumes in the medium term are likely to be relatively small compared to the NWS Project's domgas capacity, these costs and risks will be higher in comparison to the revenue returns the individual partners would gain from separately marketing their incremental production shares.
- 5.184. However, given that current prices appear to be more market-based than cost-based, the ACCC considers that it is not clear that the potential for lower costs under joint marketing will necessarily result in lower prices for consumers than would be the case under separate marketing. The ACCC's view on whether joint marketing has resulted or is likely to result in higher domgas prices in Western Australia than would be the case under separate marketing is explored in further detail in the public detriment section of this chapter.

Economic development

Applicants' submission

- 5.185. The Applicants submit that joint marketing will result in economic benefits. However, they recognise that these economic benefits are likely to arise due to the NWS Project itself as opposed to the domgas joint marketing activities. Nonetheless, the Applicants are of the view that were they to attempt to transition to separate marketing these economic benefits would be diminished.

¹¹⁷ Submission from the Applicants, 27 May 2010, page 8.

- 5.186. As outlined above, the Applicants consider that joint marketing will result in greater volumes of domgas being supplied than would be the case under separate marketing. The Applicants are of the view that this will provide security of supply that will enable customers to invest in current and new projects. In addition, the maintenance of NWS Project supply will assist in the underwriting and expansion of infrastructure such as pipelines and storage facilities.
- 5.187. The Applicants again note the findings of Frontier Economics that joint marketing will promote economic efficiency. This will occur through enabling efficient downstream projects to proceed and the creation of incentives for the efficient utilisation of gas in those projects. On the other hand, Frontier Economics concludes that the abandonment of joint marketing will increase the transactions costs associated with the implementation and negotiation of gas supply contracts.
- 5.188. The Applicants again note the response to the Varanus Island explosion in 2008 as demonstrating the benefits of joint marketing. In this respect, joint marketing constitutes a public benefit in the form of an effective response to supply interruption.
- 5.189. Joint marketing will benefit the Western Australian economy through greater output across a range of industries and higher employment than would be the case under separate marketing, submit the Applicants. In addition, it will increase revenue for both the State and Commonwealth governments through increases in taxation and royalty collections. Finally, the Applicants argue that joint marketing will benefit regional communities, such as Karratha, through employment and training and will assist Australia more generally through growth in export markets.

Interested party submissions

- 5.190. As noted previously, Alcoa is of the view that one of the central issues in the Western Australian domgas market is the uncertainty over future domgas supplies. Further, Alcoa considers that this uncertainty poses a threat to long term industry growth and job creation. In this context, Alcoa has proposed a condition of authorisation requiring the NWS partners to maintain supply at existing levels.
- 5.191. The Domgas Alliance argues that the current domgas supply imbalance and rising prices have impacted on project investment in Western Australia. The Domgas Alliance submits that it has been approached by project developers that have been unable to secure domgas supplies at competitive prices. In addition, the alliance is of the view that higher gas prices are being passed through in the form of higher household and business gas tariff and energy bills.

ACCC's view

- 5.192. As noted above, the ACCC considers that the joint marketing of the NWS Project's incremental volumes by the Applicants is likely to result in a higher level of domgas supply than would be the case under separate marketing. In addition, joint marketing may lower the risks for the Applicants in making future investments in maintaining or increasing domgas supply.

- 5.193. In a market such as Western Australian domgas, where supply is constrained and demand is forecast to continue to grow in the medium term, the continued supply from the NWS Project is important in assisting Western Australia's economic development. To the extent that the NWS Project's incremental domgas supply is higher than that under separate marketing and this enables development and associated employment, such as mining projects, the ACCC is of the view that this constitutes a public benefit.

ACCC conclusion on public benefits

- 5.194. The ACCC is of the view that joint marketing by the Applicants of the NWS Project's incremental domgas volumes is likely to result in the supply of higher domgas volumes to the Western Australian market than would be the case under separate marketing.
- 5.195. Given the current demand and supply imbalance in Western Australia, the ACCC considers the supply of higher domgas volumes constitutes a significant public benefit.

Public detriment

- 5.196. Public detriment is also not defined in the Act but the Tribunal has given the concept a wide ambit, including:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.¹¹⁸

- 5.197. Agreements between competitors which influence the pricing decisions of market participants have the potential to result in allocative inefficiencies. That is, they can move prices away from levels that would be set in a competitive market. This can result in higher prices for consumers and send market signals which direct resources away from their most efficient use.
- 5.198. Further, agreements between competitors which impose restrictions on their decisions as to in what or with whom they deal can result in allocative inefficiencies. Such agreements distort market signals and can suppress competitive dynamics that would exist in a competitive market.
- 5.199. These agreements also have the potential to increase barriers to market entry or expansion, which reduces the competitive restraint applying to market participants. Both can lead to increased prices and reduced choice for consumers and significant inefficiencies.
- 5.200. As with the assessment of the public benefits of the proposed arrangements, the Applicants and interested parties have framed their consideration of the public detriments from the perspective of the impact of joint marketing compared to separate marketing.

¹¹⁸ Re 7-Eleven Stores (1994) ATPR 41-357 at 42,683.

5.201. The ACCC considers that the public detriments of the proposed arrangements, as raised by interested parties, may be broadly categorised as:

- a lower level of competition than would be the case under separate marketing
- higher prices than would the case under separate marketing
- preventing or hindering the Western Australian domgas gas market from developing further
- the potential for commercially sensitive information to be transferred between competing projects through common ownership
- facilitating the withholding of domgas from the Western Australian market.

Reduced competition

Interested party submissions

5.202. Some gas buyers in Western Australia expressed the view that competition in the supply of domgas would be significantly enhanced by an increase in the number of gas suppliers, which would be achieved by having the NWS producers separately marketing.

5.203. Synergy notes that there are currently just two gas suppliers – the NWS Project joint venture and the Varanus Island venture – which account for approximately 98 per cent of the Western Australian domgas market. It then submits that:

With these producers holding significant market power and an ability to control the level of supply in the market no incentives exist for them to compete effectively, hence competition is reduced and the cost of gas to domestic consumers is ultimately increased.

...Synergy believes that the incremental gas for which the Applicants are seeking Authorisation ... would provide the perfect opportunity to initiate separate marketing obligations in WA.¹¹⁹

5.204. The Domgas Alliance submits that:

Despite being Australia's largest gas market, the WA gas market is the most anti-competitive. It is a duopoly market where just two producer groups control close to 100 per cent of the market.

Through joint selling arrangements, the six NWSJV producers combine together to set prices and contract terms covering almost 70 per cent of the market. Customers are forced to deal with a single seller instead of six sellers competing to offer the lowest price.¹²⁰

5.205. While still concerned to see separate marketing bring greater competition in gas supply, other gas buyers are more concerned about ensuring adequate volumes of gas supply.

¹¹⁹ Submission from Synergy, 30 April 2010, page 3.

¹²⁰ Submission from the Domgas Alliance, 30 April 2010, page 2.

5.206. In particular, Rio Tinto submits that:

Rio Tinto supports full competition and, in principle, is opposed to joint marketing of gas beyond such period as might otherwise be warranted to ensure that a Greenfield development proceeds; for example, the term of any project financing necessary to support the development where external lenders require greater certainty as the early cash-flows of the project.

Rio Tinto would, however, be deeply concerned in this particular case if the ACCC's decision making process caused a protracted delay or deferment of the marketing of gas by the North West Shelf Project Partners.¹²¹

5.207. Alcoa expressed similar concerns:

Alcoa has previously expressed its concerns about joint marketing in the context of the Gorgon Project authorisation application; however Alcoa recognises that security of natural gas supply at affordable prices for Western Australia must be paramount.¹²²

5.208. Representatives of relevant Western Australian government departments expressed the view that while consideration should be given at some stage to transitioning to separate marketing, other issues are more important in promoting competition:

Changes to the current processes for acreage management and retention leases may be more important in promoting competition in and supply of domgas in WA than separate marketing of gas.¹²³

5.209. Senator Alan Eggleston (WA) supports the applications and does not consider that separate marketing would result in greater levels of competition:

Whilst it is essential that the Western Australian gas market is workably competitive and provides a good outcome for gas buyers, I do not believe that an attempted shift to separate marketing by the NWS venture participants would result in greater levels of competition or lower domgas prices in Western Australia at this time. This is because the Western Australian domgas market is small, relatively immature and subject to 'lumpy' step changes in both supply and demand.¹²⁴

5.210. The Domgas Alliance, in a submission following the draft determination, asserts that the ACCC's potential grant of authorisation would cost WA domgas consumers \$2 billion a year due to higher prices stemming from lower competition. In particular, the Domgas Alliance submits:

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.¹²⁵

Applicants' submission

5.211. The Applicants note that if they were to continue jointly marketing in the absence of authorisation, there is no possible detriment from the conduct.¹²⁶

¹²¹ Submission from Rio Tinto, 3 May 2010, page 1.

¹²² Submission from Alcoa, 30 April 2010, page 1.

¹²³ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

¹²⁴ Submission from Senator Eggleston (WA), 30 April 2010, page 1.

¹²⁵ Submission from the Domgas Alliance, 27 July 2010, page 1.

¹²⁶ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 42.

5.212. The Applicants submit that separate marketing is not currently feasible in Western Australia for the NWS venture participants and is therefore not likely to result in more effective competition than joint marketing.¹²⁷

5.213. The Applicants noted the ACCC's view expressed in its 2009 determination on the Gorgon gas project's applications for authorisation, that separate marketing may improve certain terms and conditions offered to purchasers under gas sales contracts. The Applicants submit that any detriment in this regard would be negligible and could only relate to contractual terms at the margins:

Under separate marketing, each of the NWS venture participants would be operating from the same cost base, using facilities with the same capacity constraints and critical decisions relating to quantity and timing of gas produced would remain joint decisions. This would restrict each NWS venture participant's flexibility in relation to material terms and conditions.¹²⁸

5.214. Indeed, the Applicants submit that marketing jointly enables them to compete more effectively with other projects on material contract terms and conditions and provides greater flexibility for them to adapt offers to respond to changing market conditions – citing the NWS Project's rapid response to the Varanus Island outage in 2008 as an example.¹²⁹

ACCC's view

5.215. The ACCC considers that the level of competition in domgas supply in Western Australia over the next 5 years is not likely to be significantly different if the NWS Project is jointly or separately marketing.

5.216. As set out in the counterfactual section above, the ACCC considers that in the absence of authorisation, the Applicants are likely to continue to jointly give effect to existing contracts and are likely to attempt to separately market the incremental gas.

5.217. Given that the NWS Project's LNG plant is fully committed for a number of years, the ACCC considers there would be strong commercial incentives for the participants to seek to market their share of the incremental volumes domestically.

5.218. Nevertheless, the Applicants have stated a clear intention to not seek to separately market gas without a gas balancing arrangement in place – and have noted a number of market-based complexities in reaching such an agreement in the Western Australian context.

5.219. At the very least, the ACCC considers that incremental volumes of gas from the NWS Project are likely to be delayed while the parties seek to negotiate a gas balancing agreement. It is possible that some or all of the parties may be unable to reach agreement or be unwilling to separately market the incremental gas volumes in Western Australia.

¹²⁷ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 42.

¹²⁸ Ibid.

¹²⁹ Ibid, page 43.

- 5.220. Further, the Applicants do not face normal commercial incentives to discount prices in order to seek to increase market share and increase revenues by selling more gas. Overall production volumes are determined by the joint venture regardless of whether they jointly or separately market. And each producer's share of that volume of production is determined by their ownership stake in the joint venture.
- 5.221. Given these restrictions, coupled with a market that by all reports has demand outstripping supply, it is hard to see an incentive for individual participants to compete with each other by offering gas at lower prices.
- 5.222. As a result, in the current market circumstances the ACCC considers there is unlikely to be a significant difference in the level of competition in gas supply in Western Australia if the NWS Project were to jointly or separately market its gas.
- 5.223. The ACCC considers that in an immature gas market such as Western Australia, with relatively few customers and 'lumpy' demand, there is some additional risk that individual producers may not be able to contract for their entire share of production.
- 5.224. However, in a market with expected excess demand for the period for which authorisation is sought, the NWS Project producers should be able to sell their gas, particularly with aggregators able to purchase any small 'left-over' quantities and pull together marketable parcels of gas. This would, however, introduce an additional cost/margin into the gas supply chain and it is not clear that producers would lower the price of marginal gas volumes to offset this additional cost.
- 5.225. The ACCC considers it is likely that if marketing separately, the Applicants would be willing to offer different terms and conditions from each other and that this additional flexibility would be of benefit to gas buyers. However, given the restrictions that individual producers face because of the joint production arrangements, the ACCC considers this additional flexibility could only be at the margins.
- 5.226. The ACCC considers this loss of some additional flexibility constitutes a public detriment. This detriment is likely to be offset to some extent by the Applicants ability to better respond to some situations as a single marketing entity – the Applicants cite the rapid response to the Varanus Island gas plant failure as an example.
- 5.227. The ACCC agrees with the view of a number of interested parties that it is the overall volume of gas supplied to the Western Australian market that is most critical over the next 5 year period. This is what will have the biggest influence on the level of competition and on domgas prices.
- 5.228. The ACCC understands that the Western Australian Government is actively pursuing options to seek to ensure additional gas supplies are brought to the State.

Higher gas prices

Interested party submissions

- 5.229. A number of interested parties submitted that lower levels of competition in gas supply in Western Australia will result in higher domgas prices – with many citing the significant price differential with eastern States as evidence.

5.230. The Domgas Alliance submits that:

...Western Australia is paying up to three times for the price of gas. WA gas prices are around \$8 per gigajoule, compared to just \$3 - \$3.560 in Victoria where competition prevails. This is despite WA having Australia's biggest gas market, biggest gas production and biggest natural gas reserves.¹³⁰

5.231. In seeking to quantify the public detriment it considers will arise if the joint marketing conduct is authorised, the Domgas Alliance submits:

Authorisation for joint selling would result in immense anti-competitive detriment. Households and businesses face huge hikes in energy prices which will impact economic growth, development, employment and living standards.

...Woodside has indicated it would now seek to apply the reported \$8 per gigajoule Alinta contract price on new and existing contracts. At these prices, WA consumers would be forced to spend an additional \$2 billion a year on domestic gas, with the benefits flowing directly to major producers.¹³¹

5.232. Conversely, Senator Eggleston submits:

I do not believe that an attempted shift to separate marketing by the NWS venture participants would result in greater levels of competition or lower domgas prices in Western Australia at this time.¹³²

5.233. The Domgas Alliance, in a submission following the draft determination, rejects the ACCC's consideration in the draft that the higher costs of exploration and development are in part responsible for the reported increases in domgas prices. The Domgas Alliance points to the gas lifting costs reported in Woodside's 2009 company results that were reported as approximately 55 cents/GJ. It argues that the 300 per cent price increase experienced by domgas customers is not reflective of the costs incurred by the Applicants. Further, the Domgas Alliance submits that Woodside's lifting costs have actually decreased over the past two years.

Applicants' submission

5.234. As discussed previously, the Applicants submit that in circumstances where continued joint marketing will result in reduced costs, increased gas supply and more effective project based competition in the short to medium term, it is possible that joint marketing will lead to lower domgas prices than separate marketing – but note that the precise price effects are difficult to calculate.¹³³

...it is possible that the increased costs and risks of separate marketing would ultimately be passed on to domgas customers.¹³⁴

¹³⁰ Submission from the Domgas Alliance, 30 April 2010, page 3.

¹³¹ Ibid, pages 4–5.

¹³² Submission from Senator Eggleston (WA), 30 April 2010, page 1.

¹³³ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 39.

¹³⁴ Ibid, page 43.

- 5.235. With respect to the level of gas prices in Western Australia, the Applicants note that prices have been historically low and that these low prices arose exclusively from joint marketing arrangements. The Applicants go on to state:

The recent increases in domgas prices away from the historically low average is due to ordinary market factors...

The NWS venture participants consider that the Varanus Island outage which interrupted supply from Apache's facilities over the past year also contributed (at least temporarily) to the recent increase in domgas prices in WA.¹³⁵

ACCC's view

- 5.236. It is evident that gas prices in Western Australia have risen sharply in recent years. Given that almost all gas sold in Western Australia has been jointly marketed while prices were historically low and as they have risen, it is hard to conclude that joint marketing has caused prices to rise.
- 5.237. The ACCC considers the critical question here is whether prices are likely to be lower if the Applicants were to separately market. For the reasons outlined in the section above on whether joint marketing will reduce competition, the ACCC does not consider that prices are likely to be lower if the parties were not able to jointly market.
- 5.238. The ACCC accepts that there currently is a significant differential in the price of new domgas contracts in Western Australia compared to those in eastern states. Currently new domgas contracts are priced in at approximately \$2–\$3.50 GJ in eastern states while in Western Australia the range is \$5–\$8 GJ.¹³⁶
- 5.239. The ACCC sees the Western Australian gas market as entirely separate from eastern Australian markets. Further, the ACCC is of the view that the current significant gas price differential between Western Australia and the eastern states is not a result of joint marketing in Western Australia. Indeed, the ACCC understands that the majority of gas sold in the eastern States is also jointly marketed.
- 5.240. The ACCC rejects the Domgas Alliance assertion that authorisation of joint marketing by the NWS Project will result in significantly higher gas prices in Western Australia. Gas has always been jointly marketed in Western Australia by the NWS Project - including when gas was being sold for an extended period of time at historically low prices. In the current market circumstances, the ACCC considers that joint or separate marketing by the NWS Project in and of itself is unlikely to have a significant impact on gas prices in Western Australia.
- 5.241. The ACCC considers that there are a number of factors driving the current higher domgas prices in Western Australia, including:
- Western Australia has experienced significant increases in demand for energy, particularly from the resource sector, but there has been no significant increase in gas supply thus far.

¹³⁵ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 43.
¹³⁶ Australian Energy Regulator, *State of the Energy Market 2009*, 8 December 2009, page 245.

- Western Australian gas producers, unlike those currently in eastern states, can export gas as LNG – either through their own facilities or potentially through tolling or joint venture arrangements with other LNG projects. As a result, the price of LNG impacts on the domestic price.
 - Many gas buyers in Western Australia have (high priced) diesel as their next best alternative fuel to generate electricity – unlike eastern states, where gas is often competing with coal-fired electricity as an energy source.
 - The cost of new gas production has increased significantly recently with new developments, such as Gorgon, having complex technical and engineering issues associated with deep water locations. Additionally labour and equipment costs have been heavily impacted by the resources boom. Consequently, new sources of gas supply have broadly a cost of development and production that is greater than that of older sources.
- 5.242. The ACCC notes the Domgas Alliance’s argument that a lowering of Woodside’s lifting costs over the past two years demonstrates that the recent domgas price increases are not justified. As set out above, the ACCC is of the view that a number of factors are contributing to increased prices for domgas, including a significant increase in demand. Additionally, the ACCC notes that the measurement of lifting costs generally does not incorporate the costs associated with exploration and development of the respective fields. Finally, the ACCC further notes that the results quoted by the Domgas Alliance also incorporate Woodside Energy’s assets in Victoria, which operate in different circumstances.
- 5.243. The ACCC notes that a number of recent gas discoveries in Western Australia have been of reserves that are sufficient to potentially justify either individually or collectively with other reserves, a LNG development. Recently, Apache and Kufpec announced that their Julimar fields, which may have been commercially viable as a stand alone domgas development, would be developed in conjunction with Chevron’s Wheatstone LNG project. Wheatstone, along with other future LNG projects such as Pluto, Scarborough/Thebe and Browse, are likely to have a domgas supply requirement under the Western Australian Government’s Reservation Policy. It appears that significant sources of new domgas supply in the future are likely to be dependent on the development of LNG projects. As a consequence, the pricing of domgas is likely to remain strongly influenced by LNG prices for the foreseeable future.
- 5.244. However, the ACCC considers that the recent strength in the domgas price is providing some incentive for the development of additional or new sources of domgas supply. Of particular note is the potential development of the Macedon project by BHP Billiton and Apache Energy, which the partners are forecast to make a final investment decision on in mid 2010. The ACCC notes that this project involves unique technical challenges associated with its gas quality, and that in 2009, the Western Australian Government changed the specifications on the DBNGP to enable this gas to be transported.¹³⁷
- 5.245. Further, the ACCC notes the exploration being conducted by junior explorers into tight and shale gas in Western Australia – for instance, Latent Petroleum’s work in conjunction with Alcoa in developing the potential 150 TJ/day Waroo field by 2013.

¹³⁷ Western Australia Government media statement, *Legislation passed to help secure long term gas supplies*, 18 November 2009.

- 5.246. The ACCC further notes recent media reports and company announcements by exploration companies that the development of shale gas fields in Western Australia is being incentivised by the strong domgas prices.¹³⁸

Preventing the Western Australian domgas market from developing

Interested party submissions

- 5.247. The ACCC understands that a number of interested parties consider that joint marketing by the Applicants (and other gas joint ventures in Western Australia) is preventing the Western Australian gas market from developing.

- 5.248. In particular, the Domgas Alliance submits that:

Authorisation for joint selling has suppressed competition, protected the ongoing producer duopoly, increased prices and limited the effectiveness of State Government reforms. It remains the single biggest barrier to competition and the development of a more mature gas market.¹³⁹

Applicants' submission

- 5.249. The Applicants acknowledge that an attempted transition to separate marketing may assist in the development of the Western Australian domgas market in the medium to long term, but suggest that:

...the potential for separate marketing to assist market development must be considered in the context of the nature of demand in WA and the underlying structure of the market.¹⁴⁰

- 5.250. In particular, the Applicants consider that the long term contractual nature of the Western Australian domgas market is a significant factor impeding its development. The Applicants submit this long term contract focus is driven by the needs of the largely industrial domgas users who desire security of supply to underwrite investment in expansion and development of new projects, as well as to underwrite significant investments in pipeline capacity over time.¹⁴¹

ACCC's view

- 5.251. If the Applicants were to seek to separately market their gas into the current Western Australian domgas market, the ACCC is of the view that it is likely to create additional market opportunities for aggregators and brokers and for storage service providers. This is because the 'lumpy' nature of the Western Australian market means it is unlikely that each producer would be able to find buyers for the exact volume of their share of production.
- 5.252. It is not clear to the ACCC that denying authorisation would significantly change the market fundamentals in Western Australia – such as the overall volume of gas supply, timing and duration of contracts and the associated liquidity of the market.

¹³⁸ New Standard Energy, *The Emergence of Goldwyer Shale Gas and US Exploration Program Update*, May 2010 and WA Business News, 'New gas stream a possible game changer,' 16 April 2010.

¹³⁹ Submission from the Domgas Alliance, 30 April 2010, page 9.

¹⁴⁰ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 43.

¹⁴¹ Ibid, page 44.

- 5.253. Gas buyers are still primarily seeking very long term supply contracts – particularly for the development of a new mine or processing facility.
- 5.254. The ACCC considers that far greater supply diversity is likely to be required before buyers will be willing to invest in new facilities based on a short term gas supply contract or a long term contract that only covers part of their gas requirements – with the balance to be bought on spot or a short term basis.
- 5.255. It is hard to identify potential drivers for such significant market development prior to at least 2015, when a number of additional supplies of gas are expected to come on stream.
- 5.256. Therefore, the ACCC does not consider that joint marketing of gas by the Applicants over the next 5 years is likely to significantly restrict the development of the Western Australian domgas market.
- 5.257. The ACCC considers the critical components are drivers to bring on new sources of domgas in Western Australia– such as acreage management and retention lease policies and the obvious supply, and demand economic/profit based factors that are needed to underpin investment to bring new fields into production.

Treatment of commercially sensitive information

Interested party submissions

- 5.258. Synergy submits that:

Through involvement in various joint venture projects the Applicants, along with other large producers, currently enjoy the benefits of complete transparency with regard to pricing across the industry...

Synergy considers that, should the ACCC approve the Applicant's request to continue joint marketing of domgas, probity auditors should be in place to oversee all tendering and sales activities and to ensure that production facilities are fully utilised to substantiate that the Applicants are acting in good faith.¹⁴²

- 5.259. The Domgas Alliance submits that the market power the NWS project participants derive from joint marketing is:

...exacerbated by significant ownership concentration in existing and prospective gas developments. Cross-ownership minimises any competitive tension between projects with Chevron for example a participant in the NWSJV, Gorgon and Wheatstone projects.¹⁴³

- 5.260. The Domgas Alliance in an additional submission on 23 June 2010 provided a chart that displays the interests that individual producers have in different domgas joint ventures in the Western Australian domgas market. The Domgas Alliance is of the view that this demonstrates that project on project competition is unlikely due to the level of cross ownership.

¹⁴² Submission from Synergy, 30 April 2010, page 4.

¹⁴³ Submission from the Domgas Alliance, 30 April 2010, page 3.

Applicants' submission

- 5.261. The Applicants acknowledge the concern that commercially sensitive information should not pass to competing projects through joint venture partners having ownership in multiple fields. The Applicants have made the following response to this concern:

The NWS venture participants consider that there is a very low risk that commercially sensitive information would be 'shared' due to safeguards put in place by the NWS venture participants and their cognisance of TPA risk and compliance.

Nevertheless, to address any minimal risk of detriment, those NWS venture participants with a rival project in WA are currently implementing appropriate ring fencing arrangements based on those referred to in the Gorgon [authorisation] determination. ... These arrangements involve a clear system of governing access to and dissemination of commercially sensitive information obtained for the purposes of the Project.

The NWS venture participants submit that these arrangements adequately address the minimal potential for detriment to arise from the internal transfer of commercially sensitive information to a rival project.¹⁴⁴

ACCC's view

- 5.262. The ACCC recognises the potential for commercially sensitive information obtained by the Applicants to pass to, or be used by, competing joint ventures through partners having ownership stakes in both ventures.
- 5.263. This concern is heightened in circumstances where the main benefits of competition are likely to arise from competition between joint ventures, rather than from within them.
- 5.264. At this point, the ACCC considers it is worth noting that the risks of information flows to other producing joint ventures arises if the NWS Project producers are marketing jointly or separately.
- 5.265. The ACCC recognises that the Applicants already have measures in place to restrict the inappropriate flow of information. Nevertheless, the ACCC considers the incentives for compliance may be increased by the introduction of a level of transparency and independence to the oversight of the ring fencing arrangements.
- 5.266. In the Gorgon Determination, the ACCC granted authorisation on condition that the Applicants implement a series of ring fencing measures. For similar reasons, the ACCC considers it appropriate to apply those ring fencing measures on the NWS Project participants. The ACCC notes that the Applicants have already started to put these arrangements in place for all participants that have interests in a competing gas project in Western Australia.
- 5.267. The ACCC notes that any anticompetitive agreements between gas producing joint ventures based around information flows – such as to restrict the volumes of gas to be supplied or to increase prices – would not be exempt from the Act by any proposed authorisation and would be exposed to action by the ACCC or any affected party.

¹⁴⁴

The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 44.

- 5.268. To address the risk of inappropriate flows of commercially sensitive information between gas joint ventures, the ACCC considers that authorisation should be conditional upon the Applicants adhering to the Ring Fencing Protocol provided at Attachment 6 to the current applications for authorisation and to the following:
- A review by an ACCC approved independent compliance auditor (the Auditor), of the operation of, and the Applicants' compliance with, the Ring Fencing Protocol, to be completed by 10 October, or if the Applicants request, a later date agreed to by the ACCC in writing, annually until the conclusion of the term of authorisation. Within 30 business days of receiving the Auditor's report on the review, the Applicants must provide the full report to the ACCC, along with a separate summary, which to the ACCC's satisfaction accurately reflects the Auditor's full report. This summary will be placed on the public register.
 - The Applicants implement all of the Auditor's recommendations arising out of each compliance audit within 45 business days of the audit concluding, to the satisfaction of the ACCC on advice from the Auditor.
 - Each Applicant must report any non-compliance with the Ring Fencing Protocol to the ACCC within one week of the Applicant becoming aware of it.

Withholding domgas supply from the Western Australian market

Interested party submissions

- 5.269. The Domgas Alliance submits that with joint selling arrangements and effectively just two producer groups in Western Australia:

...producers exercise immense power to increase domestic gas prices or withhold supply.

...Gas producers also appear to be coordinating gas marketing across projects by ensuring that any marketing from a given project occurs sequentially to avoid projects competing with each other.¹⁴⁵

- 5.270. The Domgas Alliance further submits that:

Major gas producers have been withholding supply from the domestic market to increase prices. They have been able to do so through joint selling arrangements and their control of existing and prospective projects.

Gas users have been unable to secure sufficient quantities of gas or on long-term contracts. Major producers are "keeping their foot on the hose" and releasing only small volumes of gas on very short terms and very high prices. These sales have targeted the small number of north and mid-west customers whose only alternative is liquid fuels. Producers have then used these outcomes to drive their price demands for the rest of the market.¹⁴⁶

¹⁴⁵ Submission from the Domgas Alliance, 30 April 2010, pages 2 and 3.
¹⁴⁶ Ibid, page 4.

- 5.271. Representatives of relevant Western Australian government departments expressed the view that gas producers may be reluctant to bring on otherwise commercial gas fields to supply domgas because they are trying to aggregate sufficient reserves to commercialise the volumes needed for LNG development.¹⁴⁷
- 5.272. In response to concerns that insufficient gas may be made available to the Western Australian market, some interested parties have called for any authorisation granted to be conditional upon the Applicants maintaining or increasing supply from current levels for at least the period of authorisation. This issue is discussed in greater detail from paragraph 5.302.

Applicants' submission

- 5.273. The Applicants provided the following response to allegations that they are withholding supply from the Western Australian market:

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 marketing from a given project occurs sequentially so as to limit competition;
- major gas producers in Western Australia have been deliberately withholding domgas supply and 'targeting' particular customers to drive up market prices; and
- the NWS venture participants forced a 300% price increase on Alinta through a 'coordinated abuse of market power'.

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.¹⁴⁸

ACCC's view

- 5.274. It is not clear to the ACCC what incentive the Applicants currently have to withhold incremental gas supply from the domestic market.
- 5.275. Withholding domgas would mean forgoing revenue from sales. These volumes of domgas cannot be transferred to sales as LNG, because the LNG plant is already contracted for its full capacity for some time. So any potential increase in price from withholding domgas has to be offset against the time discount of significant delays in revenue from domgas sales.
- 5.276. In any event, the quantity of gas produced by the Applicants to be supplied to Western Australia will be determined by the NWS production joint venture, regardless of whether that gas is jointly or separately marketed.

¹⁴⁷ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

¹⁴⁸ Submission from the Applicants, 27 May 2010, page 9.

- 5.277. Any broader agreements between gas producing joint ventures in Western Australia to sequentially develop or market gas, or to otherwise withhold gas to increase prices, would not be authorised and would raise serious concerns under the Act.
- 5.278. The ACCC has no evidence of any such broader agreements.
- 5.279. The ACCC believes the timing of field development is more an issue for acreage management processes, including the management of retention leases. In this regard, the ACCC notes the Australian Government Department of Resources, Energy and Tourism published an options paper on this issue in June 2009.

ACCC conclusion on public detriments

- 5.280. The ACCC considers that the level of competition in domgas supply in Western Australia over the next 5 years is not likely to be significantly different if domgas from the NWS Project is jointly or separately marketed.
- 5.281. Given the structure of the domgas market, and current characteristics in Western Australia, the ACCC does not consider prices are likely to be higher if the NWS Project producers are permitted to jointly market.
- 5.282. The ACCC does not consider that the NWS Project jointly marketing domgas is likely to materially prevent the Western Australian gas market from developing further over the next 5 years.
- 5.283. The ACCC recognises the potential for anti-competitive detriment to arise if confidential gas marketing and sales information were to transfer between producing joint ventures in Western Australia. This concern can be substantially mitigated by effective ring fencing arrangements.
- 5.284. The ACCC has no evidence of domgas producers agreeing to withhold gas from the Western Australian market to seek to increase or maintain prices – and these applications for authorisation do not seek immunity for such conduct.
- 5.285. Overall, the ACCC does not consider that the proposed joint marketing of domgas by the Applicants is likely to give rise to significant detriments over the next 5 years.

Balance of public benefit and detriment

- 5.286. In general, the ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the proposed conduct is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment.
- 5.287. In the context of applying the net public benefit test in section 90(8)¹⁴⁹ of the Act, the Tribunal commented that:

...something more than a negligible benefit is required before the power to grant authorisation can be exercised.¹⁵⁰

¹⁴⁹ The test at 90(8) of the Act is in essence that conduct is likely to result in such a benefit to the public that it should be allowed to take place.

- 5.288. For the reasons outlined earlier in this chapter, the ACCC is of the view that the continued joint marketing by the Applicants of the NWS Project's incremental domgas volumes is likely to result in the supply of higher domgas volumes to the Western Australian market than would be the case under separate marketing.
- 5.289. Given the current demand and supply imbalance in Western Australia, the ACCC considers the supply of higher domgas volumes constitutes a significant public benefit.
- 5.290. Conversely, the ACCC does not consider that jointly marketing domgas from the NWS Project is likely to give rise to significant detriments over the next 5 years.
- 5.291. Having said this, the ACCC recognises the potential for anti-competitive detriment to arise if confidential gas marketing and sales information were to transfer between producing joint ventures in Western Australia. The ACCC considers this concern can be substantially mitigated by effective ring fencing arrangements.

Proposed conditions of authorisation

- 5.292. In this regard, the Act allows the ACCC to grant authorisation subject to conditions.¹⁵¹ Generally, the ACCC may impose conditions to ensure that the net public benefit test is met or continues to be met over the proposed period of authorisation.

Ring fencing conditions

Interested party submissions

- 5.293. As outlined previously in this chapter, Synergy considers that should the ACCC decide to grant authorisation for the Applicants to continue to jointly market domgas from the NWS Project:

...probity auditors should be in place to oversee all tendering and sales activities and to ensure that production facilities are fully utilised to substantiate that the Applicants are acting in good faith.¹⁵²

- 5.294. Further, the Domgas Alliance submits that the market power the Applicants derive from joint marketing is:

...exacerbated by significant ownership concentration in existing and prospective gas developments. Cross-ownership minimises any competitive tension between projects with Chevron for example a participant in the NWSJV, Gorgon and Wheatstone projects.¹⁵³

- 5.295. Regarding the treatment of commercially sensitive information, the Applicants submit:

The NWS venture participants consider that there is a very low risk that commercially sensitive information would be 'shared' due to safeguards put in place by the NWS venture participants and their cognisance of TPA risk and compliance.

¹⁵⁰ *Re Application by Michael Jools, President of the NSW Taxi Drivers Association* [2006] ACompT 5 at paragraph 22.

¹⁵¹ Section 91(3).

¹⁵² Submission from Synergy, 30 April 2010, page 4.

¹⁵³ Submission from the Domgas Alliance, 30 April 2010, page 3.

Nevertheless, to address any minimal risk of detriment, those NWS venture participants with a rival project in WA are currently implementing appropriate ring fencing arrangements based on those referred to in the Gorgon [authorisation] determination... These arrangements involve a clear system of governing access to and dissemination of commercially sensitive information obtained for the purposes of the Project.

The NWS venture participants submit that these arrangements adequately address the minimal potential for detriment to arise from the internal transfer of commercially sensitive information to a rival project.¹⁵⁴

5.296. Following the release of the draft determination and the ACCC's proposal to impose a set of ring fencing conditions on the Applicants, the Domgas Alliance provided a submission that broadly considers that the ACCC should not place weight on the proposed ring fencing arrangements. The Domgas Alliance submits that the joint marketing body for the Applicants, North West Shelf Gas, has no authority to enter into contracts on behalf of the partners. Decisions on the supply of gas and the respective terms and conditions are made individually by the project partners. As a consequence, the Domgas Alliance is of the view that ring fencing would 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.¹⁵⁵

5.297. The Domgas Alliance submits that the WA domgas market is controlled by a small producer club with the power to increase prices and withhold supply. In addition, the same producers control the bulk of new gas developments. Consequently, the Domgas Alliance argues that competition can only be achieved through separate marketing and not ring fencing.

ACCC's view

5.298. The ACCC in the draft determination recognised the potential for anti-competitive detriment to result from commercially sensitive information obtained by the Applicants possibly being passed to, or being used by, competing joint ventures through joint venture partners having ownership stakes in other joint ventures. This potential detriment is heightened where primary competition is between domgas joint ventures in Western Australia, many of which have members in common.

5.299. As noted previously in this assessment chapter, any agreements between competing domgas joint ventures that incorporated information flows would not be exempt under the Act. This conduct would be exposed to action by the ACCC or any affected party.

5.300. Nevertheless, the ACCC considers the incentives for compliance may be increased by the introduction of a level of transparency and independence to the oversight of the ring fencing arrangements.

5.301. The ACCC remains of the view that the ring fencing arrangements that were proposed in the draft determination are likely to provide an increased level of transparency and independence to the ring fencing protocol submitted by the Applicants.

¹⁵⁴ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 44.
¹⁵⁵ Submission from the Domgas Alliance, 27 July 2010, page 5.

- 5.302. Consequently, to ensure that the potential anti-competitive detriment resulting from the NWS Project's joint marketing activities is minimised, and therefore, that the public benefits generated by the arrangements outweigh the likely anticompetitive detriment, the ACCC is imposing a condition upon the Applicants to adhere to the Ring Fencing Protocol provided at Attachment 6 to the current applications for authorisation and to the following:
- A review by an ACCC approved independent compliance auditor (the Auditor), of the operation of, and the Applicants' compliance with, the Ring Fencing Protocol, to be completed by 10 October, or if the Applicants request, a later date agreed to by the ACCC in writing, annually until the conclusion of the term of authorisation. Within 30 business days of receiving the Auditor's report on the review, the Applicants must provide the full report to the ACCC, along with a separate summary, which to the ACCC's satisfaction accurately reflects the Auditor's full report, in a form that can be placed on the public register.
 - The Applicants implement all of the Auditor's recommendations arising out of each compliance audit within 45 business days of the audit concluding, to the satisfaction of the ACCC on advice from the Auditor.
 - Each Applicant must report any non-compliance with the Ring Fencing Protocol to the ACCC within one week of the Applicant becoming aware of it.

Supply conditions

Interested party submissions

- 5.303. As previously mentioned, a number of interested parties also submit that should the ACCC decide to grant authorisation to the NWS Project joint marketing arrangements, it should impose conditions of authorisation aimed at securing future domgas supply from the NWS Project.
- 5.304. In particular, Alcoa submits that the ACCC should consider imposing the following conditions of authorisation on the Applicants:
- a commitment to supply the domestic market at current levels
 - flexibility to increase or decrease supply commitment as the resource declines/increases and LNG production reduces/increases
 - an annual review process by the NWSG would have to demonstrate to the ACCC that they are doing everything practicable to market the natural gas.¹⁵⁶
- 5.305. Given the views of the Applicants, particularly their acknowledgment that domgas supplies are determined by, among other things, the terms of potential domgas sales and the value of alternative uses for the gas, Alcoa further submits that its proposed conditions will ensure that the Applicants maintain domgas supplies at existing levels for the term of the NWS Project.¹⁵⁷

¹⁵⁶ Submission from Alcoa, 30 April 2010, page 8.

¹⁵⁷ Submission from Alcoa, 2 July 2010, pages 3 and 5.

5.306. Specifically, Alcoa submits:

Without the imposed conditions, there is no obligation on the NWS venture participants to do so after 2014 and they have indicated that based on commercial considerations, they would not [supply domgas]. The public detriment of any reduction in Domgas supplies from the NWS Project is obvious.¹⁵⁸

5.307. Similarly, the Domgas Alliance suggests that any authorisation granted by the ACCC should be conditional upon the Applicants:

- meeting their original commitment in 1998 to increase domestic supply to 1100 TJ/day or
- maintaining existing levels of domestic gas supply for the life of the Project or for the duration of any authorisation period.¹⁵⁹

5.308. However, the Domgas Alliance also notes that the NWS State Agreement ‘provides a powerful mechanism for the State Government to ensure continuing and additional domestic gas supply as necessary.’¹⁶⁰ The alliance also considers that under the NWS State Agreement the Western Australian Government ‘has the power to ensure that availability of domestic gas takes precedence over any additional contracting or export of LNG from 2010 to 2025.’¹⁶¹

5.309. Synergy is of the view that in order to prevent resource restrictions, the timing of domgas sales should be made to coincide with LNG sales, and the Applicants should be required to maintain domgas supply to sufficiently cover all contracts through to their end dates.¹⁶²

5.310. The Domgas Alliance in its submission following the draft determination reiterates that conditions on the continued supply of domgas from the NWS should be imposed. In particular, the Domgas Alliance submits:

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.¹⁶³

Applicants’ submission

5.311. The Applicants submit that the conditions proposed by certain interested parties are complex and unworkable. In this regard, the Applicants highlight that the amount of domgas the NWS Project supplies to the Western Australian market will necessarily depend on investment decisions and the following factors:

- proving of gas reserves
- the terms of potential domgas sales
- the values of alternative uses for the gas

¹⁵⁸ Ibid, pages 3 and 4.

¹⁵⁹ Submission from the Domgas Alliance, 30 April 2010, page 1.

¹⁶⁰ Ibid, page 33.

¹⁶¹ Ibid, page 34.

¹⁶² Submission from Synergy, 30 April 2010, page 4.

¹⁶³ Submission from the Domgas Alliance, 27 July 2010, page 7.

- the increasing costs of producing from diminishing fields (involving investment in compression facilities and additional infrastructure to develop smaller fields) and
- assessment of regulatory options and regulatory risk.¹⁶⁴

5.312. Further, the Applicants submit that:

...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.¹⁶⁵

5.313. Regarding the Domgas Alliance's submission that the NWS Project should be required to meet its 1998 commitment to increase domestic supply to 1100 TJ/day, the Applicants advise that, due to the maturity of the project, they have no plans to expand domgas plant capacity to 1100 TJ/day. By way of further background on this issue, the Applicants outline that:

...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 GSA's totalling more than 500 TJ/day and Heads of Agreement for similar quantities with prospective buyers did not eventuate...the possible expansion was not a condition of the 1998 ACCC authorisation...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.¹⁶⁶

5.314. Finally, the Applicants highlight that they have always met, and will continue to meet, relevant legislative requirements to service the Western Australian domgas market, as set out in the NWS State Agreement. The Applicants also submit that 'the NWS venture participants are also continuing to service domestic buyers by marketing new volumes of domgas.'¹⁶⁷

ACCC's view

5.315. The ACCC considers that requiring the Applicants to supply at a certain level or setting an overall volume of supply from the NWS Project would be economically inefficient and potentially result in unintended negative market outcomes. Market interactions that determine production volumes involve a complex series of interactions that includes the level of demand, availability and forecast of reserves, technical ability to extract the volumes, costs of supply and infrastructure constraints such as pipeline capacity.

¹⁶⁴ Submission from the Applicants, 27 May 2010, page 4.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid, pages 4 and 5.

¹⁶⁷ Ibid, page 5.

- 5.316. Therefore, the ACCC is concerned that were it to require a certain level of production by the Applicants that was inconsistent with market drivers, it would result in outcomes that were not in the interest of customers or producers. For example, setting a level of supply that ended up requiring additional expense to extract domgas from reserves or additional investment in infrastructure may increase the cost of supply and as a consequence increase the price that producers are willing to sell the gas for - but there would be no guarantee that customers would be willing to demand this additional gas at a higher price.
- 5.317. Consequently, the ACCC remains of the view as expressed in the draft determination that decisions regarding optimal supply volumes from the NWS Project are most efficiently left to market forces to determine, rather than by regulatory intervention.
- 5.318. As such, the ACCC does not propose to impose conditions of authorisation which require the Applicants to supply a certain volume of domgas in Western Australia. Further, the ACCC is of the view that imposing domestic supply obligations on the Applicants (with associated necessary investment) would be outside the scope of the authorisation process under the Act.
- 5.319. In any event, the ACCC considers that the Western Australian Government has the ability to exert significant influence over domestic supply volumes. For instance, the NWS State Agreement provides that:

The Joint Venturers shall keep the Minister informed of their intended arrangements for the utilisation of natural gas processed through the onshore facilities during the years 2010 through 2025 and before entering into any arrangements for the sale, use, supply or export of such natural gas during those years the Joint Venturers and the Minister shall consult and reach agreement on the requirements in the State and the manner in which they will be met during those years having regard to requirements for natural gas which the Joint Venturers could make available on arms length commercial terms.¹⁶⁸

Length of authorisation

- 5.320. The Act allows the ACCC to grant authorisation for a limited period of time.¹⁶⁹ The ACCC does not generally grant authorisation for unlimited periods because, in granting authorisation, the ACCC needs to be satisfied that the public benefit test would be met for the period of the authorisation.
- 5.321. In this instance, the Applicants seek authorisation to jointly market and enter into domgas contracts until the end of 2016 (or at least until the end of 2015, in line with the ACCC's Gorgon Determination) to provide regulatory certainty to allow them to underwrite investment decisions to maintain capacity and deliverability for the production of domgas to be marketed by the Incremental JV participants.¹⁷⁰

¹⁶⁸ Clause 16 of Schedule 2 to the *North West Gas Development (Woodside) Agreement Act 1979* (WA), amending clause 46 of the Principle Agreement.

¹⁶⁹ Section 91(1).

¹⁷⁰ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 46.

- 5.322. In support of their request, the Applicants submit that they are unable to identify any indicators that the domgas market will develop sufficiently prior to the end of 2016 so as to support separate marketing. The Applicants also contend that even if new sources of gas become available in 2015, this is highly unlikely to immediately bring about the significant structural changes that would require a review of any ACCC authorisation of joint marketing.¹⁷¹
- 5.323. Therefore, the Applicants submit that granting authorisation to the joint marketing arrangements until the end of 2016:
- will ensure public benefits of continued joint marketing are achieved over a reasonable period; and
 - entails virtually no risk of the balance of public benefit/detriment materially changing in the intervening period.¹⁷²
- 5.324. Regarding the duration of the proposed joint marketing activities, Senator Eggleston submits:
- ...the proposed North West Shelf authorisations would allow joint marketing to continue until 2016, at which time the ACCC can again review any relevant market developments in Western Australia.¹⁷³
- 5.325. Following the release of the draft determination, Rio Tinto provided a submission in which it considered that the duration that was proposed in the draft until 31 December 2015 was too long. Rio Tinto was of the view that a more appropriate length would be until 31 December 2013.

ACCC's view

- 5.326. As previously recognised by the ACCC, the Western Australian domgas market has not significantly developed over the past decade to enable commercially viable separate marketing of large gas volumes. However, the ACCC also concluded that this does not necessarily indicate that the Western Australian domgas market will not develop sufficiently in the medium term.
- 5.327. In its recent Gorgon Determination, the ACCC concluded that it is possible that the Western Australian domgas market may mature in the medium term to the point that separate marketing may become commercially viable. In particular, the ACCC considered that the prospective entry of new sources of supply may encourage a trend towards shorter term contracts, development of secondary trading and a greater incentive to develop storage options. If this were to occur, the ACCC is of the view that joint marketing is unlikely to remain in the overall public interest.

¹⁷¹ The supporting submission to applications for authorisation A91220–A91223, 31 March 2010, page 46.
¹⁷² Ibid.
¹⁷³ Submission from Senator Eggleston (WA), 4 May 2010, page 1.

- 5.328. In this regard, the ACCC's Gorgon Determination also noted the recommendations within the GSEMC's Report to the Western Australian Government of October 2009, which demonstrated a further potential for the Western Australian domgas market to develop in the medium term. This report recommended an increase in gas storage to enable withdrawal rates of between 35 TJ/day and consideration of a short term trading marketing to facilitate the trading of gas contracts.
- 5.329. In the current applications for authorisation, the Applicants note that the GSEMC's recommendations regarding the possible development of a Gas Bulletin Board (GBB) and a short term trading market are yet to be implemented and there are no firm timelines for their implementation. The Applicants advise that in December 2009, the Western Australian government commenced a public consultation process, including on the Gas Supply and Emergency Management Committee's recommendations, with public consultation not due to close until June 2010.¹⁷⁴
- 5.330. The ACCC is advised that the Western Australian government is currently exploring the establishment of a GBB by the end of 2010.¹⁷⁵
- 5.331. On their own, the Applicants do not consider that the establishment of a GBB or short term trading market in Western Australia will have a material impact on the structure and operation of the domgas market:
- ...given the underlying lumpiness of domgas demand and market development.¹⁷⁶
- 5.332. With further regard to the development of the Western Australian domgas market, the ACCC has previously recognised that a number of projects are expected to, or may, commence production prior to 2015 or shortly after. These projects include: the Gorgon Project; Reindeer; Macedon; Pluto and Wheatstone. The ACCC therefore concluded in its Gorgon Determination, that the introduction of these projects in the Western Australian market may encourage the development of market characteristics that could enable separate marketing – such as shorter term contracts, increased storage and secondary trading.
- 5.333. Therefore, for the reasons outlined above, the ACCC granted authorisation to the Gorgon domgas joint marketing arrangements until 31 December 2015.
- 5.334. Given the short period of time that has elapsed since the ACCC's Gorgon Determination, the ACCC considers that a proposed period of authorisation of 31 December 2015 continues to be appropriate in the context of the current applications for authorisation concerning the NWS Project. That is, the ACCC is not satisfied that a longer period of authorisation (beyond 2015) is in the public interest, particularly due to the possible commencement of a number of new domgas projects in Western Australia in the coming five years.

¹⁷⁴ Submission from the Applicants, 27 May 2010, page 7.

¹⁷⁵ Record of meeting with representatives from WA Department of State Development, Department of Mines and Petroleum and the Office of Energy, 1 June 2010.

¹⁷⁶ Ibid.

- 5.335. In particular, the ACCC's views the expected commencement of new domgas supplies in Western Australia as an opportunity for the market to develop. This makes 2015 a sensible time to review whether it is commercially viable for domgas in Western Australia to be separately marketed.
- 5.336. Further, the ACCC is satisfied that this proposed period of authorisation, combined with the forecast demand from Western Australian domgas customers, should provide sufficient certainty to the NWS Applicants to allow them to underwrite investment decisions to maintain capacity and deliverability for the production of domgas to be marketed by the Incremental JV.
- 5.337. Therefore, the ACCC grants authorisation to the NWS Applicants to jointly market domgas from the NWS Project and enter into gas supply agreements until 31 December 2015.

Giving effect to contracts

- 5.338. The Applicants are seeking authorisation to give effect to:
- existing domgas contracts for the full term of those contracts (including any extensions) and
 - 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 the first delivery of gas under that contract.

Submissions prior to the draft determination

- 5.339. With regard to giving effect to new contracts entered into during the period of any authorisation, the Applicants submitted that, as noted in the Gorgon Determination, domgas customers in Western Australia have recently expressed interest in contracts for up to 25 years.
- 5.340. Having said this, the Applicants noted that while they seek authorisation to give effect to new gas supply agreements for 25 years, this does not imply that all, or even most, future gas supply agreements will necessarily have 25 year terms. In particular, the Applicants submitted that the term of any new contracts will depend on the following factors:
- ...committable reserves, investment decisions, market conditions and the requirements of the particular buyer.¹⁷⁷
- 5.341. Further, the Applicants advised that they seek authorisation to give effect to new gas sales agreements for up to 25 years in order to provide certainty, rather than being required to seek re-authorisation from the ACCC should these circumstances arise.

¹⁷⁷ Submission from the Applicants, 27 May 2010, page 2 (footnote 1).

- 5.342. Regarding giving effect to new contracts, Alcoa was encouraged that the Applicants are seeking authorisation for contracts with 25 year terms. In particular, Alcoa submitted that this suggests:

...contracts being negotiated today will supply natural gas into the Western Australian market until at least 2035. This seems consistent with recent public presentations provided by Woodside which show that the addition of North Rankin B will extend the North West Shelf field life to 2040.¹⁷⁸

Draft determination

- 5.343. In the draft determination, the ACCC proposed that with regard to NWS Project domgas contracts which existed at the time the current applications for authorisation were lodged, authorisation would extend to give effect to those contracts for their full term, including any extensions.
- 5.344. With regard to giving effect to new domgas contracts, the ACCC proposed to extend authorisation to the Applicants to give effect to any new domgas contracts entered into during the period of authorisation for a period not exceeding 5 years from the date of first delivery of gas under that contract.
- 5.345. The ACCC noted that in the Gorgon Gas Project authorisation it had extended authorisation to giving effect to contracts entered into during the period of authorisation for a period of twenty five years. This duration was informed by the interest of both the Gorgon producers and customers in signing contracts of up to this length.
- 5.346. With respect to the North West Shelf, however, the ACCC noted that there appeared to be some uncertainty about the duration of contracts that customers may seek to negotiate and the Applicants' ability or willingness to sign contracts with 25 year terms. For example, the Applicants advised that future gas supply agreements will not necessarily have 25 year terms.
- 5.347. The ACCC additionally noted that the Applicants submitted that there is limited scope for adding incremental reserves through exploration, and as such, any future discoveries within the NWS Project area are expected to be relatively minor.
- 5.348. The ACCC recognised that it is difficult to determine the appropriate period to authorise giving effect to new contracts. In particular, the balance between the potential for the market to develop by 2015 and the desire to enable customers and producers to enter into contracts of sufficient duration to underwrite investment and provide the appropriate level of certainty. As a consequence, in the draft determination the ACCC sought further information from the Applicants and interested parties in relation to the appropriate duration of authorisation to give effect to new domgas contracts from the NWS Project.

¹⁷⁸

Submission from Alcoa, 30 April 2010, page 2.

Submissions post the draft determination

- 5.349. Rio Tinto considers that the duration restrictions proposed in the draft determination may have negative consequences on the market. In particular, Rio Tinto submits:

It is RTIO's (Rio Tinto Iron Ore) view that there should be no cap on the length of new domgas contracts. The seller and the buyer should have the full flexibility to negotiate contract length, with the open knowledge that there will be new Greenfield projects commencing, as well as an ACCC review of the joint marketing arrangements, later in the decade;¹⁷⁹

- 5.350. The Applicants broadly considered that the proposed five years duration for giving effect to new contracts is insufficient to support industry development and does not reflect the actual demand for longer term contracts from WA domgas customers. The Applicants argue that a period of at least 15 years is necessary to ensure competition between the NWS Project and other WA projects.
- 5.351. The Applicants elaborate that domgas customers in WA continue to seek gas supply contracts for a duration greater than five years. The Applicants state that they have recently received expressions of interest for contracts of between six and 20 years duration as customers seek the supply security that comes with long term contracts.
- 5.352. The Applicants note that downstream customers are required to enter into gas transportation contracts of a minimum duration of 15 years with the DBNGP in order to secure a commitment for an expansion of pipeline capacity. The Applicants argue that a customer would not ordinarily sign a transportation contract without a similar 'back to back' gas supply agreement.
- 5.353. The Applicants submit that limiting the ability to enter into contracts for terms greater than five years will impair the ability of the NWS Project to effectively compete with rival projects. The Applicants consider that this will have a negative impact on competition in the WA market as it will effectively remove the NWS Project as a potential source of supply for longer term contracts.
- 5.354. The Applicants reiterate that the NWS Project is mature and the focus of the joint venture partners is resource recovery, not expansion. Nonetheless, they are of the view that investment in smaller fields and infrastructure could enable the NWS Project to continue offshore production well beyond 2020. As such, the Applicants argue that there is clear potential for them to sign contracts of a term longer than five years during the proposed period of authorisation.
- 5.355. Finally, the Applicants submit that it is not clear from the draft determination whether the proposed authorisation to give effect to existing contracts including any extensions extends to the Incremental JV giving effect to contracts assigned from the Domestic JV.

¹⁷⁹ Submission from Riot Tinto, 6 August 2010.

ACCC's view

- 5.356. As noted previously in this assessment chapter, the ACCC recognises that there exists significant demand from domgas customers in WA for long term contracts. As noted by the Applicants, domgas customers often attempt to match their respective energy contracts with an investment pay back period or the term of finance. Additionally, domgas customers appear to prefer the certainty that comes from long term contracts and in some circumstances require domgas supply contracts to match the length of transportation contracts with the DBNGP.
- 5.357. The ACCC is satisfied, based on the additional information provided by the Applicants, that the NWS Project will potentially have the ability to sign contracts of a duration longer than five years. Additionally, investment in greater resource recovery and deliverability from the NWS Project fields may enable the Applicants to sign contracts during the period of authorisation that extend to 2020 or further.
- 5.358. The ACCC accepts that in some cases a restriction on the ability of the Applicants to sign long term contracts, when they have the resource and technical capacity to do so, may limit their ability to effectively compete with other domgas producing projects. However, the ACCC notes that authorisation does not preclude the Applicants from signing contracts of a duration longer than that covered by the authorisation. Nonetheless, the ACCC recognises that the Applicants may be unwilling to do this and as a consequence may be placed at a competitive disadvantage in competing for customers against projects that do not have such a restriction.
- 5.359. As noted in the draft determination, the ACCC does not want to prevent domgas producers and customers from signing contracts of a length that aligns with their individual circumstances and investment decisions. In this respect, the ACCC notes the submissions from Alcoa and Rio Tinto that indicate that contract length should be based on the preferences of the producers and customers.
- 5.360. The ACCC considers that the 15 year term, proposed by the Applicants, for giving effect to contracts entered into during the period authorisation, is appropriate. In particular, it recognises the potential technical ability of the Applicants to sign contracts of this length, the demand for long term contracts and the need of some customers to sign transportation contracts of this duration with the DBNGP.
- 5.361. For the sake of clarity, the ACCC confirms that authorisation extends to give effect to existing contracts entered into by Domestic Gas Joint Venture that have been assigned to the Incremental Pipeline Gas Joint Venture for their full term, including any extensions.

6. Determination

The applications

- 6.1. On 31 March 2010 the North West Shelf (NWS) venture participants lodged applications for authorisation A91220–A91223 with the Australian Competition and Consumer Commission (the ACCC).
- 6.2. The NWS venture participants are: BHP Billiton Petroleum (North West Shelf) Pty Ltd; BP Developments Australia Pty Ltd; Chevron Australia Pty Ltd; Japan Australia LNG (MIMI) Pty Ltd; Shell Development (Australia) Pty Ltd; and Woodside Energy Ltd (the Applicants).
- 6.3. Applications A91220 and A91222 were made using Form A, Schedule 1 of the Trade Practices Regulations 1974. The applications were made under subsections 88(1) and 88(1A) of the *Trade Practices Act 1974* (the Act) to:
- make and give effect to a contract, arrangement or understanding, a provision of which is or may be an exclusionary provision within the meaning of section 45 of the Act and
 - make and give effect to a provision of a contact, arrangement or understanding, a provision of which is, or may be, a cartel provision and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.
- 6.4. Applications A91221 and A91223 were made using Form B, Schedule 1 of the Trade Practices Regulations 1974. The applications were made under subsections 88(1) and 88(1A) to:
- make and give effect to a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act and
 - make and give effect to a contract or arrangement, or arrive at an understanding a provision of which would be, or might be, a cartel provision (other than a provision which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act).
- 6.5. In particular, the Applicants seek authorisation to:
- jointly discuss and negotiate common terms and conditions (including price) and the methods by which domestic gas (domgas) produced from the NWS Project will be offered for sale by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture
 - enter into contracts, arrangements or understandings between the NWS venture participants containing common terms and conditions (including price) upon which domgas produced from the NWS Project will be offered for sale and sold by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture and

- give effect to existing and new contracts, arrangements or understandings for the sale of domgas by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture.

The net public benefit test

- 6.6. For the reasons outlined in Chapter 5 of this determination, and subject to the conditions below, the ACCC considers that in all the circumstances the conduct for which authorisation is sought is likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the conduct.
- 6.7. The ACCC is also satisfied that the conduct for which authorisation is sought is likely to result in such a benefit to the public that the conduct should be allowed to take place.
- 6.8. The ACCC grants authorisation **conditional upon** the Applicants adhering to the Ring Fencing Protocol provided at Attachment 6 to the current applications for authorisation (A91220–A91223) and to the following:
- A review by an ACCC approved independent compliance auditor (the Auditor), of the operation of, and the Applicants' compliance with, the Ring Fencing Protocol, to be completed by 10 October, or if the Applicants request, a later date agreed to by the ACCC in writing, annually until the conclusion of the term of authorisation. Within 30 business days of receiving the Auditor's report on the review, the Applicants must provide the full report to the ACCC, along with a separate summary, which to the ACCC's satisfaction accurately reflects the Auditor's full report, in a form that can be placed on the public register.
 - The Applicants implement all of the Auditor's recommendations arising out of each compliance audit within 45 business days of the audit concluding, to the satisfaction of the ACCC on advice from the Auditor.
 - Each Applicant must report any non-compliance with the Ring Fencing Protocol to the ACCC within one week of the Applicant becoming aware of it.

Conduct for which the ACCC grants authorisation

- 6.9. The ACCC grants authorisation to the Applicants to:
- **jointly discuss and negotiate common terms and conditions** (including price) and the methods by which domestic gas (domgas) produced from the NWS Project will be offered for sale by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture and
 - **enter into contracts, arrangements or understandings** between the NWS venture participants containing common terms and conditions (including price) upon which domgas produced from the NWS Project will be offered for sale and sold by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture,

until 31 December 2015.

6.10. The ACCC grants authorisation to the Applicants to **give effect** to:

- **existing contracts**, arrangements or understandings for the sale of domgas by the participants of the Domestic Gas Joint Venture, or the Incremental Pipeline Gas Joint Venture and
- **existing contracts**, arrangements or understandings for the sale of domgas by the participants of the Domestic Gas Joint Venture that have been assigned to the Incremental Pipeline Gas Joint Venture,

for their full term, including any extensions.

6.11. The ACCC grants authorisation to the Applicants to **give effect** to:

- **new contracts** entered into during the term of the authorisation for the sale of domgas by the participants of the Domestic Gas Joint Venture or the Incremental Pipeline Gas Joint Venture,

for a period not exceeding 15 years from the date of first delivery of gas under that contract.

6.12. This determination is made on 8 September 2010.

6.13. The attachments to this document are part of the determination.

Date authorisation comes into effect

6.14. This determination is made on 8 September 2010. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 30 September 2010.

Attachment A — the authorisation process

The Australian Competition and Consumer Commission (the ACCC) is the independent Australian Government agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.

The Act, however, allows the ACCC to grant immunity from legal action in certain circumstances for conduct that might otherwise raise concerns under the competition provisions of the Act. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an ‘authorisation’.

The ACCC may ‘authorise’ businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.

The ACCC conducts a public consultation process when it receives an application for authorisation. The ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.

After considering submissions, the ACCC issues a draft determination proposing to either grant the application or deny the application.

Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides all parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite the applicant and interested parties to lodge written submissions commenting on the draft.

The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a final determination. Should the public benefit outweigh the public detriment, the ACCC may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the benefit to the public or reduce the public detriment.

Attachment B — chronology of ACCC assessment of the applications

The following table provides a chronology of significant dates in the consideration of applications for authorisation A91220–A91223.

DATE	ACTION
31 March 2010	Applications for authorisation lodged with the ACCC.
30 April 2010	Closing date for submissions from interested parties in relation to the substantive application for authorisation.
27 May 2010	Submission received from the Applicants in response to interested party submissions.
Week commencing 31 May 2010	ACCC conducted a series of meetings in Perth with the Applicants and interested parties.
8 July 2010	Draft determination issued.
23 July 2010	Closing date for interested parties to call a pre-decision conference.
30 July 2010	Closing date for submissions from interested parties in relation to the draft determination.
8 September 2010	Final determination.

Attachment C — the tests for authorisation and other relevant provisions of the Act

Trade Practices Act 1974

Section 90—Determination of applications for authorisations

- (1) The Commission shall, in respect of an application for an authorization:
 - (a) make a determination in writing granting such authorization as it considers appropriate; or
 - (b) make a determination in writing dismissing the application.
- (2) The Commission shall take into account any submissions in relation to the application made to it by the applicant, by the Commonwealth, by a State or by any other person.

Note: Alternatively, the Commission may rely on consultations undertaken by the AEMC: see section 90B.
- (4) The Commission shall state in writing its reasons for a determination made by it.
- (5) Before making a determination in respect of an application for an authorization the Commission shall comply with the requirements of section 90A.

Note: Alternatively, the Commission may rely on consultations undertaken by the AEMC: see section 90B.
- (5A) The Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a proposed contract, arrangement or understanding that would be, or might be, a cartel provision, unless the Commission is satisfied in all the circumstances:
 - (a) that the provision would result, or be likely to result, in a benefit to the public; and
 - (b) that the benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:
 - (i) the proposed contract or arrangement were made, or the proposed understanding were arrived at; and
 - (ii) the provision were given effect to.
- (5B) The Commission must not make a determination granting an authorisation under subsection 88(1A) in respect of a provision of a contract, arrangement or understanding that is or may be a cartel provision, unless the Commission is satisfied in all the circumstances:
 - (a) that the provision has resulted, or is likely to result, in a benefit to the public; and
 - (b) that the benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision.
- (6) The Commission shall not make a determination granting an authorization under subsection 88(1), (5) or (8) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a proposed contract, arrangement or understanding, in respect of a proposed covenant, or in respect of proposed conduct (other than conduct to which subsection 47(6) or (7) applies), unless it is satisfied in all the circumstances that the provision of the proposed contract, arrangement or understanding, the proposed covenant, or the proposed conduct, as the case may be, would result, or be likely to result, in a benefit to

the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if:

- (a) the proposed contract or arrangement were made, or the proposed understanding were arrived at, and the provision concerned were given effect to;
- (b) the proposed covenant were given, and were complied with; or
- (c) the proposed conduct were engaged in;

as the case may be.

(7) The Commission shall not make a determination granting an authorization under subsection 88(1) or (5) in respect of a provision (not being a provision that is or may be an exclusionary provision) of a contract, arrangement or understanding or, in respect of a covenant, unless it is satisfied in all the circumstances that the provision of the contract, arrangement or understanding, or the covenant, as the case may be, has resulted, or is likely to result, in a benefit to the public and that that benefit outweighs or would outweigh the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision or complying with the covenant.

(8) The Commission shall not:

- (a) make a determination granting:
 - (i) an authorization under subsection 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or
 - (ii) an authorization under subsection 88(7) or (7A) in respect of proposed conduct; or
 - (iii) an authorization under subsection 88(8) in respect of proposed conduct to which subsection 47(6) or (7) applies; or
 - (iv) an authorisation under subsection 88(8A) for proposed conduct to which section 48 applies;

unless it is satisfied in all the circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract or arrangement should be allowed to be made, the proposed understanding should be allowed to be arrived at, or the proposed conduct should be allowed to take place, as the case may be; or

- (b) make a determination granting an authorization under subsection 88(1) in respect of a provision of a contract, arrangement or understanding that is or may be an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding should be allowed to be given effect to.

(9) The Commission shall not make a determination granting an authorization under subsection 88(9) in respect of a proposed acquisition of shares in the capital of a body corporate or of assets of a person or in respect of the acquisition of a controlling interest in a body corporate within the meaning of section 50A unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

(9A) In determining what amounts to a benefit to the public for the purposes of subsection (9):

- (a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
 - (i) a significant increase in the real value of exports;

- (ii) a significant substitution of domestic products for imported goods; and
- (b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

Variation in the language of the tests

There is some variation in the language in the Act, particularly between the tests in sections 90(6) and 90(8).

The Australian Competition Tribunal (the Tribunal) has found that the tests are not precisely the same. The Tribunal has stated that the test under section 90(6) is limited to a consideration of those detriments arising from a lessening of competition but the test under section 90(8) is not so limited.¹⁸⁰

However, the Tribunal has previously stated that regarding the test under section 90(6):

[the] fact that the only public detriment to be taken into account is lessening of competition does not mean that other detriments are not to be weighed in the balance when a judgment is being made. Something relied upon as a benefit may have a beneficial, and also a detrimental, effect on society. Such detrimental effect as it has must be considered in order to determine the extent of its beneficial effect.¹⁸¹

Consequently, when applying either test, the ACCC can take most, if not all, public detriments likely to result from the relevant conduct into account either by looking at the detriment side of the equation or when assessing the extent of the benefits.

Given the similarity in wording between sections 90(6) and 90(7), the ACCC considers the approach described above in relation to section 90(6) is also applicable to section 90(7). Further, as the wording in sections 90(5A) and 90(5B) is similar, this approach will also be applied in the test for conduct that may be a cartel provision.

Conditions

The Act allows the ACCC to grant authorisation subject to conditions.¹⁸²

Future and other parties

Applications to make or give effect to contracts, arrangements or understandings that might substantially lessen competition or constitute exclusionary provisions may be expressed to extend to:

- persons who become party to the contract, arrangement or understanding at some time in the future¹⁸³

¹⁸⁰ *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004. This view was supported in *VFF Chicken Meat Growers' Boycott Authorisation* [2006] ACompT9 at paragraph 67.

¹⁸¹ *Re Association of Consulting Engineers, Australia* (1981) ATPR 40-2-2 at 42788. See also: *Media Council case* (1978) ATPR 40-058 at 17606; and *Application of Southern Cross Beverages Pty. Ltd., Cadbury Schweppes Pty Ltd and Amatil Ltd for review* (1981) ATPR 40-200 at 42,763, 42766.

¹⁸² Section 91(3).

- persons named in the authorisation as being a party or a proposed party to the contract, arrangement or understanding.¹⁸⁴

Six- month time limit

A six-month time limit applies to the ACCC’s consideration of new applications for authorisation¹⁸⁵. It does not apply to applications for revocation, revocation and substitution, or minor variation. The six-month period can be extended by up to a further six months in certain circumstances.

Minor variation

A person to whom an authorisation has been granted (or a person on their behalf) may apply to the ACCC for a minor variation to the authorisation.¹⁸⁶ The Act limits applications for minor variation to applications for:

... a single variation that does not involve a material change in the effect of the authorisation.¹⁸⁷

When assessing applications for minor variation, the ACCC must be satisfied that:

- the proposed variation satisfies the definition of a ‘minor variation’ and
- if the proposed variation is minor, the ACCC must assess whether it results in any reduction to the net benefit of the conduct.

Revocation; revocation and substitution

A person to whom an authorisation has been granted may request that the ACCC revoke the authorisation.¹⁸⁸ The ACCC may also review an authorisation with a view to revoking it in certain circumstances.¹⁸⁹

The holder of an authorisation may apply to the ACCC to revoke the authorisation and substitute a new authorisation in its place.¹⁹⁰ The ACCC may also review an authorisation with a view to revoking it and substituting a new authorisation in its place in certain circumstances.¹⁹¹

183 Section 88(10).
 184 Section 88(6).
 185 Section 90(10A)
 186 Subsection 91A(1)
 187 Subsection 87ZD(1).
 188 Subsection 91B(1)
 189 Subsection 91B(3)
 190 Subsection 91C(1)
 191 Subsection 91C(3)