Gorgon Gas Project: Application for Joint Selling Authorisation

Second submission to the ACCC by the DomGas Alliance

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1. THE ACCC'S ROLE

1. The DomGas Alliance acknowledges that the ACCC's assessment of authorisation is being undertaken against a background of intense political interest in the Gorgon Project.

2. This interest has been reinforced by the current economic environment, with claims by both project proponents and governments of a "Gorgon-led national economic recovery".

3. In this highly politicised environment, the ACCC is expected to come under strong demands to not being seen to be "standing in the way of a $50 billion project", irrespective of the actual merits of the applicants' claims or the long term consequences for gas consumers in WA.

4. The ACCC's role as the only independent national agency with responsibility for administering the *Trade Practices Act* therefore assumes even greater importance.

5. The Alliance strongly supports the independent role of the ACCC which is to "enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection".[1]

6. The ACCC's role is not as a facilitator of major project developments. This function is already being performed in the Gorgon case by the Commonwealth Department of Resources, Energy and Tourism, and the WA Department of State Development.

7. It is therefore critical that the ACCC scrutinises and challenges the claims and assertions being advanced by the applicants, to ensure such arguments can be sustained on the factual evidence.

[1] *Trade Practices Act 1974 (Cth)*, section 2 (object of the Act).

2. INTERIM AUTHORISATION SHOULD BE URGENTLY RECONSIDERED

2.1 Overview

8. The DomGas Alliance is dismayed that the ACCC has granted an interim authorisation to the Gorgon applicants to permit cartel selling of Gorgon gas.

9. The WA domestic gas market is already characterised by a serious lack of competition with just two supplier groups controlling almost 100 per cent of the market.

10. As a result, WA consumers are paying around four to five times the price of gas than consumers in the Eastern States.

11. The lack of competition was the direct result of joint selling arrangements. Through the North West Shelf Joint Venture selling arrangements, six of the world's largest oil and gas companies combine together to sell as a cartel controlling 70 per cent of the WA market.

12. Extending joint selling to the Gorgon Project further entrenches these arrangements as Shell and Chevron are also participants in the NWSJV.

13. The decision to grant interim authorisation potentially sets back competition in the WA gas market for decades. Industry, small businesses and households will be the ultimate losers through higher gas and electricity prices.

14. The ACCC's decision should be urgently reconsidered and interim authorisation withdrawn given:

- it is based on the unproven claims and assertions of the applicants;
- it is based on erroneous conclusions; and
- it fails to assess the public detriment that would result from joint selling, giving rise to a serious error of law under section 90(6) of the TPA.

2.2 Unproven claims and assertions

15. In granting interim authorisation, the ACCC appears to have accepted the unproven claims and assertions of the applicants, while at the same time disregarding the substantial evidence of fact provided by consumers.

16. Major gas producers have in the past been highly effective at influencing regulatory outcomes through unproven claims that proposed responses threaten project investment, increase sovereign risk or are “not commercial”.

17. These claims are being increasingly challenged by governments and regulators. The Federal Government has for instance rejected claims by major producers that any tightening of Australia’s petroleum Retention Lease arrangements would lead to increased sovereign risk.[2]

18. It is disappointing that the ACCC has appeared reluctant to challenge producer claims that separate selling was not commercially practical or feasible in WA.

19. It has refused to do so over many years by: granting authorisations to producers to engage in anti-competitive conduct; and by failing to enforce the *Trade Practices Act* when those authorisations expire.

20. Gas consumers have been pressing the ACCC since early 2007 to remove the North West Shelf participants’ unauthorised cartel selling arrangements. No action has yet been taken in more than 2 years by the ACCC.

21. It is therefore disappointing that consumers were provided less than 10 working days to respond to Shell, Chevron and ExxonMobil’s claim for interim authorisation, with authorisation granted by the ACCC within less than 5 weeks.

22. Claims by the NWSJV and Gorgon participants that separate selling is not commercially practical or feasible have since been disproven in WA, New Zealand and elsewhere, including by the same companies making those claims.

23. The Alliance recalls the detailed submissions by the DomGas Alliance, Alcoa, CSBP, DBP, ERM Power, Synergy and Wesfarmers Energy provided to the ACCC.

[2] Minister for Resources, Energy and Tourism, ‘Retention lease discussion paper released’, 12 June 2009. The Minister strongly rejected sovereign risk claims by gas producers: “Australia is one of the most desirable investment locations in the world, so it makes sense that companies would see Australia as a safe harbour, especially in these troubled economic times. Australia's political stability can see our resources put to the back of the queue in terms of development planning, as companies choose to 'get in and get out' of nations with greater sovereign risk, knowing their Australian titles can be warehoused and kept for a rainy day.”

24. This evidence clearly demonstrated that a decision not to grant interim authorisation would not prevent Chevron, Shell and ExxonMobil from:

- separately marketing and selling gas into the domestic market;
- meeting their obligation under the State Agreement to diligently market gas to WA customers;
- separately obtaining a "firm understanding of the likely level and timing of demand for domgas from the Project prior to a Final Investment Decision"; and
- undertaking the required investment decisions for developing the Gorgon Project.

25. The ACCC's decision on interim authorisation should therefore be urgently reconsidered on the factual evidence of the matter as opposed to unproven claims and assertions.

2.3 Decision based on erroneous conclusions

26. The ACCC decision to grant interim authorisation appears based on a number of erroneous conclusions relating to the key elements of the authorisation assessment.

2.3.1 Urgency

27. The ACCC states that it "accepts that the Applicants may not be prepared to undertake further substantial customer engagement without interim authorisation".[3]

28. The ACCC considers it "common for parties to significant and complex resource projects, such as Gorgon, to require detailed customer engagement to reach an understanding of the level and nature of demand prior to making a Final Investment Decision".[4]

29. This is a serious error as it fails to distinguish between the willingness of the applicants to perform an act, as opposed to the actual practicality or feasibility of them doing so.

30. Indeed, the ACCC elsewhere in the decision acknowledges that there "should not be insurmountable difficulties in the Applicants obtaining the appropriate staffing and resources *should they wish to undertake separate marketing were interim authorisation denied*."[5] (emphasis added).

[3] ACCC Decision on Interim Authorisation, para.24.
[4] ACCC Decision on Interim Authorisation, para.25.
[5] ACCC Decision on Interim Authorisation, para.58.

31. The fact that the applicants may "not be prepared" to act in a manner that meets their obligations under the *Trade Practices Act* is not, by itself, evidence that it is not practical or feasible to do so.

32. The ACCC nevertheless assumes that joint selling is necessary to enable the applicants to engage customers prior to a Final Investment Decision, despite clear evidence to the contrary.

33. On this reasoning, project participants could *always* expect interim authorisation for cartel selling, so long as this was for the purposes of "engaging the market" prior to any Final Investment Decision.

34. The ACCC also appears to draw erroneous conclusions from a one month delay in the Reindeer domgas project. The Alliance understands that the Reindeer project involved domestic supply of up to 120 TJ/d and an $800 million project cost.[6]

35. Even assuming a $2 billion Gorgon domgas project cost for an up to 150 TJ/d supply, domestic supply would equate to around 4% of the total cost of the Gorgon project.

36. In terms of Gorgon production volumes, the initial target of up to 150 TJ/d domgas supply would only be equivalent to just over 6% of expected LNG exports. This will rise to only 13% in 2021 when the applicants expect the 300 TJ/d supply volume to be achieved.

37. LNG will therefore account for around 90% of production volume and 96% of Gorgon Project cost. Shell, Chevron and ExxonMobil have been separately selling LNG and competing with each other since as early as 2005.

38. It is therefore absurd to consider that joint selling of domestic gas is necessary to enable a Final Investment Decision on the $50 billion Gorgon Project.

39. In any event, the experience in Reindeer does not displace the clear evidence in New Zealand where Shell and its partners sold separately *before* a Final Investment Decision on the Pohokura project, despite earlier claiming separate selling to be impossible and that authorisation was necessary to enable project investment.

40. The fact the ACCC appears to have accepted the Gorgon applicants' claims and assertions is a serious error that necessitates a review of the decision to grant interim authorisation.

[6] 'Santos/Apache Reindeer gas project resurrected', ABC news online, 7 January 2009, available at: http://www.abc.net.au/rural/resource/stories/s2460837.htm

2.3.2 The extent to which the relevant market will change

41. The ACCC makes the erroneous assumption that were the applicants to be subsequently required to sell separately, they would face the same competitive pressures as if interim authorisation had not been granted.[7]

42. The ACCC goes on to consider that even if the applicants selling separately may know a customer was previously willing to pay a particular amount, "they will face the risk that if they try to hold out for that previous price, another Applicant (or indeed any alternative supplier) may undercut them to win that customer".[8]

43. This assumption appears to ignore the market reality in WA, the immense market power exercised by major producers and the commercial behaviour of suppliers operating in an extremely tight market.

44. As the Alliance advised the ACCC by way of oral evidence, such a conclusion would only be appropriate in a competitive market characterised by actual competition between different gas suppliers.

45. The WA gas market is however one of most uncompetitive markets in Australia. As outlined in the Alliance's submission, Shell, Chevron and ExxonMobil enjoy immense market and pricing power:

- the NWSJV participants – which includes Shell and Chevron – control 70% of the domestic gas sold in WA and over 92% of the gas resources in developed fields; and
- two supplier groups control close to 100% of the gas supplied into the WA domestic gas market and the resources in developed fields;
- 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 which is expected to continue for the foreseeable future;
- WA gas prices have risen dramatically to be four to five times prices in the Eastern Sates;

[7] ACCC Decision on Interim Authorisation, para.43.
[8] ACCC Decision on Interim Authorisation, para.45.

- despite WA's "abundance" of gas reserves, current domestic gas prices are significantly higher than in overseas markets (such as Henry Hub or LNG netback prices); and

- the majority of potential new field developments which could increase gas supplies to the domestic market are owned or controlled by one or more of the NWSJV participants.

46. Given the market reality, it is simply erroneous to assume that producers would not seek to abuse pricing information to secure the highest prices possible from consumers.

47. In a market characterised by a serious shortage of gas, immense market and pricing power by suppliers, and consumers having no reasonable opportunities to gas supply other than existing suppliers, the commercial driver of producers is not to undercut competitors and capture market share, but to secure the highest prices possible for their product.

48. The ACCC's assumption that access to information obtained through joint negotiations would not give rise to any market power on the part of the applicants is erroneous and ignores market reality.

2.3.3 Possible harm to the applicant

49. The ACCC notes that the applicants have:

- considerable international experience in separate marketing of domestic gas;

- are separately marketing LNG; and

- that there "should not be insurmountable difficulties in the Applicants obtaining the appropriate staffing and resources should they wish to undertake separate marketing were interim authorisation denied."[9]

50. The ACCC nevertheless goes on to assume that in the absence of interim authorisation, there may be less market knowledge which may result in greater uncertainty about the timing and outcome of a Final Investment Decision.

51. This assumption appears at odds with the ACCC's own assessment of the evidence that separate selling is commercially practical and feasible.

[9] ACCC Decision on Interim Authorisation, para.58.

52. To the extent there is any possible harm to the applicants, this could only be the result of a decision on their part *not* to sell separately, when it was otherwise commercially practical or feasible to do so.

2.3.4 Possible harm to consumers / possible benefit or detriment to the public

53. The ACCC considers that interim authorisation would provide benefits to third parties and the public from: additional supplies of domgas; avoiding delays in the Final Investment Decision or domgas supply; project investment, employment and exports; and a new source of domgas supply.[10]

54. In reaching this conclusion, the ACCC appears to ignore the substantial evidence provided by the DomGas Alliance and other submissions that separate selling is commercially practical and feasible. Indeed, the ACCC elsewhere concludes that separate selling is commercially practical and feasible.[11]

55. The evidence clearly demonstrates that any public benefits claimed by the applicants are illusory and would arise even in the absence of joint selling. The ACCC's assumption that the claimed benefits may only arise from the granting of interim authorisation is therefore erroneous.

56. Furthermore, while the ACCC decision assesses the supposed benefits from authorisation, it fails to consider the likely anti-competitive *detriments* to consumers.

57. Section 90(6) of the TPA provides that authorisation shall not be granted unless the ACCC is satisfied that it would result in a benefit to the public and that the benefit *would outweigh the detriment to the public from any lessening of competition that would result*.

58. The DomGas Alliance and other consumers provided substantial evidence that interim authorisation for joint selling would result in significant anti-competitive detriment by:

- significantly reducing the number of independent sellers from three to one;
- reducing customer choice over terms and conditions on offer;
- entrenching the already dominant market power exercised by Shell Chevron and ExxonMobil, with consumers lacking countervailing power;
- enabling the coordinated exercise of market power;

[10] ACCC Decision on Interim Authorisation, para.65-68, and 74-75.
[11] ACCC Decision on Interim Authorisation, para.58.

- extending that market power to other projects in which Shell, Chevron and ExxonMobil participate; and

- entrenching an effective minimum price for domestic gas.

- creating expectations as to price and other terms that might not otherwise be achieved if the applicants were independently competing with each other;

- creating a high risk of collusion over price-sensitive information, even if the Gorgon participants were subsequently required to sell separately;

- locking consumers into an invidious situation of having to *support* the Gorgon participants' claim for final authorisation; and

- creating significant uncertainty and delay for consumers given that any agreements entered into might be voided if final authorisation was not granted.

59. The ACCC's decision provides no assessment of these anti-competitive detriments. It ignores the disparity in market power between consumers and producers with around 30 individual gas purchasers compared to only two supply groups.

60. This market power is further extended by the fact that the NWSJV participants Shell and Chevron control 75% of the Gorgon Project.

61. To the extent there has been any consideration of the *public detriments* of authorisation, the ACCC merely assumes that Gorgon gas would provide a new source of domgas supply that will promote diversification and competition. It fails to assess the actual conditions of competition by which this new supply is being offered.

62. Accordingly, the ACCC appears to have made an error of law in only applying one limb of the test for authorisation under section 90(6) of the TPA. It has failed to provide any assessment of the public detriments that would result from the lessening of competition from cartel selling.

2.4 Conclusion

63. The WA domestic gas market is already characterised by a serious lack of competition with just two supplier groups controlling almost 100 per cent of the market.

64. As a result, for new gas, WA consumers are paying up to four to five times the price of gas than consumers in the Eastern States.

65. The lack of competition was the direct result of joint selling arrangements. Through the North West Shelf Joint Venture selling arrangements, six of the world's largest oil and gas companies combine together to sell as a cartel controlling 70 per cent of the WA market.

66. Extending joint selling to the Gorgon Project further entrenches these arrangements as Shell and Chevron are also participants in the NWSJV.

67. The decision to grant interim authorisation potentially sets back competition in the WA gas market for decades. Industry, small businesses and households will be the ultimate losers through higher gas and electricity prices.

68. The ACCC's decision should be urgently reconsidered and interim authorisation withdrawn.

3. FINAL AUTHORISATION SHOULD BE REFUSED

3.1 Overview

69. The DomGas Alliance has provided a detailed submission to the Commission in response to the applicants' request for both an interim and final authorisation. The Commission has also received detailed evidence from other gas consumers.

70. This submission will focus on:

- the need to distinguish between unproven assertions and actual evidence;
- separate selling by Shell in New Zealand;
- Shell, Chevron and ExxonMobil continuing efforts to separately market LNG;
- the use of joint selling arrangements to withhold domestic gas supply and drive up prices;
- the period of authorisation; and
- the treatment of commercially sensitive information.

71. Even if interim authorisation is considered necessary to enable the applicants to engage customers and reach a Final Investment Decision, there is no justification for permitting joint selling after a Final Investment Decision has been taken on the Project.

72. Accordingly, final authorisation should not be granted to the applicants.

3.2 Unproven assertions vs. actual evidence

73. As discussed above, in assessing the application for final authorisation, it is vital that the ACCC maintain a clear distinction between unproven claims and assertions versus actual factual evidence.

74. Claims by the applicants that separate selling is not commercially practical or feasible, or that joint selling would result in lower domgas prices, more supply or more investment, are assertions or opinions supported by little factual evidence.

75. For example, the applicants claim that separate selling would increase marketing and transaction costs which could be expected to be passed on to consumers.[12] The applicants do not, however, seek to quantify:

[12] Applicants' submission, para. 7.82.

- what these costs might be;

- what these costs might represent as a percentage of the overall Gorgon Project or individual domgas contracts; or

- how these costs compare to those already incurred by the applicants in their separate marketing of LNG.

76. Similarly, the applicants claim that separate selling would result in reduced incentive for future investment. They cite comments by the ACCC that "where *evidence* indicates that the prohibition of joint marketing of gas might dissuade new investment in gas production, then authorisation of joint gas marketing is likely to be in the public interest".

77. However, they provide *no evidence* themselves other than claiming that any requirement to sell separately in the present case would discourage future investment. They give no examples of any project where a requirement to sell separately resulted in that project not proceeding.

78. The applicants also ignore examples of other major greenfield projects which have successfully marketed LNG and domgas separately. This includes the Gorgon Project where Shell, Chevron and ExxonMobil have been separately selling LNG since as early as 2005, and the major greenfield Pohokura project in New Zealand where Shell and its partners have been separately selling domestic gas.

79. To support their claims, the applicants instead rely on consultants' reports such as the Concept Economics report and the Lateral Economics report. It is appropriate that the Commission scrutinise the factual probity of these reports to satisfy itself that they represent factual evidence as opposed to assertions or expressions of opinion.

80. To that end, it is curious that the applicants have not sought to refer to the detailed and presumably supportive consultants' reports that were tendered by Shell and its partners in the New Zealand joint selling case. These reports drew strong comparisons between the Australian and New Zealand markets to support the argument that joint selling was not practical or feasible in New Zealand.

81. The Alliance agrees with the ACCC's conclusion that:

- the applicants have considerable international experience separately marketing gas into domestic markets (in fact, all decisions by North West Shelf Gas are referred to each individual NWSJV participant, including Shell and Chevron, for individual attention and approval);

- the applicants intend to separately market their LNG shares from the Gorgon Project to overseas customers – in fact, they have been doing so since as early as 2005;

- there "should not be insurmountable difficulties in the Applicants obtaining the appropriate staffing and resources *should they wish to undertake separate marketing* were interim authorisation denied".[13]

82. Separate selling of domgas from the Gorgon Project is commercially practical and feasible, and this has been clearly established on the evidence.

3.3 Critical errors of fact

83. The applicants' claims contain numerous critical errors of fact, including on the structure and operation of the WA domestic gas market, and on gas developments and marketing in other countries.

84. For example, the applicants assert there is a lack of storage or spot market in the WA domgas market and that there is "little demand for short-term services that might support the emergence of a spot market".[14] The applicants would however be aware of clear evidence to the contrary that:

- substantial volume of short and long-term trading takes place in gas transmission capacity and physical gas;

- brokers are actively engaged in providing gas trading serves to WA gas users; and

- the DBNGP provides significant flexibility in managing supply and demand imbalances.

85. These critical errors of fact have been pointed out in submissions to the ACCC by the DomGas Alliance, Alcoa, CSBP, DBP, ERM Power, Synergy and Wesfarmers. Given the nature of these errors, the applicants' claims in support of authorisation are fundamentally flawed and should be rejected.

3.3 The actual evidence is clear and compelling

86. The Alliance considers that mere assertions and opinions cannot override the actual evidence of the matter. As outlined in the submissions to the Commission, this evidence is clear and compelling:

- the WA domestic gas market has undergone significant transformation since the mid-1990s;

[13] ACCC Decision on Interim Authorisation, para.58.
[14] Applicants' submission, 20 May 2009, para.7.39.

- gas balancing and nominations arrangements are already operating in regard to Shell, Chevron and ExxonMobil's participation in the Gorgon Project and the NWSJV;

- Shell, Chevron and ExxonMobil have been separately marketing LNG market since as early as 2005;

- separate selling is already taking place in Western Australia for other joint venture gas developments;

- Shell, Chevron and ExxonMobil have been compelled to sell separately by the European Commission in Norway and Denmark, and successfully do so;

- Shell's experience in New Zealand where it sells separately despite originally claiming it was impossible and infeasible to do so.

87. The evidence confirms that separate selling is commercially practical and feasible. There are no public benefits in permitting Shell, Chevron and ExxonMobil to sell jointly following a Final Investment Decision on the Project.

3.5 Separate selling by Shell in New Zealand

88. In contrast to the unproven assertions and opinions tendered by the applicants, Shell's actions in New Zealand constitute clear factual evidence that separate selling is commercially practical and feasible.

89. Shell and its partners sell domestic gas separately from the Pohokura gas field – a major greenfield gas development – and have been doing so since 2004. Shell's actions in New Zealand is compelling evidence in the present matter given:

- Shell and its partners' reliance in the New Zealand case on the market features identified by the ACCC in the 1998 North West Shelf determination;

- Shell and its partners' very definitive assertions that separate selling in New Zealand was impossible or infeasible because of the claimed market features;

- Shell and its partners' position that events and experience in the New Zealand gas market are instructive and useful in the Australian gas market; and

- Shell and its partners' position that to the extent there were differences between the two markets, the Australian market was significantly larger and more mature than the New Zealand market.

90. It is curious that the applicants should claim that "there is no precedent for a major greenfields gas project such as the Project being separately marketed".[15] This statement of apparent fact should be closely scrutinised by the Commission.

91. The applicant Shell also appears to have had detailed knowledge of its experience in New Zealand. The applicants lawyers - Allens Arthur Robinson – had "detailed discussions" on behalf of Shell Australia with the applicants in the New Zealand Pohokura case.[16]

92. Shell and its partners in the New Zealand case also indicated they were inviting Allens Arthur Robinson to comment on Shell's behalf on any particular issues relating to the Australian experience.[17]

3.5.1 Similarity between the Australian and New Zealand markets

93. In the Pohokura case, Shell and its partners made very definitive claims that the supposed market features rendered separate selling impossible or infeasible in New Zealand.

94. These claims – which are strikingly similar to the applicants' in the Gorgon case - were subsequently disproved by Shell and its partners' actions in separately selling gas, *with no delay to production or supply*, when they were unable to agree to joint selling arrangements.

95. While the Gorgon applicants might seek to distinguish Shell's practices in New Zealand, this is refuted by the strong comparisons made by Shell and its partners between the Australian and New Zealand gas markets:

- "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*."[18]

- "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*."[19]

- "There are a number of reasons for concluding that the Australian gas industry experience and precedents are pertinent to the New Zealand market, and the Commission references in the Draft

[15] Applicants' submission, 20 May 2009, para.7.106.
[16] Applicants' submission to the New Zealand Commerce Commission's Draft Determination in the Pohokura case, 10 June 2003, para.31.
[17] Applicants' submission to the New Zealand Commerce Commission's Draft Determination in the Pohokura case, 10 June 2003, para.32.
[18] Applicants' original submission in the Pohokura case, para.20.
[19] CRA report, December 2002, p.3.

Determination to comparisons and events in Australia, would tend to support that view."[20]

- "… In both cases the government agency responsible for promotion of competition, the ACCC in Australia and the Commerce Commission in New Zealand, has vigorously pursued the application of the relevant competition laws to achieve the objective shared by both countries, of an efficient and competitive gas industry. *It follows that events and experience in either of those countries is instructive and useful for the other*."[21]

- "… 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* …"[22]

96. The Alliance agrees with Shell that the events and experience in New Zealand are instructive and useful for Australia. They are relevant to the Commission's examination of the applicants' claims as to the practicality of joint selling from the Gorgon Project.

3.5.2 The WA market is substantially more mature

97. To the extent there are differences between the Australian and New Zealand market, the Australian (and WA) market is considerably more mature and developed than the New Zealand market. Shell and its partners emphasised in 2003 that:

- "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. Even so, Australia is only now on the verge of reaching a market which might soon be capable of supporting forms of separate marketing, and only in some regions. *The key ACCC cases were decided at a time when Australian market conditions more closely resembled those still pertaining in the less-developed and relatively immature New Zealand market. 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*."[23]

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[20] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.15.
[21] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.15.
[22] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.15.
[23] Applicants' submission to the New Zealand Commerce Commission's Draft Determination in the Pohokura case, 9 June 2003, para.43.

- "The New Zealand gas industry differs from its Australian counterpart in a number of important ways. Its production capacity is concentrated in one area of the country instead of being geographically diverse, and its ratio of reserves to production off take is far smaller, which raises the issue of some urgency in the need to stimulate new exploration. *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."[24]

- "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*. I would expect the development of a liquid trading market to occur in Australia in advance of that development in New Zealand, and that has not yet occurred in Australia. I would therefore anticipate that considerable market development will need to occur in New Zealand before the preconditions for a liquid trading market will exist."[25]

98. The statements by Shell and its partners are compelling, and highly relevant to the applicants' claims in the present case. The Alliance agrees with Shell that the Australian market was, *as early as 2003*:

- 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.

99. The Alliance agrees with Shell's assessment that at the time the key ACCC decisions examining the Australian gas market were made (the 1990s), the Australian market was in close parallel to the New Zealand market in 2003 "which is much further back along the evolutionary path".

100. The fact that Shell and its partners subsequently sold separately in New Zealand is therefore compelling evidence in the present matter. Logically, separate selling is even more practical and feasible in

[24] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, pp.2-3.
[25] 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini, 9 June 2003, p.17.

Western Australia given it is a far more mature and developed market than New Zealand today – let alone the New Zealand market in 2003.

3.5.3 The decision to sell separately was taken *prior to* FID

101. In their second submission, the Gorgon applicants repeat their claims that authorisation is necessary to allow the applicants to proceed to a FID and that any requirement for separate selling would lead to significant delays.[26]

102. As Synergy points out in its submission, the decision to sell separately in the Pohokura major greenfield project was made *prior to* a Final Investment Decision (FID) on the project.

103. Shell and its partners advised in April 2004 that they were unable to reach agreement on critical issues associated with joint marketing. The partners then went on to reach a Final Investment Decision in June 2004.[27]

104. The New Zealand Commerce Commission noted that the separate marketing and sale approach did not apparently lead to a delay in the FID or a delay in full production of the field. Rather, any delays were attributable to the *seven and a half months spent attempting*, and failing, to reach agreement on joint marketing and sale arrangements.[28]

105. This is compelling evidence that disproves the claims by the applicants that authorisation for joint selling is necessary to enable a Final Investment Decision on the Gorgon Project and that delays would ensue if the applicants were required to market separately.

3.5 Continued separate selling of LNG by Gorgon participants

106. Since the Alliance's submission of 8 June 2009, the Gorgon participants have continued to sell LNG separately.

107. On 9 June, Reuters reported that Chevron has separately secured customers in Japan and South Korea for around 70 per cent of its share of production from the Gorgon Project. The report quotes the company as stating:

> "Chevron has signed non-binding heads of agreements with three utility companies in Japan and GS Caltex in South Korea for Gorgon."
>
> "Approximately 70 percent of Chevron's LNG off-take is expected to be purchased through these agreements."[29]

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[26] Applicants' second submission, 17 June 2009, para.3.6-3.9.
[27] Synergy submission, 9 June 2009, pp.4-5.
[28] Synergy submission, 9 June 2009, pp.4-5.
[29] Reuters, 'Chevron says secures clients for Gorgon LNG project', 9 June 2009, available at: http://in.reuters.com/article/governmentFilingsNews/idINSP13804320090609

108. It is relevant that the Gorgon applicants continue to compete with each other and to separately market LNG in what is a very competitive and challenging international LNG market.

109. This disproves the applicants' claims that separate selling of domestic gas is not commercially practical or feasible, or that separate selling would result in marketing and transactions costs and risks.

110. To the extent there is any imperative to minimise risks to facilitate greenfield investment, this logically relates to:

- the product (LNG) which comprises the bulk of the capital investment and expected revenues associated with the Gorgon Project; and

- the market (the international LNG market) where the greater commercial detriment and risk could be expected from the applicants competing with each other.

111. It does not relate to domestic gas.

3.7 The use of joint selling arrangements to withhold domestic gas supply and drive up prices

112. Gas consumers have previously raised concerns with the Commission on the use of joint selling arrangements by Shell and Chevron to withhold supply into the domestic gas market and to drive up prices.

113. Since the granting of the 1998 North West Shelf joint selling 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.[30]

114. Woodside has flagged potential construction of a further six LNG Trains, with the ambition of an additional 77 million tones of LNG capacity within the next 15 years.[31]

115. In contrast, supply to the domestic market by the NWSJV has increased only marginally from the 1980s. The NWJSV has not contracted any significant new volumes of gas into the domestic market since the mid-1990s.

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[30] Woodside Petroleum, 'North West Shelf Venture Produces First LNG From Train 5 Production Facility', ASX Announcement, 1 September 2008.
[31] ABC News online, 'Outlook remains strong: Woodside', 1 May 2009, http://www.abc.net.au/news/stories/2009/05/01/2558367.htm

116. This is 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.

117. Shell, Chevron and their NWSJV partners 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.

118. It would appear that Shell, Chevron and ExxonMobil have taken a similar approach in regard to domestic gas supply from the Gorgon Project. *The West Australian* reports:

> "… 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*."[32]

119. It is extraordinary that an "expected oversupply" in the domestic market should be raised by Chevron as justification for withholding supply. To the extent there is any oversupply in natural gas, it is not in the WA domestic market.

120. Nor is the very tight domestic gas market expected to improve. The potential new production from projects that might enter the market will come nowhere near meeting the State's requirement for over 1100 TJ/day in new and replacement gas by 2014-2015.

121. Joint selling arrangements have therefore been used by Shell, Chevron and other major gas producers as a means of coordinating market power to withhold supply and drive up prices.

122. Given the intent of the Gorgon participants to withhold supply, any extension of these arrangements to the Gorgon Project will further impact the WA gas market and consumers.

[32] 'Barnett opens door to gas reserve changes', *The West Australian*, 16 June 2009.

3.8 Treatment of commercially sensitive information

3.8.1 Any apprehension about the TPA has not prevented Shell and Chevron from unauthorised cartel selling as part of the NWSJV

123. The Alliance notes with some bemusement the applicants' claim that they are "prevented from inappropriately sharing competitively sensitive information, such as price information, with competitors by the provisions of the *Trade Practices Act 1974*".[33]

124. The applicants further assert that significant penalties and reputational costs attach to such breaches of the TPA and that to claim the applicants would ignore these prohibitions is a "serious, and baseless, allegation which should be rejected".[34]

125. Any apprehension that Shell and Chevron might have in regard to the TPA has not, to date, prevented them from engaging in price fixing, exclusionary conduct or arrangements that substantially lessen competition as part of the NWSJV unauthorised cartel selling arrangements.

126. Indeed, Shell and Chevron continue to engage in this conduct despite the fact they have no authorisation to do so under the TPA. It is also in spite of the fact that consumers have been raising concerns over their anti-competitive conduct with the ACCC since as early as 2007.

127. Given that Shell and Chevron's apparent disregard for the TPA in relation to the unauthorised NWSJV cartel selling arrangements, consumers have little confidence in any voluntary arrangements or policies they might propose to avoid similar anti-competitive conduct in relation to the Gorgon Project.

3.8.2 The proposed ring-fencing arrangement is manifestly inadequate

128. In any event, the ring-fencing arrangement proposed by the applicants is itself manifestly inadequate.

129. It is merely a voluntary internal arrangement expressly caveated to be "without prejudice to any other internal procedures each Seller is required to adhere to".[35]

[33] Applicants' second submission, 17 June 2009, para.2.3.
[34] Applicants' second submission, 17 June 2009, para.2.3.
[35] Ring-fencing protocol, cl.1.

130. It does not prevent sellers from disclosing marketing information to either its directors, officers, employees, etc, engaged in a rival project or that of a related body corporate engaged in a rival project where it deems disclosure to be "necessary and reasonable for the management" of the domgas project.[36]

131. It does not prevent the transfer or promotion of marketing staff and the knowledge their retain between projects, or to positions where they could influence pricing decisions affecting different projects.

132. This was recently demonstrated in relation to the NWSJV. The current General Manager for the NWSJV, whose responsibilities include coordinating domestic gas sales for the six NWSJV participants, was previously responsible for domestic gas marketing from the "competing" Woodside Pluto project.

133. It is unrealistic to assume that all the personal knowledge and information he acquired on pricing, contract terms and customers during his time at Woodside Pluto is no longer carried with him in his role in the NWSJV.

134. Finally, the proposed "firewalls" only apply to marketing team or staff as narrowly defined. They do not apply to senior officers who have control over marketing team decisions and who can coordinate and direct pricing policy across different projects.[37]

135. Critically, ring-fencing would not apply to individuals who are not otherwise "directly involved" in sales, sales promotion and negotiations, but who could nevertheless control, coordinate or direct pricing policy across different projects. These include "officers to whom Marketing Staff report either directly or indirectly".[38]

136. These significant flaws cannot be remedied simply by having an independent compliance auditor review compliance with these arrangements.

137. Even if an effective and ACCC-enforceable ring fencing protocol could be implemented, it would not alter the fact that:

- separate selling is commercially practical and feasible;
- there are no public benefits from authorisation joint selling; and
- any joint selling by the applicants would result in significant anti-competitive detriment.

[36] Ring-fencing protocol, cl.4.2.
[37] Ring-fencing protocol, definition of 'Marketing Staff' and cl.4.2.
[38] Ring-fencing protocol, definition of 'Marketing Staff', cl.4.1 and 4.2.

3.9 Final authorisation should be refused

3.9.1 Final authorisation should be refused

138. A key element of the applicants' claims is that authorisation for joint selling is necessary to enable them to engage customers prior to a Final Investment Decision.

139. This imperative would no longer apply after a Final Investment Decision is made.

140. It has been clearly established on the evidence – and accepted by the ACCC in its decision on interim authorisation – that separate selling is commercially practical and feasible.

141. Given there is nothing preventing the applicants – once a Final Investment Decision is made – from selling separately to WA consumers, any authorisation for joint selling should cease with a Final Investment Decision. Final authorisation should therefore be refused.

3.9.2 Timeframe of any final authorisation

142. Given that final authorisation should be refused, the timeframe of any final authorisation is redundant.

143. The submission will however respond to the timeframes being sought by the applicants.

The 2000 PJ timeframe equates to a 60 year authorisation period

144. The applicants have sought authorisation for the period until customer agreements have been reached for the sale of 2000 PJ of domgas, or alternatively 6 years from the date of First Gas.

145. As the applicants concede in their submission, the 2000 PJ timeframe is an open-ended one and the Commission's preference is to grant authorisations for definite, limited periods of time.

146. The Alliance further points out that given the 2000 PJ supply commitment relates to the life of the Gorgon Project, the applicants are in fact seeking a 60 year authorisation period. This should be rejected by the ACCC.

Six years from First Gas

147. The applicants claim in the alternative that authorisation should be granted for 6 years from the date of First Gas, i.e. until 2021 – a 12 year authorisation period.

148. The 12 year authorisation period sought by the applicants appears completely at odds with their claims that authorisation was "urgently" needed to allow them to engage the market prior to a Final Investment Decision. Elsewhere in their submission, the applicants claim authorisation was urgently needed to enable them to:

- Call for expressions of interest;
- Issue a gas sales agreement;
- Evaluate tenders under the bidding process; and
- Engage in subsequent discussions and negotiations in relation to terms of supply.[39]

149. The applicants claim that they "urgently need to progress through these steps, and in particular have substantive discussions with customers, as soon as possible in order to obtain the required information in relation to the level of customer demand and thus meet the anticipated timeframe for a FID".[40]

150. The Alliance considers that either the application for interim authorisation did not have the urgency claimed by the applicants, or that authorisation is only required to allow the applicants to "engage the market" *prior to* FID. If the latter, authorisation – if granted – should only be for the period until a FID for the Gorgon Project is taken.

151. This apparent contradiction is also evident in the applicants' second submission where they assert that that given the expected time lag between approaches to the market under an interim authorisation and possible approaches after final authorisation, "any information obtained during an interim authorisation would not be material to negotiations if and when a second approach is required to be made".[41]

152. Given the apparent lack of materiality of the information obtained during an interim authorisation, the applicants' claims as to the urgency and importance of this information to enable a FID is open to challenge.

153. The Alliance agrees with the comments in DBP's submission to the Commission that the six year from First Gas authorisation period sought by the applicants represents a notional period that bears little meaning to the true impact of any authorisation.

154. Both the Gorgon participants and consumers would be looking to secure long term contracts to underpin investment. The impact of any authorisation permitting the applicants to sell as a cartel would therefore be for the duration of these contracts. It would not simply

[39] Applicants' submission, 20 May 2009, para.6.10.
[40] Applicants' submission, 20 May 2009, para.6.10.
[41] Applicants' second submission, 17 June 2009, para.4.5.

disappear once supply contracts are entered into. Nor would it be limited to the 2009-2021 authorisation period sought by the applicants.

155. Furthermore, as the North West Shelf Joint Venture case demonstrates, once authorisation is granted and long term contracts entered into, producers are extremely reluctant to abandon joint selling. This is the case long after any original authorisation has lapsed. The NWSJV participants continue to sell jointly notwithstanding that authorisation for the Incremental Joint Venture lapsed in 2005.

156. Arguments have been made in regard to the North West Shelf Joint Venture that existing supply contracts constitute an "obstacle" to any ceasing of joint selling arrangements. According to this logic, cartel selling arrangements should never be removed, and producers should be permitted to continue to sell to new consumers as a cartel, so long as there are existing contracts in force.

157. It is therefore vital that in deciding whether to grant authorisation and in determining the period for authorisation, the Commission consider the long term impacts on the WA gas market and consumers. These impacts are not limited to the already extensive 12 year period sought by the applicants, or indeed to any "interim" authorisation period.

List of Attachments

1. Submission by Shell and its partners in response to the Commerce Commission Draft Determination in the Pohokura authorisation application, 9 June 2003.

2. Submission by Shell and its partners in response to the Commerce Commission Draft Determination in the Pohokura authorisation application, 10 June 2003.

3. 'A Critique of the Commerce Commission's Draft Determination', report by M.D. Agostini submitted by Shell and its partners in the Pohokura authorisation application, 9 June 2003.

4. 'Barnett opens door to gas reserve changes', *The West Australian*, 16 June 2009.