APPENDIX TO SUBMISSION

1. A LARGE AND MATURE GAS MARKET

The WA domestic gas market is a large and mature market. This market is characterised by:

- a large number of downstream customers that purchase directly from gas producers;
- a mix of short and long-term supply contracts;
- significant short and long-term gas trading; and
- substantial transportation and storage capacity

1.1 Australia's largest domestic gas market

The WA domestic gas market is the largest in Australia. According to ABARE, Western Australia accounts for almost 40 per cent of Australia's total natural gas demand.[1]

The State consumes more gas than New South Wales, ACT and Queensland combined; and almost as much as New South Wales, Victoria and Queensland combined.[2]

Natural gas consumption averaged an estimated 1,194 TJ/day in 2006-07 – seven times the volume used in 1983 prior to deliveries from the North West Shelf.[3] Since 1984, domestic demand for gas has been growing at around 8.5 per cent per year.[4]

It is a multi-billion dollar market in which more than 30 customers purchase directly from two producer groups. Recent WA domestic gas prices would equate to Western Australia spending $3.1 - $3.5 billion on domestic gas annually.

Natural gas fuels 70 per cent of WA's electricity-generation and supplies gas for mineral and chemical processing, industrial applications for 200,000 small businesses, home heating and other household uses for 2 million West Australians.

[1] ABARE, *Energy Update 2009*, Table e 'Australian consumption of natural gas by state'.
[2] ABARE, *Energy Update 2009*, Table e 'Australian consumption of natural gas by state'.
[3] ABARE, *Natural gas consumption by State*, 2008.
[4] ABARE, *Natural gas consumption by State*, 2008.

The size of the WA domestic gas market and the continuing opportunities for major gas producers was demonstrated by Santos entering into a $100 million four year contract to supply gas to Newmont Australia's mining operations in July 2009.[5]

1.2 Downstream market transformation

At the time the North West Shelf Joint Venture (NWSJV) commenced production in 1984, domestic gas supply in WA was characterised by a single monopoly seller (the NWSJV) and a single vertically integrated State monopoly buyer (SECWA) which owned and operated the gas transmission pipeline between Dampier and the South West of the State.

Since the 1990s, Western Australia has undertaken extensive reform of the structure and characteristics of the downstream market. This has increased competition between customers and promoted market maturity.

The disaggregation of SECWA and the single domestic gas contract transformed the domestic gas market from one characterised by a vertically-integrated monopoly buyer to one where there are now around 30 individual customers which purchase directly from gas producers.

Downstream reforms gathered momentum with the subsequent deregulation of the gas and electricity markets.

As a result of these reforms, the WA domestic gas market has fundamentally changed – at least with respect to the downstream market. There has been a significant increase in:

- the breadth of the domestic market and the size of domestic demand;
- the number of direct gas customers;
- the number of parties buying through an aggregator, many of whom could also elect to purchase directly from gas producers;
- the entry of brokers providing gas trading services to gas users;
- short and long-term trading in gas transmission capacity and physical gas;
- additional transportation and storage options;
- the flexibility within the Dampier to Bunbury Natural Gas Pipeline system to deal with supply and demand imbalances; and

[5] Santos, "Santos secures $100 million Newmont gas supply extension in Western Australia", ASX / Media Release, 27 July 2009.

- connectivity between gas pipelines in Western Australia – gas can now be traded either physically or commercially in any part of the system.

In contrast, the upstream market retains the same high level of concentration and lack of competition between suppliers as was the case in the mid-1990s.

The upstream market remains a duopoly. Through joint-selling arrangements, which are not authorised by the ACCC, just two producer groups continue to control almost 100 per cent of the domestic gas market.

Major producers exercise immense market power through these unauthorised joint selling arrangements, and through their common or overlapping ownership of new developments such as Gorgon and Wheatstone. This results in a significant disparity between the market power of producers and that of consumers.

1.3 Around 30 domestic gas customers

In 1995, the original SECWA contract was disaggregated which led to the emergence of six major independent buyers:

- the Electricity Corporation (South West);
- the Electricity Corporation (Pilbara);
- the Gas Corporation;
- Alcoa of Australia Limited;
- Hamersley Iron Pty Limited; and
- Robe River Mining Co. Pty Ltd.

There were also a number of buyers who purchased their gas from one or other of the Apache joint ventures.

Other key reforms implemented after 1995 to increase downstream competition in the market included:

- the separation of the supply and transmission components of the SECWA domestic gas supply contract as part of the disaggregation;

- the introduction of an open access regime for the Dampier to Bunbury Natural Gas Pipeline;

- the establishment of AlintaGas and Western Power as separate corporatised businesses (albeit government owned);

- the sale of the Dampier to Bunbury Natural Gas Pipeline to Epic Energy in 1998;

- the staged removal of barriers to competition downstream in the domestic gas market;

- the privatisation and sale of AlintaGas in 2000; and

- the disaggregation of Western Power to establish four entities (Verve, Synergy, Horizon Power and Western Power) with existing gas supply contracts (the ability to contract with gas suppliers).[6]

As a result of these reforms, the downstream segment of the market today comprises around 30 customers – who now buy gas directly from producers. This compares to the previous market situation which was characterised by a single vertically-integrated monopoly buyer.

The Apache-led joint ventures supply the majority of these parties, including most of the NWSJV's customers. These contract sizes range from >80 TJ/d (such as with Burrup Fertilisers, Verve, Alinta and Alcoa) down to approximately 1 TJ/d.

Gas customers are dependent on existing gas producers and have no reasonable alternatives for supply. Major gas producers on the other hand can supply to both the domestic and international markets.

1.4 Aggregators

In addition to customers directly buying from producers, a large number of customers purchase through aggregators such as Alinta and Synergy. These customers range from light industrial and commercial customers, as well as small businesses and households.

Many of these customers can purchase directly from a producer and arrange their own transmission. However for reasons of convenience, some customers prefer to purchase a delivered service through an aggregator.

Perth Energy is also building a presence in the domestic market as an aggregator supplying to gas users.

1.5 Short term gas trading and brokers

Trades in gas transmission capacity and physical gas are regularly being conducted on a short and long term basis.

While no formal market has been established, given the relatively small number of major players, large gas consumers and pipeline shippers commonly trade amongst themselves either independently, or with the assistance of brokers.

Smaller industrial gas consumers also trade either independently or with the assistance of brokers.

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[6] Western Power (Networks) was created without the ability to purchase power or gas.

There is now a high level of sophistication in trading arrangements between gas users.

DBP, the owners of the Dampier to Bunbury Natural Gas Pipeline (DBNGP), posts spot transmission capacity, subject to availability.

A gas trading exchange (gasTrading) already facilitates trades of both gas and pipeline capacity, with trades accounting for up to 10 per cent of the gas delivered into the DBNGP on some days.

Since 2007 – with the completion of the DBNGP / Goldfields Gas Pipeline interconnect - there has been complete interconnectivity between pipelines in Western Australia.

Customers now have the ability either physically or with swaps to trade gas to most of the market. Gas from the North West Shelf can therefore be traded - either physically or commercially - in any part of the system.

There has been a significant increase in the number of independent brokers providing gas trading services to gas users. Gas users engaging brokers range from large industrial to smaller industrial customers.

Extensive work is being undertaken by the State Government and gas market participants to improve transparency and expand short term trading through the establishment of a Gas Bulletin Board.

A Gas Bulletin Board was rapidly developed and deployed by the WA Independent Market Operator in response to the 2008 Varanus Island outage. It operated for over three months between July – October 2008. The Independent Market Operator reported in 2009 that:

> "The GBB was designed and implemented in a short period of time to facilitate the trading in natural gas during the disruption in supplies as a result of the explosion on Varanus Island.
>
> The GBB provide transparent trade data, including pricing information, which allowed Western Australian gas users to evaluate the cost of securing gas supplies. This information was published to the public on the IMO website.
>
> The IMO received a great deal of cooperation from the gas traders, gas pipeline owners and the Office of Energy during the design and implementation of the GBB.
>
> Despite the limited time the GBB operated, with 27 registered traders, 14 active traders, and trading volumes of 47.8 TJs, this initiative could only be viewed as a success.

> The GBB demonstrated that a formal regulated gas market could be successfully implemented in Western Australia."[7]

The State Government has committed to implementing the recommendations of the State's Gas Supply and Emergency Review Committee, including the establishment of a permanent Gas Bulletin Board.

As the Independent Market Operator points out, such arrangements could be successfully implemented in Western Australia and within a short period of time.

Gas consumers are supportive of efforts to improve transparency and short term trading arrangements. However, the volume of trades during the Varanus Island emergency is tiny compared with the volume of day-to-day direct trades already taking place between market participants.

1.6 Gas storage and balancing options

There are substantial and well-developed gas storage and balancing arrangements operating in the WA domestic gas market.

There have been recent and substantial changes in the role that the duplicated DBNGP can play in load profile management and storage:

- The capacity of the DBNGP is being expanded with expansion expected to be completed in the first half of 2010;
- Following expansion, the pipeline will be approximately 85 per cent looped with approximately 441 km of additional looping installed as part of Stage 5B;
- Firm full haul capacity of the pipeline will be increased to approximately 840 TJ/day;
- The DBNGP provides shippers with an unconditional Accumulated Imbalance Limit of +/- 8 per cent of Contracted Capacity and a conditional limit of +/- 20 per cent – which are among the most generous in the world;
- Given that the current Contracted Capacity across all firm services on the DBNGP exceeds 800 TJ/day, the 20 per cent imbalance limit equates to over 160 TJ/day – which is more than the proposed initial production target for the Gorgon Project;

[7] Independent Market Operator, 'Gas Bulletin Board Report', presentation to the WA Gas Supply and Emergency Management Review, available at: http://www.energy.wa.gov.au/3/3270/64/presentations.pm

- In addition, DBP offers Park & Loan Storage services on the DBNGP and has entered into Operational Balancing Limits with the operators of production facilities and interconnected pipelines;

- Producers and gas customers therefore have a high degree of flexibility to balance daily, monthly and even yearly variances between contracted sales and actual gas volumes.[8]

DBP is in active discussions with gas shippers on engineering options to further increase the storage capability of the pipeline. This could significantly expand storage by around 150-200 TJ/d.

In addition, the APA Group already operates a gas storage facility at Mondarra in the Perth Basin, which is used by Western Power. As the Office of Energy's report during the Apache Energy Varanus Island outage noted:

> "[T]he APA Group's Mondarra Storage facility, which is located adjacent to both the Parmelia and DBNGP pipelines south of Dongara, has been running at full production for the entire duration of the outage, presently contributing a useful 12 TJ/d to the overall WA gas market."[9]

It is understood that APA has proposed further expanding this storage capacity through the installation of additional gas compressors.

A recent report commissioned by APPEA does not consider any lack of gas storage options as a significant market barrier:

> "Australia's need for storage facilities is mitigated by the fact that gas production facilities are generally located close to the main demand centres. Gas production matches demand and Australia relies on spare pipeline capacity to deal with the supply / demand mismatch. *This spare capacity acts effectively as gas storage*."
>
> "Unlike other countries, most of Australia is not exposed to strong seasonal swings in demand. However, Victoria, Tasmania and the ACT experience seasonality in winter demand and the storage facilities do not always solve the problem as they have limited capacity. *Whilst it would be ideal to have additional storage facilities in key locations, an option to increase pipeline capacity will also increase flexibility in the markets*."[10]

[8] DBP submission to the ACCC, 4 June 2009.
[9] Office of Energy, 'Information Update', 18 June 2008, available at: http://www.energy.wa.gov.au/cproot/1179/10284/Gas%20Update%20OOE%20Web%2020%20Jun%2008.pdf
[10] Asia-Pacific Partnership and PriceWaterhouseCoopers, *Asia-Pacific Gas Market Growth*, June 2009, p.31.

2. JOINT SELLING IS ANTI-COMPETITIVE

2.1 WA has one of the most uncompetitive gas markets in Australia

Western Australia has one of the most uncompetitive gas markets in the country. It is a duopoly market in which just two producer groups control close to 100 per cent of the market.

Through joint selling arrangements, the six North West Shelf Joint Venture producers combine together to set prices and contract terms that cover almost 70 per cent of the market.

There is now increased alignment between the North West Shelf/Gorgon entities and the other major supplier into the WA domestic market, Apache.

Joint ownership of Macedon, and recent agreement to undertake joint development of Apache's Brunello and Julimar fields with Chevron's Wheatstone LNG project, demonstrates the extent of this alignment and the focus on the export market rather than the domestic market.

Table: WA gas projects and participants

Project	Participants
NWSJV	Woodside, Chevron, Shell, BP, BHP Billiton, Mitsui-Mitsubishi
Pluto	Woodside
Macedon	BHP Billiton and Apache
Wheatstone	Chevron and Apache
Gorgon	Chevron, Shell and Exxon Mobil
Reindeer	Apache, Santos

The WA gas market is therefore characterised by a very small grouping of producers which have immense market power through joint selling arrangements and ownership concentration. Joint selling confers significant power on producers to increase domestic gas prices and/or withhold supply.

This situation will continue with prospective gas developments also controlled by those same producers. Any competitive pressure that new projects might otherwise assert have been minimised by cross-ownership across different projects and joint selling.

Table: Major WA domestic gas suppliers

	Woodside	Shell	Chevron	BHP	BP	MIMI	ExxonM	Apache	Santos	Tap	Kufpec
Woodside											
Shell											
Chevron											
BHP											
BP											
MIMI											
ExxonM											
Apache											
Santos											
Tap											
Kufpec											

Denotes producers in a direct JV or project arrangement

Denotes producers linked by a common partner. E.g. Woodside (NWSJV) and ExxonMobil (Gorgon) both share Chevron as a common partner.

It is telling that gas producers already appear to be coordinating gas marketing across projects by ensuring that any marketing from a given project occurs *sequentially*. This can only serve to further limit competition between different projects.

The ESAA Report considers the lack of competition in Western Australia's wholesale gas market a cause of "market failure which could explain the occurrence of a domestic gas shortage.[11] The report identifies authorisation for joint selling and marketing as a key factor potentially inhibiting the development of further competition in the WA wholesale gas market.[12]

The report concludes that until these impediments to competition are addressed by the Western Australian and Commonwealth Governments, a domestic gas reservation policy may be a necessary policy tool to secure domestic supply.[13]

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

[11] Energy Supply Association of Australia, *Western Australian Energy Market Study*, November 2009, p.49.
[12] Energy Supply Association of Australia, *Western Australian Energy Market Study*, November 2009, p.49.
[13] Energy Supply Association of Australia, *Western Australian Energy Market Study*, November 2009, p.9.

2.2 Joint selling reduces the number of independent sellers

Each of the NWSJV participants would have the right and obligation to own, take and separately dispose of their production entitlements. With six participants, this would equate to six individual sellers each owning a significant share of production that could be sold to local consumers.

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

The effect is to suppress "rivalrous market behaviour" and the "independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers".[14]

Reducing competition can only lead to higher prices. As the ACCC-commissioned Allen Consulting Group Report on the Gorgon Gas Joint Venture considered: "[P]rices will probably be lower if the GGJV markets separately rather than jointly because of the weakened bargaining power of the sellers."[15]

As the recent Alinta price outcome demonstrates, the result is immense market power on the part of major gas producers and a reported 300 per cent increase in domestic gas prices.

2.3 Joint selling reduces customer choice

By setting a common price and conditions, joint selling arrangements limit customer choice over terms and conditions. This was acknowledged by the ACCC as early as 1998:

> "[S]eparate marketing of gas by joint venture producers, where feasible, will be more competitive than coordinated marketing and likely to provide a wider variety of supplier options that would better meet market demands."[16]
>
> More recently in the 2006 PNG Determination, the ACCC acknowledged:
>
> "[S]eparate marketing can add value and lead to enhanced dynamic efficiency … 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."[17]

[14] *Re QCMA*(1976) 25 FLR 169, at 188-189.
[15] The Allen Consulting Group, *Gorgon Gas Project Joint Venture Application for Authorisation of Joint Marketing: Final Report*, July 2009, p.28.
[16] ACCC, North West Shelf Project, Determination, 29 July 1998, pp.32 and 47.
[17] ACCC, PNG Gas Project, Determination, 3 May 2006, p.36.

As demonstrated by the current domestic gas market, joint selling limits the ability of customers to secure competitive terms, including on price and supply. This lack of choice is impacting on customers, and on investment and development in the State. Gas users are dependent on competitively priced gas and diversity over contract terms to underpin capital intensive developments in resource and minerals processing developments, new power stations and gas transmission facilities.

Joint selling arrangements have operated to limit consumer choice and supply. The NWSJV participants appear to have taken an approach of not typically supplying customers of less than around 15 TJ/d demand. Smaller customers are effectively forced to purchase from Apache; the 'effective' monopoly seller for that section of the market.

The Alliance is not aware of the NWSJV offering significant new volumes of gas into the domestic market for many years, notwithstanding the severe gas market shortfall.

Since at least 2006, there has been a dramatic increase in domestic gas prices – with a reported 300 per cent price increase in the recent Alinta price outcome. On a delivered basis, WA gas prices are now up to three times the price of gas in the Eastern States – where the market is characterised by greater competition.

Suppliers have shortened terms on a “take it or leave it basis”. Given that investment decisions are frequently based on 15-20 year time-frames, the inability of consumers to secure long term energy contracts adversely impacts major project developments.

By contrast, overseas gas customers continue to benefit from greater competition and long term contracts for LNG sales. Overseas customers can negotiate with a diversity of potential suppliers and are not subject to a “captive market”. This forces WA gas producers to compete with other intentional suppliers to provide diversity on price and contract terms. At current domestic gas prices, local consumers are effectively being required to subsidise major producers in their sales to overseas customers.

2.4 Joint selling entrenches the already dominant market power of major producers

Major producers exercise immense market power in the WA domestic gas market:

- there are significant barriers to the entry of *competitive* new suppliers to the domestic gas market;

- producers include the world’s largest oil companies with immense commercial and negotiating power;

- local consumers have no reasonable alternatives to gas supply other than existing suppliers;

- the current market is experiencing a serious shortage in gas supply;

- WA gas prices have risen dramatically to up to three price of gas in the Eastern States; and

- despite a so-called "abundance" of gas reserves, WA gas prices are now among the highest of any gas producing and exporting economy in the world.

Joint selling entrenches the already dominant market power of major gas producers, giving them immense power to increase prices or withhold supply.

2.5 Joint selling entrenches an effective minimum floor price for domestic gas

Through joint selling arrangements, each of the NWSJV participants have access to detailed knowledge of the commercial terms and timing of all domestic gas sales arrangements entered into or being negotiated by the NWSJV including on:

- price;
- supply volumes;
- contract term and expiry; and
- the identity and supply demand of potential customers seeking gas.

This sharing of what would otherwise be confidential commercial and market sensitive information confers major gas producers significant advantage in negotiations with individual consumers. This advantage extends to other domestic gas projects which they are participants in.

The sharing of information between gas sellers and projects can only serve to eliminate any competitive pressure that new projects like Gorgon, Wheatstone or Macedon might otherwise assert on the domestic market.

This was acknowledged by the ACCC in PNG Gas Project Determination:

> "Under joint marketing arrangements each of the participants in the Process 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 … a Project participant could use this information as leverage in negotiations in respect of its other interests in gas basins in Australia."[18]

[18] ACCC, PNG Gas Project, Determination, 3 May 2006, pp.36 and 63.

> "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."[19]
>
> "The exercise of market power in an anti-competitive manner is another potential detriment associated with joint marketing arrangements … The extent of cross-ownership may heighten market power concerns. If a firm in other gas interests … 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."[20]

In contrast, domestic gas customers have no access to commercial information on other gas contract sales or negotiations, including what other consumers have paid in recent contracts. This severely limits their ability to bargain on a level playing field with major producers.

In the absence of separate selling and *effective* ring-fencing commitments, the risk of collusion and price co-ordination by different joint venture projects is high. In the case of the NWSJV and Gorgon Projects for example;

- Shell, Chevron and ExxonMobil are unlikely to sell Gorgon gas at prices lower than those agreed to by Shell and Chevron in the sale of NWSJV gas;

- Shell and Chevron are unlikely to agree to sales of NWSJV gas at prices lower than that attained by Shell, Chevron and ExxonMobil in regard to Gorgon gas; and

- the NWSJV participants are unlikely to sell gas in their other developments at prices lower than NWSJV and Gorgon gas.

Joint selling therefore entrenches and extends an effective minimum price for domestic gas.

2.6 Joint selling enables the coordinated abuse of market power

Joint selling enables major gas producers to act in a united way in the market and thereby to co-ordinate the exercise of their market power.

In 2008, the NWSJV participants publicly threatened to force domestic consumers to pay higher gas prices as a result of the Federal condensate excise removal. This was despite there being no justification for doing so. The excise was applied on the production of condensate, not natural gas.

[19] ACCC, PNG Gas Project, Determination, 3 May 2006, p.63.
[20] ACCC, PNG Gas Project, Determination, 3 May 2006, p.63.

It was telling that the NWSJV participants did not threaten to pass on the cost of the removal of the condensate excise exemption to overseas LNG customers, or to local or overseas condensate customers. Passing on the cost to domestic customers would effectively force WA gas users to subsidise the international customers of the NWSJV participants.

The coordinated abuse of market power was highlighted in the recent Alinta pricing outcome. Major producers have publicly indicated that they will seek to establish the reported 300 per cent increase in price as the new benchmark for all new domestic gas contracts. *WA Business News* reports comments by Woodside CEO Don Voelte:

> "The exact settlement is to remain confidential, but I can say we are pleased that ... it compares favourably with recent WA gas sales agreements."
>
> "This is a huge new revenue exposure for North West Shelf and Woodside and my expectation is that when other new or existing contracts come up for review, there will now be a new price foundation to work from."[21]

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

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

2.7 Joint selling has not delivered additional gas supply to WA consumers

In 1998, the NWSJV participants - as part of their justification for seeking authorisation for joint selling – that they intended to increase the capacity of the domestic gas processing plant to 1,100 TJ/d through the construction of an additional domestic gas processing train. They claimed:

> "[T]he Joint Venture Participants are contemplating expanding the capacity of the Project. *The proposed expansion will increase the production of gas for sale in Western Australia.* This will result in the current capacity of the Domestic Gas Joint Venture (the Domgas Venture) being exceeded. The Joint Venture Participants, for reasons of certainty, have decided to seek additional authorisation to that issued on 15 February 1977 (the 1977 Authorisation) by the Trade Practices Commission (the TPC) to the then participants of the Project."[22]

[21] *WA Business News*, 'Woodside hails new domgas price mark', 24 February 2010.
[22] North West Shelf Project, *Submission to the ACCC in Support of an Application for Authorisation*, 5 September 1997, para. 1.2.

> "To be able to compete for the supply to industrial projects forecast to be undertaken in the short to medium term, and in some cases to render a project, the Joint Venture Participants are contemplating an *expansion of capacity of 550 TJ/day to enable them to accept obligations for the supply on a firm basis of approximately 1,100 TJ/day.* Sellers are currently negotiating with existing and prospective customers for supply to various new and expanded facilities and projects. The industrial tranches of gas necessary to meet these customers' demand is in excess of what any individual participants would be able to meet from their respective shares. *Therefore these discussions must involve all the Joint Venture Participants*." [23]
>
> "The proposed expansion by the Joint Venture Participants therefore extends to creating additional capacity for existing customers, as well as capacity for new customers and projects. The national importance of these developments in terms of increased exports and import replacement, as well as the direct benefits enjoyed by the businesses and communities concerned, are likely to be significant. However, such an expansion decision must necessarily involve all the Joint Venture Participants, including MIMI, because it will result in supply of natural gas by the Incremental Venture … *It must also be predicated on the ability of the Joint Venture Participants to co-ordinate the marketing of any expanded capacity*." [24]
>
> "The proposed expansion which also includes potential investment in LNG expansion entails the construction of:
>
> (a) a second pipeline from North Rankin A platform to the onshore processing facilities on the Burrup Peninsula; and
>
> (b) a third pipeline gas processing train and additional fractionation and stabiliser facilities (which would be installed alongside the existing processing facilities on the Burrup Peninsula)." [25]

This commitment to expand domestic gas capacity, construct a third domgas processing train and increase domestic gas supply *was never met* despite:

- the ACCC granting authorisation in 1998;
- clear demand for domestic gas; and
- the NWSJV partners continuing to sell jointly.

It is astonishing that the same NWSJV producers should again claim that joint selling would lead to more domgas being supplied to WA at lower prices.

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[23] North West Shelf Project, *Submission to the ACCC in Support of an Application for Authorisation*, 5 September 1997, para. 9.7.
[24] North West Shelf Project, *Submission to the ACCC in Support of an Application for Authorisation*, 5 September 1997, para. 9.8.
[25] North West Shelf Project, *Submission to the ACCC in Support of an Application for Authorisation*, 5 September 1997, para. 9.9.

Since the granting of the 1998 authorisation, there has however been a significant expansion in LNG exports. LNG Train 4 was completed in 2005 and LNG Train 5 completed in 2008. LNG Train 5 is producing 4.4 million tonnes of LNG annually, bringing total LNG export production to 16.3 million tonnes per year.[26]

Woodside has flagged construction of a further six LNG Trains, with the ambition of an additional 77 million tones of LNG capacity within the next 15 years.[27]

In contrast, supply to the domestic market by the NWSJV has increased only marginally from the 1980s. This was notwithstanding the severe gas market shortfall, and their earlier commitment to double the size of the domestic gas processing plant as part of their justification for seeking the 1998 authorisation for joint selling.

The NWSJV participants also appear to have taken a deliberate view to not typically supply customers of less than around 15 TJ/d demand. Smaller customers are effectively forced to purchase from Apache - the 'effective' monopoly seller for that section of the market or from an aggregator such as Alinta or Synergy.

2.8 As a result, WA gas prices are among the highest in Australia

Despite having Australia's largest gas resources, largest gas production and biggest and most developed gas market, WA gas prices are up to three times that on the East Coast. They are also among the highest of any gas producing / exporting economy in the world.

Historically, prices for gas delivered to South West markets (including gas pipeline transmission costs) have been around $3.50 - $4.00 per gigajoule. Recent years have however seen a sharp rise in gas prices. This has seen wholesale gas priced at up to $14-16 per gigajoule before transport costs.

In November 2009, an arbitrator delivered an interim award on the price of gas supplied by the North West Shelf Joint venture to Alinta under an existing long term contract. Alinta is the State's largest retailer of gas and purchases wholesale gas from the North West Shelf to supply to 600,000 homes and businesses in Western Australia. Media reports have indicated a final agreed price of over $8 per GJ, representing a 300 per cent price rise.[28]

At these prices, domestic gas customers are being forced to deliver premium returns to gas producers – in excess of that obtainable from overseas customers.

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[26] Woodside Petroleum, 'North West Shelf Venture Produces First LNG From Train 5 Production Facility', ASX Announcement, 1 September 2008.
[27] ABC News online, 'Outlook remains strong: Woodside', 1 May 2009, http://www.abc.net.au/news/stories/2009/05/01/2558367.htm
[28] *WA Business News*, 'Woodside hails new domgas price mark', 24 February 2010.

It is therefore astounding that in its August 2009 submission to the ACCC on the Gorgon authorisation, the NWSJV participants would claim:

> "It is incorrect to suggest that joint marketing of natural gas in WA has resulted in high domestic gas prices. The low average weighted price enjoyed by the WA market as a result of large, long term contracts negotiated under joint marketing arrangements is evidence that joint marketing has not itself led to high gas prices."
>
> "the weighted average price of WA domestic gas has been below that prevailing in eastern Australia and major international markets for many years (and the NWS Sellers believe that this situation would extend back many years prior to that shown on the graph). This low average price was achieved during a period when joint venture production and marketing of natural gas was in place, particularly by the NWS Sellers"
>
> "a gradual increase in average gas prices in WA during 2006 and 2007. This was consistent with a period of commodities price rises. This was also coincident with significantly increased costs for the gas-producing industry in WA (and internationally) over the same period"[29]

Yet, at the same time, the same NWSJV participants were combining together to press for a massive increase in the price of gas supplied under a "large, long term contract" with Alinta.

2.9 Impact of rising gas prices

Impact on industry

Western Australia's power generation, resource processing and manufacturing industries are highly sensitive to gas prices and depend on affordable energy supply.

The serious gas shortage and rising gas prices have impacted project investment in Western Australia. This includes a number of prospective projects being suspended or lost to overseas or interstate.

The DomGas Alliance continues to be approached by major project developers unable to secure world-competitive gas prices to support project developments.

Impact on households

Higher gas prices are also impacting small business and households through higher energy bills. In June 2009, the WA Government approved significant increases in business and residential gas tariffs. These new tariffs came into force on 1 July 2009.

[29] NWS Gas submission to the ACCC on the Gorgon joint selling authorisation; 18 August 2009.

As a result, the annual gas bill of the average Mid West and South West household has increased by $78 or almost 23 per cent. [30]

Table: Impact of Tariff Cap Increases on Median Customers (based on Annual Bills) [31]

	Cost increase	Gas Disruption Costs	Total
Mid-West / South-West Residential	$78 (20%)	$11 (2.4%)	$89 (22.9%)
Mid-West / South-West Non-Residential	$78 (4.9%)	$47 (2.8%)	$126 (7.9%)
Kalgoorlie – Boulder Residential	$86 (20%)	$11 (2.2%)	$98 (22.6%)
Kalgoorlie-Boulder Non-Residential	$109 (20%)	$17 (2.6%)	$127 (23.2%)
Albany Residential and Non-Residential	$78 (20%)	-	$78 (20%)

A key driver for the gas tariff increases was significantly higher wholesale gas prices. As the WA Office of Energy report notes:

"Natural gas commodity costs in the Western Australian domestic market have increased dramatically in recent periods, moving sharply away from historical prices in the $2.50 per GJ range earlier this decade." [32]

In March 2010, the State Government announced new increases in gas tariffs for residential and small business customers in the Mid-West / South-West, Kalgoorlie-Boulder and Albany regions.[33]

The new increases will be 7 per cent for residential customers and 6.5 per cent for small business, with the exception of Albany where increases will be 10 per cent.

[30] WA Office of Energy, *Gas Tariffs Review: Interim Report to the Minister for Energy*, June 2009, p.3.
[31] WA Office of Energy, *Gas Tariffs Review: Interim Report to the Minister for Energy*, June 2009, p.3.
[32] WA Office of Energy, *Gas Tariffs Review: Interim Report to the Minister for Energy*, June 2009, pp.14-15.
[33] Premier Colin Barnett and Minister for Energy Peter Collier, *State Government announces increases in tariff arrangements*, Media statement, 8 March 2010.

It is understood that current gas tariffs have yet to reflect the reported 300 per cent increase in the price of gas supplied by the NWSJV to Alinta. Escalating wholesale gas prices can only lead to higher gas and electricity prices for WA business and households.

The ACCC should refuse to sanction a $2 billion subsidy to the world's biggest oil and gas consumers

The public detriment caused by joint selling can be readily quantified. The NWSJV participants have previously referred to "average" WA domestic gas prices of around $3 per gigajoule.

Domestic gas prices in Victoria - where supply and competition prevails – are around $3 – 3.50 per gigajoule.

At the reported $8 per gigajoule gas prices that the NWSJV producers combined together to force upon Alinta – and which Woodside is now publicly asserting to be the new "benchmark" price – WA consumers would be forced to spend an *additional* $2 billion on domestic gas each year.

This equates to a $2 billion subsidy that the world's biggest and most profitable oil and gas companies are seeking from consumers - $1000 for every business and individual in the State.

Such a subsidy would be unacceptable were it to be funded by Commonwealth revenues. It is equally unacceptable that it be paid by businesses and households.

The ACCC should refuse to sanction what could well be the largest transfer of wealth from consumers to a small number of private companies in the State's history.

3. THE COUNTERFACTUAL

3.1 Separate selling is commercially and practically feasible

Separate selling of domestic gas is commercially and practically feasible, and should be required in the WA gas market:

- the WA domestic gas market has undergone significant transformation over the past 10 years;

- separate selling of domestic gas took place in the major Pohokura gas field in New Zealand, despite Shell and its partners originally claiming it impossible to do so because of supposed market features;

- long term contracts have not prevented major producers from supplying international customers and expanding LNG supply;

- major producers already enjoy complete transparency over domestic demand and contract pricing, whereas domestic consumers have no access to this information;

- there is no commercial imperative for joint selling to offset any market power of customers – the downstream market has transformed from a single monopoly buyer to some 30 gas customers;

- the operational measures necessary to enable separate selling are well-known and practical;

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

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

- producers in other joint venture gas developments sell separately into the WA domestic gas market; and

- the same major producers have been compelled by governments to sell separately in other countries including Norway, Denmark and New Zealand.

The costs and risks claimed by the NWSJV that would result from separate selling are therefore exaggerated. The Allen Consulting Group report concluded:

> "Separate marketing into any market involves additional risk and increases the potential for conflict within the JV. These issues are compounded when the market is illiquid and lacks price transparency. Further, the potential to extract a premium for the risk is limited. *Notwithstanding these factors, the degree to which the participants would be dissuaded from future domestic gas production is debatable*, particularly given the requirements of the WA Gas Reservation policy."[34]

3.2 Operational measures necessary to enable separate selling are well known and practical

Contrary to the applicants' assertions, the operational measures to enable separate selling are well-known and practical.

In fact, they are already in place for NWSJV. The NWSJV maintains mechanisms to manage supply from two separate domestic gas JVs, with two different ownership structures.

[34] The Allen Consulting Group, *Gorgon Gas Project Joint Venture Application for Authorisation of Joint Marketing: Final Report*, July 2009, p.9.

Both JVs currently operate contemporaneously to supply the WA domestic gas market. These two JVs comprise:

- the original five party Domestic Gas Joint Venture (the Domgas Venture) created to supply 5064 PJ of sales gas to the WA domestic market. This JV was the subject of the 1977 TPA authorisation; and

- the subsequent six party Incremental Venture created to produce natural gas for supply into WA in excess of the scope of the Domgas Venture. This JV was the subject of the 1998 authorisation.[35]

The two JVs have different ownership structures and different entitlements to reserves and production/processing facilities. At the time the original Domgas Venture was established, the participants and ownerships were:

- Woodside Energy Limited (50%)
- Shell Development (Australia) Pty Ltd (81/3%)
- BHP Billiton Petroleum (North West Shelf) Pty Ltd (81/3%)
- BP Developments Australia Pty Ltd (162/3%); and
- Chevron Australia Pty Ltd (162/3%)[36]

The Incremental JV comprises six participants – each holding an equal 1/6th share:

- BP Developments Australia Ltd;
- Chevron Australia Pty Ltd;
- Japan Australia LNG (MIMI) Pty Ltd – an investment vehicle of Mitsui and Mitsubishi;
- Shell Development (Australia) Ltd;
- BHP Petroleum (North West Shelf) Pty Ltd; and
- Woodside Energy Ltd

Gas for supply to the domestic market is processed through the Goodwyn and North Rankin production platforms on behalf of both joint ventures.

Production from these platforms comes together in two production trunk lines which deliver the gas to processing facilities on the Burrup Peninsula. There is therefore a fully blended stream of product that is owned by two *separate JVs with different ownership structures*.

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35 ACCC, North West Shelf Project, Determination, 29 July 1998, p.7.

36 ACCC Determination, Revocation of Authorisation A18492 – North West Shelf Gas Pty Ltd, 5 March 2008, Public Register no. C2008/55.

This product is being sold to the domestic market on the basis of different shares reflecting the different ownership structure of the two JVs.

There are therefore two separate sellers with the participants internally managing production and sales nominations between the original Domgas and the Incremental JVs.

North West Shelf Gas (NWSG) has been selling jointly on behalf of Shell and Chevron which are participants of both the original Domgas JV and the Incremental JV. There are clearly practical and effective arrangements in place to allocate gas for:

- production shares between the two different JVs; and
- within each JV, production shares vis-à-vis other participants.

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

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

3.3 Flexibility within the DBNGP to manage "overs and unders"

To the extent that there is a difference between actual offtakes and nominations, an "Operating Balancing Agreement" can be implemented between the joint venturers and the pipeline operator for any excess or shortfall in demand.

DBP operates the Dampier to Bunbury Natural Gas Pipeline under an "Operating Balancing Arrangement" agreed with sellers under which NWSG delivers gas into the pipeline against pressure and not to specific nominations. This essentially operates as a "park and loan service".

This provides for any excess production to be parked in the pipeline or a gas supply shortfall drawn from pipeline linepack within a range of +/- 300 TJ a day. This is equivalent to half a day's gas production from the NWSJV, or a full day's production of 600 TJ/day in terms of the total "swing capacity".

The pipeline therefore already provides the buffer to cover variations between nominations (i.e. production) and actual market demand.

The pipeline has *individual shipper agreements* with more than 20 gas purchasers (shippers) that provide for an imbalance range at any one time of

+/- 8% of their contracted capacity. This provides for shippers to add to "linepack" (gas in the pipeline) or draw from it within this range.

This means that shippers who cannot control their physical usage to meet their nominated daily intake have a latitude of +/- 8%. The benchmark for other pipelines in the world is +/- 2%.

To the extent that shippers look like breaching these limits, they have the ability to – and in fact do - trade imbalances between themselves.

The total flexibility between inlets (production) and outlets (demand) which could be managed on the Dampier to Bunbury Natural Gas Pipeline under these various arrangements is therefore approximately +/- 470TJ or in excess of 1 day's production from the NWSG plant.

The terms on which Woodside provides operating services to the NWS Project and the detailed joint venture arrangements themselves are governed by detailed contracts. These contracts would already – or could readily - provide for:

- the nature of delivery obligations to individual JV participants;
- dispossession of product whether liquids, LPG, LNG or domestic gas;
- physical delivery arrangements;
- nomination arrangements that each of the individual parties of the two separate JVs would have for their own offtake;
- some form of balancing arrangement amongst the joint venturers

3.4 Downstream market participants have invested in a more mature and developed market

In contrast to the NWSJV producers, downstream market participants have undertaken significant investments in gas storage, transportation and demand/load management. This demonstrates commitment by downstream participants in a more mature gas market.

Australian Pipeline Trust (APA) has expanded the Goldfields Gas Pipeline with two new compressor stations. The expansion increased pipeline capacity by 20 per cent.[37]

[37] APA, Group Annual Meeting: Chairman Address, 30 October 2009, p.4.

APA has completed a major expansion of the Mondarra Gas Storage Facility. The project involved constructing an additional injection and production well drilled into the Mondarra reservoir. The expansion improves peak demand management, especially in power generation.[38]

Expansion of the Mondarra Gas Storage Facility forms part of APA's Mondarra Gas Hub development which straddles the DBNGP and the Parmelia Gas Pipeline. The Mondarra Gas Hub provides interconnected pipeline gas transportation services, load management, storage, compression and processing.

APA is now working with customers and will further develop the storage facility in line with demand requirements.[39]

DPB has completed a three stage expansion program which has seen $1.8 billion invested in the DBNGP since 2004. Key features of the expansion program include:

- a 50 per cent increase in pipeline capacity to meet gas demand in the South West and Pilbara;
- meeting delivery schedules and supply lead times of gas shippers; and
- increased reliability of services delivered on the DBNGP.[40]

The Stage 5B Expansion Project improved reliability and increased the pipeline's full haul capacity by around 110 terajoules per day. Stage 5B involved installation of 440 km of parallel pipe and upgrade works on the pipeline's compressor station facilities.

As a result of the three stage expansion program, firm full haul capacity has been increased by more than 300 terajoules per day. Around 85 per cent of the DBNGP between the North West Shelf and Bunbury is now duplicated – effectively creating a second pipeline.

3.5 Marketing decisions for domestic gas are already being made separately by the NWSJV producers

All of the NWSJV participants substantial marketing capability within their respective organizations to support the marketing of NWSJV Domgas Venture and Incremental Venture production.

All contracts for supply of gas to domestic customers from the NWSJV involve all six (for the Incremental JV) counterparties contracting severally.

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[38] APA, 'APA to expand the Mondarra Storage Facility', media release, 27 February 2006; APA, Annual Report 2008, p.11.
[39] APA, Group 2009 Annual Meeting: Chairman's Address, 30 October 2009, p.5.
[40] DBP, 'Completion of third pipeline project to meet the energy needs of Western Australia', media statement, 29 April 2010.

While North West Shelf Gas Pty Ltd negotiates with a purchaser on behalf of the JV participants, it has to communicate with and seek approval from all six JV participants on contract terms and price.

North West Shelf Gas Pty Ltd has no authority to agree terms – it is a clearing house or postbox by which all six parties come together to set contract prices and terms.

DBP's Operating Balancing Agreement is with all six JV participants severally.

In the event of an emergency which has any bearing on contractual obligations of the NWSJV, North West Shelf Gas refers every action to all six JV participants for responses.

Individual NWSJV producers retain substantial marketing capacity within their respective organisations for domestic gas. This was confirmed by the Shell and Chevron's submission to the ACCC on the Gorgon Project:

According to the Gorgon participants, Shell already has "relevant staff with experience of sales in WA and the facilities they use [which] are firewalled from the [Gorgon] Project *because of their involvement in the NWS Venture*".[41]

Shell staff with experience with WA domgas sales, and their dedicated facilities, clearly perform a function that is more than as a mere postbox for rubber stamping decisions by North West Shelf Gas.

Similarly, Chevron "has developed the knowledge, expertise and resources to enable it to fulfil the marketing role on behalf of the Participants".[42] To the extent that this knowledge, expertise and resources relates to the marketing of domestic gas to the WA market, they could only have arisen from active participation in domgas marketing in WA.

To conclude, marketing decisions for domestic gas are already being made separately by the NWSJV participants. Participants possess substantial marketing expertise and capacity within their individual organisations – both within WA, and as part of their global operations.

[41] Applicants' submission to the ACCC in support of application for interm and final authorisation: Gorgon Gas Project, 20 May 2009, para.6.14.
[42] Applicants' submission to the ACCC in support of application for interm and final authorisation: Gorgon Gas Project, 20 May 2009, para.6.14.

3.6 Producers in other joint venture gas developments sell separately in WA and the Eastern States

Separate selling is practical and feasible. Major producers sell separately in WA and the Eastern States.

Separate selling is taking place by Apache and Santos from the John Brookes field joint venture. While Apache (operator, 55 per cent share) and Santos (45 per cent) initially sold their gas jointly, during later marketing efforts, the JV participants could not agree on remaining available reserves.

Santos took a more aggressive view in respect of available reserves than Apache and decided to market additional gas from John Brookes separately, with Apache not marketing any further John Brookes gas.

Separate selling of natural gas is also happening in the Otway Basin in Eastern Australia. Santos has separately marketed gas from its interest in the Casino field. Woodside has separately marketed gas from its interest in the Geographe/Thylacine field.

3.7 Shell and Chevron sell separately in Denmark and Norway

Shell and Chevron been compelled by governments to sell separately in other countries. They do so successfully. It is illogical that they continue to engage in conduct in Australia that they are prohibited from engaging in elsewhere in the world.

Denmark

In 2003, the Danish and European Commission competition authorities settled an antitrust investigation in Denmark involving the Danish gas supplier DONG and the country's main gas producers Shell, Chevron Texaco and A.P Moller.

The investigation related to the joint selling of North Sea gas by the parties to the Danish Underground Consortium (DUC). DUC, which accounted for 90 per cent of Danish gas production, was composed of Shell, Chevron and A.P Molle

As a result of the settlement, the gas producers committed to market their production individually.[43] Producers also undertook to offer an additional 7 billion cubic metres of gas for sale to new customers over a period of 5 years when new gas volumes are available. This corresponded to around 17 per cent of the total production of the DUC parties.

[43] European Commission, 'Commission and Danish competition authorities jointly open up Danish gas market', 24 April 2003, available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/566&format=HTML&aged=0&language=EN&guiLanguage=en

In accepting this commitment, the European Commission noted that a significant number of customers inside and outside Denmark had actively looked at alternative sources of supply in the past and had continued to do so at the time of the investigation.

This commitment clearly recognised that the effect of joint selling in Denmark had been to limit gas supply and competition.

Norway

In 2001, the European Commission issued a formal warning to Norwegian gas producers – including Shell and ExxonMobil - about the joint sale of gas by the Gas Negotiation Committee (GFU).

The case concerned joint sales of natural gas through a single seller, the GFU, from Norway to the European Union. The GFU negotiated natural gas sales contracts with buyers on behalf of all the other natural gas producers in Norway and thus fixed the selling price, volumes and all other trading conditions:

> "The European Commission has warned Norwegian gas producers that the joint sale of Norwegian gas carried out through the Gas Negotiation Committee (GFU) is in breach of the European Union competition rules as it fixes, among other things, the price and the quantities sold."
>
> "As the European gas market is progressively being liberalized, it is of paramount importance that producers sell their gas individually so that those customers that can already choose their supplier benefit from real choice and competitive prices."[44]

The case was settled in 2002 with Norwegian gas producers confirming that they will market their gas individually.[45] These included six groups of gas companies which were sellers to Norwegian gas negotiated under the GFU scheme – Shell, ExxonMobil, TotalFinaElf, Conoco, Fortum and Agip. The companies provided written commitments to discontinue all joint marketing and sales activities.

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44 European Commission, 'Commission objects to GFU joint gas sales in Norway', IP/01/830, Brussels, 13 June 2001; available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/830&format=HTML&aged=0&language=EN&guiLanguage=en

45 European Commission, 'Commission successfully settles GFU case with Norwegian gas producers', IP/02/1084, Brussels, 17 July 2002; available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/1084&format=HTML&aged=0&language=EN&guiLanguage=en

3.8 Shell sells separately in New Zealand

Shell and its partners sell domestic gas separately from the Pohokura gas field in New Zealand – a major Greenfield gas development. They have been successfully doing so since 2004. The New Zealand experience is highly pertinent to the WA gas market.

Shell's claims for joint selling authorisation

In the Pohokura case, Shell and its partners applied for authorisation by the New Zealand Commerce Commission to jointly sell domestic gas from the field. Shell and its partners claimed joint selling was necessary to underpin a major new gas field investment and that separate selling was not feasible or practical because of the "immature" New Zealand market.

According to Shell and its partners, separate selling would lead to significant if not indefinite delay in domestic gas development and supply:

- "The immaturity of the New Zealand market means that the practical problems the Pohokura JV parties would face in separately marketing gas would be *difficult if not impossible to overcome*."

- "*Substantial welfare losses* will occur if joint marketing is not authorised."

- "Absent joint marketing, a *substantial delay* in the development of the field is expected, at a time of scarcity of resource."

- "In addition, separate marketing would result in *significant extra transaction and production costs, and sub-optimal field depletion*. This would impact significantly on the value of the field, and that effect would have the potential of significantly reducing exploration in New Zealand." [46]

In making these claims, Shell and its partners relied heavily on the ACCC's reasoning in the 1998 North West Shelf authorisation determination. On the basis of these claims, the New Zealand Commerce Commission granted authorisation for joint selling in 2003. This was despite concluding that:

- Separate selling would offer different dynamics to negotiations between the buyer and the seller. Within limits, buyers would have choices not available to them under joint selling.[47]

- Joint selling would, on the balance of probabilities, result in gas prices being higher on average than they would be under separate selling. This would result because joint selling would shift the relative

[46] Applicants' submission in the Pohokura case, para.16.

[47] New Zealand Commerce Commission Determination, Decision 505, September 2003, para.372.

bargaining strength of buyers and sellers in favour of the seller and because it would facilitate price discrimination.[48]

- The range of terms and conditions on offer would be more limited with joint selling.[49]

- Joint selling could have a material impact on development of a competitive market in the future. This was because a future competitive environment depended on having a number of sellers in the market, including a number selling from each field.[50]

Shell's claims were subsequently disproved

Shell and its partners' claims were subsequently disproved when they began separately selling domestic gas – with no delay to production or supply – *when they were unable to agree to joint selling arrangements* between themselves.

Accordingly, separate selling had marginal if any impact on either viability of the Pohokura project or fist supply of domestic gas. As the New Zealand Commerce Commission acknowledged, separate selling alone is not likely to make an otherwise viable field non-viable:

> "While it is axiomatic that any additional cost faced by new entrants act as a disincentive to entry, the Commission considers that the scale of these additional costs, in comparison with the potential rewards, would not be likely to be sufficient to make a viable field non-viable."[51]

Far from being a necessary enabler for domestic gas supply, joint selling arrangements in New Zealand in fact operated as a potential barrier to timely domestic gas supply.

In 2006, the New Zealand Commerce Commission unilaterally revoked authorisation against strong opposition by Shell and its partners.

The New Zealand experience is highly pertinent to WA

The New Zealand experience is highly pertinent to the WA gas market because of Shell and its partners' reliance on the very same market features identified by the ACCC in the 1998 North West Shelf Determination to justify joint selling; and by the strong comparisons made by Shell and its partners between the New Zealand and WA gas markets:

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[48] New Zealand Commerce Commission Determination, Decision 505, September 2003, para.377.

[49] New Zealand Commerce Commission Determination, Decision 505, September 2003, para.383.

[50] New Zealand Commerce Commission Determination, Decision 505, September 2003, para.392.

[51] New Zealand Commerce Commission Determination, Decision 505, September 2003, para.391.

- "The Australian gas markets are described in contrast as 'contract' or 'project' markets where gas is only produced to meet specific contractual obligations. *Like Australia, gas in New Zealand is only produced to meet specific contractual obligations*."[52]

- "Our conclusion is implied by the peculiar nature of the industry and the state of the New Zealand gas market. It is also the position on the joint marketing of gas in Australia, *where the market characteristics are similar to those in New Zealand*."[53]

- "… The New Zealand market is dominated in gas volume terms by industrial and power generation buyers, *similar in this respect to the West Australian State market* …"[54]

Significantly, Shell and its partners acknowledged that the Australian (and WA) market – in 2003 - was considerably more mature and developed than the New Zealand market:

- "There remains a major question whether Australian markets in 2003 are the appropriate comparison point for the New Zealand market. *The Australians have evolved a lot further down the path towards a mature gas market than we have*. Critically, the Australian market is many times larger than is the case in New Zealand …"

- *"Australian experience from the 1990s provides a close parallel for the New Zealand market in 2003, which is much further back on that evolutionary path*."[55]

- "The New Zealand gas industry differs from its Australian counterpart in a number of important ways … *But perhaps the most important difference is one of size. Whilst the New Zealand gas industry production is now in the order of 180 PJ per annum, its Australian equivalent annual production is approximately 1350 PJ*. Even if comparison is made with the Australian Eastern States interconnected market as a discrete entity, separate from Western Australia, the market is still many times larger than New Zealand at 600 PJ per annum."[56]

[52] Applicants' original submission in the Pohokura case, para.20.
[53] CRA report, December 2002, p.3.
[54] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.15.
[55] Applicants' submission to the New Zealand Commerce Commission's Draft Determination in the Pohokura case, 9 June 2003, para.43.
[56] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, pp.2-3.

- "It is my opinion that *the New Zealand gas market is even less mature than the Australian equivalent. It is considerably smaller and has less depth in terms of market participants* …"[57]

According to Shell and its partners, the WA gas market in 2003 was:

- considerably more mature and developed than the New Zealand market;
- many times larger than the New Zealand market; and
- possessed more depth in terms of market participants than the New Zealand market.

The fact that Shell and its partners subsequently sold separately in New Zealand is therefore compelling. Logically, separate selling is even more practical and feasible in Western Australia today given it is far bigger and more mature market than New Zealand today – let alone the New Zealand market in 2003.

The ACCC appears misinformed about the New Zealand experience

On the basis of evidence presented by Chevron, Shell and ExxonMobil, the ACCC concluded in the Gorgon Determination that:

> "[T]he partners in the Pohokura joint venture appear to be experiencing significant problems managing the arrangements associated with separate marketing. The ACCC understands that with the urgent demand for the project to proceed, the parties left negotiation of a GBA until after project commencement. It has subsequently proved very difficult for the parties to reach such an agreement and the ACCC understands that no GBA is currently in place. Further, litigation is currently occurring between the Pohokura partners over how balancing is managed. The ACCC considers that the Pohokura experience reinforces the greater risks involved in seeking to separately market gas in an immature market."

The Alliance is perplexed that major producers attached such significance to the difficulties of gas balancing / separate selling arrangements in the Pohokura case. As the New Zealand Commission pointed out in its 2006 Determination to revoke authorisation, the partners were unable to agree on arrangements for the *joint marketing* of gas and proceeded to market and sell separately:

> "The separate marketing and sale approach did not apparently lead to a delay in the final investment decision or a delay to full production from the field. Instead, any delays were likely to be attributable to the

[57] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.17.

> seven and a half months that the Pohokura joint venture partners spent attempting (and failing) to reach agreement on joint marketing and sale arrangements."[58]

It is disingenuous and self-contradictory for producers to now claim that the Pohokura experience demonstrated the risks and costs of separate selling.

The Gorgon and NWSJV producers further claimed that ongoing litigation demonstrates the risks and costs of separate marketing. A review of public source reports failed to identify gas balancing / separate marketing as a significant factor in the disputes between joint venture partners.

The *New Zealand Press Association* provides a useful summary of the partners' disagreements in the Pohokura case:

> "The row began in 2004 as Todd faced off against Shell over which company would operate the offshore natural gas field, which was due to start production. Up to that point it had been operated by Shell Todd Oil Services, a 50:50 joint venture that had been running oil and gas enterprises for the previous 50 years.
>
> … The partners in the field won special Commerce Commission approval in 2003 to jointly market the gas, claiming development of the field would otherwise be delayed.
>
> But they decided to go ahead and sell the gas separately anyway - with no delay in production - and Shell moved to have its 50:50 joint venture with Todd, Shell Todd Oil Services (STOS) "resign" as operator of the field.
>
> More litigation followed, and in 2005, Todd lost a High Court case over who operated Pohokura.
>
> Shell and OMV used their majority voting power to pass the Offtake Rules, which required Shell to assess the "total production available", a level it claimed was 70 petajoules a year.
>
> At the time, a retailer, Wanganui Gas, reported conditions for the sale of the Pohokura gas would probably result in the price that retailers paid for gas doubling, and also facing significant "take-or-pay" conditions.
>
> Todd has claimed the amount of gas available from the field was actually 87 petajoules a year, with potential for extra revenue of $12 million to be generated by each additional petajoule."[59]

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[58] New Zealand Commerce Commission, Determination Decision 581, 2 June 2006, para.22-23.

[59] New Zealand Press Association, 'Court rejects Todd family's Pohokura collusion appeal', 39 November 2009, available at: http://www.stuff.co.nz/business/industries/3108491/Court-rejects-Todd-familys-Pohokura-collusion-appeal

The High Court of New Zealand decision *Todd Pohokura Ltd v Shell Exploration NZ Litd and Anor* also provides a useful summary:

> "[1] Originally they planned that jointly operated export pipelines would be used to take the gas from the PPS [Pohokura Production Station] to a connection with the Maui Pipeline near Waitara and the condensate to Port Taranaki. Each party would then be free to take and dispose of its agreed share of the gas or condensate from those points.
>
> [2] However the parties fell out after development of the field began in 2004. Instead of using joint pipelines, they agreed that each would export its respective share of the two different products through separate pipelines.
>
> [3] Each party has substantially constructed its pipelines. Shell and OMV, operating in a new joint venture known as the EPJV, have connected their pipelines to the PPS. But those two parties, working through Shell in its capacity as the Operator of the field, have refused to allow Todd to connect its pipelines to the PPS unless it agrees to execute an Interconnection Deed. However, Todd challenges the validity of certain rules and protocols incorporated in the document and refuses to sign.
>
> [14] On 3 March 2006 the Operating Committee, over Todd's objection, resolved to adopt a set of rules prescribing the basis upon which the joint venturers would be entitled to take natural gas and condensate from the PPS. They are known as the Off-Take Rules. Todd objected because it considered that, first, adoption of the Off-Take Rules was inconsistent with its rights … to take its equity share of the total production available on a given day and, second, the Operating Committee could not in the absence of a unanimous agreement validly impose arrangements which affect the rights of joint venturers."[60]

The ACCC appears to have been misinformed by producers about the significance of risks and costs of gas balancing / separate selling arrangements in the Pohokura experience.

Instead, the disputes appear to be concerned with Shell having operational control of the Pohokura Project, the rate of gas production and minority partner Todd's rights as a joint venture partner.

3.9 The North West Shelf State Agreement gives domestic supply priority over LNG contracts

The North West Shelf State Agreement provides a powerful mechanism for the State Government to ensure continuing and additional domestic gas supply as necessary. In particular, clause 46(1a) provides:

[60] *Todd Pohokura Ltd v Shell Exploration NZ Ltd and Anor* HC WN CIV-2006-485-1600

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

The State Government therefore has the power to ensure that availability of domestic gas takes precedence over any additional contracting or export of LNG from 2010 through 2025. This is consistent with the original intent of the State Agreement.

It is disingenuous for the NWSJV applications to assert that they would need to "reconsider" their activities in the State, including domestic supply, should authorisation not be granted.

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