



NORTH WEST SHELF GAS: APPLICATION FOR JOINT SELLING AUTHORISATION

30 April 2010

Key Points

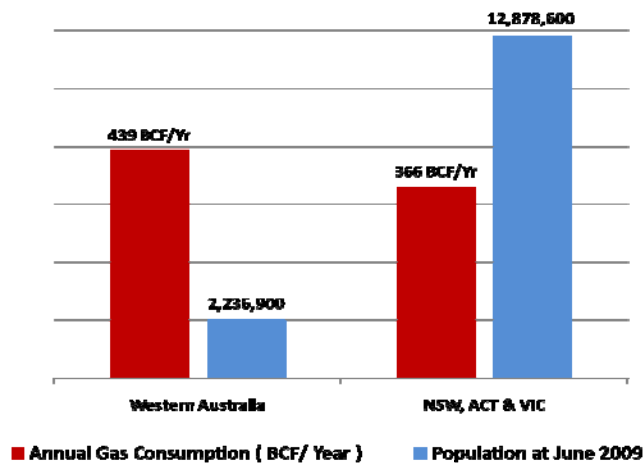
- Joint selling by the NWSJV producers has been the single biggest barrier to domestic gas competition and supply in Western Australia.
- Gas producers have immense market power to increase prices or withhold supply. WA consumers are paying up to three times the price for gas.
- ACCC endorsement of joint selling would force WA consumers to pay an extra \$2 billion a year on gas.
- This equates to a \$2 billion subsidy to some of the world's biggest oil and gas companies – or \$1000 a year for every WA business and individual.
- Separate selling by the NWSJV producers is practical and feasible. Producers currently sell domestic gas separately in Western Australia, the Eastern States and overseas.
- WA gas users have been raising concerns over the NWSJV joint selling arrangements for over three years with no outcome. The ACCC should now act to end the State's gas duopoly and enforce competition.
- Should, however, the ACCC grant authorisation, this should be made conditional on the NWSJV producers:
 - meeting their original commitment in 1998 to increase domestic supply to 1100 TJ/d; or
 - maintaining existing levels of domestic gas supply for the life of the Project or for the duration of any authorisation period.

Australia's largest and most developed domestic gas market

The WA domestic gas market is Australia's largest and most developed domestic gas market. 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

Chart: Domestic gas consumption



The WA domestic gas market is over 25 years old and mature. More than 30 downstream customers purchase directly from just two producer groups. It is characterised by a mix of short and long-term supply contracts; significant short and long-term gas trading; and substantial transportation and storage capacity.

Joint selling is the single biggest barrier to competition and supply

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

Through joint selling arrangements, the six NWSJV producers combine together to set prices and contract terms covering almost 70 per cent of the market. Customers are forced to deal with a single seller instead of six sellers competing to offer the lowest price. As a result, producers exercise immense power to increase domestic gas prices or withhold supply.

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'.

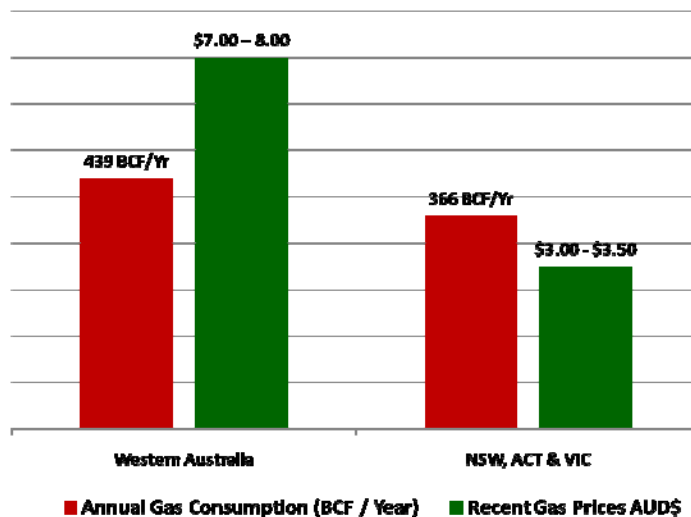
This market power is exacerbated by significant ownership concentration in existing and prospective gas developments. Cross-ownership minimises any competitive tension between projects with Chevron for example a participant in the NWSJV, Gorgon and Wheatstone projects.

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

WA is paying up to three times the price for gas

As a result, Western Australia is paying up to three times for the price of gas. WA gas prices are around \$8 per gigajoule, compared to just \$3 - \$3.50 in Victoria where competition prevails. This is despite WA having Australia’s biggest gas market, biggest gas production and biggest natural gas reserves.

Chart: Domestic gas prices



The NWSJV authorisation application comes just weeks after five of the six NWSJV producers combined together to force a reported 300 per cent price rise on Alinta. Alinta is the State’s largest gas retailer and supplies 600,000 homes and businesses.

Woodside has indicated the NWSJV producers will continue to exercise their market power by seeking to apply the reported \$8 per gigajoule price on other new or existing contracts”.³

Given the significant price increases are the direct result of joint selling, it is absurd for the NWSJV producers to claim that joint selling “has continuously delivered domgas at competitive prices”.⁴

³ “This is a huge new revenue exposure for North West Shelf and Woodside and my expectation is that when other new or existing contracts come up for review, there will now be a new price foundation to work from”: *WA Business News*, ‘Woodside hails new domgas price mark’, 24 February 2010, quoting Woodside CEO Don Voelte.

Producers are “keeping their foot on the hose”

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

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

That producers are actively withholding supply is demonstrated in the case of Gorgon. Gorgon operator Chevron, which is also a participant in the NWSJV, has indicated it would delay meeting the 300 TJ/d domestic gas supply commitment until 2021 – some 12 years after the project’s final investment decision:

“Chevron says it does not expect to be delivering its full quota of 300 tj/day until 2021 *because of an expected oversupply in the domestic market* ... Chevron said a number of competing projects would come on to the market by 2015 *and it needed to be mindful of oversupply.*”⁵

Claims about an “oversupply” in the WA gas market are not supported by any evidence. Studies being undertaken by the WA Department of Mines and Petroleum indicate that Western Australia faces a serious domestic gas shortfall.

Rather than an oversupply of gas in the WA market, it appears that a deliberate shortfall of gas by producers exercising market power is more likely.

Joint selling authorisation would equate to a \$2 billion producer subsidy paid by consumers

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

⁴ NWSJV participants’ submission, 31 March 2010, para.1.6.

⁵ *The West Australian*, ‘Barnett opens door to gas reserve changes’, 16 June 2009.

There is overwhelming evidence that joint selling:

- reduces the number of independent sellers from six to one;
- reduces customer choice on price and other conditions;
- entrenches an effective minimum floor price for domestic gas; and
- enables the coordinated abuse of market power.

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

This would equate to a \$2 billion subsidy to the world's biggest and most profitable oil and gas companies – or \$1000 for every business and individual in the State.

The ACCC should refuse to sanction what could well be the biggest transfer of wealth from consumers to a small number of private corporations in recent Australian history.

Higher gas prices are already impacting business and households

Higher wholesale gas prices as the result of producers' market power was a key driver in the State Government approving significant rises in business and residential gas tariffs in June 2009. This increased average household gas bills by \$78 or almost 23 per cent.

In March 2010, the State Government announced further gas tariff increases – 7 per cent for residential customers and 6.5 per cent for small business, with the exception of Albany where the increases were 10 per cent.

It is understood that current gas tariffs are yet to reflect the reported 300 per cent price increase forced upon Alinta by the NWSJV producers' joint selling arrangement. This can only lead to sharply higher gas and electricity prices for WA business and households.

The NWSJV producers have failed to demonstrate how reducing competition and reducing the number of sellers leads to lower gas prices.

Joint selling is a relic of the past

While joint selling might have been justified 33 years ago - when the North West Shelf project was being established, and when producers were selling to a single State-owned monopoly (SECWA) – it cannot be justified today.

Joint selling authorisation was granted in 1977 to the North West Shelf producers. The Project has since grown into one of Australia's biggest and most profitable projects.

Woodside, the operator of the North West Shelf Project, has grown from a company with no operating experience or revenues into one of Australia's largest companies - with a market capitalisation of around \$36 billion and reported a 2009 net profit of \$1.8 billion.⁶

The project risks identified by the ACCC in making its 2009 Gorgon Project Determination therefore do not apply to the NWSJV. Unlike Gorgon, the NWSJV is a long-established project that delivered returns for decades. The commercial imperatives that might arise in regard to a Greenfield project do not apply to the NWSJV.

In 2008, the Federal Government ended another 30 year old "sweetheart deal" granted to the NWSJV producers by removing their exemption from paying excise tax on condensate production. That historical subsidy was granted to support the original investment in the Project. As Prime Minister Rudd noted:

"Woodside are not happy, let's just be blunt about it ... [But the excise exemption was to encourage the development of the industry] some decades ago. Now some decades have now passed and I think it's time the broader Australia taxpayer got a return on all that."⁷

The Federal Government's action was taken in the face of fierce opposition by the NWSJV producers. Claims by Woodside and its partners that removing the exemption would threaten the North West Shelf Project have proven hollow.

The ACCC should now act to end the 33 year old joint selling subsidy. In Prime Minister Rudd's words, "some decades have now passed" since these arrangements were granted to support the original Project investment.

The fact that the NWSJV producers might encounter "administrative difficulties" in ending their arrangements cannot justify the continued suppression of competition and increased prices.

Separate selling is practical and feasible

Separate selling is practical and feasible and should be required of the NWSJV producers:

- the WA domestic gas market has undergone significant transformation since the 1990s;
- long term contracts have not prevented major producers from supplying international customers and expanding LNG supply;

⁶ Woodside website;

<http://www.woodside.com.au/Investors+and+Media/Financial+and+Production+Results/>

⁷ Sydney Morning Herald, 'Higher gas bills a gift for WA Libs', 28 August 2008, available at: <http://www.smh.com.au/news/environment/higher-gas-bills-a-gift-for-wa-libs/2008/08/27/1219516564933.html>

- major producers sell separately and compete with each other in marketing gas to international customers;
- 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; and
- gas balancing and nomination arrangements are already in place in the WA market.

Producers sell separately in WA

Separate selling is practical and feasible. Major gas producers sell separately in Western Australia and the Eastern States.

Apache and Santos have been separately selling gas from the John Brookes field. Santos has a 45 per cent non-operating interest in the John Brookes gas field with operator Apache Energy holding 55 per cent.

In July 2009, Santos announced it had separately secured a four year extension to its existing gas supply contract with Newmont. Total sales revenue under the four year contract was estimated to be \$100 million.⁸

In April 2010, Santos announced an agreement to separately supply gas to Wesfarmers Energy from its share of the John Brookes' field production. The agreement was for the supply of up to 60 petajoules of gas over more than five years.⁹

⁸ 'Santos secures \$100 million Newmont gas supply extension in Western Australia', Santos media statement, 27 July 2010, available at:

<http://www.santos.com/Archive/NewsDetail.aspx?p=121&id=1155>

⁹ 'Santos signs Gas Sale and Purchase Agreement with Wesfarmers', Santos media statement, 13 April 2010, available at:

<http://www.santos.com/Archive/NewsDetail.aspx?p=121&id=1200>

Governments have forced producers to sell separately in other countries

Many of the same NWSJV producers have been compelled by competition authorities to sell separately in other countries. They do so successfully. It is illogical that they should continue to engage in conduct in Australia that they prohibited from engaging in overseas.

In 2002, NWSJV producer Shell was compelled by the European Commission to sell separately in Norway. The European Union considered it 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.”¹⁰

In 2003, NWSJV producers Shell and Chevron were compelled by the European Commission to sell separately in Denmark. Producers also undertook to offer an additional 7 billion cubic metres of gas for sale to new customers over a period of 5 years.¹¹ This commitment recognised that the effect of joint selling had been to limit gas supply and competition.

In New Zealand, Shell and its partners claimed that separate selling was not practical or feasible from the major Pohokura gas field. New Zealand competition authorities granted them authorisation to sell jointly on the basis of these claims. These 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.*

The public benefits claimed by the NWSJV producers are illusory

Separate selling of domestic gas in Western Australia is practical and feasible. The “public benefits” claimed by the NWSJV producers would therefore arise even in the absence of joint selling.

Claims by the NWSJV producers that they will need to “re-consider their activities in WA” in regard to ongoing investment and supply lack any credibility.

Gas producers acknowledge the WA domestic gas market to be both highly profitable and highly valued. It is Australia’s biggest gas market and larger than Victoria, NSW and the ACT’s combined. At recent domestic gas prices, the WA gas market represents a \$3 billion market.

¹⁰ 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>

¹¹ 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>

The WA gas market delivers premium returns – in excess of that obtainable from overseas customers. As Apache Energy’s Chief Executive, Steve Farris, publicly stated: “For price, it’s the domestic market, for quantity it’s the LNG market.”¹²

Commenting on the reported 300 per cent price rise secured by the NWSJV producers from Alinta, Woodside CEO Don Voelte said:

“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.”¹³

It bears no logic that Woodside and their NWSJV partners would now turn their back on this “huge new revenue exposure” simply on the basis of the manner in which gas is marketed to consumers.

The NWSJV producers’ claims do not appear to align with their market statements

There appears to be a substantial disjoint between the NWSJV’s claims to the ACCC and NWSJV operator Woodside’s market statements.

The NWSJV producers claim that refusal to grant authorisation would lead to “very large transaction risks and costs” and “revenue risk”. They also claim that it would “jeopardise the ability of joint venture participants to maximise their revenue from and recoup investment in joint production”.

Presumably if these risks were as “significant” as claimed by the NWSJV producers, there would be a requirement for Woodside to make full disclosure of these risks to the market. The Alliance has been unable to identify market disclosure statements by Woodside that highlight these risks.

In fact, Woodside’s public statements appear to suggest the opposite. Woodside’s 2009 Full Year Results Presentation declares with confidence: “NWS operations: future supply is being readied now”.

It also states that completion of the North Rankin 2 Project would develop an additional 5 trillion cubic feet of reserves and extend North West Shelf field life to around 2040.

The presentation states that gas lifting costs have *decreased* from 2008 to \$3.35 / barrel of oil equivalent, or \$0.55 per gigajoule. Yet, Woodside and its NWSJV partners are combining together to force prices of around \$8 per gigajoule on domestic gas customers.

¹² Reuters, ‘Apache decision on Australian gas by October’, 4 June 2009, available at: <http://www.reuters.com/article/GlobalEnergy09/idUSTRE5535LZ20090604>

¹³ *WA Business News*, ‘Woodside hails new domgas price mark’, 24 February 2010.

That Woodside has attached little if any import to domestic gas marketing arrangements in its public statements to the market suggests one of two possibilities. Either the NWSJV producers consider ACCC authorisation to be a mere formality. Or the costs and risks claimed by the NWSJV producers have been considerably overstated and have no basis in fact.

In 1998, the NWSJV producers claimed authorisation would enable them to double domestic gas supply – this never happened!

It is striking that in 1998, the NWSJV producers claimed that authorisation for joint selling would enable them to increase domestic gas supply to 1100 TJ/d through the construction of an additional domestic gas processing train.

This commitment was never met despite the ACCC granting authorisation and producers continuing to sell jointly. 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.

Should authorisation be granted, any “benefits” would accrue exclusively to the NWSJV producers and other major producers. These include significant windfall gains from the continuing suppression of competition and concentration in market power.

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

The North West Shelf State Agreement provides a powerful mechanism for the State Government to enforce continuing and additional domestic gas supply. It empowers the State 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 be refused.

Even if the NWSJV producers satisfy their 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.

The ACCC should delay making a Determination until completion of the Parliamentary Inquiry

On 20 April 2010, the WA Legislative Assembly referred the issue of domestic gas prices for industry and consumers as a matter of public interest to a Parliamentary Committee Inquiry.

The Parliamentary Committee will specifically investigate:

- (a) the price of gas for customers throughout Western Australia;
- (b) the comparison of the price of gas with other States, especially Victoria, and whether there is a significant price differential and if so, why; and
- (c) the contrast between domestic gas prices in Western Australia and international LNG prices and the LNG contracts that govern these international prices.

The Parliamentary Committee was tasked to make recommendations on any measures that could be implemented to reduce the price of gas in Western Australia.

Issues of market power and joint selling by the NWSJV producers were raised by members of Parliament as directly relevant to domestic gas prices. Given these matters are now before the Parliament, the ACCC should delay making its Determination until completion of the Parliamentary Inquiry.

Authorisation should be refused

WA gas users have been pressing the ACCC for over three years to end the NWSJV joint selling arrangements. The ACCC has yet to respond to consumers' concerns.

The ACCC should now require the NWSJV producers compete with each and sell separately to consumers. Authorisation should be refused given overwhelming evidence that joint selling suppresses competition and increases prices; while separate selling is practical and feasible.

Gas consumers would however benefit from an orderly transition to a more competitive market, particularly with respect to existing contracts. The timeframes and conditions for the cessation of joint selling could be determined in consultation with individual gas customers.

Any authorisation should be made conditional on the NWSJV producers maintaining supply

Should however the ACCC decide to grant authorisation, this should be conditional on the NWSJV producers meeting the commitment they made in 1998 to increase domestic gas supply to 1100 TJ/d through the construction of an additional domestic gas processing train. This commitment was never met by the NWSJV producers despite the ACCC granting authorisation in 1998.

Alternatively, any authorisation should be made conditional on the NWSJV producers maintaining existing levels of domestic supply for the life of the North West Shelf Project, or at the minimum, the duration of any authorisation period.

The NWSJV producers have justified their application on the basis of the significant public benefits of ongoing domestic supply and security of supply. They should therefore have no difficulties in committing to such a condition.

A domestic supply condition would provide certainty and security to WA gas users who are already paying three times the price of domestic gas. This would allow businesses sufficient certainty to be able to plan future project investments and developments.

Table: WA domestic gas market: 1984 and 2010

Downstream market 1984	Upstream market 1984
<p>✗ Single monopoly buyer (SECWA)</p>	<p>✗ Single monopoly seller (NWSJV)</p>

Downstream market 2010	Upstream market 2010
<ul style="list-style-type: none"> ✓ Disaggregation of SECWA monopoly contract ✓ Over 30 gas customers buying directly from producers ✓ Privatisation of Alinta and the DBNGP ✓ Open access regime for the DBNGP ✓ Alinta, Synergy and Perth Energy operating as aggregators ✓ Short and long-term trading in gas transmission capacity and physical gas ✓ Significant expansion in market breadth and size ✓ Connectivity between gas pipelines in WA ✓ Greater flexibility within the DBNGP to manage supply and demand imbalances 	<ul style="list-style-type: none"> ✗ Duopoly seller – NWSJV producers control almost 70 per cent of the market ✗ NWSJV producers continue to sell jointly to set prices, terms and conditions