Senate Economics Committee
Inquiry into the

Joint Marketing Arrangements in the North West Shelf

North West Shelf Project Participants:

BHP Billiton Petroleum (North West Shelf) Pty Ltd
BP Developments Australia Ltd
CNOOC NWS Private Limited
Chevron Australia Pty Ltd
Japan Australia LNG (MIMI) Pty Ltd
Shell Development (Australia) Proprietary Limited
Woodside Energy Ltd

15 October 2008

Introduction

The North West Shelf (**NWS**) Project is Australia's largest resources and infrastructure project with capital expenditure over almost three decades totalling A$25 billion.

The NWS Project's co-ordinated marketing activities have been (and continue to be) essential for the significant investments made in domestic gas production and supply facilities which have effectively serviced the Western Australian market since 1984.

There is no evidence to suggest that coordinated marketing of domestic gas from the NWS project to new and existing customers has lessened competition in the Western Australian gas market. The substantial long-run benefits of joint venture activity are recognised throughout the world. As recently as 2007, the Federal Government acted to introduce enhanced protection for joint ventures under the *Trade Practices Act* (**TPA**) by including broad-based joint venture defences to price fixing and exclusionary provisions. These laws were uncontroversial and had widespread support – because joint venture activity, particularly when it is related to the development and operation of large scale infrastructure projects, usually substantially enhances welfare and has no adverse effect on competition.

All price negotiations conducted by the NWS venturers are a result of prevailing market fundamentals (described below) and the terms and conditions negotiated in individual gas sales agreements. It is these market fundamentals that regulate the Western Australian domestic gas market. Any increased regulatory burden that runs contrary to market fundamentals would only have the likely effect of increasing costs and risks in the short term and to stifle future investment in the medium to long term.

NWS Project gas marketing

The NWS Project's domestic gas production and sale activities are currently carried out by the Domgas Joint Venture (**DGJV**) and the Incremental Pipeline Gas Joint Venture (**IPGJV**) (see **Appendix 1**).

When the DGJV was established, it was allocated 5064 PJ of natural gas to be produced and sold for consumption in Western Australia. Pursuant to existing DGJV gas supply contracts, and the future commitments arising under them, it is anticipated that the DGJV will clear its 5064 PJ entitlement by around 2016. In addition to the overall production and sales limit, the DGJV is also subject to daily production limits. If gas supply requirements under DGJV contracts exceed the DGJV production limits (as they presently do and will), then to ensure the customer receives uninterrupted supply and to minimise inconvenience and transaction costs, the DGJV essentially purchases the difference from the IPGJV. A financial settlement then occurs between the two relevant joint ventures. In the future, the IPGJV may undertake some limited short term sales of domestic gas in circumstances where capacity is available but the DGJV is fully committed under existing contracts.

Since 1977 the DGJV has entered into various long term, large volume gas supply arrangements with Western Australian customers. The greater part of these arrangements comprise sales under contracts which are restatements of the original foundation contracts entered into between the DGJV and the State Energy Commission of Western Australia (**SECWA**). SECWA was disaggregated into AlintaGas and Western Power Corporation (which was subsequently broken into 3 entities) and gas supplied under the foundation contract was allocated to these disaggregated utilities and certain of their customers including Alcoa, Robe River Iron Associates and Hamersley Iron.

Future domestic gas production and sales are likely to come from reserves available to the IPGJV (as mentioned above) and also potentially from reserves that are proved up and become available to a potential new Extended Interest Joint Venture (**EIJV**). If required, the new EIJV would be established to recognise the participation of CNOOC in the NWS project since 2004 (i.e. there could be 7 joint venturers in the EIJV). CNOOC has an interest in the NWS project gas but not in the infrastructure.

The DGJV and IPGJV have always taken a conservative and proactive approach to managing trade practices compliance obligations, particularly given the significant investment in and commitments to the Western Australian market and the underlying structural and legal complexity. This conservative approach has included:

- seeking authorisation (in 1977 for the DGJV and in 1998 for the IPGJV) for their marketing activities, at a time when there was some uncertainty regarding the technical application of competition laws to joint ventures; and

- providing the Australian Competition and Consumer Commission (**ACCC**) and the Australian Energy Regulator (**AER**) with market research updates.

It was this approach that led each of the DGJV and IPGJV to conclude that its respective co-ordinated marketing activities raise no concerns under the TPA. In 2005 after a review of the gas market and discussions with the ACCC the IPGJV chose not to seek to renew its 1998 authorisation. After further discussions with the ACCC and the AER and following changes to competition laws that afford more protection and certainty to joint ventures, in 2007 the DGJV applied to the ACCC to revoke its 1977 authorisation. The request for revocation was granted in March 2008.

The ACCC (in conjunction with the AER) is currently conducting a private review of gas marketing arrangements in Western Australia as part of the finalisation of the DGJV authorisation revocation process. The NWS venturers continue to support this review and provide information as and when required by the ACCC or AER.

Western Australian gas marketing – why there is no impact on competition

Separate marketing of gas is not feasible for the NWS project participants given the relative immaturity of the Western Australian market.

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).

In the 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."[1]

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[2] confirm that 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.

These market fundamentals when combined with the complexity of the underlying NWS joint venture arrangements essential to facilitate the large investments involved do not support separate marketing. A critical factor here is the inability of the NWS project participants to formulate a workable and efficient mechanism (in the face of large and lumpy demand, inflexible transportation (single pipeline operator) and lack of storage options, and no market clearing mechanisms or spot prices) to clear the large and persistent trading imbalances that would arise from separate marketing in a Western Australian context.

In circumstances where separate marketing is not feasible (having regard to the economic costs and technical impediments), it must follow that coordinated marketing will not result in any lessening of competition. To the contrary, coordinated marketing has facilitated enormous investment by the NWS project participants in gas production and supply facilities that have serviced the Western Australian economy extremely well over a sustained period of time

Conclusion

Separate marketing is not feasible due to the complexity of NWS joint venture arrangements and the immature and project-based nature of the Western Australian gas market (and these market fundamentals are unlikely to change in the medium term).

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[1] See generally, North West Shelf Project, Authorisation No A90624, 29 July 1998, pp 47-48.

[2] See, for example: *Towards a truly national and efficient energy market*, December 2002 (the 'Parer Report'), chapter 7; the Ministerial Council for Energy and Petroleum Resources / Ministerial Council on Energy Joint Working Group on Natural Gas Supply, *Final Report*, September 2007, at pp 10, 11, 18-24 ; *Critique of the Synergies report: WA Gas supply and demand – the need for policy intervention*, CRA International, July 2007; Western Australian Department of Industry and Resources, *Western Australian oil and gas review 2008*, at 9 and 10; ABARE, *Australian Gas markets – moving towards maturity*, December 2003.

A move to separate marketing at this time would introduce large costs and risks for the NWS project participants, efficiency and competition would be harmed in the short term and this, in turn, would have flow-on adverse effects upon future investment decisions of the NWS venturers and other gas producers operating in Western Australia, potentially compounding the problems in the medium and long term.

The NWS project participants are committed to continuing the marketing of domestic gas to new and existing customers in Western Australia and ensuring its gas marketing practices comply with the requirements of the TPA and other applicable laws and regulations.

Appendix 1

NWS Project participant joint venture interests

	DGJV	IPGJV	EIJV
Woodside Energy Ltd.	50%	16 ⅔%	15.78%
BP Developments Australia Pty Ltd	16 ⅔%	16 ⅔%	15.78%
Chevron Australia Pty Ltd	16 ⅔%	16 ⅔%	15.78%
BHP Billiton Petroleum (North West Shelf) Pty Ltd	8 ⅓%	16 ⅔%	15.78%
Shell Development (Australia) Proprietary Limited	8 ⅓%	16 ⅔%	15.78%
Japan Australia LNG (**MIMI**) Pty Ltd	NA	16 ⅔%	15.78%
China National Offshore Oil Corp Ltd (**CNOOC**)	NA	NA	5.3%