Australian
Competition &
Consumer
Commission

Determination

Application by certain companies within
ExxonMobil Group, Oil Search Group, the
Mineral Resources Development Company
Limited Group, the Merlin Petroleum Company
and AGL Gas Developments (PNG) Ltd

for authorisation in respect of

the **PNG Gas Project**

3 May 2006

Authorisation No: A40081

Public Register No: C2000/1421

Commissioners

Samuel
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Abbreviations

ABARE	Australian Bureau of Agriculture & Resources Economics
ACCC	Australian Competition and Consumer Commission
Act	Trade Practices Act (1974)
APC	AGL-Petronas Consortium
ATPR	Australian Trade Practice Reporter
CCGT	Combined cycle gas turbine
CoAG	Council of Australian Governments
EUAA	Energy Users Association of Australia
ExxonMobil	ExxonMobil Group
GJ	Gigajoule, equal to one thousand million joules
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
Merlin	Merlin Petroleum Company
MRDC	Mineral Resources Development Company Limited Group
Oil Search	Oil Search Group
PDL	Petroleum development licence
PJ	Petajoule, equal to one million GJ
PNG	Papua New Guinea
PRL	Petroleum retention licence
QAL	Queensland Alumina Ltd
QCMA	Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd
QMGUG	Queensland Major Gas Users Group
Santos	Santos Group
TJ	Terajoule, equal to one thousand GJ
Tribunal	Australian Competition Tribunal
UIWG	Upstream Issues Working Group

Summary

On 14 December 2004 an application was made to the Australian Competition & Consumer Commission (ACCC) by joint venture participants in a proposed PNG Gas Project (the Project) for authorisation of the joint marketing of gas produced by the Project.

In summary, the Project will involve the development of petroleum fields by the applicants in the Southern Highlands of PNG, and the transportation and marketing of natural gas produced from those fields to Australian customers. The gas will be transported to Australia via a pipeline to be constructed from PNG to Queensland.

A consortium of AGL and Petronas is developing the Australian component of the gas transmission pipeline. A lateral extension of the pipeline to the Northern Territory is also proposed.

The original parties to the application were certain companies within the Exxon Mobil Group, Oil Search Group, the Mineral Resources Development Company Limited Group, and the Merlin Petroleum Company. In March 2006 the applicants amended their application to include AGL Gas Developments (PNG) Pty Limited.

Arrangements relating to the Project have been in motion since 1996. A number of changes to the Project, including changes in the interests of participants in the joint venture, have occurred since that time. Interim authorisations in relation to the Project have applied in various forms since 1998. This matter has not progressed beyond the interim authorisation stage until now. The application for authorisation submitted by the applicants on 14 December 2004 updated the previous applications.

Authorisation is a process whereby immunity is granted from court action by the ACCC or any other party for certain arrangements or conduct that might otherwise breach the *Trade Practices Act 1974* (the Act).

Specifically, the joint venture participants sought authorisation to:

- negotiate the common terms and conditions (including price) under which gas produced by the Project will be offered for sale
- jointly market that gas to a common buyer or common buyers
- enter into and give effect to contracts, arrangements and understandings between the participants relating to common terms and conditions (including price and price arbitrations/determinations) upon which gas will be offered for sale and sold by the participants to buyers.

The ACCC may grant authorisation only if it is satisfied that the public benefits arising from the joint marketing conduct outweigh any anti-competitive detriments.

The applicants requested that authorisation be granted for the life of the Project, which they estimated to be around 30 years. They also requested that the authorisation be expressly stated to apply to future participants in the Project.

The applicants contended that the Project will deliver substantial public benefits and have no effect or likely effect of lessening competition. Instead they asserted that the Project is 'overwhelmingly pro-competitive'.[1] According to the applicants, both the joint venture participants and their financiers require the legal certainty of authorisation before funds will be committed to the Project. The applicants stated that without authorisation they will not proceed with the Project within the foreseeable future.

Concerns were raised by interested parties that the Project may dominate the Queensland market and stifle growth in the coal seam methane industry and customers may have limited opportunity to negotiate a better price or find an alternative supplier. It was further suggested that under joint marketing terms and conditions may be imposed that would not be imposed under separate marketing and that dynamic efficiencies may be lost.

It was also suggested that commercially sensitive information, such as pricing, volume and delivery points, to which not all the Project participants would have access under separate marketing, might be inappropriately used by Project participants who have interests in other gas basins in Australia.

To address these concerns the applicants indicated that they will undertake joint marketing within the framework of ring-fencing and confidentiality arrangements to protect commercially sensitive information. The arrangements, which form part of the authorisation, are attached as Appendix 1.

The consensus in submissions from interested parties in response to the application was that joint marketing is required for the Project to proceed. However, some interested parties submitted that the authorisation should apply only to financial close.

On 16 January 2006 the ACCC released its Draft Determination proposing to authorise the joint marketing in Australia of gas from the Project. The ACCC proposed to grant authorisation for 16 years and to extend authorisation to future participants who met certain criteria.

A 'pre-decision conference' was held on 1 March 2006. In submissions in response to the conference and Draft Determination some interested parties supported the ACCC's position while others expressed concern at some aspects of the Draft Determination, notably the proposed duration of the authorisation.

The ACCC considers that substantial public benefits will arise as a result of the Project proceeding. While the Project is likely to enjoy a large share of the Queensland market, the ACCC considers that it is likely that coal seam methane, other sources of natural gas and alternative forms of energy will provide some competitive constraints on the Project.

The ACCC accepts that there is a net public benefit and has decided to grant authorisation to joint marketing undertaken within a framework of confidentiality and

[1] Applicants' submission, 14 December 2004, par 1.7.

ring-fencing arrangements. Joint marketing undertaken outside of these arrangements is not authorised.

The ACCC is not confident that a net public benefit would continue over such a long term as the life of the Project. Conversely, the ACCC does not accept the submissions that authorisation should cease at financial close. Accordingly, the ACCC has decided that authorisation will expire 16 years from the date of authorisation. The ACCC has further decided that authorisation will apply to future participants in the Project under certain circumstances.

The Determination has not changed from the Draft Determination. The ACCC was not persuaded by submissions in response to the Draft Determination that changes were warranted.

1. Introduction

On 14 December 2004 an application was made to the Australian Competition & Consumer Commission (ACCC) under the *Trade Practices Act 1974* (the Act) by joint venture participants in a proposed PNG Gas Project (the Project) for authorisation of the joint marketing of gas. In support of their application the applicants lodged a detailed submission including reports from ACIL Tasman, Frontier Economics and Lateral Economics.

A key objective of the Act is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.

The Act, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an 'authorisation'.

Broadly, the ACCC may 'authorise' businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.

The Act provides that the ACCC may grant authorisation subject to conditions. The Act also provides that authorisation may be expressed to apply to a party that becomes a party after a contract, arrangement or understanding is made, or becomes a party after an understanding is arrived at.

A necessary step in conducting this assessment of public benefits and anti-competitive detriments is analysis of the market within which the conduct will occur. Following this, the ACCC applies the 'future with-and-without' test, in which the state of the relevant market in the future is compared with and without the proposed conduct.

In response to concerns raised by interested parties regarding the applicants' proposal for the authorisation to extend to future participants, the applicants proposed to undertake joint marketing within the framework of ring-fencing and confidentiality arrangements.

This Determination outlines the ACCC's analysis and assessment of the application for authorisation of joint marketing of gas from the Project. The ACCC's discussion of the 'future with-and-without' test is contained in Chapter 7. The assessment of the public benefits is contained in Chapter 8, while the market definition and anti-competitive detriments are discussed in Chapter 9. Chapter 10 contains the ACCC's assessment of the balance between public benefits and detriments and the ACCC's Determination is set out in Chapter 11.

2. The application

Authorisation has been sought by the applicants under subs. 88(1) of the Act to make and give effect to contracts, arrangements or understandings, provisions of which would have or might have the effect of substantially lessening competition within the meaning of s. 45 of the Act.

2.1 The proposed conduct

The applicants applied for authorisation to:

- negotiate the common terms and conditions (including price) under which gas produced by the Project will be offered for sale
- jointly market that gas to a common buyer or common buyers
- enter into and give effect to contracts, arrangements and understandings between the participants relating to common terms and conditions (including price and price arbitrations/determinations) upon which gas will be offered for sale and sold by the participants to buyers.

The applicants have requested that authorisation be expressly stated to apply for the life of the Project, which is estimated by the applicants to be around 30 years. In addition, they proposed that authorisation cover future participants in the Project.

Following the release of the Draft Determination, the Energy Users Association of Australia (EUAA) queried whether the authorisation applied to wet or dry gas.[2] While the submission accompanying the original application suggested that it is dry gas that is being marketed to potential customers in Australia, in response to the EUAA's query the applicants clarified that authorisation is sought for any gas produced by the Project.[3]

2.2 Parties to the application

The original parties to the current application are the following companies within the Exxon Mobil Group (ExxonMobil), Oil Search Group (Oil Search), the Mineral Resources Development Company Limited group of companies (MRDC), and the Merlin Petroleum Company (Merlin):

- ExxonMobil – Esso Highlands Limited, Ampolex (Highlands) Limited, Ampolex (PNG Petroleum) Inc., and Merlin Pacific Oil Company Limited
- Oil Search – Oil Search Limited, Oil Search (Moran) Limited, Oil Search (Tumbudu) Limited, Oil Search (Kutubu) Limited, Oil Search (Gobe) Limited,

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[2] EUAA submission 15 March 2006, p. 20.

[3] Applicants' submission, 15 March 2006, p. 5.

Orogen (Exploration) Inc., Orogen Minerals (Gobe) Limited, Orogen Minerals (Kutubu) Limited and Oil Search (PNG) Limited[4]

- MRDC – Petroleum Resources Kutubu Limited and Petroleum Resources Gobe Limited[5]
- Merlin.[6]

The operator of the Project is Esso Highlands Limited (Esso).

On March 2006 the applicants notified the ACCC that they wished to amend their application to include AGL Gas Developments (PNG) Pty Limited. This followed AGL Gas Developments (PNG) Pty Limited acquiring a ten per cent interest in the Project on 17 February 2006.

On 3 May 2006, the applicants advised the ACCC of an amalgamation within the Oil Search Group of companies. This left three Oil Search companies as parties to the application for authorisation. Those companies are Oil Search Limited, Oil Search (Tumbudu) Limited and Oil Search (PNG) Limited.

It is likely that other parties, such as Santos and the State of PNG, who are not current parties to the application for authorisation, may join the Project at some stage.

2.3 Previous authorisation applications relating to the Project

On 24 June 1998 the original participants in the Project applied to the ACCC for interim authorisation. At that time they indicated that they expected to provide the ACCC with more detailed information to enable the ACCC to progress the matter to authorisation proper. Pursuant to subs. 91(2) of the Act, interim authorisation was granted on 5 August 1998.

Interim authorisation confers immunity from court action for certain types of market arrangements or conduct that may otherwise breach certain restrictive trade practices provisions of the Act, and applies for an interim period. This interim period is typically until such time as the determination in relation to an application for authorisation takes effect, or until interim authorisation is revoked.

In November 1999 modifications were sought by the applicants to the August 1998 interim authorisation. The modifications sought were generally administrative, with the exception of the request that the interim authorisation be extended to include companies within the Santos Group (Santos). On 3 December 1999 the ACCC revoked the August 1998 interim authorisation and substituted it with a new interim authorisation. The December 1999 interim authorisation granted the administrative

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4 Oil Search is incorporated in PNG and listed on the Australian and PNG stock exchanges.

5 MRDC is a 100 per cent PNG government owned company representing landowner interests.

6 Merlin is a subsidiary of Japanese Papua New Guinea Petroleum Company Limited (JPP). JPP is a related company of Nippon Oil Corporation.

modifications sought but did not extend the interim authorisation to cover Santos. Santos' involvement as a gas supplier in both the Project and the Cooper Basin was a source of concern for the ACCC at that time.

On 6 September 2000 a fresh application for authorisation was lodged which included Santos as a party. Interim authorisation was also sought and was granted on 13 October 2000 and extended to Santos. The ACCC's concern regarding Santos' involvement in both the Project and the Cooper Basin was addressed by granting interim authorisation subject to the parties entering into confidentiality deeds to protect commercially sensitive information.

The parties to the October 2000 interim authorisation consisted of the current applicants (except for AGL) in addition to the following parties:

- Chevron Overseas Petroleum Inc and subsidiaries (Chevron) - the original operator of the Project. Esso replaced Chevron as operator of the Project in June 2001, and Chevron announced its withdrawal from the Project in July 2003, selling its interests to Oil Search in October 2003
- Orogen Minerals Limited (merged with Oil Search in April 2002)
- PNG Gas Supplies Ltd
- Santos (withdrew from the Project on 31 December 2001).

In its media release of 2 January 2002 announcing its withdrawal from the Project, Santos cited as the reason for its withdrawal an inability to reach agreement with ExxonMobil on new commercial terms governing interaction between the participants to the joint venture.

The interim authorisation of October 2000 applies to joint marketing activities up to financial close[7] only, and is still current. The current application for authorisation amends the application of 6 September 2000. Following the entry of AGL Gas Developments (PNG) Pty Limited to the Project, on 2 March 2006 the applicants applied to the ACCC to vary the interim authorisation to include AGL Gas Developments (PNG) Pty Limited as a party to the interim authorisation. On 15 March 2006 the applicants were advised that the ACCC had varied the interim authorisation as applied for.

As the ACCC has now made its Determination on this matter, the October 2000 interim authorisation and the interim authorisation of 3 December 1999 are revoked.[8] The

7 Financial close is defined as the time at which key approvals and agreements required for the Project to proceed are obtained and reached. They include conditional gas sale agreements having been entered into, firm financing having been obtained and regulatory approvals necessary for the Project to proceed having been obtained.

8 While it appears that the December 1999 interim authorisation was replaced by the October 2000 interim authorisation, to avoid any doubt both authorisations are revoked.

timing of the revocation of these interim authorisations will coincide with the commencement date of the authorisation.

3. Public consultation process

3.1 The application for authorisation

The ACCC has a statutory obligation under s. 90 of the Act to undertake a public consultation process when assessing an application for authorisation and to take into account submissions received as part of that process before making a determination on the application. In making its Determination the ACCC consulted widely with interested parties and the members of the Australian Energy Regulator (AER).

Notice of the applicants' revised application for authorisation was sent to interested parties and posted on the ACCC's website on 23 December 2004. An information paper was prepared by the ACCC which highlighted the key information and issues arising from the applicants' submission. Parties were invited to comment on any issues arising from the information paper or any issues they considered relevant to the application by 15 February 2005.

In response to the application for authorisation the ACCC received nine submissions from interested parties. A supplementary submission from the applicants was received on 11 April 2005, in which issues raised by interested parties were addressed.

The main issues of concern raised in submissions was the length of the term of the authorisation proposed by the applicants (in the order of 30 years) and the proposed extension of the authorisation to cover all future participants.

3.2 The Draft Determination and pre-decision conference

On 16 January 2006 the ACCC released its Draft Determination proposing to authorise the joint marketing in Australia of gas from the PNG gas project. The ACCC proposed to grant authorisation for 16 years and to extend authorisation to future participants who met certain criteria.

In proposing a term of 16 years the ACCC relied in part on confidential material supplied by the applicants' financial advisers that the likely term of the project finance for a project of this nature is in the order of 15 years. The ACCC allowed an extra year for the Project to reach financial close.

The ACCC proposed that authorisation would be extended for the full term of contracts written within this period and which expired after the term of the authorisation (in other words these contracts would be 'grandfathered').

To address concerns with the proposal that the authorisation should be extended to all future participants in the joint venture the ACCC proposed to limit the authorisation to future participants who met certain criteria. Specifically the ACCC proposed that authorisation be extended to future participants who:

a. do not themselves, or though a related body corporate, have an economic interest in any other gas business (production, sales and/or transportation) in eastern Australia; or

b. if they do;

   i. have less than a 20 per cent interest in the Project; and

   ii. do not have the individual capacity, either directly or indirectly, to determine the outcome of decisions about the Project's financial, marketing and operating policies.

In all other cases the applicants would need to re-apply for authorisation if they wish to include any other future participants in the authorisation.

In addition the ACCC proposed to authorise joint marketing undertaken within the framework of ring-fencing and confidentiality arrangements. In other words authorisation would not cover joint marketing conducted outside of this framework.

The ACCC invited interested parties to request a conference in accordance with s. 90A of the Act by 30 January 2006, or to provide written submissions by 6 February 2006 in response to the Draft Determination.

On 27 January 2006 the EUAA requested that the ACCC hold a pre-decision conference. The conference was held on 1 March 2006 in Brisbane. The ACCC received ten submissions in response to the Draft Determination and the conference (including three from the applicants, two from the EUAA and a confidential submission from Santos). Cheetah Oil and Gas (PNG) Ltd, the AGL-Petronas Consortium, the PNG Government, NRG Flinders and Townsville Enterprise Ltd (either orally at the pre-decision conference or in subsequent written submissions) supported the ACCC's position. Santos supported the applicants' proposal. NRG Flinders submitted that the important issue for gas users is that the Project proceeds, not the manner by which gas is marketed. The EUAA, the Queensland Major Gas Users Group (QMGUG), Comalco and Energex expressed concern at some aspects of the Draft Determination, notably the proposed duration of the authorisation.

All relevant documents, including a record of the conference, have been placed on the ACCC's public register and are available on the ACCC's website.[9] A person dissatisfied with the Determination may apply to the Australian Competition Tribunal (Tribunal) for its review. The Tribunal must review the Determination if the person applying for review is either the applicant or the Tribunal is satisfied that the person has a sufficient interest in the matter (s. 101 of the Act).

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[9] www.accc.gov.au.

4. The statutory test

Application 40081 was made under subs. 88(1) of the Act to make and give effect to arrangements that might substantially lessen competition within the meaning of s. 45 of the Act.

In assessing the application, the relevant test is outlined in subss. 90(6) and 90(7) of the Act.

Subsections 90(6) and 90(7) of the Act provide that the ACCC may grant authorisation in respect of a contract, arrangement or understanding, or in respect of a proposed contract, arrangement or understanding that may have the purpose or effect of substantially lessening competition, if it is satisfied that:

- the contract, arrangement or understanding would be likely to result in a benefit to the public; and

- the benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding.

Subsection 88(10) of the Act provides that an authorisation may be expressed to apply to or in relation to another person who becomes a party to the proposed arrangements in the future. The applicants have sought authorisation to apply to any future participant to the proposed arrangements.

4.1 Application of the statutory test

The assessment of whether or not the ACCC may grant an authorisation involves:

- a consideration of the relevant market/s[10]

- comparison of the likely shape of the future both with and without the relevant conduct for which authorisation is being sought[11]

- an examination of the public benefits arising from the arrangements or conduct in question

- an examination of the detriment constituted by any lessening of competition arising from the arrangements or conduct in question

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10 Market definition assists in identifying public benefits and anti-competitive detriments. However, depending on the circumstances, the ACCC may not need to comprehensively define the relevant markets, as it may be apparent that a net public benefit will or will not arise regardless of this definition.

11 Re Tooth & Co Ltd and Tooheys Ltd (1979) ATPR 40-113 at 18, 186-187.

- a weighing of the public benefits against any anti-competitive detriments.

If the public benefits or expected public benefits outweigh the anti-competitive aspects, the ACCC may grant authorisation. Authorisation may be granted subject to conditions.

5. Background to the gas industry in eastern Australia

5.1 Overview

Historically, the gas industry in Australia consisted of state-based markets with legislative and regulatory barriers restricting trade between states. The supply chains in each market were highly integrated with monopolies operating at the production, distribution and retailing stages.

In the last decade legislative and regulatory barriers to free trade in gas have been removed. Transmission and distribution have been separated from the publicly-owned utilities and ring-fencing arrangements in the privately-owned retail utilities have been introduced. Public utility businesses have been corporatised.

While these reforms have generated benefits, the gas industry in Australia is characterised by a small number of producers, limited depth in consumption and long-term contracts limiting competition. This means that developing markets for natural gas in Australia continues to be a challenge.[12] As the Ministerial Council on Energy observed in December 2004:

> …while Australian wholesale gas market(s) are becoming more competitive, the structure of the industry and patterns of consumption suggest that many markets are likely to remain less than optimally competitive for an extended time.[13]

5.1.1 Upstream gas industry in eastern Australia

The majority of gas supplied to eastern Australia[14] is produced from only two basins, Cooper and Gippsland. In 2002 the Cooper Basin contributed 43.7 per cent to eastern Australia's production of gas, and the Gippsland Basin contributed 49.5 per cent.[15]

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12 Australian Bureau of Agricultural and Resource Economics, 'Australian Gas Markets moving towards maturity (eReport 03.23)', December 2003 (ABARE 2003), p. 7.

13 Ministerial Council on Energy, 'Statement on Principles for Gas Market Development', December 2004, p. 3.

14 In paragraph 5.53 of the applicants' submission it is claimed that Project gas will provide price competition in the entire eastern Australian region. The applicants have not indicated that Project gas will affect the prices of gas in Western Australia. This Determination therefore excludes analysis of the natural gas industry in Western Australia, and any reference to eastern Australia means all states and Territories except for Western Australia. This definition corresponds with that in the ACIL Tasman report submitted by the applicants.

15 Percentages calculated using data from GeoScience Australia (2002), Department of Industry Tourism and Resources (2000) and Woodlands, Wong and Bernecker (2002), as cited in Dickson and Noble 2003, p 135-145 and reproduced in Frontier Economics, *Implications of emerging patterns in energy markets for the PNG Joint Venture* (Annexure 3 to applicants' submission) (the Frontier Economics report), 18 November 2004, p. 26.

The Cooper Basin is the main supplier of gas to South Australia and New South Wales. The Gippsland Basin supplies 90 per cent of Victoria's natural gas, with the remainder being produced out of the Otway and Cooper Basins.

In Queensland, gas in the Cooper Basin is supplemented by gas from the Surat and Bowen Basins. Currently there is major movement to extract coal seam methane from the deeper parts of the Bowen Basin and supply it to the Brisbane market.

The source of natural gas supplies from major basins for eastern Australia in 2001 is shown in Table 1.

Table 1: Natural gas sources in eastern Australia in 2001

State/Territory	Basin	Location of basin	% of demand supplied by basin
New South Wales	Cooper	SA	85
	Gippsland	Victoria	15
Queensland	Surat/Bowen	QLD	40
	Cooper/Eromanga	QLD	40
	coal seam methane	QLD	20
Victoria	Gippsland	Victoria	90
	Otway	Victoria	7
South Australia	Cooper	SA	100
Northern Territory	Amadeus	NT	100

Source: ABARE, 'Australian gas supply and demand balance to 2019-20', 2002, reproduced in Frontier Economics, *Implications of emerging patterns in energy markets for the PNG Joint Venture*, 18 November 2004, table 3, p. 25.
Note: The table is based on 2001 data and does not include the impact of the recently constructed SEAGas pipeline.

Gas exploration and production requires significant investment. In Australia it has usually been carried out under joint venture arrangements. Table 2 illustrates the major participants in the joint ventures producing significant amounts of natural gas from eastern Australian basins.

Table 2: Joint venture natural gas production in eastern Australia

Basin	Major participants in production joint ventures
Cooper	Santos, Delhi Petroleum,[1] Origin Energy
Gippsland	Esso,[2] BHPB
Bowen/Surat	Santos, Origin Energy

Note: 1. ExxonMobil sold its interest in Delhi Petroleum on 31 March 2004 to Gradav Limited.
2. Esso is a subsidiary of ExxonMobil.

ABARE reported in December 2003 that BHP Billiton, ExxonMobil and Santos collectively controlled more than 95 per cent of gas reserves in eastern Australia with contractual commitments for consumption. The sale of ExxonMobil's affiliate, Delhi Petroleum, in March 2004, which held a 21 per cent interest in the Cooper Basin, means that present joint venture production is slightly less concentrated than this. ABARE noted that new contracts for the supply of gas will see five new firms supplying gas in eastern Australia. Despite the entry of these new firms, ABARE estimated that in 2010, BHP Billiton, ExxonMobil and Santos would still have 87 per cent of the eastern Australian markets.[16] When Origin is included, ABARE estimated that these four companies would account for in the order of 93 per cent of the market.

5.1.2 Upstream gas industry in Queensland

As noted above, the majority of Queensland's gas is sourced from the Cooper, Surat and Bowen Basins. Coal seam methane has emerged as a significant source of gas in Queensland. The coal seam methane industry in Queensland has developed from supplying around 2 PJ of Queensland's demand for gas in 1998, to 11 PJ in 2001, 25 PJ in 2002, and around 30 PJ of Queensland's total demand for gas of 100 PJ per annum in 2004.[17]

The regulated transmission pipelines (for third party access) in Queensland are:

- Wallumbilla (Roma) to Brisbane
- Ballera to Wallumbilla
- Wallumbilla to Gladstone via Rockhampton
- Ballera to Mt Isa

A number of transmission pipelines are not regulated. These are:

- Kinora to Wallumbilla
- Dawson Valley to Wallumbilla-Rockhampton pipeline
- Moura Mine to Wallumbilla-Rockhampton pipeline
- Gladstone to Bundaberg
- Morandah to Townsville

None of the Project participants have any ownership of the existing pipelines in Queensland. However, AGL has an interest in the Australian component of the proposed gas transmission pipeline from PNG.

The Map below shows the current pipelines in Queensland and a potential route of the PNG pipeline. The route of the PNG pipeline is indicative only and subject to change.

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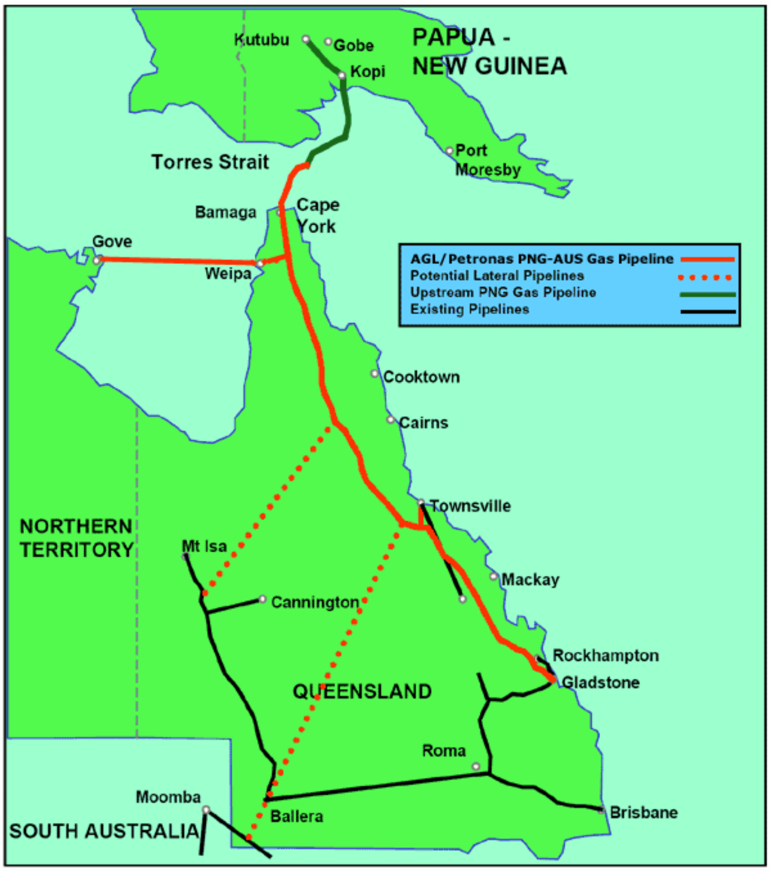
16 ABARE 2003 p. 33

17 PESA newsletter August/September 2004 Issue 71; John Mickel (Minister for Energy, Queensland), *13 per cent gas scheme driving billion dollar developments,* media release, The State of Queensland (Department of the Premier and Cabinet), 18 February 2005.



Source: http://www.agl.com.au/AGLNew/About+AGL/PNG+Gas+summary.htm, AGL Website viewed 24 March 2006.

6. The Project

In summary, the Project will involve the extraction of natural gas from the Southern Highlands of PNG, and the transportation and sale of large volumes of that natural gas to customers in eastern Australia. The applicants have stated that while the Project will produce a number of products gas is the only product which is intended to be jointly marketed and sold to customers in Australia.

6.1 Structure of the Project

The application indicated that the proposed Project will comprise the following five distinct operations:

- production of gas in PNG
- refinement of gas products in PNG
- transportation of dry gas through a pipeline from PNG to Queensland[18]
- marketing of the dry gas to customers in eastern Australia
- sale of the dry gas to customers in eastern Australia.

Buyers of Project gas will enter sales contracts with individual Project participants. The applicants seek authorisation to negotiate common terms for these contracts.

In their application the applicants stated that the total cost of the development, including the construction of the PNG upstream facilities and the Australian gas transmission pipeline, was estimated to be more than US$3 billion. At the pre-decision conference the applicants revised this figure to US$4 billion. Development of the Australian component of the gas transmission pipeline is being undertaken by a consortium of AGL and Petronas.

6.1.1 Project reserves

In their submission of 14 December 2004, the applicants stated that the petroleum reserves within the fields in PNG from which Project gas will be extracted are extremely large, and estimate that up to 200 PJ per annum could be supplied to eastern Australia. This volume is significant when compared to the consumption of natural gas in eastern Australia, estimated by ABARE as follows:

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18 Subsequent to the submission of the application, a conditional agreement with Alcan was negotiated for the supply of Project gas to Alcan's Northern Territory-based Gove project, which will require a lateral pipeline to Gove.

- 2004/05: 715 PJ
- 2009/10: 1070 PJ
- 2014/15: 1061 PJ
- 2019/20: 1197 PJ[19]

Gas will be sourced from the Hides field, parts of the Moran field, the Kutubu fields, the Gobe Main field and the Gobe 2X field.

The reserves are located within various development licences granted under PNG legislation. These licences are held by a number of joint ventures, in which the applicants to this authorisation have differing interests. The licence areas in which the Project will operate and the applicants' interests in each licence are detailed on p. 9 of the applicants' submission.

6.1.2 Applicants' interests in the Project

The participating interests of the applicants in the Project at the time that the applicants lodged their application are shown in Table 3.

Table 3: Participating interests in the Project

Company	Participating Interest (%)
ExxonMobil	39.434
Oil Search	54.151
Merlin	3.391
MRDC	3.024

Source: Applicants' submission, 14 December 2004, par 2.13, p. 10.

Each participant will be entitled to receive sales revenue in accordance with their interest in the Project and is similarly obliged to contribute funding in accordance with their interest in the Project.

The applicants indicated that the interests of the participants detailed above were current at the time of submission of the application but were subject to change. In July 2005 it was announced that AGL had entered into a conditional agreement to acquire a ten per cent share in the Project.[20] On 16 January 2006 AGL and Oil Search announced that that they had finalised an agreement for AGL to acquire a ten per cent interest in

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19 ABARE, 'Australian Energy, national and state projections', August 2004, Table E2 pp. 73-75, cited in Frontier Economics op. cit., at p. 14.

20 AGL, *AGL commits to PNG Gas*, media release, 5 July 2005.

the PNG Gas Project. The arrangements were completed on 17 February 2006 and were effective from 1 January 2006.[21]

The interests may be further revised if, for example, the State of PNG exercises its right to participate further in the Project and Santos joins the Project.[22]

6.1.3 Supply to Australian customers

The applicants indicated that the Australian pipeline will be approximately 3200 kilometres long, running south from the PNG/Australian border in the Torres Strait to connect with the existing gas distribution infrastructure at Gladstone in Queensland. The conditional agreement with Alcan for the supply of Project gas to the Northern Territory, negotiated subsequent to the application being submitted, will increase the length of the pipeline.

The Australian pipeline is expected to be built and operated by a joint venture formed by AGL Pipelines Investments (Qld) Pty Limited and Petronas Australia Pty Limited (AGL-Petronas). The pipeline route has not been finalised. It will be determined by the location of foundation customers and other factors, including environmental and land owner issues and cost optimisation.

A dry gas pipeline is also expected to be constructed between Moomba in South Australia and Ballera in Queensland, facilitating the delivery of Project gas to south-eastern Australia. This pipeline, together with the pipeline to be built as part of the Project, will result in an interconnected dry gas pipeline over the east coast of mainland Australia.[23]

The four customer types to whom Project gas is marketed are:

- energy retailers for re-supply to end users
- electricity generators for use as a fuel
- large industrial customers for use as a fuel in boilers and furnaces, or as a feedstock in the production of ammonia and other products
- large industrial customers for use as a fuel in co-generation plants.[24]

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21 AGL media release, *AGL achieves financial close on PNG equity*, 17 February 2006.

22 An ABC news article dated 4 May 2005 reported that PNG's Minister for Petroleum and Energy, Sir Moi Avei, said PNG will be taking up a six per cent interest in the Project and had appointed the Macquarie Bank as its financial adviser to this end. ABC Radio Australia website, viewed 12 May 2005, <http://www.abc.net.au/ra/news/stories/s1359168.htm>.

23 Currently the pipeline connecting Ballera and the Moomba hub is a wet gas pipeline. Wet natural gas consists of methane and other hydrocarbons, while dry natural gas is almost pure methane, having had other hydrocarbons removed.

24 Co-generation occurs where an industrial customer produces steam and electricity for use in its production processes.

The applicants stated that Project gas will be supplied to customers in rural, regional and metropolitan Queensland as well as customers in south-eastern Australia.[25] The conditional agreement with Alcan reached after the application was submitted will involve the supply of Project gas to the Northern Territory. Frontier Economics noted that potential customers are located throughout Queensland, in locations including Townsville, Rockhampton, Gladstone, Brisbane and Mt Isa.[26]

Pursuant to the interim authorisations granted by the ACCC, the joint venture has been negotiating with potential customers of Project gas for five years. A number of conditional agreements to purchase Project gas have been secured.

At the time of submitting their application the applicants had successfully negotiated conditional agreements with four parties: Energex in Queensland; WMC Olympic Dam in South Australia; Queensland Alumina Limited in Gladstone; and CS Energy in Brisbane. The applicants stated, however, that further contracts would be required in order to reach financial close and substantial further supply contracts would be needed in the future in order for the Project to reach its required investment return.[27] Further conditional agreements were reached with Alcan[28] for its Northern Territory-based Gove alumina project, AGL[29] to supply customers in NSW, ACT, SA and Qld, and Comalco in Gladstone and Weipa. Subsequently, Energex and BHP Billiton (Olympic Dam) decided not to enter into contracts to purchase PNG gas. On 16 January 2006 it was announced that the Project participants had signed a Gas Sale Agreement with AGL in the order of 1500 PG of gas over 20 years.[30]

Many potential customers who had previously negotiated conditional agreements subsequently sought alternative supply and withdrew their commitment to purchase Project gas. The applicants stated that over the past five years of negotiations the Project secured and then lost over 100 PJ of custom.[31] The applicants have provided the ACCC on a confidential basis with a list of parties that have engaged in serious negotiations to purchase Project gas, including those that did not result in any purchase commitments and those that have withdrawn commitments. The Frontier Economics report notes that negotiations with potential customers in New South Wales, Victoria, South Australia and the Northern Territory have taken place, demonstrating the geographical spread of potential customers.

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25 Applicants' submission, 14 December 2004, par 2.22.

26 Frontier Economics, *Implications of emerging patterns in energy markets for the PNG Joint Venture,* 18 November 2004.

27 Applicants' submission, 14 December 2004, par 6.50.

28 Alcan, *Alcan reaches an agreement with PNG gas project for supply of gas to Gove refinery*, media release, 28 June 2005.

29 AGL, *AGL commits to PNG Gas*, media release, 5 July 2005.

30 AGL, *AGL concludes $5 billion PNG gas deals,* media release 16 January 2006.

31 Applicants' submission, 14 December 2004, par 6.37.

6.2 Relevant history of the Project

The Project was first mooted in 1996. Its name was changed in July 2003 to the Highlands Gas Project. In November 2004 it was announced that the name would be changed from the Highlands Gas Project to the PNG Gas Project.

A number of preliminary arrangements have been made by the participants, including the execution of a joint venture Heads of Agreement and a cost sharing agreement. However, the participants have not committed the necessary capital and are yet to make a decision to sanction the Project.

On 6 October 2004 the joint venture participants decided to proceed to the Front End Engineering and Design (FEED) phase of the Project. The FEED phase involves detailed design and feasibility studies being undertaken, commercial negotiations continuing and government and regulatory approvals necessary for the Project to proceed being sought. Current indications are that the Project will be sanctioned and financial close reached in 2006.[32] First gas is expected to flow in 2009.[33]

AGL-Petronas commenced a FEED program for the gas pipeline to be built from PNG to Australia and awarded the key engineering contract to GHD Pty Limited.[34]

32 Exxon Mobil, *Sale of gas to Comalco*, media release, 19 September 2005.

33 See, for example, AGL, *The National importance of the PNG Gas Project*, presentation to the Australia and PNG gas conference, 5 December 2005.

34 AGL, *APC awards key contract for pipeline FEED*, media release, 5 May 2005.

7. The future with-and-without test

In the course of applying s. 90 of the Act the ACCC is required to apply a 'future with-and-without' test to identify and measure the public benefit and anti-competitive detriment generated by the arrangements for which authorisation is sought. In *Re Media Council of Australia & Ors*, which involved a review of an existing authorisation, the Tribunal stated:

> …in the course of determining relevant public benefit and detriment the Tribunal must compare the position which would or would be likely to exist in the future, on the one hand if the authorisation were to continue, and on the other hand if it were absent.[35]

Under this test, the ACCC must compare the public benefits and anti-competitive detriments generated by the arrangements in the future if the authorisation is granted, with those generated if the authorisation is not granted. This requires the ACCC to make a reasonable forecast about how the relevant markets will react if authorisation is not granted. This forecast is often referred to as the 'counterfactual'.

It is clear that the future with authorisation is one in which the Project proceeds under joint marketing arrangements. Differing views have been advanced, however, as to the appropriate counterfactual.

7.1 The counterfactual

The applicants argued that separate marketing is not feasible for the Project and if authorisation is not granted the Project will not proceed in the foreseeable future. Some of the interested parties questioned whether the viability of the Project turns on the ability to jointly market, arguing that the counterfactual could be the future in which the Project proceeds under separate marketing. This involves an assumption that separate marketing is a feasible option, which the applicants dispute.

7.1.1 Joint versus separate marketing

This section examines the preference natural gas producers in Australia have for jointly marketing gas and considers whether separate marketing of natural gas is feasible in Australia.

The preference for joint marketing

The exploration and production of natural gas is a costly and risky enterprise. Traditionally natural gas exploration and production in Australia has been undertaken by joint ventures, principally as a mechanism to share the costs and risks.

Generally, joint venture participants in Australia have also preferred to market their gas on common terms and conditions, including price (usually referred to as joint or

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35 (1996) ATPR 41-497 at 42,241.

coordinated marketing). The alternative is for each producer to separately market their share of the gas produced.

For separate marketing to be effective the joint venture partners would need to implement balancing arrangements (such as borrow and loan arrangements). In a commodity market, imbalances can be readily adjusted in the short term.

The situation is different in a contract market in which gas is supplied under long-term contacts. Imbalances are likely to continue for prolonged periods with the possibility of some gas producers in the joint venture receiving little or no return on their investment for the life of foundation contracts. Given that gas production is a costly enterprise and each producer is required to fund the investment in proportion to their share in the joint venture, gas producers are unwilling to take the risk of receiving a share of the cash flows that is not commensurate with their share in the joint venture. Hence, producers require a share in the cash flows under joint marketing arrangements.

The applicants stated that the Project will not proceed in the absence of authorisation allowing them to jointly market their gas. Their submission detailed the reasons why they consider that separate marketing is not feasible. Some of these relate to the structural characteristics of the market while others relate to the Project itself. The arguments submitted by the applicants in support of joint marketing include:

- despite industry developments in recent years, there are still significant barriers to separate marketing, including: lack of liquidity; shallow customer pool; prevalence of long-term contracts; no significant spot market; and limited gas storage facilities

- the high capital costs of developing the Project and, as a greenfield project, the participants incur these costs well in advance of the first supply of gas to customers

- the participants, their financiers and the owners of the Australian pipeline require a high degree of certainty that the Project is financially viable and will deliver an appropriate return over the life of the Project

- customers need to be confident that the Project will proceed before making a commitment

- the difficulty of aligning customer demand with the likely date of commencement of the Project, given the magnitude of the Project and long project lead time

- the difficulty of amalgamating sufficient customer volumes to underwrite the Project, given the small customer pool

- buyers are aware that sales agreements are crucial in order for the Project to proceed, and therefore have countervailing power. This countervailing power, coupled with competition from other energy sources, makes it difficult to attract the custom required for the Project to proceed

- given that Oil Search, MRDC and Merlin have no presence or experience in the Australian gas industry, customers are likely to prefer to deal with ExxonMobil. Oil Search, MRDC and Merlin would have little prospect of obtaining sufficient customers under separate marketing to warrant the financial risk of proceeding with the Project

- since Oil Search, MRDC and Merlin would have little individual bargaining power with large, sophisticated buyers, multiple commercial negotiations would be unlikely to result in prices and terms that make the Project viable.

The majority view in submissions is that joint marketing is required for the Project to proceed but should not be necessary beyond financial close (in other words, authorisation would only apply in relation to the marketing of gas to foundation customers).

The ACCC must decide what the most likely position would be if authorisation of the joint marketing conduct is denied. In doing so consideration must be given to whether separate marketing is a likely outcome should authorisation be denied. At the outset it is useful to consider two related issues:

- Is the separate marketing of gas feasible? And, if so

- Would separate marketing deliver more efficient economic outcomes than joint marketing?

Clearly, the second question only has relevance if separate marketing is feasible.

Is separate marketing feasible for PNG gas?

The gas market in Australia is often contrasted with overseas markets, particularly US gas markets. In the USA, while exploration and production is often undertaken under joint venture arrangements, it is usual for each joint venture partner to separately market their gas.

The US market has been described as a commodity market, whereas the Australian market is described as a contract market. The US market includes many buyers and sellers, a network of interconnected pipelines, storage facilities, short and medium term contracts as well as long-term contracts, a spot market and various financial instruments. By contrast, in Australia investment in gas infrastructure has generally been underwritten by long-term contracts with few of the other features observed in US markets.

Examples of previous cases in which authorisation of joint marketing of gas were sought were the North West Shelf in Western Australia[36] and Mereenie gas fields in the Northern Territory.[37] In those cases the ACCC concluded that gas markets in Australia were not mature or liquid enough for separate marketing to be feasible. The ACCC accepted that the projects would not have proceeded unless the applicants were allowed

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[36] ACCC, Determination, application for authorisation, North West Shelf Project, 29 July 1998 (North West Shelf determination).

[37] ACCC, Determination, application for authorisation, Mereenie Producers – Gasgo Sales Agreement, 7 April 1999 (Mereenie determination).

to jointly market their gas. Consequently, the ACCC concluded that the public benefits outweighed any anti-competitive detriment and granted authorisation.

Although in each case the ACCC granted authorisation it expressed a view that separate marketing, if feasible, would be preferable to joint marketing as it would deliver more efficient economic outcomes than the producers acting cooperatively.

In the North West Shelf matter, the ACCC identified several features that would need to be present in the WA gas market before the market was mature enough to support separate marketing, namely:

- a significant increase in the number of customers
- the entry of new competitive suppliers
- additional transportation options
- the construction of storage facilities
- the entry of brokers and aggregators
- the creation of gas-related financial markets
- the development of substantial short term and spot markets.

The ACCC did not suggest that all of these features needed to be evident for separate marketing to be feasible. However, the ACCC concluded that the greater the number of these features that developed the greater the likelihood that separate marketing would be viable.

The issue of separate versus joint marketing has subsequently been considered by a number of working groups and reviews, including the Upstream Issues Working Group (UIWG) in 1998 and the Energy Market Review Panel established by CoAG in 2002 (the Parer Review).

The UIWG adopted a similar list of market developments to the ACCC and stated:

> Whilst parts of the Australian gas market can currently be considered as immature, the UIWG believes that markets are evolving in ways that can support separate marketing by individual joint venture participants.[38]

The Parer Review concluded that not all the features of a mature market need be present for separate marketing to be feasible. The Parer Review stated that the existence of secondary markets with associated financial products is an outcome of a mature market and not a prerequisite for separate marketing. Moreover, according to the Parer Review some market features would be more important than others for each joint venture in considering the feasibility of separate marketing. It recommended:

38 *Report of the UIWG to ANZMEC and CoAG* (December 1998) (the UIWG Report) p. 4.

> …the first steps should now be taken toward encouraging greater competition through separate marketing where this can be achieved.[39]

According to the Parer Review separate marketing should be regarded as one of the ingredients in the promotion of competition and a mature market in appropriate circumstances. It considered that separate marketing could promote competition in the upstream sector, particularly in the south eastern Australian market.

Support for joint marketing for the Project can be found in a report by KPMG, who were commissioned by the Parer Review to report on the feasibility of separate marketing. KPMG distinguished between brownfield and greenfield projects. KPMG concluded that separate marketing is likely to be feasible for brownfield projects but unlikely to be feasible for costly greenfield projects. This position was supported by the Parer Review.

In relation to gas coming to Australia from sources north of Australia (either PNG or the Timor Sea) KPMG stated:

> Having regard to the need of these potential northern Australia joint ventures to secure significant market to underpin the investment, the importance of timing and coordination between joint venturers in a greenfield development and the remoteness of the gas from the major demand centres, separate marketing would not appear to be feasible.[40]

The applicants have cited a limited number of recent examples of separate marketing of gas in Australia. The applicants have submitted that due to the particular circumstances of these examples they do not indicate that separate marketing is viable in general for greenfield projects. Instead, according to the applicants:

> they illustrate the extent to which on-going structural features of the industry limit instances of separate marketing to cases involving very small gas fields or fields where a vertically integrated joint venturer can supply itself with gas produced from the field.[41]

In a subsequent submission the applicants reiterated that a long term authorisation of joint marketing conduct was necessary for the Project to proceed, given the ‘illiquid and shallow dynamics of the eastern Australia energy market’.[42] They stated that if the right market conditions exist it is the applicants’ preference to separately market the gas. Santos expressed a similar view at the pre-decision conference.

At the pre-decision conference MRDC stated that it does not have the capability to separately market PNG gas. Both Merlin and MRDC stated that the without joint marketing the Project will not proceed.

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39 *Towards a Truly National and Efficient Energy Market* (the Parer Report), December 2002, p. 204

40 KPMG, *CoAG Energy Market Review, Separate marketing of natural gas in Australia*, October 2002, p. 37.

41 Applicants’ submission, 14 December 2004, Annexure 7, *Structural characteristics of the gas industry that prevent separate marketing*, p. 8.

42 Applicants’ submission, 15 March 2006, p. 3.

In its report Frontier Economics outlined recent developments in Australian gas industry. In relation to PNG gas, it stated:

> This project represents a major infrastructure project in the Australian energy sector and would contribute to the process of development that has already been occurring in this sector following energy market reforms of the 1990s.[43]

In Frontier Economics' view, joint marketing is the preferred approach while the market is characterised by low levels of liquidity. However, retention of joint marketing if liquidity improves would be hard to justify. Frontier Economics suggested that a substantial improvement in liquidity in the gas industry in Australia is not expected to occur in the near future.

Comalco submitted that the ACCC should consider how much more the market will mature over the next 30 years. Comalco considered that the market is maturing and the entry of PNG gas will hasten the maturity of the market. In Comalco's view, joint marketing over an extended period of time may prevent or at least hinder the development of a more mature market.

The EUAA expressed similar views, stating that restricting the development of a new gas field by adherence to long-term joint marketing arrangements would be a retrograde step in terms of the future of competitive gas markets in Australia.

The EUAA submitted that the eastern Australia and Queensland gas markets are very dynamic, suggesting that the conditions for separate marketing are likely to exist before the expiration of the 16 year term of the authorisation proposed by the ACCC in its Draft Determination. The EUAA submitted that Oil Search and AGL are currently separately marketing Project gas. The EUAA submitted that an agreement between AGL and NRG Flinders for AGL to supply gas to NRG Flinders must be an example of separate marketing as AGL was not covered by the October 2000 interim authorisation at that time.[44]

In response the applicants stated that the AGL/NRG Flinders arrangement did not constitute separate marketing. Rather it is an instance of the Project participants jointly marketing gas to AGL and AGL as a retailer on-selling that gas out of its supply portfolio. With regard to Oil Search the applicants submitted that in the event that Oil Search identifies any future sales opportunities, it is ExxonMobil as the project operator who approaches the potential customers if the Project decides to pursue the Project.

Would separate marketing deliver more efficient economic outcomes?

In previous determinations the ACCC expressed the view that separate marketing, if it is feasible, is preferable to joint marketing. For example in the Mereenie Determination, the ACCC stated:

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43 Frontier Economics, op. cit., p. 3.

44 EUAA's submission, pp. 7 and 19-20.

The Commission [the ACCC] believes that separate marketing of gas by joint venture producers, wherever feasible, will be more competitive than co-ordinated marketing and likely to provide a wider variety of supply options that would meet market demands.[45]

Both the UIWG and the Parer Review also considered that separate marketing could help to foster more competitive gas markets. The UIWG stated:

… the UIWG agrees with the argument that separate marketing is more competitive than joint marketing, and the aim of the policy in this area should be to encourage the separate marketing of gas by individual participants in a joint venture. By creating price competition between as many suppliers of gas as possible, separate marketing should result in lower prices.[46]

The UIWG further considered that in moving the Australian gas industry forward joint venture arrangements needed to evolve in such a way that competition was not impeded. The UIWG concluded that gas markets in Australia were evolving in ways that could eventually support separate marketing. The UIWG considered that, while joint marketing may be appropriate in the short term, the longer term policy objective should be to encourage separate marketing wherever it is feasible.

The Parer Review expressed similar views to those of the UIWG. It suggested that the limited competition arising from the small number of basins supplying eastern gas markets was further reduced by joint marketing of gas within those basins. The Parer Review considered that separate marketing, where appropriate, could significantly increase competition in the upstream gas sector. It stated:

Moving toward separate marketing should be considered as part of the overall package to improve the competitive nature of the natural gas market. Separate marketing itself should be regarded as one of the ingredients that in the appropriate circumstances helps to create competition and thereby a more mature market.[47]

The Parer Review's position was also supported by KPMG, which stated that separate marketing is likely to be effective in increasing upstream competition. KPMG stated:

… separate marketing may have an initial propensity to increase costs, for example, in the marketing area. However, the price outcome from increasing competition, and the contribution that may be made by separate marketing, could be expected to result in significantly reduced upward pressure on the price of gas supply, if not in real lower prices. The real price needs to be understood in all the circumstances of the market.[48]

Nevertheless, KPMG cautioned that separate marketing should neither be seen as a panacea for any lack of competition in upstream gas markets nor the whole solution but rather as part of the solution. KPMG stated that 'Separate marketing is but one facet

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[45] Mereenie determination, p. 32.

[46] UIWG Report, p. 29.

[47] Parer Report, p. 200.

[48] KPMG, op. cit., p. 15.

that may encourage or be an ingredient that contributes to increased upstream competition.'[49]

The view that rivalry between joint venture partners separately marketing their share of the gas produced will deliver lower gas prices is not shared by all commentators. In a report submitted by ExxonMobil to the Parer Review and also by the applicants in support of their application for authorisation, Lateral Economics expressed the view that separate marketing will not lead to more competitive prices.

Lateral Economics argued that the joint production arrangements amounted to market sharing, and under these arrangements forcing joint venture partners to market separately would not dilute any market power they may have. Lateral Economics stated:

> One way of putting the case is to say that, for monopoly rents to be competed away, the competitors must compete for each others' market share. Yet this cannot happen where the shares of each marketer are already determined by joint production decisions.[50]

Lateral Economics also stated:

> … even if the co-venturers in a JVP [joint venture project] enjoyed an unreasonable degree of market power, at best requiring them to market their gas separately would achieve 'precisely nothing'. It would do nothing to reduce whatever market power the JVP had. But in doing so it would add to costs.[51]

Lateral Economics suggested that forcing joint venturers to separately market their gas could lead to higher costs (for example, higher transaction costs and development of the gas fields in an inefficient manner). This in turn could result in higher prices.

In its 1995 report the then Industry Commission expressed a similar view to that of Lateral Economics. The Industry Commission stated that any market power stemmed from the joint production arrangements, which was unaffected by the marketing arrangements. It stated:

> Any market power available to producers acting jointly is inherent in the exploration and production leases they collectively control. It is exercised when the pricing, extent and/or other terms of gas supply are determined, for the duration of the supply contract. It can be exercised by joint venturers marketing jointly and so collectively determining the price and/or quantity of gas they are prepared to sell. However, joint producers can still exercise whatever market power is inherent in their leases even when marketing separately. They can do so by determining the quantity and terms on which gas is made available for (separate) marketing.[52]

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[49] KPMG, op. cit., p. 18.

[50] Lateral Economics, '*Accomplishing precisely nothing': requiring joint venture producers to market their gas separately*, a supplementary submission to the Energy Market Review", September 2002, p. 4.

[51] Ibid.

[52] Industry Commission, *Australian gas industry and markets*, 6 March 1995, p. 126.

Nevertheless, the Industry Commission talked of 'constrained competition' within a single joint venture under a successful open access regime with a large number of buyers. The Industry Commission said that 'This competition could yield benefits to consumers, in terms of improved service, even in the absence of competition for aggregate market volume'.[53] The applicants themselves submitted that in an immature market separate marketing would not add any value to off-set higher marketing and administrative costs. However, in a mature market the joint venture partners may be able to add value through separate marketing. The applicants stated:

> The increased marketing and administrative costs associated with separate marketing could only be justifiable if they were off-set by a reduction in price or some other benefit through competition between the participants. In mature markets, participants in gas production joint ventures may be able to add value in separately marketing on account of their marketing methods and networks spread across a portfolio of gas production assets. However, where such value cannot be added due to the immaturity of the market (such as in Australia), separate marketing will not yield any meaningful price competition that could off-set these increased marketing and administrative costs. This is because the participants all face the same or very similar cost structures arising out of the joint production of Project gas and, due to complex balancing arrangements that would be necessary to support separate marketing, the Participants would be unable to compete for each others' market share without owing that market share back to the other Participants during the life of the Project.[54]

Some submissions put forward an alternative view. They suggested that individual producers have different required rates of return and therefore some might be willing to offer lower prices than others. Whereas under joint marketing arrangements the highest price will prevail.

In response to the applicants' comments that separate marketing can add value, Comalco stated:

> The Parer Report, quoted by the Applicants, commented that all the features of a mature market do not have to be present to support separate marketing. It is difficult on this basis to accept the Applicants' implicit opinion that sufficient, if not all, requirements for a mature market would not be achieved for the next 30 years. It is confusing to see that the Applicants agree separate marketing can add value but not until beyond 30 years …[55]

Energex submitted that dynamic efficiencies might be lost under joint marketing arrangements. Energex, a retailer of gas, said it would prefer to negotiate with individual producers separately where practicable. This would provide greater flexibility in the terms and conditions of contracts and allow Energex to tailor its gas supply arrangements to suit the needs of its own customers.

Energex stated:

> … Energex may wish to optimise price, terms and conditions and such other elements as credit risk to procure a package that best meets its needs. By joint marketing, dynamic efficiencies

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53 Ibid.

54 Applicants' submission, 14 December 2004, Annexure 7, p. 15.

55 Comalco's submission, 15 February 2005, pp. 3-4.

> are likely to be lost. Specifically, innovation may be stifled, as the Project will be marketed with common prices and terms and conditions.[56]

Other users also submitted that they would prefer to negotiate with individual producers after financial close of the Project.

The EUAA queried why joint marketing was necessary if prices are no different to prices under separate marketing.[57]

The applicants responded by submitting that the lack of any difference in prices is an indication of the competitiveness of the market and hence there is no public detriment from joint marketing in the form of higher prices. In other words participants are unable to extract monopoly rents through joint marketing.

The applicants also submitted that the price that would apply under separate marketing has little relevance to the ACCC's consideration of the authorisation for joint marketing conduct since the Project will not proceed under separate marketing arrangements and hence the public benefits will be lost if authorisation is denied.

Of relevance in this regard is the fact that revenues are a function of both prices and volumes. As noted earlier a key argument presented by the applicants against separate marketing of PNG gas is that individual participants would be unwilling to fund part of the costs of the Project if there is a risk they will not obtain a commensurate share of the contract revenues.

ACCC's conclusions on separate marketing

The ACCC accepts the arguments submitted by the applicants that the Project will not proceed under separate marketing arrangements. The ACCC also notes that this is the consensus expressed in submissions. However, the ACCC does not conclude that separate marketing will be infeasible for the life of the Project.

There is no doubt that the gas industry in Australia has undergone considerable development since the CoAG reforms introduced in the 1990s and is continuing to develop.[58] The construction of the Project should aid this development.

Lateral Economics suggested that forcing joint venture partners to separately market their gas would achieve at best nothing and may even lead to higher costs. The ACCC considers, however, that measures could be implemented to mitigate these costs. The potential for the inefficient depletion of the gas fields could be addressed by the joint venture partners through balancing arrangements.[59] Moreover, the potential for higher

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56 Energex's submission, 15 February 2005, p. 3.

57 EUAA's submission, 15 March 2006, p. 5.

58 For an outline of developments in the gas industry, see Frontier Economics op. cit.

59 The applicants stated 'in the first stage it [a borrow and loan arrangement] allows production to proceed at a rate which satisfies the needs of the partner wishing to take the most gas whilst ensuring the resource is being managed to produce optimal results'. Applicants' submission, 14 December 2004, Annexure 7, p. 12.

transaction costs can be mitigated, particularly for joint venture partners with small shareholdings, through the presence of brokers and aggregators.

The extent to which separate marketing could encourage rivalry between individual producers in a joint venture and lead to lower prices is uncertain. However, it is appropriate to consider the issue of separate marketing in a broader context. The conclusions of the UIWG and the Parer Review that separate marketing could aid in the development of a more mature and competitive gas market and assist in the evolution of the factors listed earlier in this Determination are noted. It would be a concern if adherence to joint marketing, when separate marketing became feasible, hindered the continued development of a competitive and mature gas industry. Nevertheless, the ACCC agrees with KPMG that separate marketing should not be seen as the whole solution for promoting upstream competition.

The ACCC considers that separate marketing can add value and lead to enhanced dynamic efficiency. As Energex submits, users could negotiate more flexible terms and conditions with individual producers. This in turn would allow users to tailor their supply contracts to match the needs of their own customers.

Moreover, potentially anti-competitive detriments may arise where cross-ownership among PNG gas producers and producers in other gas basins exists. These detriments, which are discussed in more detail in section 9, are associated with the potential misuse of confidential information and exercise of market power. These detriments should not arise under separate marketing arrangements.

7.1.2 Other possible projects

It is appropriate for the ACCC to consider whether the claimed public benefits could be delivered by some other means should the Project not proceed. The concept that northern gas, either from PNG, the Timor Sea or the North West Shelf, would at some stage be shipped to eastern Australia has generally been accepted for some time.

Although the applicants have indicated that the Project will have the capacity to supply up to 200 PJ of gas to Australia per annum, they state that the development of the Project is not inevitable.[60] They have put forward a number of options for use of the gas in the event that the Project does not proceed, including:

- a liquids cycling project based on raw gas from the Hides field
- supply of gas to a methanol plant within PNG
- a gas pipeline to Port Moresby for industrial customers
- supply of compressed natural gas to customers in New Zealand and the Pacific Islands

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60 Applicants' submission, 14 December 2004, par 6.55.

- development of less capital intensive oil and gas projects for domestic supply within PNG or export to Asia.

It is conceivable that if authorisation is denied the Project may not proceed and an alternative project would be developed (for example, the shipment of Timor Sea or North West Shelf gas to eastern Australia) that would deliver similar public benefits as the Project.

In considering the future-with-and-without test the counterfactual must be foreseeable and probable, not merely possible or speculative. The Tribunal stated:

> That does not mean that we prophesy the future. As QCMA expressed the point …:
>
> We are concerned with probable effects rather than with possible or speculative effects. Yet we accept the view that the probabilities with which we are concerned are commercial or economic likelihoods which may not be susceptible of formal proof. We are required to look into the future but we can be concerned only with the foreseeable future as it appears on the basis of evidence and argument relating to the particular application.[61]

The applicants submitted a report by ACIL Tasman in which the future with and without the Project is modelled in various markets.[62] In its scenarios without PNG gas ACIL Tasman did not factor into its analysis the alternative of gas being supplied from either the Timor Sea or the North West Shelf. ACIL Tasman stated that if the Project did not proceed an alternative project could not be developed within the same timeframe as PNG gas.

While the delivery of gas from the Timor Sea or North West Shelf has been mooted for some time it would appear that it has not progressed much beyond the conceptual stage. There is no alternative project involving either Timor Sea gas or North West Shelf gas currently competing for the same customers as PNG gas. It may be that if the Project does not go ahead at some stage in the future a project to ship gas to Australia from other northern sources could be developed. However, given the lead time required to develop such a proposal and undertake a project of this nature the ACCC considers that this is unlikely to occur for some years. Therefore, the ACCC considers that neither Timor Sea gas nor North West Shelf gas should be considered as a counterfactual to PNG gas at this time.

The EUAA submitted that a counterfactual that the ACCC should consider is the possibility of the PNG Project proceeding at some stage in the future without authorisation of joint marketing conduct (or authorised for a short period). According to the EUAA in this manner the public benefits would still be realised (albeit with some delay) and the anti-competitive detriment would be less.[63]

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61 Re Queensland Independent Wholesalers Ltd (1995) ATPR 41-438 at 40,960-961.

62 ACIL Tasman, 'Economic impacts of the PNG Gas Project: an assessment of impacts in Australia at national, state and regional level', 17 November 2004 (the ACIL Tasman report).

63 EUAA submission, 25 March 2005, p. 23.

In response the applicants submitted that the counterfactual assessed by the ACCC in its Draft Determination was appropriate. The applicants stated:

> in the future without a long term authorisation in place, the public benefits will be foregone and a critically important opportunity to facilitate a major infrastructure development and investment in Papua New Guinea and rural and regional Australia will have been denied.[64]

In the event that the Project does not proceed, while it is not likely that an alternative project would be developed within the current timeframe in which the Project will be developed, it is likely that it will occur at some time within the next 30 years (the estimated Project life). As discussed in section 8 of this Determination, the ACCC considers it is appropriate to discount the extent of the public benefits claimed by the applicants, given that many of these benefits are likely to arise from another project if the Project does not proceed.

7.1.3 Conclusion on the counterfactual

Given that separate marketing for the Project is not feasible at this time, the ACCC agrees with the applicants that the counterfactual is that the Project will not proceed in the foreseeable future. Once the Project has been commissioned and as the market develops separate marketing, however, could become feasible and joint marketing might not be necessary to sustain the Project.

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[64] Applicants’ submission, 27 March 2005, p. 9.

8. Public benefits

The *Trade Practices Act 1974* does not define public benefit. In the words of the Tribunal, a public benefit includes:

> anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements…the achievement of the economic goals of efficiency and progress.[65]

Public benefits that have previously been accepted by the ACCC or the Tribunal include:

- industrial rationalisation that resulted in more efficient allocation of resources and in lower or contained unit production costs
- expansion of employment or prevention of unemployment in efficient industries
- promotion of industry cost savings that resulted in contained or lower prices at all levels in the supply chain
- development of import replacements
- growth in export markets
- steps to protect the environment.

The submissions on public benefits arising from the Project that were advanced by the applicants and interested parties follow. The submissions were made prior to the conditional agreements for the sale of Project gas to Alcan and AGL being negotiated.

8.1 What the applicants said

Increased competition in the eastern Australian energy market

The applicants stated the Project will increase competition as follows:

- Project gas will place competitive pressure on gas from other existing and developing basins in eastern Australia.
- Once constructed the pipeline could be utilised by other producers. Therefore the pipeline may encourage the development of gas reserves in Queensland and further production in PNG, resulting in additional supply to Australia which would further enhance competition.

65 Re QCMA (1976) ATPR 40-012, at 17,242.

- Wholesale gas prices will fall. The ACIL Tasman report estimates average reductions in the wholesale price of gas over a 20 year time horizon from 2003 to 2022 as a result of the entry of Project gas to Australia as follows:
    - Queensland - $0.25/GJ (in real terms) below the prices expected in the absence of Project gas
    - Eastern Australia - $0.15 to $0.20/GJ (in real terms) below the prices expected in the absence of Project gas.[66]
- Competition will be promoted in the energy market, particularly between gas and electricity, as a consequence of lower gas prices.
- Capital investment will increase due to the availability of a secure and competitively priced gas supply.
- A net economic gain will arise. The ACIL Tasman report forecasts an increase in Australia's Gross Domestic Product (GDP) attributable to the Project of a net present value of $2.85 billion over the period 2005–2020. The net present value of Queensland's annual increments in Gross State Product (GSP) due to the Project is estimated as $2.89 billion. In addition to increased GDP and GSP, it is argued that output across a wide range of industries will increase and employment will rise.
- Commonwealth and state government revenues are forecast to increase due to an increase in taxes collected attributable to the Project.

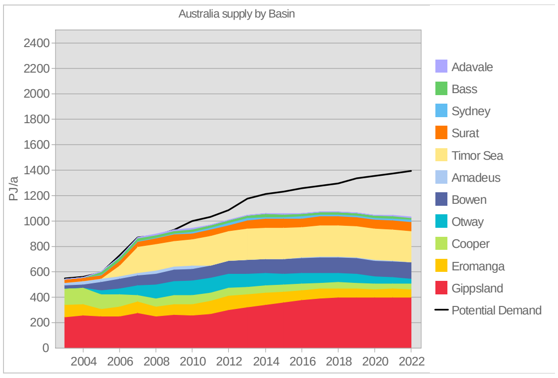
Essential supply of gas to the eastern Australian market

In the absence of Project gas, the ACIL Tasman report forecasts a shortfall in supply to meet the expected potential demand for natural gas in eastern Australia beginning in around 2009. Although the entry of Project gas is expected to lessen the shortfall a gap in supply and potential demand will still exist with the Project proceeding. The forecast supply and demand in eastern Australia with and without the Project as modelled by ACIL Tasman is shown below.

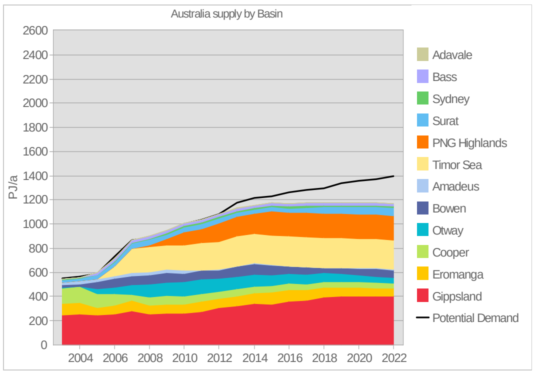
The models predict a shortfall of slightly under 400PJ in 2022 without the Project proceeding compared to a shortfall of slightly over 200PJ in the same year with the Project proceeding.

[66] ACIL Tasman, op. cit., figures 13 and 17.

Supply v Demand in Eastern Australia without the Project



Supply v Demand in Eastern Australia with the Project



Source: ACIL Tasman report, figures 8 and 9

Benefits to regional communities

Improvements to local infrastructure, such as upgrading roads and bridges, will occur as part of the pipeline construction. Various benefits are argued to arise for the following groups of people in regional Australia:

- traditional landowner groups – compensation; employment; training and business opportunities and capacity building
- land owners – improved access; business opportunities and employment and training opportunities
- regional communities – reduced power generation costs; reduced LPG costs; employment opportunities; business opportunities and the upgrading of roads and other infrastructure enhancements including a fibre optic cable co-located with the Australian pipeline.

Business efficiency

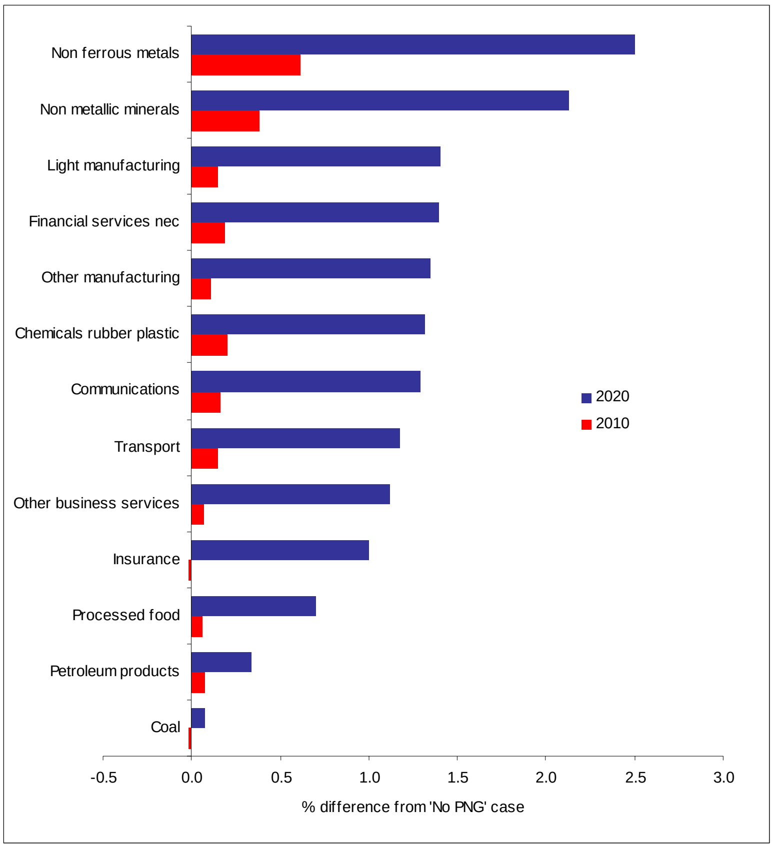
The forecast decrease in the price of gas is expected to bring about increased business efficiency for industries that use gas as a fuel. The lower production costs for these industries are expected to be passed on to consumers in the form of price reductions, stimulating further sales in these industries.

Development of import replacements and growth in export markets

The applicants submitted that the increased business efficiency arising from the Project will develop a range of export and import replacement markets. The applicants stated that the development of import replacements and increase in exports has the potential to improve Australia's external balance of payments.

In support of their argument, the applicants drew attention to the following figure from the ACIL Tasman report forecasting the impact of the Project on exports in Queensland in 2010 and 2020.

Impacts on exports from proposed PNG Gas Project in Queensland, 2010 and 2020, percentage difference from the 'No PNG' case



Source: ACIL Tasman report, figure 48.

Employment benefits

Employment in eastern Australia is forecast to increase by the year 2020 by 884 jobs, 838 of which will be in Queensland. The need for jobs will arise due to the construction, maintenance and oversight of the pipeline, expansion of the gas, manufacturing and electricity sectors and the encouragement of projects in downstream markets due to lower gas prices.

Environmental benefits

Given the forecast reduction in gas prices the Project is expected to prompt conversion from coal-fired to gas-fired electricity generation and conversion from electricity to gas as an industrial feedstock. This conversion is expected to reduce greenhouse gas emissions.

Australia-PNG relationship

The benefits of the Project to PNG's economy, including improvements to infrastructure, essential services, employments and social programs, are argued to bring about improved social and political stability for PNG. The applicants contend that this will in turn benefit Australia through an improvement in regional stability and security.

8.2 What the interested parties said

AGL-Petronas, the consortium selected to build the PNG pipeline, submitted that the new source of gas will enhance competition and expand the rate of market development in Australia. Specifically, the benefits advocated by AGL-Petronas were:

- a major new source of gas supply into eastern Australia and increased competition between basins
- the addition of a major piece of energy infrastructure
- associated benefits to the economy of the construction project.

WMC (Olympic Dam Corporation) Pty Ltd (WMC) supported the application for authorisation without qualification. WMC stated that no advantage would accrue to the Project participants, customers, or the market from the separate marketing of gas. The benefits claimed by WMC were:[67]

- the promotion of competition generated by the new source of gas provided by the Project
- the long-term, reliable and low cost energy supply that the Project will facilitate. Without the Project WMC believed its energy costs would be significantly higher and its projected demand for gas could not be met. A low cost energy supply was a key element of a proposed expansion of WMC's Olympic Dam Operations and infrastructure, requiring a $4 billion investment.
- The availability of an additional gas supply to South Australia will support the installation of additional gas-fired power generation. WMC submitted that this could alleviate the existing constraints on the electricity supply in South Australia.
- Increased gas-fired generation in South Australia, promoting significant environmental benefits by reducing greenhouse gas emissions.

TXU submitted that the Project will provide greater competition in the gas market through the introduction of a new supply source. While TXU expressed concern with the long-term anti-competitive detriments of joint marketing, its view was that the public benefits will outweigh the anti-competitive detriments of joint marketing.

The EUAA submitted that the issue for consideration is whether the public benefits outweigh the anti-competitive detriment relating to the joint marketing arrangement, as distinct from the Project itself. Energex also submitted that the only relevant public benefits are those arising from the joint marketing arrangement as distinct from the Project. Energex submitted that the applicants have not identified any public benefits associated specifically with the proposed joint marketing arrangements. Nonetheless, Energex supported joint marketing for a limited period.

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67 This submission was made prior to BHP Billiton acquiring the Olympic Dam assets and deciding not to enter into a contract for PNG gas.

According to the EUAA, the benefit of joint marketing is that it ensures a sufficient volume of gas can be made available in order to attract customers and establish foundation contracts. The EUAA submitted that the only benefit that would arise beyond financial close is the reduction of transaction costs in negotiating with a single unit rather than with individual producers.

BHP Billiton supported the authorisation until financial close only. It stated that the benefits from the continuation of joint marketing after that time will not be public benefits but rather private benefits accruing to the Project participants.

Comalco agreed with the applicants that the Project will generate significant public benefits through expanding gas markets at reduced prices, particularly in minerals processing industries. Comalco also agreed that the applicants need the ability to negotiate firm contracts to underpin their decision to invest. It supported joint marketing until financial close. Comalco was of the view that there are insufficient public benefits after financial close to warrant authorisation beyond that time. According to Comalco the benefits of joint marketing that will arise after financial close will accrue to the Project participants and thus were private benefits.

Comalco suggested that it is unclear from the ACIL Tasman report whether the public benefits projected in the report are modelled on an assumption of joint marketing for the life of the Project. Comalco argued that the report's approach of measuring benefits through the impact of lower gas prices in a general equilibrium model suggests that the Project's benefits would be diminished at a higher gas price. Comalco noted that a comparison of the benefits after financial close of joint marketing with separate marketing is not made in the ACIL Tasman report.

Some of the interested parties suggested that without an effective regime governing access to the pipeline the potential of the pipeline to encourage other producers to utilise the infrastructure and increase competition is limited or nil. It was suggested that the ACCC should gain an understanding of the likely access regime before assessing the effect of the Project on competition.

In response to the Draft Determination Townsville Enterprise Ltd submitted that the Project will bring substantial benefits to gas users, the State of Queensland and the national economy through increased competition and a new source of gas.[68] The PNG Government submitted that the Project will bring substantial public benefits to the State of PNG, including improvements in health, education, employment, resource development, trade, economic stability and essential services such as infrastructure.

8.3 Applicants' response to submissions of interested parties

The supplementary submission of the applicants argued that joint marketing is a crucial factor in determining the viability of the Project, and therefore the benefits of the Project generally should be taken into account.

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68 Townsville Enterprise Ltd's submission, 27 February 2006.

The applicants also argued that the public benefits of the Project will extend beyond financial close. The applicants stated that the participants and the Project's financiers will expect the participants to be in a position to secure further gas sale contracts after financial close. They suggested that any obstacle to joint marketing of gas may jeopardise further sales. The applicants submitted that there are clear public benefit reasons for joint marketing to continue for a significant period beyond financial close.

The applicants noted the comments of the Tribunal in *Re AGL Cooper Basin Natural Gas Supply Arrangements* suggesting that public benefits can continue to exist in the long term from arrangements 'necessary to sustain substantial, long-lived, sunk investments'.[69] They argued that the long-term public benefits eventuating from the Project will not cease at financial close.

8.4 ACCC assessment of public benefits

Benefits of Project v benefits of joint marketing arrangement

If it were feasible for the Project to proceed under separate marketing arrangements the benefits arising from the Project could not be attributed to the joint marketing conduct. They would arise under both the future with and without joint marketing arrangements.

However, if separate marketing is not feasible joint marketing is necessary for the Project to proceed and for its benefits to materialise. For at least as long as separate marketing remains infeasible benefits arising from the Project can be characterised as benefits arising from the joint marketing conduct, because without joint marketing the benefits cannot materialise. The ACCC is of the view that separate marketing is not currently feasible and accordingly the benefits of the Project are relevant at this time.

Public benefits after financial close

Comalco and BHP Billiton submitted that the benefits of joint marketing after financial close are private benefits and therefore not relevant to a consideration of whether authorisation should be granted. BHP Billiton did not elaborate on what the private benefits were. Comalco argued that the private benefits accruing to the Project participants after financial close consisted of higher returns to the applicants than would occur under separate marketing.

Comalco's argument involves a comparison between the future with authorisation in which the Project proceeds under joint marketing and the future without authorisation in which the Project proceeds under separate marketing. As noted above the ACCC is of the view that separate marketing is currently not feasible. For the period in which separate marketing is not feasible the argument is not relevant. It is only potentially relevant at a time when separate marketing is likely to be feasible.

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69 (1997) ATPR 41-593 at 44,216.

Essential supply of gas

Given the forecast shortfall of gas supply to meet the demand in Queensland and eastern Australia the ACCC accepts that the supply of large volumes of gas by the Project constitutes a public benefit.

Increased competition

The ACCC accepts the claim that by introducing a significant volume of gas to Australia the Project will enhance competition in Queensland for both natural gas and coal seam methane. The entry of Project gas will provide a major source of competition for coal seam methane and Cooper Basin producers in Queensland.

The entry of PNG gas to the Northern Territory may also increase competition in the Northern Territory. The extension of the pipeline to Gove creates the potential for the pipeline to be further extended to other locations in the Northern Territory in competition with existing sources of gas.

AGL has entered into a agreement to acquire in the order of 1500 PJ of Project gas over a 20-year period. AGL has indicated that PNG gas will be used to meet its future customer demand in NSW, ACT and SA, as well as Queensland. This arrangement has the potential for competition with respect to not only the Cooper Basin in SA (which supplies the majority of the gas markets in NSW and SA), but also the Gippsland Basin in Victoria (which supplies markets in NSW and ACT via the Interconnect and the Eastern Gas Pipeline) and the Otway Basin in Victoria (which supplies gas to SA via the SEAGas pipeline).

The ACIL Tasman report modelled the expected impact of Project gas on the wholesale price of gas in eastern Australia.[70] The reduction in price is modest before 2019, at which point it peaks at around $0.20/GJ, before falling to $0.15/GJ. The report explained that the reasons for the increasing price gap include:

- much larger volumes being sold to low-priced industrial and base load combined cycle gas turbine (CCGT) plant, thereby diluting the proportion of relatively high priced gas users; and

- increased competitive discipline on the market.[71]

The first point suggests that prices in eastern Australia for a number of relatively high priced users may fall by only modest amounts, if at all.

The ACIL Tasman report predicts that in the future there will be a shortfall in supply to meet demand for gas in Queensland. Given this projected shortfall the ACCC expects that if the Project does not proceed it is likely that a new source of gas, such as gas from the North West Shelf or Timor Sea, will enter the market at some time in the future. While there is likely to be a lengthy delay in an alternative project commencing

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[70] Figure 4, p. 7.

[71] At p. 15.

operations, it is likely that it will occur at some time within the 30 year period during which the Project is expected to operate.

Given that the ACCC considers that separate marketing may be feasible in the future, there is some possibility that any future projects could be developed under separate marketing arrangements.

The ACCC considers that if the Project does not go ahead, price decreases are likely to occur due to the entry of an alternative source of gas. However, there will be a significant delay in any price decreases eventuating as development of a project of a size comparable to the size of the Project is likely to take some years. Further, any price decreases from an alternative Project may not be as substantial as those expected to arise as a result of the Project.

Therefore the ACCC accepts that price decreases are likely to arise as a result of the Project and that they constitute public benefits. However, the ACCC considers that the extent of the price decrease predicted by the ACIL Tasman report may be overstated and, consequently, estimates as to the increase in GDP and GSP may also be overstated. Nonetheless, the ACCC considers the public benefit by way of the expected price decrease is significant.

Competition with alternative energy sources

In addition to enhancing competition for gas in Queensland, the ACCC expects the Project will promote competition between gas and other energy sources. A large number of negotiations undertaken by the Project to date for the sale of Project gas have been unsuccessful due to potential customers choosing alternative energy sources such as coal and liquid fuels. The fact that potential customers have chosen alternative energy sources attests to the competition Project gas currently faces from these other energy sources. Similarly, in some cases the agreements that have been successfully negotiated to date will result in PNG gas replacing other types of energy.

As long-term supply contracts are negotiated for Project gas and available Project gas decreases,[72] the extent to which the Project will act as a competitive constraint on alternative energy sources will decrease. To the extent that additional contracts will continue to be actively sought after financial close, this will provide a constraint on alternative energy sources for some time after financial close.

The lack of certainty regarding timing of delivery of Project gas has been a significant impediment to obtaining purchase commitments from some customers. If the Project does proceed the uncertainty regarding timing will no longer hinder the procurement of purchase commitments and the Project will be a more viable option for potential customers. At that time the Project will be able to compete against other energy sources, as well as coal seam methane and conventional gas, more effectively.

Competition between Project gas and other energy sources should intensify as prices for gas start to fall. The ACIL Tasman report suggested that the expected price

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72 While the reserves may be large, the amount of gas that can be delivered at any one time will be limited by capacity constraints.

reductions for gas will increase demand from customers that are less price-tolerant, as they will be able to access gas at affordable levels. The ACIL Tasman report suggested that this will result in much larger sales to low-priced industrial and base-load CCGT plants. As demand for energy grows, producers of non-gas energy sources, as well as coal seam methane, may compete with the Project to supply the growing demand.

For those customers that invest heavily in plant to facilitate the use of gas, the Project will not face direct competition from non-gas energy sources over significant periods while gas remains the only viable option.

Access to the pipeline

The applicants suggested that the pipeline to be constructed as part of the Project may be utilised by other producers in the future and, accordingly, that the Project may encourage future development of sources of gas, resulting in greater competition. Interested parties suggested that in the absence of an effective access regime such a public benefit will not eventuate.

The issue of access to the pipeline was given some prominence at the pre-decision conference. The QMGUG submitted that it was a concern that no access principles were in place for the proposed pipeline. The question was raised of how the ACCC could make a decision on the application for authorisation when details of the access regime were unknown.

Cheetah Oil and Gas (PNG) Ltd submitted that it expected that the authorisation, together with access to the pipeline, would be conducive to PNG producers such as Cheetah being able to access natural gas markets in Australia.[73]

The EUAA submitted that two separate projects should be distinguished. One project is the production and sale of PNG gas and the other project is the transportation of gas from the Queensland border to users. Accordingly, authorisation should only apply to the marketing of the gas up to its entry into Australia. In reply, the applicants stated that the gas will be delivered to delivery points agreed between the customer and the participants in Gas Sales Agreements.

Two important points are worth noting here. First, the application for authorisation is not about third party access to the pipeline. Second, the application for authorisation deals with horizontal arrangements between the applicants. It is not an application for authorisation of the vertical gas supply agreements between the applicants and their customers. While the applicants are authorised to negotiate common terms and conditions on which gas will be marketed, the actual terms and conditions (including delivery points) are a matter for negotiation between the applicants and their customers.

As the access regime is uncertain at this time the ACCC gives less weight to the claim that a public benefit will arise by way of other producers utilising the pipeline. The benefits of the Project may be greater under an open access regime. However, even in

[73] Cheetah Oil and Gas (PNG) Ltd' submission 27 February 2006

the absence of third party access to the pipeline substantial benefits will arise from the Project simply by virtue of the addition of a major new source of gas to Queensland.

Increased business efficiency and investment in downstream markets

The ACCC expects that lower gas prices than what they otherwise would be will increase business efficiency by lowering production costs. This increased efficiency will stimulate investment in downstream industries in the form of both expansions of existing operations and new investments.

Import replacements and growth in export markets

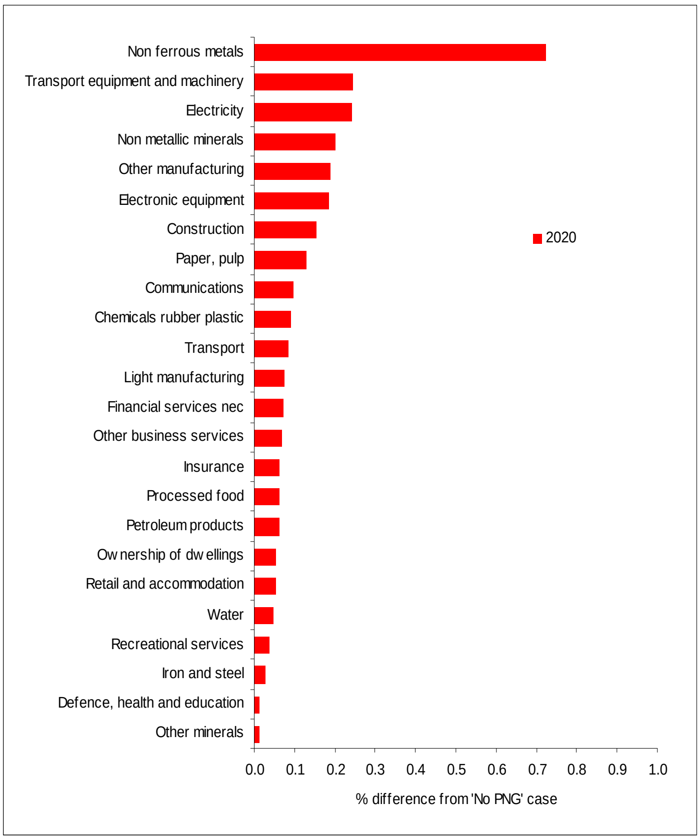
The applicants refer to the predictions of growth in exports for Queensland illustrated in figure 48 of the ACIL Tasman report in support of their argument that export markets will grow as a result of the Project. The report shows an increase in exports for Queensland. The report further predicts that Queensland will improve its competitive advantage in exports relative to other states and that the impact of the Project on the GSP of some states will be slightly negative.[74] This suggests that the growth in Queensland's exports arises partly due to the displacement of some exports from other states.

The ACCC does not consider that Queensland's increase in exports alone represents the quantity of the benefit to the public to which the ACCC should have regard. It is the **net** increase in Australian exports, however, that is the relevant public benefit. Australia's net increase in exports due to the Project was not modelled by the ACIL Tasman report but displacement of exports from other states is not expected to be significant. In such circumstances exports from Queensland represent a close proxy for exports for Australia as a whole.

Instead, the expected increase in output for Australia across a range of industries was modelled by ACIL Tasman as follows:

[74] Pages 38-39.

Value of output in Australian industries with the PNG Gas Project – percentage differences from the 'No PNG' case, 2020



Source: ACIL Tasman report, figure 45.

The biggest increase in output of around 0.72 per cent is in the non-ferrous metals industry.

Given the expected increase in GDP of a net present value of $2.85 billion over the period 2005–2020 and the increase in output for Australia across the industries represented above, the ACCC expects that a net increase in exports will arise due to the Project.

Environmental benefits

The ACCC accepts that any increase in gas-fired generation that displaces coal will reduce greenhouse gas emissions and constitute a public benefit. In regions where coal-fired generation is constrained and gas-fired generation merely supplements coal-fired generation no public benefit in the form of reduction of greenhouse gas emissions will arise. However, where industrial users of Project gas choose gas as an alternative to coal, which is likely to occur as a result of the expected reduction in the price of gas, an environmental benefit will arise.

Encouragement of future gas market developments

Any future projects utilising the pipeline are speculative and no proposals of this nature have materialised. Accordingly, while such developments are possible little weight has been given to them as a likely public benefit.

Benefits to regional communities

The ACCC accepts that the Project will create benefits for regional communities resulting mainly from upgrading local infrastructure as part of the pipeline construction.

Conclusion

The ACCC considers that the methodology of the model in the ACIL Tasman report and its underlying assumptions are generally reasonable. The model is an attempt to quantify the outcomes of the Project and was based on the most likely route of the Australian component of the pipeline given available information. However, each of the predicted outcomes will not necessarily occur in the quantities predicted by the report.[75] For example, the estimate in the report of the increase in employment may be incorrect if it does not take into account the jobs in other industries that will be displaced as a result of the Project. Another factor that will affect the outcomes of the model is the final route of the pipeline.

Further, the ACCC considers that some of the benefits, such as the extent of the price decreases, may be overstated. This is because those benefits would be likely to arise under an alternative project, which the ACCC considers is likely to be developed at some stage during the next 30 years (the expected life of the Project) if the Project does not proceed. However, these benefits under an alternative project would be significantly delayed and the ACCC recognises the value in having the benefits realised sooner rather than later.

While some of the quantities in the report may be uncertain the ACCC accepts that the sum of the benefits will be substantial.

In contrast to some of the views expressed by interested parties, the ACCC is of the view that public benefits arising from the Project, as distinct from the joint marketing arrangement itself, are relevant for the period in which separate marketing is not likely to be feasible. In summary, the ACCC considers that substantial public benefits are likely to result from jointly marketing Project gas in this period, including the following:

- wholesale gas prices in Queensland are likely to be lower than they would be in the absence of the Project
- increased competition in Queensland between gas and other energy sources
- greenhouse gas emissions will be lower
- capital investment will increase
- Australia's GDP and exports will increase

[75] The ACCC notes that the actual route of the pipeline is likely to differ to the route assumed by the model, as the conditional contract with Alcan for supply to the Northern Territory was negotiated subsequent to the modelling. However, this does not change the ACCC's overall conclusions.

- regional communities will benefit from improvements to local infrastructure and employment

- efficiency in industries using gas as an input will increase.

9. Anti-competitive detriments

The Tribunal has defined public detriment to be:

> …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…[76]

The detriments to be taken into account are limited by subs. 90(6) of the Act to detriments to the public caused by any lessening of competition. Anti-competitive detriments that have been accepted by the Tribunal and the ACCC include:

- a reduction in the number of effective competitors
- increased restrictions on entry
- constraints on competition by market participants affecting their ability to innovate effectively and conduct their affairs efficiently and independently.

9.1 The relevant market

In assessing anti-competitive detriments the state of competition in the future with authorisation is compared to the state of competition in the future if authorisation is denied. Defining the markets affected by arrangements proposed for authorisation assists in assessing the detriment arising from any lessening of competition.

In general terms, markets must always be defined with a view to the purpose of doing so.[77] In this instance market definition is undertaken in order to assess the impact of the proposed arrangements on the level of competition within the relevant market(s).

A market can be defined as the smallest area over which a hypothetical monopolist (or monopsonist) could exercise a significant degree of market power. If in the event of an attempt to exercise market power consumers would switch their demand to substitute products, and/or firms would switch their production to supply substitute products, the relevant market should be expanded to include those substitute products.

Markets are generally defined in product, geographic and functional terms. The timeframe over which substitution possibilities in these dimensions should be considered is relevant to market definition and is referred to as the temporal dimension of a market.

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

77 Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor (1989) ATPR 40-925 at 50,008; Australian Meat Holdings Pty Ltd v Trade Practices Commission (1989) ATPR 40-932 at 50,104.

The applicants submitted that irrespective of how the market is defined joint marketing of Project gas will not lead to any lessening of competition. According to the applicants, the dimensions of the relevant market within which competition should be considered submitted by the applicants are:

- product – energy, in which gas both competes with electricity as an energy source and is increasingly used as an alternative to other forms of energy in the generation of electricity
- geographic – eastern Australia
- functional – the sale of gas to end users encompassing industrial, commercial and domestic users.

The applicants also submitted that in the gas industry it is appropriate to consider substitution possibilities with other forms of energy over the long term.

The Frontier Economics report concluded that the relevant market in which the Project will compete is a gas market that encompasses coal seam methane and embraces at least the east coast of Australia.[78]

The relevant market advocated by the applicants was supported by AGL-Petronas. On the other hand Comalco and the EUAA argued that the market advocated by the applicants was too wide. Given the prohibitive costs of switching from gas to another fuel Comalco argued that it will be limited to sourcing supply from the market for gas in Gladstone. The EUAA argued that if the Project proceeds under joint marketing it will be difficult for alternative gas sources to compete for Queensland customers and there will be limited competition for Queensland customers.

A number of interested parties focused on the effect of the Project on competition in Queensland without commenting directly on the market advocated by the applicants.

The product and geographic dimensions of the market advocated by the applicants are broader than those previously found by the ACCC and the Tribunal for gas-related matters. The applicants submitted that the Project will result in a significant change in the nature and structure of the gas industry in Australia. They stated that a broader market definition than has previously been found in gas matters is appropriate. The ACCC recognises that markets evolve over time and has previously stated that market definition in the energy sector requires a case by case approach.[79] Therefore previous findings of market dimensions in energy matters do not demand the same findings in this matter.

The ACCC has previously found in gas-related matters that the product dimension of the markets was confined to gas. While recognising that gas competes with electricity

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[78] Frontier Economics op. cit., par 158.

[79] ACCC, Determination, Applications for authorisation: National Electricity Code, 10 December 1997 (the NEM authorisation), p. 13.

at the fringes of the market the ACCC has not previously recognised a fully integrated energy market as submitted by the applicants in this application.[80]

In considering the geographic dimension the ACCC and the Tribunal have previously found there to be a south eastern Australian market. This consisted of New South Wales, South Australia, Victoria and southern Queensland.[81] The applicants submitted that the Project will have the effect of increasing the geographic dimension to encompass Queensland, New South Wales, Victoria, South Australia, potentially Tasmania and possibly the Northern Territory.

The narrower the market is defined the fewer are the competitive constraints and the more likely it is that the joint venture will have market power and the capacity to lessen competition. If the product dimension is confined to that product supplied by the Project, i.e. gas, the joint venture will have a larger market share than if a broader product dimension encompassing other energy sources were considered. The reason is that in this broader market there are many other firms competing in the supply of various sources of energy. Similarly, if the geographic dimension is restricted to that in which the effect of the Project will be most pronounced, i.e. Queensland,[82] the joint venture will have greater market power than it would if this dimension was extended to eastern Australia.

The ACCC commences its analysis of competition in this matter in the narrow market consisting of the wholesale supply of gas in Queensland. The product dimension is extended only to include coal seam methane, which is substitutable for natural gas. If the detriments resulting from a lessening of competition in this narrow market are outweighed by the public benefits, analysis of competition effects in wider markets will not be necessary. This is because the market share and capacity to lessen competition will decrease as the boundaries of the market are expanded, and the net public benefit will invariably increase.

The next sections examine the anti-competitive detriments likely to arise in the wholesale market for gas in Queensland.

9.2 What the applicants said

The applicants argued that since the Project will facilitate a development that would not otherwise occur there is no anti-competitive detriment arising from the Project. They

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[80] See East Australian Pipeline Marketing Pty Limited Determination, 1998; VENCorp Market and System Operation Rules Determination, 1998; Mereenie Determination, 1999. In the NEM authorisation, 1997, the ACCC found that an electricity market existed, rather than an integrated energy market, but noted that in the longer term the energy markets may be integrated.

[81] ACCC, Final determination, Application by Victorian Energy Networks Corporation for authorisation of the Market and System Operation Rules, 16 October 2002, at p. 14; *Eastern Gas Pipeline* (2001) ATPR (National Competition Council) 70-007 at 76,108.

[82] Figure 3 in the ACIL Tasman report, at p. 6, indicates that the greatest impact on gas supply will be in Queensland.

submitted that actual and potential suppliers of gas, coal seam methane and other energy sources will exert strong competitive constraints on the Project and that this competition will strengthen as the market expands. The applicants also argued that the large customers with whom the Project contracts have significant countervailing bargaining power due to the fact that they have alternative energy options and are aware of the importance to the Project participants of securing sales. Therefore, according to the applicants the Project will not have sufficient market power to lessen competition.

9.3 What the interested parties said

Dominance of the Project

The EUAA submitted that the Project will restrict growth in coal seam methane and that the Cooper Basin will provide only limited competition because its reserves are declining. The EUAA submitted that the Project will dominate the Queensland market which will allow it to dictate the price, terms and conditions upon which supply will be offered. It was suggested that customers in this market will have limited ability to negotiate a competitive price or find an alternative supplier. This in turn will lead to an increase in prices.

Energex also expressed the view that the Project will dominate the Queensland market for at least some periods over the life of the Project. Energex expressed concern that conditions may be imposed in gas supply contracts under joint marketing arrangements which would not be imposed under separate marketing arrangements and that dynamic efficiencies would be lost, specifically innovation.

At the pre-decision conference the QMGUG submitted that there was a lack of competition in the upstream gas market in Queensland and PNG gas could become a monopoly. QMGUG stated that the ACCC has a role to ensure that PNG gas does not swamp the market, resulting in anti-competitive outcomes.

The EUAA assumed that the pipeline will not be regulated (for third party access) and expressed the view that this would exacerbate the detriments arising from the dominant position that the Project will occupy in the market.

Countervailing bargaining power

Queensland Alumina Ltd (QAL) stated that if its proposed cogeneration facility proceeds it will be effectively locked into using gas for the economic life of the facility. Comalco argued that those customers of the Project that invest heavily in plant in order to commit to gas, including Comalco, will not have significant countervailing bargaining power after the conclusion of their initial contracts, as the costs of switching to an alternative fuel will be prohibitive. The EUAA also commented on the limited opportunity to switch to alternative energy sources due to sunk costs and long-term contracts.

Joint marketing v separate marketing

Some of the interested parties argued that separate marketing would bring about benefits such as lower prices and dynamic efficiencies due to competition among the participants in the Project that joint marketing would prevent. These arguments are noted in the context of consideration of whether separate marketing would deliver more efficient outcomes as discussed in section 7 of this Determination.

Other comments

WMC appeared to be of the view that the Project will not result in any anti-competitive detriment. WMC stated that it will promote competition rather than having the effect or likely effect of lessening competition.

Although supporting the application TXU expressed some concern regarding the anti-competitive impacts of joint marketing in the long term. AGL-Petronas also suggested that some anti-competitive detriment (albeit limited) may arise. Nevertheless, AGL-Petronas was of the view that any reduction in competition will be greatly outweighed by the public benefits of the Project and argued that without the ability to jointly market the Project cannot proceed.

Energex argued that authorisation of joint marketing will result in resource misallocation due to the absence of price competition. This will lead to monopoly prices and higher costs. Comalco argued that joint marketing for an extended period would prevent or at least hinder the development of a more mature market and help sustain market inflexibilities.

9.4 Applicants' response to submissions of interested parties

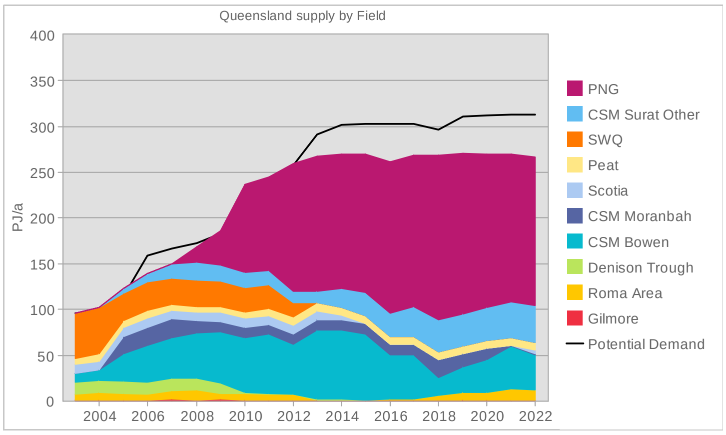
The applicants acknowledged that if the Project proceeds it will become a major supplier of gas in Queensland. However, they argued that the Project will have neither market power nor the ability to extract monopoly rents. The constraints on the Project in the supply of gas will come from coal seam methane for incremental demand, coal for major projects and non-Project natural gas. It was suggested that the only way the Project will occupy a large share of the market is if it is competitive against existing energy suppliers.

The applicants also stated that they believe that the customer market for the supply of gas in Queensland will remain illiquid and Project-based.

9.5 ACCC assessment of anti-competitive detriment

Will the Project dominate the market?

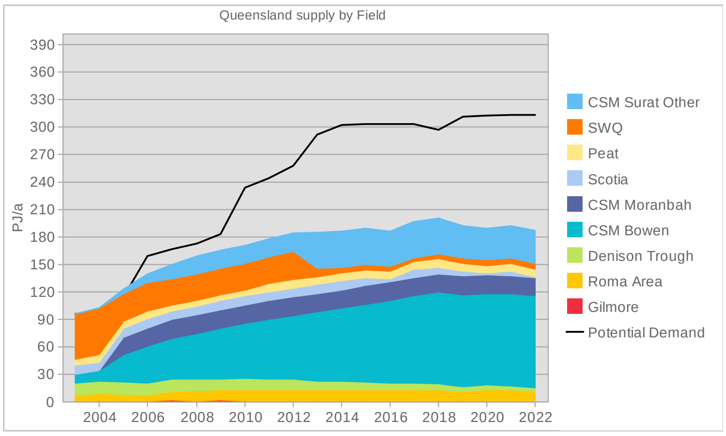
The state of the supply and demand for gas in Queensland with the Project proceeding was modelled in the ACIL Tasman report as follows.



Source: ACIL Tasman report, figure 15.

The model predicted that the Project will begin to dominate the market from around 2012. It is clear that the Project will supply a very large proportion of Queensland’s total gas supply, increasing steadily from around 30 per cent in 2010 to around 62 per cent in 2022. The second largest source of gas over this period will be coal seam methane from the Bowen Basin, contributing around 29 per cent of Queensland’s total gas supply in 2010 and declining steadily over the period to only 15 per cent in 2022. Initially, gas from south west Queensland is a significant source also. However, supply to Queensland ceases from this source in around 2013.

The future of the natural gas market in Queensland without the Project proceeding was also modelled by ACIL Tasman.



Source: ACIL Tasman report, figure 14.

The main sources of gas supplying the Queensland market under this model are coal seam methane from the Surat and Bowen basins. As to the future with authorisation gas from south west Queensland is also a significant source initially. However, this source is predicted to be depleted in around 2012 and the market left with only two significant sources. Both of these are predicted to increase their share of the market throughout the period.

The ACCC notes that the model considers only two scenarios; Queensland’s gas supply being supplemented by gas from the Project and Queensland’s gas supply not being supplemented at all. As discussed in section 7, the ACCC considers it likely that a third scenario will eventuate if the Project does not proceed; Queensland's gas supply will be supplemented by an alternative source of gas such as the North West Shelf or Timor Sea.

Will the Project possess market power?

While the Project is likely to enjoy a large market share significant market share is not synonymous with market power. The ACCC agrees with the applicants that potential customers of Project gas currently possess countervailing bargaining power and thus the capacity of the Project to impose monopoly prices and terms is limited. The difficulties the Project has encountered to date in securing sales attests to the lack of market power the Project possesses in any market at this time.

The applicants argued that this lack of bargaining power will continue over the life of the Project. It was submitted by the applicants that the process of competition between gas and other energy sources should be viewed as a spectrum over which customers are continually making investment decisions. Household consumer investment decisions relate to whether to purchase new appliances and industrial consumer investment decisions relate to whether to invest in new plant. It was submitted that at any given time a range of customers will have equipment of replaceable age and that substitution from gas to another energy source will be a viable option.

The ACCC considers that the lack of bargaining power currently held by the Project is likely to change in the future for two reasons. First, potential customers are aware that currently the Project is eager to secure sales. Once the Project is operational, however, potential customers will not know how crucial further sales are for the Project. While further custom may be necessary after the Project proceeds in order to meet required returns, the information asymmetry between Project participants and potential customers regarding the size of returns and the level of sales required to achieve them means that the bargaining power of potential customers will decrease relative to the bargaining power they currently possess.

Second, customers that invest heavily in plant to facilitate the use of gas are effectively locked into gas for the economic life of the plant, which is likely to exceed the length of the foundation contracts. For example, if the economic life of a plant is 30 years and foundation contracts are for 20 years, upon expiry of the foundation contracts there will be a number of years before the plant will be of replaceable age. Thus the only economic option for customers in such a position will be to continue to purchase gas. According to the ACIL Tasman models the Project will be the dominant source of gas in Queensland at that time. For customers with very large load requirements it may be the only source of gas able to meet their demand, particularly if Cooper Basin reserves decline as predicted.[83]

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[83] On the other hand, by that time there may be greater interconnection between the states and these customers may be able to purchase gas from interstate. Depending on the transport costs, interconnection could improve the bargaining power of the customers. However, whether or not the requisite interconnections will exist at that time with low transport costs is uncertain. The ACCC considers the more likely position to be that customers that have invested heavily in plant will have limited bargaining power upon expiry of their foundation contracts.

Given the limited scope for substitution to energy sources other than gas, coupled with the Project being the dominant supplier for these customers, it is likely that the Project will possess significant bargaining power with regard to some customers upon expiry of the foundation contracts.

The ACCC accepts the applicants' argument that at any given time there may be a number of customers with switching options and consequently those customers will possess some bargaining power. However, the ACCC also considers that the Project will possess bargaining power at various stages over its life, as some customers will have to wait a number of years after investment in plant before switching from gas to an alternative fuel source becomes an option. The ACCC expects this bargaining power will vary over time.

The degree of bargaining power will also vary among customers. Retailers and customers using gas for power generation collectively comprise 55 per cent of the projected customer profile. They will have more viable substitution possibilities than industrial customers and hence more bargaining power. However, the legislative requirement for retailers in Queensland to source at least 13 per cent of electricity from gas-fired generation will give the Project a degree of bargaining power against those customers.

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

Coal seam methane

Coal seam methane has experienced significant growth in recent years. It has developed from supplying around 2 PJ of Queensland's demand for gas in 1998 to 11 PJ in 2001, 25 PJ in 2002 and around 30 PJ of Queensland's total demand for gas of 100 PJ per annum in 2004.[84] The loss of potential customers to coal seam methane producers demonstrates that coal seam methane is currently a competitive constraint on the Project. Nevertheless, as the industry is still developing, it is difficult to make predictions about its development beyond the foreseeable future with a high degree of confidence.

Differing views were expressed on the likely future of the coal seam methane industry if the Project proceeds. Some interested parties suggested that the Project will dominate the market and stifle growth in coal seam methane. On the other hand the applicants argued that coal seam methane will act as a competitive constraint on the Project.

The applicants argued that coal seam methane is increasingly competitive with natural gas. They pointed to the CH4 contract with the Queensland Government and Origin Energy's contract with AGL as examples of its increasing competitiveness. The applicants suggested that coal seam methane does and will continue to exert a strong

[84] PESA newsletter August/September 2004 Issue 71; John Mickel (Minister for Energy, Queensland), *13 per cent gas scheme driving billion dollar developments,* media release, The State of Queensland (Department of the Premier and Cabinet), 18 February 2005.

competitive constraint on the Project.[85] QAL stated, however, that the current coal seam methane producers are relatively small and their ability to provide large quantities of gas reliably over a long period has not been demonstrated.

The EUAA argued that the coal seam methane industry is still in its infancy and that the Project will stifle its growth and inhibit its ability to compete for large customer loads. Moreover, the EUAA pointed to recent consolidation in Queensland coal seam methane producers with larger producers acquiring the assets of smaller players. According to the EUAA, smaller coal seam methane producers who remain will have difficulty competing with the larger players.

The ACIL Tasman models of the future with and without the Project predicted that coal seam methane production in Queensland will decrease in the future with the Project relative to the future without the Project. ACIL Tasman's approximate predictions of production under both scenarios are shown in Table 4.

Table 4: CSM predictions with and without the Project

	Production in 2014 (PJ/a)		**Production in 2022 (PJ/a)**	
	With the Project	*Without the Project*	*With the Project*	*Without the Project*
Surat	20	35	40	40
Bowen	75	95	40	100

Source: figures derived from ACIL Tasman report figures 14 and 15.

The effect of the Project is most pronounced on production levels in the Bowen Basin, which fall to around 40 PJ/a in 2022 with the Project proceeding compared to 100 PJ/a in the same year if the Project does not go ahead. The change in Surat Basin production levels is less significant.

Loads contracted to the Project will decrease the potential customer base for coal seam methane producers, as some of the customers the Project supplies will be customers that coal seam methane producers could supply if the Project did not proceed. While the likely effect of the large volumes of gas expected to enter Queensland is that growth in coal seam methane will be discouraged to some extent, the ACCC notes that according to the ACIL Tasman models even with the Project proceeding excess demand in the Queensland market will remain. This suggests that growth opportunities may exist.

The Queensland government is confident that growth in both coal seam methane and conventional gas production in Queensland will continue. Although it did not provide a submission on the application for authorisation, a media release of the Hon. John Mickel MP, the Minister for Energy, predicts $1 billion worth of investment in the conventional and coal seam gas industries in the south and south west of the state. According to the Energy Minister, a driver of this expected growth is Queensland's

85 Applicants' submission, 14 December 2004, par 8.3.

13 per cent Gas Scheme which began operating on 1 January 2005 and requires all energy retailers in Queensland to source 13 per cent of their electricity from gas-fired generation. The Minister stated ‘the scheme is acting as a catalyst for investment’.[86]

The Frontier Economics report noted that coal seam methane production enjoys some advantages over gas production. Those advantages include shorter lead times on project developments and proximity of reserves to users. This allows producers to avoid significant sunk costs associated with building pipelines and to minimise transport costs. If coal seam methane producers can utilise these advantages to offer competitive prices, in addition to competing for unsatisfied demand they may be able to compete for satisfied demand by filling the gap in take-or-pay contracts.[87]

The Frontier Economics report suggested the coal seam methane industry is developing, and pointed to the Parer Review’s observation that ongoing research into extraction techniques continues to lower production costs.[88] Suggestions of growth in the industry are supported by an article in The Financial Review on 7 January 2005 reporting that an announcement by Queensland Gas of ‘extremely successful new completion techniques’ triggered an 11.5 per cent increase in its share price.

While it is clear that coal seam methane has been competing with the Project for foundation customers it is difficult to predict the future of the coal seam methane industry in Queensland. Nevertheless, given the growing market for gas in Queensland, the advantages coal seam methane production enjoys over conventional gas and the ongoing research into extraction techniques, the ACCC considers it is likely that coal seam methane will remain competitive for the foreseeable future and that the establishment of PNG gas will not foreclose this development.

Joint marketing and cross-ownership

Potential anti-competitive detriments may arise where a participant in the Project has other economic interests, either directly or through a related body corporate, in gas businesses in eastern Australia, for example, where cross-ownership among PNG gas producers and producers in other gas basins exists.

Currently, the only participant in the Project with such an interest is ExxonMobil through its subsidiary Esso Australia, which has interests in gas fields in Bass Strait in Victoria. However, if authorisation is extended to future participants, the extent of cross-ownership may increase (for example, if Santos joins the Project).

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86 John Mickel (Minister for Energy, Queensland), *13 per cent gas scheme driving billion dollar developments*, media release, The State of Queensland (Department of the Premier and Cabinet), 18 February 2005.

87 Take-or-pay contracts require the purchaser to agree to purchase a minimum percentage (usually at least 80 per cent) of the total annual volume of gas specified in the agreement in a contract year, with provision for gas paid for but not taken in a contract year to be taken free of charge in the subsequent contract year.

88 Parer Report p. 185, as cited in Frontier Economics op. cit., at p. 30.

Under joint marketing arrangements each of the participants in the Project would have access to commercially sensitive information about the Project's customers, such as pricing, volumes and delivery points. The potential exists for such information to be inappropriately disclosed and used in an anti-competitive manner by parties who have other gas interests in eastern Australia. As Energex submitted a Project participant could use this information as leverage in negotiations in respect of its other interests in gas basins in Australia.

This issue would not be of such concern under separate marketing arrangements, as potential customers would have a choice of suppliers within the joint venture with whom to negotiate. Under separate marketing arrangements commercially sensitive information would not be shared in the same manner as under joint marketing arrangements.

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

Conclusion on anti-competitive detriment

Currently, in the ACCC's view, there is little to no anti-competitive detriment from the joint marketing of Project gas. Arguments claiming that joint marketing results in anti-competitive detriment that would not arise under separate marketing are not relevant for the foreseeable future in which separate marketing is not a viable option for the Project.

In contrast to some of the views expressed that the dominant position the Project will occupy in the Queensland market will lead to an increase in prices, the ACIL Tasman report suggested that prices in Queensland will fall steadily as a result of the Project. While the figures in the ACIL Tasman report are predictions that may not eventuate in the exact quantities expected, the ACCC agrees with the substance of the predictions. That is, prices in Queensland are likely to fall at least in the short to medium term as a result of the entry of Project gas.

Although coal seam methane production in Queensland is likely to face greater competitive pressure from the Project, the ACCC expects it will continue to compete against the Project. While the Project will possess some bargaining power, the ACCC expects that other energy sources will constrain the Project from exercising market power and imposing monopoly prices, at least in the foreseeable future. Among these sources will be gas from the Cooper Basin, which will constrain the Project at least in the first few years of operation.

Over time the Project is forecast to become the major source of gas supply into Queensland. While this in itself is not synonymous with market power, it is conceivable that the Project could possess market power at some stage in the future. This problem could be exacerbated if the composition of the joint venture changes, as is likely, particularly if it leads to cross-ownership between gas basins or alternate, future sources of supply.

10. Balancing public benefits and anti-competitive detriments

10.1 What the applicants said

The applicants submitted that the Project will generate significant public benefits and no anti-competitive detriments and, therefore, that authorisation should be granted. Alternatively, they argued that if the ACCC considers there to be a lessening of competition arising from the joint marketing arrangements, the public benefit would significantly outweigh any detriment to the public and authorisation should be granted.

10.2 What the interested parties said

There was consensus among all of the interested parties that joint marketing should be authorised at least until financial close, implying that a net benefit will arise from the conduct at least until financial close.

10.3 ACCC assessment

The ACCC must not grant authorisation unless it is satisfied that the public benefits outweigh, or are likely to outweigh, the detriments arising from any lessening of competition due to the joint marketing conduct.

For the period in which separate marketing is not a feasible option for the Project the joint marketing of Project gas will allow substantial public benefits to be realised and the detriments arising from any lessening of competition in the wholesale market for gas in Queensland will be sufficiently low such that a net public benefit will arise. Consideration of broader markets encompassing other energy sources and/or the whole of eastern Australia is unnecessary as a net public benefit will invariably arise for the period in which separate marketing is not feasible.

Should separate marketing become a feasible option the relevant benefits of joint marketing are only those that would not also arise under separate marketing. Benefits relating to the Project would no longer be relevant, because they would materialise under both joint and separate marketing. Conversely, arguments relating to detriments from joint marketing relative to separate marketing would become relevant, because those detriments would not materialise under separate marketing.

Potential benefits of joint marketing while separate marketing is feasible could include the avoidance of the cost and complexity of balancing arrangements and lower negotiation and transaction costs for gas users. Potential detriments could include the loss of dynamic efficiencies and the loss of the potential for lower prices that may eventuate if one or more Project participants were willing to accept lower returns than those under joint marketing. Further detriments associated with joint marketing arrangements could arise where cross-ownership among sources of gas supplies exists. These detriments include the potential exercise of market power in an anti-competitive manner and the potential for a Project participant to inappropriately disclose confidential information obtained through joint marketing.

Given the uncertainties regarding the state of the Queensland gas market in the future, the ACCC is not satisfied beyond the time that separate marketing becomes feasible that the public benefits of joint marketing are likely to outweigh the detriments arising from any lessening of competition. This is because the state of the market and the competition therein is uncertain and, accordingly, an assessment of the extent of the anti-competitive detriments cannot be made.

Analysis of wider markets would not facilitate a conclusion in favour of authorisation beyond the point at which separate marketing becomes feasible. This is because the state of competition in broader markets in the future is also uncertain and the ACCC cannot predict the extent of the likely detriments arising from any lessening of competition. Therefore, the ACCC is not satisfied that a net public benefit will arise after the point at which separate marketing becomes feasible, regardless of the dimensions of the market. This does not mean that the ACCC is of the view that a net public detriment will definitely arise. Rather, it reflects the fact that on the basis of the information currently available the ACCC cannot be satisfied that a net public benefit will arise beyond that time.

Given the development of the gas market/s in Australia that has occurred in recent years, the ACCC is not satisfied that separate marketing will remain infeasible for the life of the Project. While the ACCC is satisfied that the benefits currently outweigh any detriments it is not satisfied that they will continue to do so for the life of the Project.

Accordingly, the ACCC has decided to grant authorisation for a limited period only. Moreover, the ACCC has decided that the circumstances under which future participants will be automatically covered by the authorisation be restricted. Further, the ACCC is cognisant of the concerns raised by interested parties regarding the applicants' access to confidential information. The ACCC notes that the applicants have proposed that joint marketing occur within the context of ring-fencing and confidentiality arrangements which have the purpose of maintaining the integrity of confidential information. These issues are discussed in detail in the next sections.

10.4 Duration of the authorisation

Section 91(1) of the Act states:

> An authorisation may be expressed to be in force for a period specified in the authorisation and, if so expressed, remains in force for that period only.

The issue of joint marketing in the long term has been considered by the UIWG and more recently by the Parer Review.

The UIWG supported separate marketing in the long run. It stated:

> … whilst joint marketing of gas may be appropriate in many Australian gas markets in the short-term, it recommends that the policy objective in this area should be to encourage separate marketing whenever and as soon as this is feasible. [89]

The Parer Review was mindful of the potential for long-term authorisations of joint marketing to hinder the emergence of separate marketing, recommending in the context of authorisations of joint marketing:

> Given the ongoing reforms and changes in the gas industry, the Panel believes that any authorisations granted should contain a review date.[90]

This recommendation was endorsed by the Ministerial Council on Mineral and Petroleum Resources and subsequently by the Ministerial Council on Energy.[91]

10.4.1 What the applicants said

The applicants sought authorisation for the life of the Project, which they estimate to be in the order of 30 years. They submitted that a long-term authorisation is required to provide commercial and regulatory certainty and that without a long-term authorisation the project will not proceed. In the absence of a long-term authorisation they could not attract sufficient commitment from customers necessary over the life of the Project to justify the substantial costs and risk. The applicants asserted that a long-term authorisation is a requirement of their financiers also.

They further submitted that an authorisation placing a time limit on the period during which joint marketing may be undertaken will have a significant impact on the analysis of the financial viability of the Project for the participants, their financiers and AGL-Petronas. The applicants stated:

> If the Participants are not permitted to jointly market gas, or are only permitted to jointly market for a short period of time, the resulting uncertainty over the stream of Project revenue into the future is likely to result in the Participants (or their financiers) not proceeding with the Project.[92]

According to the applicants a requirement to separately market before the life of the Project ceases would adversely affect the cost and availability of finance. Before agreeing to commit funds financiers will need to be satisfied of the capacity of the borrowers to service the debt. The ability of the Project to generate revenues will be a significant factor in a financier’s consideration of whether to provide finance. The applicants stated that financiers are likely to consider the requirement to separately market gas as diminishing the security of anticipated sales, and will factor this increased risk into the cost of debt.

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89 The UIWG Report, p. 4.

90 Parer Report p. 219.

91 MCE Statement on Upstream Gas Issues, December 2004.

92 Applicants’ submission, 14 December 2004, par 6.52.

Moreover, the applicants submitted that financiers will only provide finance in relation to foundation contracts if they are free from significant variation during their full term. They also argued that a requirement to separately market after financial close will adversely affect the cost and availability of finance necessary to proceed with the Project. Further, it will negatively affect their ability to obtain refinancing after financial close should further capital expenditure be required or should the participants wish to optimise their debt or cash flows.

10.4.2 What the interested parties said

In response to the application

In their submissions some interested parties expressed concern with the applicants' proposal for a long-term authorisation. While acknowledging that joint marketing is required for the Project to proceed, some parties submitted that separate marketing should be feasible after financial close.

Moreover, concern was expressed that the PNG producers will dominate the market in the medium term. Some parties submitted that this will allow the PNG producers to exercise market power and charge monopoly prices.

Comalco and the EUAA both referred to the application for interim authorisation in 2000 (in which the applicants requested interim authorisation until financial close only) and submitted that this indicated that authorisation was unnecessary beyond financial close. The EUAA submitted that the Project's financiers should get sufficient comfort that the project is viable up to financial close and authorisation beyond that point is not warranted.

In response to the Draft Determination

The AGL-Petronas Consortium (APC) supported the term of 16 years proposed in the Draft Determination. APC stated:

> … the financial viability of the Pipeline and the financial viability of the Project are dependent upon the ability of the PNG Gas Producers to market a sufficient level of gas, not only through to Project Sanction and Financial Close of the Project but also well into the future.[93]

APC submitted that the commitment of equity participants and financiers will be required and will be dependent on the reliability of projected revenues. In APC's view this will require a continuation of joint marketing after financial close. A similar view was expressed by NRG Flinders at the pre-decision conference.

The QMGUG questioned the need for authorisation beyond financial close. The QMGUG submitted that the Queensland gas market has undergone significant change over the last year and it is difficult to predict the state of the market over the next 16 years. In the QMGUG's view further rationalisation is likely and there is a need for the ACCC to review the authorisation before the proposed 16 year term of the authorisation.

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[93] APC submission, 15 March 2006, p. 1.

At the pre-decision conference Comalco submitted that the applicants had not provided sufficient evidence that the structural impediments to separate marketing will be sustained for the next 30 years. Comalco stated that unless the ACCC was satisfied that separate marketing will not be feasible at some stage in the next 30 years, the appropriate course of action is to grant a relatively short-term authorisation so that the development of the market can be reviewed.

On the other hand, Santos submitted that the ACCC has the right under s. 91B of the Act to revisit the Determination should there be a material change of circumstances.

The EUAA disputed that the likely term of project financing is as long as 15 years. The EUAA presented a number of reasons to support its argument. For example, the EUAA stated that the term of finance is likely to be limited to political risk insurance (5-7 years for PNG) and export credit agency finance, which will depend on the input sourcing strategy. Moreover, the EUAA questioned why financiers would require joint marketing after financial close given that contracted volumes are likely to be close to full capacity. The EUAA also noted that at the pre-decision conference the applicants stated that ExxonMobil was not intending to seek project finance.

The EUAA submitted that little reliance could be placed on s. 91B of the Act which allows the ACCC to review an authorisation before its expiry if there has been a material change in circumstances. The EUAA submitted that a review of the ACCC's authorisation register has shown that since January 1999 the ACCC has on only one occasion threatened to use its powers under s. 91B. In EUAA's view, the reasons for this are:

- Revocation involves a reversal of proof with the ACCC having to demonstrate that the anti-competitive detriment now outweighs the public benefits.

- Only the ACCC can initiate a review. An interested party could approach the ACCC for a review but the ACCC is not obliged to act on it.

The EUAA stated that the eastern Australian gas market is undergoing significant change and it is difficult to predict the state of the market 'in 5 years time, let alone 16 years'.[94] Accordingly, the EUAA submitted that the ACCC should either retain an ability to review the authorisation outside the constraints of the s. 91B provisions, or only allow a short authorisation term with the applicants having the ability to reapply for authorisation.

Alternatively, the EUAA submitted that the duration of the authorisation could be linked to attainment of a certain level of volumes. The EUAA stated:

> … the Commission could consider an approach based on joint authorisation [sic] until certain threshold volumes are achieved to meet reasonable Project return requirements. This would suggest that if there is little uncontracted pipeline capacity at the time of financial close, then the threshold volumes may well have been achieved.[95]

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[94] EUAA's submission, 15 March 2006, p. 7.

[95] EUAA's submission, 15 March 2006, p. 14.

The EUAA did not propose a specific level of volumes. However, the EUAA did also submit that the authorisation should not apply to any expansion of the Project.

The EUAA submitted that authorisation in relation to foundation contacts should be extended for the full term of the contract if the contract term is longer than the authorisation period. However, in EUAA's view if the ACCC grants authorisation beyond financial close the authorisation should not be extended for contracts written after financial close. The EUAA stated that by allowing a 20 year contract written in, say, year 15 of the authorisation to be 'grandfathered' in this manner, the ACCC would effectively be granting an authorisation for a period of up to 35 years.

10.4.3 Applicants' response to submissions of interested parties

In response to the application

The applicants advanced a number of arguments in response to the suggestion by some interested parties that authorisation should apply until financial close only.

First, it was argued that both the Project participants and their financiers will expect the participants to be in a position to secure further gas sales contracts after financial close. Any impediment to obtaining contracts, including the requirement that Project participants separately market gas, will increase the risk that further sales will not be achieved. The increased risk profile may delay financial close while participants seek further contracts to mitigate the additional risks. The applicants suggested that this has the potential to create a negative cycle where the loss of custom delays financial close and the delays cause the loss of further customers as they choose alternative energy sources to meet their needs. This may prevent the Project from ever reaching financial close.

Furthermore, the applicants submitted that a variety of events could occur that might lead to lower than expected returns from contracts secured before financial close. Insolvency of a foundation customer was cited as one possible event. The applicants concluded, therefore, that revenues from contracts secured before financial close are not the only relevant consideration in the analysis of the Project's risk-adjusted returns.

Furthermore, the applicants submitted that if authorisation was granted only to financial close there would be a potential for misalignment of commercial interests between the applicants if they were forced to engage in separate marketing. Such a potential misalignment may add to the financial risks of the Project. The necessary agreements for the administration of separate marketing would also need to be finalised before financial close if a short term authorisation for joint marketing was granted. The applicants submitted that this would add to the complexity of the Project development.

The applicants also pointed to a number of decisions by international regulators and courts granting long-term exemptions from competition regulations or laws for projects requiring the investment of significant amounts of capital in order to commence supplying a new service. The decisions recognise that an increased level of risk would result from a shorter exemption.

In response to the Draft Determination

Given that the ACCC in its Draft Determination proposed not to accept the applicants' proposed term of life of project but instead proposed a term of 16 years, at the pre-decision conference the EUAA asked what term would be acceptable to the applicants. The applicants responded that 16 years would be the minimum acceptable authorisation period. The applicants maintain that the Project will not proceed under a short-term authorisation and that is important that the authorisation term is at least as long as the financing term in order for the Project to proceed.

The applicants reiterated that financiers are keen to see the Project obtain authorisation beyond financial close so that the Project is as robust as possible. The applicants submitted that financiers seek reassurance that the applicants will be able to secure additional sales after financial close and that the Project is operated in a way that will not upset the Project's revenue base and cash flow.

The applicants submitted that irrespective of whether ExxonMobil seeks external financing, the Project will not proceed unless the applicants who are seeking external financing are able to obtain finance. Therefore the term of project financing for these applicants is the appropriate measure for the term of the authorisation.

Moreover, the applicants submitted that the Project is one of many potential projects in which ExxonMobil is participating globally and each project is competing for internal finance. ExxonMobil would have to consider and address the same risks as the applicants who are seeking external financing. Accordingly, internal financiers also require the regulatory certainty that a long term authorisation provides before investing in the Project.

The applicants disagreed with the proposal to link the duration of the authorisation to the attainment of a certain level of volumes for the following reasons:

- A decision to sanction the Project will be based on several factors, not just the attainment of a certain level of volumes.
- The applicants and their financiers will have regard to the ability to secure sales after financial close as a buffer against the risks of failing to secure cash flows under foundation contracts (for example, because of insolvency or force majeure) and to meet required rates of return.
- It will increase the uncertainty surrounding the investment in the Project as financiers would be unsure of the cash flow once the level of volumes is reached.
- It will restrict the applicants from jointly marketing to expand the Project and deny the community the ancillary public benefits.
- It will restrict the ability of the Participants to act in the event of customer insolvency or a force majeure event occurring.
- It will not allow the applicants to offset any unexpected additional costs of developing the Project.

- The applicants have negotiated only one firm contract to date and there is no certainty that the indicative term agreements will convert to the same volume levels under sales agreements.

The applicants submitted that 'grandfathering' of contracts written within the authorisation period was necessary for the following reasons:

- In the absence of 'grandfathering' of contracts, the applicants and their financiers may have doubts about the applicants' ability to continue to conduct their business affairs in relation to contracts without potentially breaching s. 45A of the Act.

- Customers require certainty of the legal status of the applicants' dealings with them and the applicants' ability to properly manage the gas supply agreements. Without this certainty potential customers may be reluctant to commit to the Project.

- The owners' ability to compete would be affected as customers would be unwilling to enter into contracts before the expiration of the authorisation period because of the uncertainty, nor would they be willing to enter into short-term contracts.

- If the applicants are unable to obtain security of returns through long-term incremental contracts, they are unlikely to undertake future investment beyond foundation customers, threatening any expansion of the Project.

- In the absence of 'grandfathering' of contracts, complex gas balancing arrangements, which would be costly and difficult to negotiate, would need to be put in place.

- Joint production and marketing is the basis on which financiers are assessing the Project. If contracts are not 'grandfathered' the risk profile of the Project will change and thus the financiers' assessment of the Project will also change.

10.4.4 ACCC assessment

The applicants sought authorisation for the life of the project. The applicants' current estimate of the life of the project is 30 years. However, as this is only an estimate it could conceivably be longer. Following the Draft Determination the applicants have submitted that the proposed duration of the authorisation of 16 years is the minimum term required for the Project to proceed.

Given the uncertainty surrounding future market conditions the ACCC cannot be confident that the public benefits will outweigh the detriments for an indeterminate time or even for a period as long as 30 years. While there are reasonable arguments justifying joint marketing to facilitate the development of the Project, the arguments for an authorisation for the life of the Project are not so compelling.

It is uncertain that separate marketing will not become feasible at some stage. As discussed earlier, the public benefits of the Project can only be attributed to the conduct of joint marketing while separate marketing is not feasible. Moreover, the ACCC agrees with the view that separate marketing, where feasible, can add value and lead to enhanced dynamic efficiency. There is more scope under separate marketing arrangements for users to negotiate more flexible terms and conditions. Moreover, the detriment of inappropriate use of commercially sensitive information that could arise under joint marketing arrangements when there is cross-ownership of competing sources of gas supply is diminished under separate marketing arrangements.

Nevertheless, even if separate marketing becomes feasible, there may well be other benefits inherent in joint marketing that outweigh any anti-competitive detriment. That is a matter for the Project participants to argue at the appropriate time.

The applicants advised that the 2000 application was framed to apply only until financial close for reasons of expediency. It was a preliminary step and not intended to be binding or indicative of an intention to proceed with the Project if authorisation was granted for that period. The ACCC accepts this. Further, the ACCC notes that circumstances have changed since 2000, the most noteworthy being changes to the composition of the participants in the Project. Even if the view was taken at that time that authorisation until financial close would be sufficient, this view may have changed.

The applicants have indicated that authorisation for the life of the project may be a requirement of their financiers. The applicants referred to a report by Macquarie Bank to the ACCC in May 2002 which covered the issues for debt and equity providers in assessing greenfield gas pipelines. As the applicants noted, many of the principles can be applied to major gas developments such as the Project.

As the applicants point out, the Macquarie Bank report states that the greater the certainty of projected cash flows the lower the risk profile, the greater the debt capacity and the lower minimum debt cover ratios required by the financiers. The Macquarie Bank report states:

> For an infrastructure asset which is expected to have a very long life with very stable and predictable cashflows, Debt Providers will generally not require as big a comfort margin as for risky projects. They may be expected to offer debt facilities which do not amortise quickly, if at all and the interest margin may be lower. With shorter life assets or those with less predictable cashflow, the Debt Providers will require debt to be paid down more quickly.
>
> Generally if a pipeline has contracted revenue and the Debt Provider believes that the market risk beyond the end of the contract is too great for it to take, then it will require its debt facility to amortise fully prior to the expiry of the contract. If some level of market risk is acceptable to the Debt Provider, it will structure the debt facility so as to ensure that amortisation can occur from the acceptable cashflows.[96]

The Macquarie Bank then discussed the various risk categories of infrastructure assets which would influence the structure, level and cost of finance. These include; general business risk, construction risk, operations risk, project vehicle and legal due diligence, market and revenue risk, capital expenditure and other expenses, environmental and native title risk, interest rate and inflation, regulatory risk, by-pass risk, and financial risk. As can be seen, regulatory risk is just one of many factors.

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96 Macquarie Bank, report to the ACCC, *Issues for debt and equity providers in assessing greenfields gas pipelines*, May 2002, p. 12, as cited in the applicants' submission, 14 December 2004, par 6.32, p. 40.

There is some risk to the Project with respect to the signing of additional contracts after financial close and the renewal of foundation contracts. This applies irrespective of whether the participants jointly or separately market their gas and depends on market conditions at the time. The term of the authorisation may be one of many factors influencing the structure, level and cost of finance. That is a matter for negotiation between the applicants and financiers.

The ACCC does not consider that an authorisation for the life of the Project is necessary for the applicants to obtain finance to fund the Project. Information obtained by the ACCC in confidence suggests that given the nature of the Project financiers are likely to require authorisation for the term of the project finance, which would likely to be in the order of 15 years.

Setting a time limit (prior to the end of the Project) on the authorisation does not mean that the Project participants will be forced to separately market their gas when the authorisation has expired. The applicants have the option of applying to the ACCC for a new authorisation if they have any competition concerns. The ACCC will consider the application on its merits at the time. Energex submitted that there should be no possibility of renewal of the current authorisation, if granted, once it ceases. The ACCC, however, cannot impose such a condition.

For reasons cited above the ACCC does not consider that authorisation should be granted for the life of the Project. On the other hand, the ACCC does have some concerns with the proposal that authorisation should be limited to financial close. First, the ACCC is not convinced that separate marketing will necessarily become a feasible proposition immediately after financial close, or that there will be an increase in anti-competitive detriments.

Moreover, the ACCC considers that the arguments presented by the applicants in its supplementary submission against the authorisation ceasing at financial close are valid. In particular, additional contracts may need to be negotiated after financial close for the applicants to earn a sufficient return on their investment. While to date the applicants have negotiated a number of indicative term agreements only one firm contract has been negotiated, that with AGL.

Accordingly, the ACCC considers that an authorisation for a period beyond financial close is appropriate.

One option available to the ACCC is to set the period of authorisation at 15 years after financial close, coinciding with the likely term of finance that has been advised to the ACCC. As the date of financial close is not yet known, the expiry date of the authorisation would also be uncertain. The ACCC has decided that the authorisation should cease 16 years after the date of the authorisation. This provides 12 months for the Project to reach financial close.[97]

The ACCC notes the comments of the EUAA that this term of project finance may be overstated. On the other hand the applicants are confident that this term is realistic. The

[97] Current indications are that the Project will reach financial close in the second half of 2006.

ACCC is mindful of the need to ensure that authorisation is granted for a period of time that ensures that the Project will proceed. If the Project does not proceed the public benefits of the Project will be lost. While the ACCC has aligned the term of the authorisation to the likely project financing period, the ACCC considers that equity holders would also likely require a reasonably lengthy authorisation period before committing funds to the Project. Accordingly, the ACCC is not persuaded to change its view from that expressed in its Draft Determination.

Alignment to a level of volumes

The ACCC is not convinced that the duration of the authorisation should be aligned to the attainment of a particular level of volumes. The ACCC considers that this would create uncertainty in terms of the timing of the expiry of the authorisation with adverse consequences for the project partners and customers. There are also practical and legal impediments to setting an appropriate threshold level.

As the applicants stated only one sales contract has been negotiated to date. Hence the final capacity of the Project and foundation contract volumes, and the choice of an appropriate threshold level of volumes, are inherently uncertain. The scope of the Project has changed since the applicants submitted their application in December 2004. Since then the applicants have signed a supply contract with AGL and negotiated an indicative term agreement with Alcan for delivery of gas to Gove. In their submission of 14 December 2004 the applicants anticipated that the capacity of the Project would be 200 PJ/pa. EUAA submitted that the total volumes including indicative term agreements, the contract with AGL and other potential customers amount to between 220 PJ/pa and 300 PJ/pa, suggesting the final capacity could be as high as 300 PJ/pa.

Given that the applicants are negotiating a range of volumes under each indicative term agreement, the issue arises of what threshold level of volumes would be appropriate for authorisation purposes. Where the applicants are negotiating with multiple potential customers and the total volumes involved exceed the authorisation limit the legality of those negotiations is called into question. Similarly, if the applicants are negotiating with the marginal customer and that customer requires a load that takes the total volumes over the threshold, doubt is then cast on the legitimacy of the negotiations for the volumes above the threshold.

In the event of insolvency of a customer, there would be uncertainty as to whether the authorisation has lapsed or whether the participants could again jointly market up to the threshold level. In any case, it is likely that the participants would wish to start negotiations with new customers as soon as they perceived that an existing customer was in financial difficulties. If they had to wait until the customer ceased to trade before they could commence marketing to new customers the joint venture’s cash flows could be adversely affected.

The applicants have submitted that the final costs of the Project are still estimates and therefore the breakeven threshold of volumes is unknown. If the threshold level of volumes for authorisation purposes is to be set at some breakeven level, this presents difficulties in setting a specific threshold.

An underlying assumption in setting a threshold level of volumes is that the applicants would separately market gas above that level. That may not be the case. Another plausible outcome is that once the threshold is reached that applicants will market no more gas beyond the threshold level. Hence, there would be no marketing of Project gas until the foundation contracts expire in 20 years. One of the public benefits of the Project is that it provides a new source of gas to meet the growing demand for gas in eastern Australia. It would be a perverse outcome if in attempting to increase competition by setting a threshold level of volumes for the authorisation a major player in the market is discouraged from competing further in the market.

The applicants have previously submitted that their financiers may be looking for the Project to secure additional cash flows beyond financing close to ensure that the Project has the capacity to meet its debt obligations. Aligning the authorisation to a level of volumes would create uncertainty for financiers in terms of future cash flows.

From a legal perspective, the statutory test states that the ACCC may grant authorisation if it is satisfied that the public benefits of the conduct outweigh any anti-competitive detriment. For the ACCC to restrict the authorisation to a particular level of volumes, it would have to conclude that once the threshold is reached, the anti-competitive detriments of joint marketing conduct above this level would outweigh the public benefits. The ACCC does not consider that there is any evidence to justify this conclusion.

Given the uncertainty that setting a threshold level of volumes is likely to create for the applicants, customers and financiers of the Project in terms of the expiry of the authorisation, the ACCC considers that a more appropriate course of action is to set a specific time period for the authorisation.

Review outside of s. 91B

The EUAA has submitted that the ACCC should consider a review of the authorisation outside the provision of s. 91B of the Act. However, the ACCC is required to assess the application for authorisation in accordance with the provisions of the Act. The review suggested by the EUAA would be tantamount to an earlier expiry date under subs. 91(1) of the Act.

The EUAA stated that the ACCC cannot rely on s. 91B of the Act (material change of circumstances) to review the authorisation prior to its expiry date. In support of this view the EUAA noted that this mechanism is rarely used by the ACCC. It is worth noting, however, that many authorisations granted by the ACCC are of a relatively short-term nature, five years or less. On the other hand, for authorisations dealing with long-term projects with significant upfront investment, the ACCC recognises that in these cases a longer authorisation period may be warranted.[98]

Grandfathering of contracts

The authorisation is of joint marketing conduct between the applicants. The terms and conditions of gas sales contracts between the applicants and their customers are not covered by the authorisation. Nevertheless, those gas sales contracts will be entered into pursuant to the joint marketing conduct.

98 ACCC *Guide to Authorisation* (draft for comment), February 2006.

Contracts negotiated within the authorisation period are likely to contain clauses requiring the periodic renegotiation of the terms and conditions (including price) and these contracts may extend beyond the duration of the authorisation. For example, the applicants have negotiated conditional agreements to date with terms of 20 years. Hence, there may some uncertainty regarding the validity of any clauses requiring the applicants to jointly renegotiate specific terms and conditions of those contracts after the expiration of the authorisation. To remove any doubt the ACCC has decided that the term of the authorisation should be extended to cover these circumstances. A similar provision was approved in the 1998 North West Shelf (NWS) authorisation.

The extension is limited to gas sales contracts entered into during the currency of the authorisation and where:

- the gas sales contract contains provisions for renegotiation or redetermination of terms and conditions of supply during the life of the gas sales contract; and
- the contract expires after the period of the authorisation.

The extension only applies to the initial term of a gas sales contract. It does not apply to any renewal of a gas sales contract where the commencement of the renewal period would occur after the expiration of the authorisation.

The EUAA submitted that 'grandfathering' should be confined to foundation contracts. However, the ACCC sees no reason to distinguish between foundation contracts and contracts written after financial close. Any uncertainty surrounding the validity of renegotiation clauses applies equally to all contracts.

The EUAA submitted that by extending the authorisation for the life of contracts written after financial close the ACCC will effectively be granting an authorisation term up to 35 years. However, this is unlikely to be the case for most contracts. The ACCC's decision to 'grandfather' all contracts written within the authorisation period is made in the knowledge that foundation contracts will be written for 20 years. Therefore, the authorisation will expire before the foundation contracts expire. When the foundation contracts expire – and these are likely to account for the bulk of the volumes – new contracts will be negotiated either under a new authorisation (if one is granted at the time) or under separate marketing arrangements. If, as the EUAA submitted, volumes under foundation contracts are close to full capacity at financial close, then any prolonged extension of the term of the current authorisation is likely to apply only to volumes at the margin.

The EUAA raised an issue that was discussed in the North West Shelf Determination. That is, the reluctance of customers to agree to long-term contracts in the final years of the authorisation given the uncertainty concerning how gas will be marketed after the authorisation expires. In that matter the ACCC stated:

> … at the time of contract negotiation, both parties should have some confidence in assessing whether the Commission would continue to authorise joint marketing after 2005 [the expiry date of the North West Shelf authorisation] and, therefore, whether a better deal under separate marketing would be possible beyond the time period of this authorisation. Indeed, should it appear that joint marketing would not be authorised after 2005, purchasers should not be disadvantaged in negotiations. If anything, they would stand to benefit as the risks for

producers associated with separate marketing beyond 2005 could be factored into negotiations with producers prior to the end of the authorisation period.[99]

The ACCC does not consider that gas users will be disadvantaged by grandfathering contracts written within the authorisation period. For foundation customers, there may be an incentive for the PNG participants to put pressure on those customers to renew their contracts before the authorisation expires in order to gain the advantages of joint marketing beyond the authorisation period. However, customers would only agree to break their existing contracts if they considered that they would be able to negotiate favourable new terms and conditions, including price. Similarly, potential customers could use the imminent expiry of the authorisation as a factor in their negotiations with the Project participants.

The ACCC does not consider that the alternative of not grandfathering contracts written after financial close would be more favourable for customers given the uncertainty surrounding the contract after the authorisation has expired. It may be that in the lead-up to the expiry of the authorisation PNG participants or potential customers will be less willing to negotiate long-term contracts. This could put the PNG participants at a competitive disadvantage. Alternatively gas users who are looking for the security of supply that a long-term contract offers could be disadvantaged.

The applicants have submitted that they will proceed with the Project when they have sufficient firm contracts in place to make the Project viable, but would likely rely on additional contracts after financial close to earn a reasonable return on their investment. One of the arguments against granting authorisation to financial close only is that this may encourage the PNG participants to seek more foundation contracts than they would seek under a long-term authorisation. That is turn would unduly delay the Project and increase the overall risk of the Project not proceeding. The same scenario could arise if grandfathering of contracts is restricted to foundation contracts.

10.5 Parties to the Authorisation

The applicants have proposed that authorisation should cover future participants in the Project. The composition of the joint venture has changed over time and the applicants stated in their supplementary submission that the structure of the Project is very likely to continue to change. The conditional agreement for the sale of a ten per cent share in the Project to AGL, which was reached after the supplementary application was lodged, is one example of such a change. The applicants also indicated there is a potential for the State of PNG to enter the Project and/or other third parties with interests in licences containing Project reserves to become participants (such as the Santos group of companies).

The applicants argued that requiring them to re-apply for authorisation to cover new participants would be a costly administrative exercise and could delay the Project. They also stated that it might be a problem for their financiers. It was further argued in the supplementary submission that if new participants were forced to separately market gas

[99] North West Shelf determination, p. 43.

in the future, the Project's ability to secure gas contracts could be undermined and therefore all participants, both current and future, need the ability to jointly market.

Some submissions expressed concern with the proposal that any future participants in the Project will be automatically covered by the authorisation, particularly if a future participant already had a market presence in eastern Australia. In that case it has been suggested that the applicants should have to re-apply for authorisation. If authorisation were granted it should be subject to ring-fencing provisions similar to those imposed by the ACCC when granting interim authorisation in 2000.

In response to the Draft Determination the PNG Government submitted that the authorisation needs to be flexible enough in order to accommodate changes in the membership of the Project, including the State of PNG's entry to the Project.

The applicants noted in their supplementary submission that the circumstances which prompted the ACCC to require confidentiality arrangements under the interim authorisation have changed. Specifically, Santos is no longer a participant in the Project and ExxonMobil no longer has an interest in the Cooper Basin. Given these changes the applicants considered that ring-fencing was no longer necessary.[100] Nevertheless, in their supplementary submission the applicants stated they were willing to address concerns regarding confidentiality. The applicants are now proposing that joint marketing conduct will be undertaken within the framework of ring-fencing and confidentiality arrangements to address the concerns.

The ACCC understands that the parties entered into confidentiality agreements among themselves as a matter of course to protect commercially sensitive information obtained through joint marketing activities.

Features of the arrangements include:

- a comprehensive definition of 'confidential information' adapted from the *National third party access code for natural gas pipeline systems* (the Gas Code)

- a requirement that the participants must offer potential customers a confidentiality deed in similar terms to the arrangements

- provision of disclosure to related bodies corporate and third parties only for the purpose for which the information was given or for a purpose agreed to with the customer or prospective customer

- related bodies corporate and third parties (and their contractors, consultants and advisors where applicable) to provide undertakings to keep the information confidential

[100] However, this does not mean that circumstances will not change in the future and some cross-ownership could occur. For example, Santos may rejoin the Project.

- ring fencing provisions prohibiting the passing of confidential information concerning the Project to staff involved in other related gas operations in eastern Australia

- marketing staff of the Project must not also be involved in the marketing and sale of gas in other related operations in eastern Australia

- a provision for periodic reporting to the ACCC of compliance with the arrangements

Under this approach only joint marketing undertaken within the framework of the ring-fencing and confidentiality arrangements would be covered by the authorisation. Any joint marketing undertaken outside this framework would not be authorised.

At the pre-decision conference the QMGUG submitted that ring-fencing is difficult to put into practice and impossible for the parties involved to comply with. On the other hand, Santos submitted that ring-fencing is an effective mechanism for safeguarding competition and is an appropriate mechanism under which Project gas should be marketed.

In response to the Draft Determination, the EUAA stated that generally the ring-fencing arrangements were reasonable. However, the EUAA submitted that a problem could arise where a participant's Board is concurrently considering gas deals with the same customer for gas from different fields, including PNG.[101]

In response, the applicants submitted that an inevitable consequence of these arrangements is that on occasions a participant's Board might be considering competing contracts. The Board's duty to act bona fide for the benefit of the company as a whole would require the Board to give due consideration to both contracts. This would involve a consideration of whether the Board acted in the best interest of the joint venture. The applicants further submitted that the Board would be required to act ethically and in accordance with the ring-fencing arrangements. Failure to comply with the ring-fencing requirements would mean that the conduct would be outside the scope of the authorisation.

The ACCC acknowledges that directors and certain other personnel within a company will have access to information relating to the different business units of the company. This cannot be avoided as it is necessary for strategic and management purposes. The ring-fencing provisions contained in the authorisation are designed to prevent the misuse of commercially sensitive information and inappropriate disclosure of the information. All employees, including directors, are required to comply with the ring-fencing provisions. Moreover the party involved must provided a ring-fencing compliance report to the ACCC. This must be considered by the party's Board and Directors and signed by the CEO and a director.

The ACCC also understands that the agreements between the joint venture partners include provisions designed to prevent the misuse of confidential information. Thus no

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101 EUAA's submission, 15 March 2006, p. 24.

joint venture partner should be able to gain an unfair advantage for any other gas businesses it may have in eastern Australia to the detriment of the other PNG joint venture partners. Hence, the success of the joint venture depends on the joint venture partners enforcing their ring-fencing obligations and ensuring that commercially sensitive information is not used to the detriment of the joint venture.

The ring-fencing and confidentiality arrangements will apply to existing participants and those future participants who are covered by the authorisation.

The ring-fencing and confidentiality arrangements are a means of addressing the concerns regarding the inappropriate disclosure and use of commercially sensitive information. However, the ACCC has some concerns with the proposal that the authorisation should be extended to all future participants without the need for the parties to re-apply for authorisation. The ACCC considers that the composition of the joint venture is crucial to the realisation of the public benefits and the minimisation of any anti-competitive detriment. The effect on the market dynamics of any change in the make-up of the joint venture is inherently uncertain and may affect the balance of benefits and detriments, particularly if the extent of cross-ownership increases and one or more participants possess market power.

Nevertheless, the ACCC agrees with the applicants that it is not necessary for the authorisation to be re-opened on all occasions that the composition of the joint venture changes. For example, if the State of PNG joins the Project. The ACCC also recognises that other changes are likely to the joint venture prior to the Project being sanctioned.

The ACCC has decided that the authorisation be extended to future participants who:

- do not themselves, or though a related body corporate, have an economic interest in any other gas business (production, sales and/or transportation) in eastern Australia; or

if they do;

- acquire less than a 20 per cent interest in the Project at the time of entry to the Project; and

- do not have the individual capacity, either directly or indirectly, to determine the outcome of decisions about the Project's financial, marketing and operating policies.[102]

In all other cases the applicants would need to re-apply for authorisation if they wish to include any other new participant in the authorisation.

In response to the Draft Determination the applicants submitted that in their view such restrictions were unnecessary as the ring fencing arrangements and ss. 91B and 50[103] of

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[102] Adapted from Corporations Law.

[103] S. 50 covers mergers and acquisitions.

the Act provide sufficient protection. The ACCC does not consider that the position is as straightforward as the applicants' submission would suggest.

The applicants have submitted that the entry of a new participant could constitute a material change of circumstances that could trigger a review of the authorisation. However, it should be borne in mind that the ACCC cannot authorise any conduct unless it is satisfied that the public benefits outweigh any detriments. If the ACCC were to allow blanket coverage of all future participants it would in effect be making a decision now that, irrespective of who the future participants are, for the duration of the authorisation the benefits are likely to outweigh the detriments. The ACCC does not consider this to be the case.

Where the ACCC has extended the authorisation to cover a future participant, the entry of the future participant to the Project is of itself unlikely to constitute a material change in circumstances. While there may be circumstances surrounding the entry of a new participant that may justify a review of the authorisation it is unlikely that the entry of a new participant in itself would do so.

The ACCC does not consider that it can be satisfied that the benefits of the conduct would outweigh any anti-competitive detriment for the duration of the authorisation if the authorisation is automatically extended to all future participants. Accordingly, the ACCC considers that the above criteria are warranted.

If restrictions on new entrants were to apply, the applicants submitted that the 20 per cent entry threshold (which was adapted from Corporations Law) should be increased to 25 per cent. The applicants stated that 20 per cent threshold is included in Corporations Law because it is often the case that less than 40 per cent of shareholders attend general meetings in person or by proxy. In such circumstances ownership of 20 per cent of the issued capital of a company could confer some control over the affairs of the company. The applicants submitted that the circumstances are entirely different to those facing a joint venture and that the ACCC should have regard to specific circumstances of the Project.

The applicants submitted that increasing the threshold to 25 per cent threshold would not place the new participant in a position to determine the outcomes of decisions concerning the affairs of the Project. In support of their submission the applicant's pointed to the percentage[104] pass mark voting provisions in the Heads of Agreement.

The ACCC considers that the Corporations Law is a reasonable reference point to determine the threshold level of entry interest in the Project, above which the applicants would have to re-apply for authorisation if they wish the new participant to be covered by the authorisation. The ACCC is not persuaded that the reference to the pass mark voting provisions in the Heads of Agreement is more appropriate and justifies increasing the threshold to 25 per cent.

If Santos and the State and PNG join the Project, under the above conditions and based on their expected interests in the Project, it is likely that these parties would be covered

[104] The actual percentage is confidential.

by the authorisation without the need for the Project participants to re-apply for authorisation.

The applicants submitted that the threshold should only apply to the entry level of interest in the Project and placing restrictions on the ownership interests after entry could create problems. For example, if some participants had to acquire the interests of another participant for whatever reason (such as default caused by insolvency). This was the intention of the Draft Determination and a minor amendment has been made to the Draft Determination to clarify the matter.

However, the ACCC emphasises that should the respective interests of the parties change over time, this may constitute a material change of circumstances, in which case the ACCC could review the authorisation with a view to revoking it, if appropriate.

11. Determination

1. Any defined terms in this Authorisation have the meaning as set out in Appendix 1.

2. For the reasons outlined in this Determination, the ACCC grants Authorisation to the Applicants with respect to A40081 to engage in Joint Marketing, where Joint Marketing means:

   a. the making of a contract, arrangement or understanding by the Applicants between themselves to negotiate common terms and conditions (including price) under which gas produced by the Papua New Guinea Gas Project (the Project) will be offered for sale in Australia;

   b. the marketing of gas from the Project to a common customer or common customers on behalf of all Applicants, including the negotiation of common terms and conditions (including price and price arbitration and determination); and

   c. giving effect to the contract, arrangement or understanding between the Applicants by entering into contracts with customers of the Project,

   undertaken within the framework of the confidentiality and ring-fencing arrangements detailed in Appendix 1.

3. Any joint marketing undertaken outside of the framework of the ring-fencing and confidentiality arrangements in Appendix 1 is not authorised.

4. The Authorisation will expire on a date 16 years from the date that the Determination comes into effect.

5. This Authorisation is not an authorisation of the terms and conditions, as between buyer and seller, of contracts for the sale to customers of gas produced by the Project (gas sales contracts).

6. While this Authorisation is not an authorisation of the terms and conditions of gas sales contracts, subject to clauses 7 and 8, the period of Authorisation is extended where:

   a. the Applicants, and any Future Participant if relevant, are parties to a gas sales contact; and

   b. the gas sales contract contains provisions for renegotiation or redetermination of terms and conditions of supply during the life of the gas sales contract; and

   c. the gas sales contract expires after the period of this Authorisation.

   The period of authorisation is extended to a period not beyond the initial term of any gas sales contracts entered into prior to the expiry of the Authorisation.

7. The extension in clause 6 above is limited to the applicants and Future Participants, if relevant, to engage in Joint Marketing for the purpose of renegotiation, redetermination or to give effect to a gas sales contract entered into during the currency of this Authorisation.

8. The period for extension of Authorisation does not apply to Joint Marketing engaged in with respect to any renewal of a gas sales contract where the commencement of the renewal period would occur on a date after the expiry of the Authorisation.

9. Authorisation is extended to Future Participants who:

   a. do not themselves, or though a related body corporate, have an economic interest in any other gas business (production, sales and/or transportation) in eastern Australia; or

   b. if they do;

      i. acquire less than a 20 per cent interest in the Project at the time of entry to the Project; and

      ii. do not have the individual capacity, either directly or indirectly, to determine the outcome of decisions about the Project's financial, marketing and operating policies.

   In all other cases the applicants would need to re-apply for authorisation if they wish to include any other future participants in the authorisation.

10. This Determination is made on 3 May 2006. If no application for review is made to the Australian Competition Tribunal (the Tribunal), the Determination will come into effect on 25 May 2006. If an application is made to the Tribunal, the Determination will come into effect:

    - where the application to the Tribunal is not withdrawn – on the day on which the Tribunal makes a Determination on the review: or

    - where the application to the Tribunal is withdrawn – on the day on which the application is withdrawn.

11. Interim authorisations dated 3 December 1999 and 13 October 2000 are revoked and cease to apply on the date that the Determination comes into effect.

Appendix 1: Ring-fencing and confidentiality arrangements

1. Confidential Information

1.1 The Parties must not enter into discussions with prospective customers without first offering to enter into a confidentiality agreement which contains confidentiality terms and conditions substantially in the same form as those set out in this clause 1.

1.2 Where a confidentiality agreement is entered into between a Party and a customer or prospective customer, the confidentiality agreement must include a provision listing any purposes and categories of recipients pursuant to which the Confidential Information may be disclosed.

1.3 Regardless of whether the Party and the customer or prospective customer enter into a confidentiality agreement both the Party and the customer or prospective customer must negotiate the purposes and the categories of recipients pursuant to which a customer's or prospective customer's Confidential Information will or may be disclosed.

1.4 Each Party must not use any Confidential Information for any purpose other than a purpose for which the information was provided, or where the use is necessary and reasonable for the management or operation of the Project, or for any other purpose which has been agreed to by the customer or prospective customer.

1.5 Where a Party intends to disclose Confidential Information pursuant to an agreed purpose the disclosure must only be to the categories of recipients agreed to by the customer or prospective customer.

1.6 Subject to clause 2, a Party may disclose Confidential Information to its directors, officers, employees, contractors, consultants or advisors provided:

a. the disclosure is necessary and reasonable for the management or operation of the Project; or

b. is made for one of the purposes agreed to between the customer or prospective customer and the Party; and

c. in the case of a contractor, consultant or advisor of a Party the person receiving the Confidential Information has prior to receipt of the Confidential Information given the Party a written undertaking that it will keep the information confidential and will not use the information for any purpose other than the reasonable management or operation of the Project or a purpose which was agreed to between the customer or prospective customer and the Party.

1.7 Subject to clause 2, a Party may disclose Confidential Information to a Related Body Corporate or the directors, officers, employees, contractors, consultants or advisors of a Related Body Corporate or to a Third Party provided:

a. the disclosure is necessary and reasonable for a purpose for which the information was provided; or

b. is made for one of the purposes agreed to between the customer or prospective customer and the Party; and

c. the person receiving the information, whether it is a Related Body Corporate or the contractors, consultants, advisors of a Related Body Corporate or a Third Party, has prior to receipt of the Confidential Information given the Party a written undertaking that it will keep the information confidential and will not use the information for any purpose other than a purpose for which the information was provided by the customer or prospective customer to the Party, or a purpose agreed to between the customer or prospective customer and the Party.

1.8 Where a Party discloses Confidential Information to the directors, officers, employees, contractors, consultants or advisors of a Related Body Corporate or to a Third Party, it must use its best endeavours to enforce the obligations of confidentiality owed by the recipient to the disclosing Party.

1.9 The provisions of this clause 1.1 to 1.8 (inclusive) do not apply to the disclosure of Confidential Information by a Party:

a. which is required to comply with any law, legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised Stock Exchange; or

b. to directors, officers or employees, or directors, officers or employees of a Related Body Corporate of that Party in connection with credit risk concerns relating to a customer or prospective customer; or

c. to financial institutions for the purpose of financing a stage of the Project.

2. Internal ring fencing

2.1 Where a Party, or Related Body Corporate of that Party, has or gains an Economic Interest in a business engaged in natural gas production or sales or transportation or a combination of such businesses in Eastern Australia, other than as a result of its participation in the Project, that Party:

a. must ensure that any Marketing Staff involved in the marketing of Project gas are not also the Marketing Staff involved in the marketing in respect of those other Eastern Australian interests;

b. must ensure that Confidential Information does not pass to Marketing Staff involved in the marketing in respect of those other Economic Interests in Eastern Australia;

c. must ensure that Confidential Information does not pass to other employees, contractors, consultants or advisors, either of the Party or any

Related Body Corporate, engaged in operations with respect to those other Economic Interests in Eastern Australia;

d. must, before engaging in conduct permitted in the Authorisation or prior to gaining the Economic Interest, implement and thereafter maintain such internal procedures as are necessary to ensure that Confidential Information does not pass to its own employees, contractors, consultants or advisors (including Marketing Staff) or the employees, contractors, consultants or advisors (including the Marketing Staff) of a Related Body Corporate engaged in those other Economic Interests in Eastern Australia.

2.2 Clauses 2.1(c) and (d) above do not prevent the Party receiving the Confidential Information from disclosing it to its directors, officers, employees, contractors, consultants or advisors, or the directors, officers, employees, contractors, consultants or advisors of a Related Body Corporate engaged in those other Economic Interests in Eastern Australia, where disclosure is necessary and reasonable for the management of the Project or for a purpose agreed to by a customer or prospective customer pursuant to clause 1.

3. Compliance

3.1 Each Party must include in and implement appropriate policies and measures to ensure that directors, offices, employees, contractors, consultants and advisors of the Party are aware of these requirements and are complying with these requirements.

3.2 Measures to ensure compliance with the ring fencing requirements in clause 2 must include, but are not limited to, the following:

a. the development and dissemination of information on a regular basis detailing ring-fencing obligations and highlighting to directors, officers, employees, contractors, consultants and advisors their obligations to comply with ring-fencing obligations;

b. the regular review of the information dissemination process to ensure that directors, officers, employees, contractors, consultants and advisors are aware of their obligations to ring fence Confidential Information;

c. the integration of ring-fencing measures into forms, contracts, administrative procedures and performance evaluations;

d. investigative steps to be put in place to investigate breaches of the ring fencing obligations;

e. each Party ensuring appropriate disciplinary action is taken against a person or persons who has breached the ring fencing measures.

3.3 Each Party, to which the ring-fencing obligations are applicable at the time, must provide the Commission with details of the measures referred to clause 3.2 to ensure compliance with the ring-fencing requirements and must advise the

Commission when the policies and measures to maintain compliance with these requirements have been implemented.

3.4 Each Party acknowledges that the Commission may, upon receipt of information under paragraph 3.3, request that Party to make changes to its compliance measures, and each Party must implement such changes as are reasonably requested by the Commission after consultation with the relevant Party.

4. Information to the Commission

4.1 The Parties must promptly provide to the Commission any further information reasonably requested by the Commission relating to compliance with these requirements.

4.2 Where a Party, or Related Body Corporate of that Party, has an Economic Interest in a business engaged in natural gas production, sales or transportation in Eastern Australia or a combination of such businesses, other than as a result of its participation in the Project, that Party must provide an annual statement to the Commission that:

a. confirms that the Party has policies and measures in place to ensure compliance with these requirements;

b. confirms that these policies and measures are being applied;

c. provides details of any changes made to the policies and measures implemented to ensure compliance with these requirements since the last compliance statement was lodged with the Commission;

d. where applicable, provides details of any breach of these requirements, details of the investigation into the breaches; any action taken to discipline those responsible for the breach and the measures taken to ensure that there is no recurrence of such a breach; and

e. where no breaches have occurred in the time period for which the statement is provided confirms that to the best of the Party's knowledge and belief after making due inquiry there have been no breaches of the policies or measures.

4.3 Each statement must be considered by the Board of Directors and shall be signed by the Chief Executive Officer and a director of that Party, or where a Party does not have a Chief Executive Officer, by the Managing Director or Chairperson and another director of that Party, or where there is no Managing Director or Chairperson, by two directors of that Party.

4.4 The first statement will address the period from the commencement of these requirements to 30 June 2006 and will be provided to the Commission on 30 September 2006. Each subsequent statement will address each subsequent 12 month period (that is from 30 June 2006 until 30 June 2007 and so on) and will be provided no later than three months after the expiry of the relevant 12 month period.

4.5 Each Party acknowledges that the Commission may, upon receipt of information under paragraph 4.2, request that Party to make changes to the steps it will take to implement and maintain compliance with these requirements, and each Party must implement such changes as are reasonably requested by the Commission after consultation with the relevant Party.

4.6 In addition to the annual statement, when any Party becomes aware of a breach or potential breach, that Party must as soon as possible provide to the Commission details of that breach or potential breach. Additionally, the Commission may at any time seek additional information from a Party relating to a breach or potential breach. The request for information may relate to a breach which has been the subject of a notification to the Commission or it may relate to a breach the details of which have not yet been provided to the Commission. Information which may be sought by the Commission may include whether such a breach is a recurrence of earlier breaches, the length of time between occurrence of the breach and investigation of the breach, details of how the breach was discovered, similar breaches that have occurred, and any action taken by the relevant Party to rectify the breach and ensure that there was no recurrence of the breach.

5. Obligations to procure and notify

5.1 Related Bodies Corporate

Where the performance of an obligation under the Authorisation requires a Related Body Corporate of a Party to take some action or refrain from taking some action, the Party must use best endeavours to procure that Related Body Corporate to take that action or refrain from taking that action.

5.2 Provision of information

The Parties must promptly provide to the Commission all information and documents reasonably requested by the Commission for the purpose of monitoring compliance with these requirements. The fact that the information and documents are in the possession and control of a Related Body Corporate is not of itself a reasonable excuse for the failure to provide the information and documents sought by the Commission.

6. Future Participants

6.1 The Parties must:

a. ensure that person who seeks to be admitted as a Future Participant, where that person does not have an address for service in Australia as provided for under Order 7 Rule 2 of the Federal Court Rules, appoints a local agent who will be vested with authority to accept service of an originating process or other document on behalf of that person and provides the details of the local agent to the Commission; and

b. ensure that the Deed of Assignment and Assumption to the Heads of Agreement or any agreement varying or replacing the Heads of Agreement require Future Participants to comply with these requirements.

7. Interpretation and definitions

7.1 Defined terms

Act means the Trade Practices Act 1974 (Cth).

Applicants means any of the named parties in the Application.

Application means the amended authorisation application A40081 lodged with the Commission by the Parties on 14 December 2004.

Authorisation means this authorisation granted under section 88 of the Act in respect of the Application.

Commission means the Australian Competition & Consumer Commission.

Confidential Information means information either provided by a customer or a prospective customer of the Project or relating to the customer, or prospective customer that is of a commercially sensitive and confidential nature and relevant to the supply or potential supply of gas and/or the transportation of any gas supplied from the Project, including information:

a. which, where provided by a customer or prospective customer, is advised to be confidential;

b. which, where relating to a customer or a prospective customer, but provided by a person other than a customer or prospective customer, is advised by the provider of the information to be confidential;

c. relating to the financial position of a customer or prospective customer and, in particular includes information relating to the assets or liabilities of the customer or prospective customer and any other material that affects or may affect the financial position or reputation of the customer or prospective customer;

d. relating to pricing, including price structure, price formulas and price reviews;

e. relating to volumes;

f. relating to delivery points;

g. relating to a customer's or a prospective customer's proprietary strategies and business plans;

h. relating to a customer or a prospective customer's own customers, suppliers and Pipeliners that has actual or potential commercial value; and

i. other similar information that has actual or potential commercial value;

but does not include information that is in, or comes into, the public domain otherwise than by disclosure by a Party in breach of an obligation of confidence owed by a Party, or which is created, calculated or ascertained from information in the public domain,

Corporations Act means the Corporations Act 2001 (Cth).

Eastern Australia means the Australian Capital Territory, Queensland, New South Wales, Victoria, South Australia, Tasmania and the Northern Territory.

Economic Interest means:

a. interests in a company or partnership, including shares, voting rights, rights to receive dividends, rights to receive other distributions of income or capital, rights to receive a share of proceeds on winding up;

b. contractual rights relating to any aspect of the marketing operation of any company, partnership or joint venture; or

c. any similar legal or equitable interest.

Financial Close means the date after Project sanction when all Parties have access to the funds required to fund their respective participating shares of the costs of construction of the PNG infrastructure and any production facilities required for first gas production. For each Party who is borrowing money for that purpose, that date shall occur in respect of that Party when it is first able to issue draw down notices to its financiers in respect of such funding. If more than one Party is borrowing money for that purpose and such notices are given by those Parties on different days, the date occurs on the date when the last of such notices is able to be given.

Future Participant means any person who becomes a participant in the Project pursuant to the Heads of Agreement or any agreement that replaces that agreement and seeks to engage in Joint Marketing of gas in accordance with the Authorisation who:

a. does not itself, or through a Related Body Corporate, have an Economic Interest in any other gas business (production, sales and/or transportation) in Eastern Australia; or

b. if such an Economic Interest is held by the Future Participant or a Related Body Corporate, then:

    i. the Future Participant's interest in the Project is less than 20%; and

    ii. the Future Participant does not have the individual capacity, either directly or indirectly, to determine the outcome of decisions about the Project's financial, marketing and operating policies.

Heads of Agreement means the PNG Gas Project Co-operative Development Heads of Agreement 2003 as amended or replaced, which sets out the terms and conditions for the Parties to identify and develop proposals to produce, store, transport and sell gas and associated liquids from Papua New Guinea, initially to customers in Papua New Guinea and Australia, by the construction and operation of the necessary production and transportation facilities in relation to certain gas reserves in PNG.

Joint Marketing means

a. the making of a contract, arrangement or understanding by the Applicants between themselves to negotiate common terms and conditions (including price) under which gas produced by the Project will be offered for sale in Australia;

b. the marketing of gas from the Project to a common customer or common customers on behalf of all Applicants, including the negotiation of common terms and conditions (including price and price arbitration and determination); and

c. giving effect to the contract, arrangement or understanding between the Applicants by entering into contracts with customers of the Project,

undertaken within the framework of the confidentiality and ring-fencing arrangements detailed in this Appendix 1.

Marketing Staff means employees, consultants, independent contractors or agents directly involved in sales, sales promotion and negotiations (whether or not they are also involved in other functions) but does not include employees, consultants, independent contractors or agents involved only in:

a. strategic decision making and general stewardship, including the executive officer or officers to whom Marketing Staff report either directly or indirectly;

b. technical, administrative, accounting or service functions.

Party or **Parties** means any of the Applicants and any Future Participant.

Pipeliner means the owner or operator of a pipeline used to transport gas.

Project incorporates the three stages of evaluation, development and implementation of the Parties' proposal to produce, process, store, sell and transport gas from Papua New Guinea to customers in Eastern Australia.

a. The first stage of the Project involves establishing the technical and commercial viability of the proposal.

b. The second stage of the Project involves the construction and operation of the production and transportation facilities necessary to process, store and transport gas.

c. The third stage of the Project involves the actual production, processing, storage, and transportation of gas.

Related Body Corporate has the meaning given to it by the Corporations Act.

Third Party means any person other than a Party or Parties, the employees, contractors, consultants or advisors of a Party, a Related Body Corporate of a Party, the contractors, consultants or advisors of a Related Body Corporate of a Party.

7.2 Other rules of interpretation

a. In this attachment, the singular includes the plural and vice versa, unless the context requires otherwise.

b. References to clauses and paragraphs are references to clauses and paragraphs of this attachment.