The Senate

Standing Committee on Economics

Joint marketing arrangements on the North West Shelf project

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Senate Standing Committee on Economics

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Dr Richard Grant, Principal Research Officer
Mr Glenn Ryall, Senior Research Officer
Ms Lauren McDougall, Executive Assistant

PO Box 6100
Parliament House
Canberra ACT 2600
Ph: 02 6277 3540
Fax: 02 6277 5719
E-mail: economics.sen@aph.gov.au
Internet: http://www.aph.gov.au/senate/committee/economics_ctte/index.htm

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Chapter 1

Introduction

Referral

1.1 An amendment to the Excise Legislation Amendment (Condensate) Bill 2008 on 25 September referred to the Economics Committee for inquiry 'the joint marketing arrangements on the North West Shelf project and their impact on competition in the upstream gas market and on prices paid by consumers'.

Background

1.2 The North West Shelf Venture is Australia's largest resource development project based on the gas and condensate fields of the North West Shelf of Western Australia. The Venture supplies natural gas to the domestic market in Western Australia, liquefied natural gas to Japan and condensate, crude oil and liquefied petroleum gas to international markets.[1]

1.3 The Venture has six participants who hold an equal one-sixth share in future gas sales. These are BP Developments Australia Ltd., Chevron Australia Pty Ltd., Japan Australia LNG Pty Ltd., Shell Development Ltd., BHP Petroleum Pty Ltd. and Woodside Energy Ltd. Woodside is the operator of the Venture and, under current sales arrangements, gas buyers have to deal exclusively with Woodside. Each of the six participants has the right and the obligation to own and take its production entitlement.[2]

1.4 The six Venture participants market gas to WA domestic customers through a joint selling arrangement, North West Shelf Gas Pty Ltd. This arrangement provides each participant significant market power with the Venture controlling about two-thirds of the WA gas market.[3] One other company supplies most of the rest.[4]

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1 North West Shelf Venture, http://www.nwsg.com.au/about/venture.html

2 DomGas, *Submission 1*, p. 5. The DomGas Alliance represents gas customers including Alcoa, Alinta, the Dampier Bunbury pipeline, Fortescue Metals, Newmont and Horizon Power and Synergy.

3 DomGas, *Submission 1*, p. 5.

4 Apache Energy is the second largest producer of both oil and gas in the offshore Carnarvon Basin in Western Australia. Its primary production hub is on Varanus Island, and it provides around 30 per cent of WA's domestic natural gas supply. BHP Billiton and ARC Energy supply about 5 per cent of the market.

The context of this inquiry

1.5 The North West Gas Shelf joint selling arrangement was introduced in 1977 as part of an authorisation made by the Trade Practices Commission (now the Australian Competition and Consumer Commission).[5] In making the decision, the TPC recognised the potential benefits to the Australian economy and that the success of the project depended on the joint venture arrangement. Specifically, authorisation was granted for the partners to:

> discuss and agree together the common terms and conditions (including price) upon which [their] gas…will be offered for sale to potential customers and to discuss and agree a method(s) for marketing such gas.[6]

1.6 The TPC's decision provided immunity from court action for conduct that might otherwise raise concerns under the competition provisions of the Trade Practices Act 1974. The Venture partners sought, and gained, a further authorisation from the application of the TPA in 1998.

1.7 On 14 December 2007, North West Shelf Gas Pty Ltd applied to the ACCC to revoke this authorisation on the basis that the joint marketing arrangements no longer needed authorisation. As part of its usual consultation process, the ACCC received eight submissions on the application. While all eight supported the revocation of the application, several queried whether the existing marketing arrangements were in keeping with the terms of the TPA.[7]

1.8 The DomGas Alliance[8], most notably, argued that the 1977 authorisation is an 'historical anomaly' which no longer applies to current marketing arrangements. Moreover, it argued that in the absence of an authorisation for anti-competitive practices, North West Shelf Gas 'appears' to be in breach of section 45 of the TPA. The Alliance's submission to the ACCC formally requested a review of the current joint selling arrangements.[9] A review was also supported in separate submissions from the Dampier Bunbury pipeline, Horizon Power, Fortesque Metals and the State Minister for Energy and Resources, the Hon. Fran Logan MLA.

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5 Authorisation A18492

6 Australia Competition and Consumer Commission, 'ACCC revokes North West Shelf Gas joint marketing authorisation', *Media Release*, 6 March 2008.

7 This authorisation was for a fixed term. It expired in 2005. See 'North West Shelf authorisation', Australian Competition and Consumer Commission, 31 July 2008. http://www.accc.gov.au/content/index.phtml/itemId/86976/fromItemId/621589

8 The DomGas Alliance was formed in 2006 to represent the interests of gas consumers and transporters.

9 DomGas Alliance, *Submission*, 18 January 2008, p. 2. http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D08+7285.pdf&trimFileTitle=D08+7285.pdf&trimFileFromVersionId=821029

1.9 Freehills, which represents the Venture participants, also supported revoking the authorisation but took issue with DomGas' concerns. Its submission noted that in 2007, the federal government acted to enhance protection for joint ventures under the TPA by including a broad-based joint venture defence to price fixing and exclusionary provisions. It added that joint venture activity, 'particularly when it is related to the development and operation of large scale infrastructure', is pro competitive. The Freehills submission also cited a 1998 ACCC inquiry into joint ventures which doubted whether the joint venturers could readily move to a separate marketing model.

1.10 In March 2008, the ACCC revoked the joint marketing authorisation.

1.11 In August 2008, the ACCC announced an investigation into whether the project should be allowed to continue selling gas as a single supplier, or if each of the project's six partners should have to strike their own individual sales arrangements. The investigation was initiated following a complaint by customers that the arrangement could be forcing them to pay higher prices. It has been reported that Woodside Petroleum would argue that the state's gas market was too small to demand that each of the partners trade as individual suppliers.

Conduct of the inquiry

1.12 The committee advertised the inquiry nationally and posted details about the inquiry on its website. In addition, it wrote to selected organisations and relevant statutory authorities advising them of the inquiry and inviting them to make submissions.

1.13 The committee received 4 submissions to the inquiry which are listed at Appendix 1, and are available at the Committee's website; http://www.aph.gov.au/Senate/committee/economics_ctte/tpa_unconscionable_08/index.htm.

1.14 A public hearing was held in Canberra on 11 November 2008. There were three witnesses: Ms Eva Howell, Chief Executive Officer of the North West Shelf Venture, Mr Stuart Hohnen, Executive Director of the DomGas Alliance and Associate Professor Zumbo from the University of New South Wales School of Business Law and Taxation. The committee thanks all those who participated in the inquiry.

1.15 At the hearing, the committee placed several questions on notice for the North West Shelf Venture and the DomGas Alliance. The committee notes that its deadline for responses was not met.

Chapter 2

The case for maintaining the joint marketing arrangements

A 'project based' market

2.1 In its submission to this inquiry, the North West Joint Shelf Venture argued that 'separate marketing of gas is not feasible…given the relative immaturity of the Western Australian market'. The hallmark of this 'immaturity', it claimed, is the 'project-based' nature of the domestic gas market. This is characterised by large and lumpy demand, inflexible transportation, a lack of storage options and no market clearing mechanism. The Venture argued that without joint marketing arrangements, the market would not attract the substantial capital investment for these large-scale projects and would be unable to clear, 'in a timely and efficient manner', the large trading imbalances.

2.2 Ms Eva Howell, Executive Director of the North West Shelf Venture, elaborated on these matters for the committee:

> …the ability of any gas producer to produce for the domestic market depends on having a commitment from purchasers in aggregate sufficient to underwrite the initial capital investment in the project and its ongoing operating costs. The volume of sales needed to underwrite these capital investments requires purchasers who are willing to commit to large quantities of gas for a long period of time. This is why we and every other credible commentator in the field, including the ACCC, the Ministerial Council on Energy, the Office of Energy and economic analysts, have previously characterised the Western Australian gas market as a project market where producers' projects and buyers' projects come together to create a viable business case for new supply to enter the market.[1]

2.1 The Venture claimed that an important part of creating a 'viable' business in this market is to jointly explore, develop *and* sell their gas products. Ms Howell argued that joint marketing arrangements are needed to give the companies confidence that the products in which they have jointly invested can then be sold. Only with these joint arrangements—from exploration to sale—can there be the certainty necessary to ensure continued investment in circumstances where 'each participant has similar revenue, cost and risk exposure'.[2]

2.3 Ms Howell contrasted the Western Australian gas market with the North American gas market. She noted that while Western Australia's market is based on a

1 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, pp. 2–3.

2 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 4.

small number of large buyers and sellers exchanging large quantities over large periods, the North American market has:

> …literally thousands of producers and production facilities that are generally of a much smaller scale, a very dense transportation network, storage facilities for gas, brokers and aggregators who act as intermediaries between the suppliers and the customers, and an advanced financial market for the purchase and sale of gas.[3]

2.4 Ms Howell also explained to the committee that the Western Australian gas market is different to the market for other products supplied by the Venture's companies. The companies' oil, condensate and LPG are sold separately because these markets are 'deep' and 'liquid' with storage facilities, brokers and aggregators and a related financial market. The Western Australian gas market does not have these characteristics.[4]

When would separate marketing arrangements become viable?

2.5 Based on the ACCC's 1998 determination, the Venture argued that there is a greater likelihood that separate marketing arrangements will become viable if there is:

- a significant increase in the number of customers;
- entry of new competitive suppliers;
- additional transport options;
- gas storage facilities;
- entry of brokers;
- creation of gas-related financial markets; and
- development of substantial short-term spot markets.[5]

2.6 However, the Venture claimed that a move to separate marketing arrangements at this time would introduce large costs and risks for the participants. This would harm efficiency and competition in the short term and have adverse effects upon future investment decisions.[6] Moreover, the Venture argued that its participants would not be able to formulate a workable and efficient mechanism to clear the trading imbalances that would arise from separate marketing arrangements. It added that given these separate marketing arrangements are not feasible, the current arrangement 'will not result in any lessening of competition'. Rather:

> …coordinated marketing has facilitated enormous investment by the NWS project participants in gas production and supply facilities that have

3 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 3.

4 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 3.

5 North West Shelf Venture, *Submission 3*, p. 4.

6 North West Shelf Venture, *Submission 3*, p. 5.

> serviced the Western Australian economy extremely well over a sustained period of time.[7]

Why did the Venture revoke its authorisation?

2.7 The Venture was asked why they chose to ask the ACCC to revoke the authorisation to conduct joint marketing arrangements. Ms Howell initially responded that the authorisation was no longer needed given the Venture believed they were complying entirely with the TPA. She then took this position further:

> It is probably a moot point that we needed the authorisation in the first place. But, obviously, when investment was made in the infrastructure, given the billions of dollars and the requirement to satisfy bankers and so on, a cautionary step was taken to have that authorisation. Now that the project is more mature we felt that that was no longer necessary and that there had never been any suggestion that we were not acting in accordance with the Trade Practices Act.[8]

Conclusion

2.8 The North West Shelf Venture has defended the need for maintaining its joint marketing arrangements on the basis that the domestic gas market in Western Australia is 'immature'. It cites lumpy demand, inflexible transportation, a lack of storage option and no market clearing mechanism. These are the same factors identified by the ACCC in 1998 upon granting the Venture its authorisation. Moreover, the Venture claims that for its domestic gas production to be commercially viable, all six companies need to have similar revenue, cost and risk exposures which could not be ensured if the joint marketing arrangements were terminated.

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7 North West Shelf Venture, *Submission 3*, p. 4.

8 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 8.

Chapter 3

The case for ending the joint marketing arrangements

3.1 The DomGas Alliance represents the majority of Western Australia's gas consumption and gas transmission capacity. In its submission and verbal evidence to this inquiry, the Alliance described the North West Shelf Venture as a 'cartel' which substantially lessens competition in the domestic market.[1] It argued that the joint selling arrangement 'has the purpose or likely effect of fixing controlling or maintaining prices for gas supplied by the individual…participants'.[2] Were it not for the joint marketing arrangements, each company would be offering gas for sale at a price and on terms individually determined by that participant.

3.2 The DomGas Alliance notes that the six participants in the North West Shelf Venture currently enjoy substantial market power and are all highly profitable producers.[3] It claims that this market power is a direct consequence of the joint selling arrangements which have shifted bargaining power 'unfairly' to gas producers. Specifically, the current arrangements:

- constrain the entry of new suppliers;
- reduce the number of independent producers selling gas to the domestic market;
- create a significant disparity in information which undermines the power of consumers;
- effectively maintain a minimum price floor; and
- operate to withhold supply from the domestic market with the Venture focussing on a small number of larger customers.[4]

Is the Western Australian gas market 'immature'?

3.3 The DomGas Alliance contests the claim that the current gas market in Western Australia is 'immature' (see chapter 2). The Chairman of the Alliance told the committee that since the mid-1990s, there had been a 'transformation' in the downstream gas market. There are now 25 to 30 individual customers and gas purchase and transmission have been separated. There is also third party access to pipelines and deregulation of energy utility and markets generally.

1 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 18.

2 DomGas, *Submission 1*, p. 5.

3 Woodside alone recorded a half-yearly net profit this year of over $1 billion.

4 DomGas, *Submission 1*, p. 6.

3.4 The DomGas Alliance argued that the deregulation of the downstream market gas market means that joint selling by the joint venture participants is no longer required to balance the market power of a single buyer.[5] The 'immaturity' of the Western Australian gas market, therefore, is principally a product of the joint selling arrangement itself. The Venture argues that it cannot end joint selling without a more mature market but DomGas say the main obstacle to a more mature market is the Venture's joint selling arrangement.

Does the Venture need to sell jointly?

3.5 Recall from chapter 2 that one of the Venture's key arguments was that they needed to explore and develop gas collectively to meet common infrastructure costs that would be too large for a single company to cover. Having made this investment jointly, they argued, joint selling is necessary to ensure that their product is sold and the risks are shared equally across the whole chain. The other submitters found these arguments less than convincing.

3.6 On the high cost of common infrastructure, the Chairman of the Alliance told the committee:

> Ms Howell talked about the difficulty of aggregating sufficient volumes to underpin investment. That is something that we in the pipeline business do every day. We have mounted three very large expansion projects in the last four years. We have committed $1.8 billion to the Western Australian market. We have aggregated a series of diverse customer loads and engineered and financed those expansions. That is not all that difficult.[6]

3.7 On the need for joint arrangements 'across the whole chain', the Alliance's Executive Office, Mr Gavin Goh, gave the following response:

> …when you are looking at these joint ventures, you have production infrastructure and exploration and operations going on. What we are talking about is the disposal of the product at the end point. Being required to sell independently and compete, in our mind, does not impact on the production of that resource. It is probably relevant to note that the argument was raised with the New Zealand authorities that joint selling was necessary to underpin investments. New Zealand found as a matter of conclusion that separate selling was not going to make an otherwise viable field nonviable. What I am trying to say is that it is not going to impact the viability or otherwise of a field.[7]

5 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 19.

6 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 26.

7 Mr Gavin Goh, *Proof Committee Hansard*, 11 November 2008, p. 25.

Anti-competitive practices

3.8 In putting the case that the Venture's activities are anti-competitive, the DomGas Alliance emphasised that the six Venture companies share knowledge on contract terms, prices, timing and all the provisions of a commercial gas contract.[8] This cooperation among major industry players allowed the Venture to set a minimum price for gas. There is no incentive for participants in prospective joint ventures to undercut the Ventures prices.[9] Only in a competitive market with 'a sufficient number of competing players' will gas prices be set appropriately.[10]

3.9 This active price setting is only one manifestation of the Venture's market dominance. DomGas alleged that the Venture also withholds the supply of gas to the local market which is 'at least as powerful an action as putting up prices'.[11] However, the committee has no evidence to corroborate this claim.

3.10 The DomGas Alliance also claimed that the Venture's dominance in the domestic market is reflected in their recent attitude to cost increases for local consumers. It cited Woodside's recent threat to pass on to domestic consumers the cost of the condensate excise exemption removal as evidence that the Venture has substantial market power. The Alliance noted that Woodside had not threatened to pass on the excise to customers in Japan or China where competitive markets exist.[12] In response, the Venture replied:

> Any impost or fixed cost has to go into consideration when we look at our business and when we look at the prices we charge.[13]

3.11 Indeed, the DomGas Alliance put to the committee that the joint selling arrangement for the local market was creating a price premium for producers which they are not getting from the international market.[14] Associate Professor Zumbo also noted:

> …the possibility that there is cross-subsidisation—that the domestic consumers to some degree are cross-subsidising the need for the joint venturers to cut their prices on global markets, because those global markets are more competitive, and hence make those up somehow with domestic consumers.[15]

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8 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 28.

9 Mr Gavin Goh, *Proof Committee Hansard*, 11 November 2008, p. 25.

10 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 25.

11 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 28.

12 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 19.

13 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 13.

14 Mr Gavin Goh, *Proof Committee Hansard*, 11 November 2008, p. 25.

15 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, p. 35.

The Trade Practices Act

3.12 The question of whether the Joint Venture's activities are legal under the *Trade Practices Act* is only relevant because it no longer has an authorisation.

3.13 Section 45 of the *Trade Practices Act* prohibits a contract, arrangement or understanding which has the purpose, or would be likely to have the effect, of substantially lessening competition'.[16] Both the DomGas Alliance and Associate Professor Zumbo argued that the Venture's joint selling arrangement was clearly a breach of this section.

3.14 Mr Hohnen told the committee:

> …the requirement of the Trade Practices Act is that their behaviour—the way in which they organise their marketing—is not substantially lessening of competition. Quite frankly, we cannot believe that an amalgamation of six companies like that, with 70 per cent market share, cannot lessen competition in the marketplace.[17]

3.15 Associate Professor Zumbo explained to the committee that while section 76 of the Act refers to joint ventures, there is an onus on the joint venturers to prove that they do not have the purpose, the effect or the likely effect of substantially lessening competition. On all three grounds, he argued, the joint venturers 'would fail to satisfy this defence'[18].

3.16 If it could be established that the purpose, effect and likely effect of the joint selling is to substantially lessen competition, there may be some basis to 'investigate and possibly institute proceedings' for breaches of the TPA.

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16 *Trade Practices Act 1974,* Section 45(2)(a)(ii)

17 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 23.

18 Associate Professor Frank Zumbo, *Submission 4,* p. 5.

Chapter 4

The committee's view

4.1 The committee has heard contradictory evidence on the arguments for maintaining joint selling arrangements for the North West Shelf Joint Venture. On the one hand there is the argument that these arrangements have set a price floor for gas and have stunted the competitive development of the Western Australian gas market. On the other is the argument that the market is still developing and that the substantial capital investment for these large scale projects would not be feasible under separate selling arrangements. The evidence presented to the inquiry was not substantive enough for the committee to make a recommendation at this point in time.

The need for joint selling

4.2 As noted in chapter 2, the Venture's Chief Executive Officer argued that joint selling is necessary because the risks need to be equally shared across the whole supply chain and the initial investment has to be based on certainty that the product will find a market.[1]

4.3 However if the Venture develops its products on the basis of satisfying existing aggregate market demand in the local market, the individual companies—particularly if they are competitive—should be able to sell their share. Indeed, any concern that separately marketed gas would not be able to find a market seems most peculiar in light of Ms Howell's comments that there is more demand than supply in the local market. She argued that this reflects low supply of gas, which surely makes it more likely that a separately sold product will find a market.[2] Low supply of gas and the five-fold increase in gas prices in the past two years , may diminish the Venture's argument that the transition from joint to separate marketing arrangements would be costly.

The ACCC's investigation

4.4 In her evidence to the committee, Ms Howell claimed that the Australian Competition and Consumer Commission's current inquiry was 'a review…instigated by the North West Shelf Venture participants when they revoked the authorisation'.[3] By contrast the DomGas Alliance characterised it as a consideration by the ACCC's enforcement division in response to a submission DomGas made to the ACCC.[4] The

1 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 5.

2 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p. 6.

3 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, p.4.

4 Mr Stuart Hohnen, *Proof Committee Hansard*, 11 November 2008, p. 29.

ACCC wrote in a letter to the committee: 'the ACCC is currently conducting an investigation into certain aspects of the joint marketing arrangements on the North West Shelf. The investigation is still in a preliminary stage, and is currently awaiting advice from external consultants'.[5]

The need to liberalise gas markets

4.4 The committee also emphasises the broader importance of full liberalisation of gas markets. The committee heard the importance of consumers being able to choose their suppliers; that access to the pipeline is transparent and non discriminatory; and that there are a variety of producers marketing independently are crucial for a true competitive market. While progress made been made in the Western Australian gas market towards the first two of these preconditions, the third has not yet been attained.

4.5 The committee believes it is difficult to make any recommendations prior to the release of the ACCC's investigation and report.

Senator Annette Hurley

Chair

5 Brian Cassidy, Australian Competition and Consumer Commission, *Correspondence*, 10 November 2008.

Coalition Senators' Minority Report

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

In evidence given to the committee the WA domestic gas market was described as being small and immature. The committee was informed that there were about 30 purchasers in WA for domestic gas largely supplied by two producers namely the North West Shelf Joint Venture and Apache for a single gas pipeline – Dampier to Bunbury.

In their submission to the economics committee the North West Shelf Joint Venture explained that:

> The Western Australian domestic gas market currently operates primarily as a 'contract' or 'project' market, where gas project investment, development and production is undertaken to meet specific, and often large and long-term, contractual obligations with customers (most of whom themselves require supply security to underpin their downstream investments).[1]

The submission goes on to say that:

> In the Incremental Pipeline Gas Joint Venture (IPGJV) 1998 determination, the ACCC stated 'while it is impossible to be prescriptive about exactly what market features need to develop before separate marketing will become viable in Western Australia, the greater the number of the following list of market developments that are introduced, the greater the likelihood that separate marketing will be viable:
>
> • a significant increase in the number of customers,
>
> • entry of new competitive suppliers,
>
> • additional transportation options,
>
> • storage,
>
> • the entry of brokers and aggregators,
>
> • the creation of a gas-related financial market, and
>
> • development of significant, short-term and spot markets.'
>
> Comprehensive industry and market analysis undertaken by the DGJV and the IPGJV in 2005 and 2007 (provided to the ACCC on a confidential basis) together with other major government and expert studies confirm that

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1 North West Shelf Venture, *Submission 3*, p. 3.

> the relevant features of the Western Australian gas market remain essentially unchanged since 1998. The current Western Australian market fundamentals can be summarised as:
>
> • a small number of market participants,
>
> • concentration of supply and demand,
>
> • prominence of long term supply and transportation contracts,
>
> • lack of transportation and storage flexibility / capability,
>
> • lack of market intermediaries and financial instruments, and
>
> • no substantial structure or mechanism in the market through which short term sales occur.[2]

The Committee was informed that separate marketing has produced competitive pricing in large markets such as the US and European market where there are a large number of suppliers, a choice of modes of transport and a well established gas market. It was noted that the Eastern Australian gas system has more of the features considered to be desirable precursors to separate marketing operations than WA.

There was discussion regarding the implications of the ACCC having withdrawn the existing authorisation for a joint selling arrangement for the North West Shelf Joint Venture. The Coalition Senators noted that Freehills, which represented the NWSJV at the ACCC inquiry leading to the withdrawal of the authorisation (as is said in Chapter 1 of the Chair's report) had drawn attention to the fact that in 2007 the Federal Government acted to enhance protection for joint ventures under the *Trade Practices Act* and added that joint venture activity, particularly when it is related to development and operation of large scale infrastructure is pro-competitive.

Given the high dependence of WA industry on stability of the overall gas supply system the Coalition Senators are of the opinion that any change to the WA domestic gas marketing system needs very comprehensive evaluation of all relevant factors before any decisions are made.

Senator Alan Eggleston **David Bushby** **Barnaby Joyce**

Deputy Chair

2 North West Shelf Venture, *Submission 3*, pp 3-4, citing North West Shelf Project, Authorisation No A90624, 29 July 1998, pp 47-8.

Minority report
Senator Nick Xenophon

The Joint venture reduces competition

The bulk of the evidence before the committee is that the joint marketing arrangements of the North West Shelf Joint Venture are anti-competitive. In the absence of an authorisation from the ACCC, they would appear to be a breach of the *Trade Practices Act*. The committee was not told of any practical or logistical reasons for maintaining joint selling.

An independent legal opinion was offered by Associate Professor Zumbo:

> In my opinion, there is a breach of section 45 of the Trade Practices Act. It can be through price fixing—and we know there is price-fixing conduct. Also there is conduct that is likely to have the effect of substantially lessening competition.[1]

The Venture clearly has the *effect* of substantially lessening competition in the Western Australian gas market because of the lack of import competition, the very high barriers to entry of the market, high levels of market concentration and the lack of countervailing power of gas buyers.[2] The Joint Venture reduces the number of significant sellers from seven to two.[3] In terms of whether its *purpose* is to substantially lessen competition:

> …you have to ask: what is the goal they are seeking to achieve by engaging in joint marketing? I would submit that there is only one goal, and that is to maintain or raise prices above competitive levels. If that is the case, then they would have the purpose of substantially lessening competition.[4]

Once it is established that the purpose and effect of the joint selling is to substantially lessen competition, there is a basis to 'investigate and possibly institute proceedings' for breaches of the TPA. Associate Professor Zumbo cites two European precedents in which the European Commission settled cases involving the joint marketing of gas in the Norwegian and Danish gas markets.

It is arguable that the joint venture was justified when first introduced as the producers were effectively facing the government as a vertically integrated monopsony buyer. But the subsequent deregulation and privatisation of the domestic gas market means this justification no longer holds.

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1 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, p. 31.

2 Associate Professor Frank Zumbo, *Submission 4*, p. 6.

3 It increases the Herfindahl-Hirschman concentration index (which can vary from 0 representing perfect competition to 1 representing monopoly) from around 0.16 to 0.52.

4 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, p. 31.

The individual companies in the Joint Venture are all large and profitable. The profitability of the joint venture project itself was not disclosed. At one point, the Joint Venture's CEO said 'the joint venture is not an incorporated entity. It does not have profits per se', which seemed inconsistent with her later claim that 'through what I call "the lean years" of the nineties this project was far from highly profitable'.[5]

There was no convincing evidence presented that the viability of the North West Shelf gas project would be compromised if the joint activities in the local gas market were restricted to exploration and development.

There is some irony in the Venture's argument that their joint marketing arrangement must continue because the Western Australian gas market is 'immature'. It is a vicious circle as the joint marketing arrangements are themselves an impediment to the maturing of the market. It is a bit like the classic economic argument about protecting 'infant industries' who then never grow up. If the Venture's partners were able to market their products independently to consumers, the various factors cited by the Venture as signs of the market's immaturity would be overcome.

This point was made by Associate Professor Zumbo:

> …you will never get the market to develop to a fully mature status until you remove the joint marketing arrangements, because the joint marketing arrangements are an impediment to the development of all the factors you pointed out. Until you have separate marketing, all these additional facilities will not develop. There is no incentive to develop them because you essentially have a very dominant player, it being the North West Shelf project.[6]

The puzzle of the lifting of the authorisation

Chapter 1 of the majority report notes that in December last year, the Venture applied to the ACCC to have its authorisation for joint selling revoked. Ms Howell claimed the authorisation was no longer necessary and may not have been needed at all (see paragraph 2.7). Associate Professor Zumbo questioned this strategy:

> My advice to any person in the position of the joint venture—given the considerable risk, given the size of the venture—is: if you have an authorisation you keep it, and if you do not have an authorisation you get one. It is just far too risky. The penalties under the Trade Practices Act could be 10 per cent of turnover or 10 million [dollars, if greater] per offence. They are very significant penalties. There is a real question as to why they sought to revoke that authorisation. If it is there, you keep it. Why give it up?... what I still cannot understand is: if the benefits that the joint venture believe they are contributing outweigh the cost—that is, the

5 Ms Eva Howell, *Proof Committee Hansard*, 11 November 2008, pp 13, 16.

6 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, p. 35.

> reduction in competition—why don't they seek an authorisation? That would put the issue beyond doubt.[7]

Associate Professor Zumbo speculated before the committee that the ACCC may have given the joint venturers 'a level of comfort' that the arrangements are not in breach of the Act and that no action would be taken. He stressed that if an understanding along these lines had been reached, it is important for that to be made public.[8]

Conclusion

The North West Shelf Joint Venture's arguments for maintaining joint selling arrangements are flimsy and unconvincing. All of the arguments put to the committee in defence of joint selling were soundly rebutted. Further, the arguments that the arrangements stunted the competitive development of the Western Australian gas market are cogent and well founded. Having had its authorisation for joint selling revoked, the Venture seems to be in breach of section 45 of the Trade Practices Act. Whatever the legal ramifications of current practices, there is no reason why joint selling arrangements should be allowed to continue.

If there has been an understanding between the Venture and the ACCC that the joint selling arrangement is protected *on the basis of matters other than the provisions of the Act*, then these details must be made public. If the ACCC decides as an outcome of its investigation that the Venture is complying with section 45, the basis of this finding must be made public.

Ending the North West Shelf Joint Venture is a crucial requisite for deregulating the upstream gas market in the State and ensuring that the welfare of domestic gas consumers is maximised.

Recommendation

The ACCC should either abolish the joint marketing arrangements on the North West Shelf or provide clear, publicly stated reasons as to why the current arrangements should be permitted within the provisions of sections 45 and 76C and 76D of the Trade Practices Act.

Senator Nick Xenophon

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7 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, pp 32–4.

8 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 11 November 2008, p. 36.

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	DomGas Alliance
2	Chamber of Commerce and Industry of WA
3	North West Shelf Venture
4	Associate Professor Frank Zumbo

Additional Information Received

TABLED DOCUMENTS

- 11 November 2008, CANBERRA ACT:
    - Mr Stuart Hohnen, DOMGAS Alliance, '*Senate Joint Selling Inquiry: Opening Presentation*'.

APPENDIX 2

Public Hearings and Witnesses

CANBERRA, 11 NOVEMBER 2008

- GOH, Mr Gavin, Executive Officer,
  DomGas Alliance
- HOHNEN, Mr Stuart, Chairman,
  DomGas Alliance
- HOWELL, Ms Eva Alexandra, Chief Executive Officer,
  North West Shelf Venture
- ZUMBO, Associate Professor Frank