Authorisations and notifications

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GORGON GAS PROJECT: APPLICATION FOR AUTHORISATION TO JOINTLY MARKET AND SELL GAS

INTRODUCTION

On 5 November 2009, the Australian Competition and Consumer Commission (ACCC) granted authorisation to the Gorgon gas project (Gorgon) to jointly market and sell natural gas to customers in Western Australia (WA).

Gorgon is a major new greenfields gas development off the northwest coast of Western Australia. It comprises both a liquefied natural gas (LNG) and a domestic gas (domgas) component. Gorgon is Australia's single biggest resource project, with an estimated resource base of more than 40 trillion cubic feet of gas and a nominal development life of around 60 years.

Due to the high commercial risk of separately selling gas into the WA domgas market, the participants in Gorgon (participants) intended to jointly market and sell the domgas produced by the project, including jointly setting the prices and terms and conditions of sale. As such arrangements might give rise to issues under s 45 of the *Trade Practices Act 1974* (Cth) (TPA), the participants sought authorisation for their proposed conduct.

The ACCC granted interim authorisation on 24 June 2009. Final authorisation, subject to certain audit conditions, was granted on 5 November 2009, allowing the participants to jointly market and sell domgas until 31 December 2015. The participants are authorised to continue to jointly give effect to any WA domgas sales agreements entered into during the period of interim and final authorisation for a period not exceeding 25 years from the date of the first supply of domgas.

This determination displays a pragmatic approach by the ACCC towards joint venture activity, and a recognition of the significant public benefits that can arise from conduct that would not be possible without collaboration between competitors through a joint venture. The ACCC also recognised the significant structural differences that exist between the gas industry in WA compared to other States and countries, and adopted a commercially realistic approach which will support ongoing investment, and therefore increasing competition, in the WA gas industry.

BACKGROUND

Gorgon is an unincorporated joint venture between ExxonMobil, Shell and Chevron. It involves the development of gas fields off the northwest coast of WA, including development of infrastructure to recover and transport gas from the gas fields to Barrow Island for processing into LNG for export and domgas of pipeline quality for delivery to customers in WA.

Gorgon is primarily an LNG development, but pursuant to an agreement with the WA government, the participants are required to supply 2000 petajoules (PJ) of natural gas over the life of the project into the WA domgas market. This requirement is subject to a commercial viability test.

LNG produced by Gorgon will be sold and marketed by the participants separately. The authorisation concerns only the domgas component of the project.

THE PARTICIPANTS' AND THIRD-PARTY SUBMISSIONS

The authorisation sought

The participants sought authorisation to:

(a) jointly negotiate common terms, including price, under which they would offer domgas to customers;

(b) agree between themselves as to the common terms, including price and price determinations, upon which they will sell the domgas; and

(c) for any domgas sales agreements entered into during the authorisation period, continue to give effect jointly to such agreements over their term.

Authorisation was sought for the earlier of:

(a) the period until customer agreements have been reached for the sale of 2000 PJ of domgas (the volume of gas that the Gorgon gas project is obliged to supply into WA under its State Agreement); or

(b) six years from the supply of domgas to a customer in WA (first gas, expected to be in late 2015).

The participants also sought (and obtained) interim authorisation to allow them to engage with customers to obtain a firmer understanding of the likely level and timing of demand for the domgas. The attaining of final authorisation was a condition precedent to executed domgas sales agreements entered into during this period.

Commercial viability of the domgas project

The participants' primary argument was that, given the current immature nature of the WA domgas market, separate sales of domgas would have been commercially unfeasible for the foreseeable future. Even if it were theoretically possible to engage in separate marketing, the high commercial risks would have increased prices, the volumes delivered would have been lower and the commencement of the project most likely delayed. In addition, there was a risk that one or more of the participants would determine that this component of the project was not commercially viable, which could delay the domgas development.

The participants argued that with authorisation, the ability to jointly market gas would mean that the domgas project was commercially viable and therefore the detriments listed above would be avoided and major public benefits of the domgas project would be enjoyed sooner. They argued that therefore the public benefits of authorisation outweighed any public detriments.

State of the WA market

Submissions from all parties primarily focused upon the state of the WA market and its ability to support separate marketing. The participants argued that the WA domgas market displayed the following key features:

- a highly concentrated number of suppliers, with two suppliers accounting for approximately 96% of the supply;
- a small number of large customers, with six customers estimated to consume over 90% of supply;
- a significant lack of liquidity due to the existence of an underdeveloped spot market and a resulting lack of transparency in gas prices and demand; and
- a general lack of storage facilities or spare capacity in pipelines available for storage.

The participants emphasised that the WA domgas market was dominated by large, long-term agreements, where major domgas projects such as Gorgon needed to secure long-term customers upfront. Due to the "lumpy" demand profile caused by the predominance of large, long-term contracts, if the participants were forced to market gas separately, there would be a significant risk that one (or more) of them may be left without a buyer for a substantial part of its share of the domgas. This risk was heightened as several other domgas developments of substantial size are also expected to begin supplying gas during the same period. While, in liquid gas markets, these potential imbalances may be addressed through a gas balancing agreement, this was not possible in the WA domgas market because it would be commercially unfeasible to rely on the small spot market and limited storage facilities to dispose of any gas that was not sold. The lack of a transparent, well developed spot market would make the "balancing" of excess gas between the participants unviable.

As part of the authorisation process, the ACCC commissioned an independent report[1] on the state of the WA domgas market and its ability to support separate marketing by the Gorgon project. The report, to which the ACCC referred frequently in determining final authorisation, generally agreed

[1] The Allens Consulting Group, *Gorgon Gas Project Joint Venture Application for Authorisation of Joint Marketing – Final Report*, Report to the Australian Competition and Consumer Commission (2009), http://www.accc.gov.au/content/trimFile.phtml?trimFileName=D09+85644.pdf viewed 12 May 2010.

with the participants' characterisation of the market. It concluded that:

> The market currently has few of the characteristics that would allow the Applicants to be confident that they each can secure contractual arrangements for comparatively similar lifting profiles at comparatively similar prices. Nor does the WA market have the attributes to allow large sellers like the [participants] to mitigate their risks through gas-related financial instruments or deferred supply by access to gas storage facilities.

ACCC's DECISION

The counter-factual

Under s 90(8) of the TPA, the ACCC considers authorisations by the future "with or without test", comparing the potential public benefits and anti-competitive detriments that would flow from the situation with joint selling to those that would arise without.

The ACCC accepted that, absent authorisation, the participants were unlikely to engage in joint marketing due to the significant regulatory risks. It found that the participants were most likely to attempt to engage in separate marketing, but that due to the increased commercial risks involved in separate marketing, there would likely be a delay in the commencement of the domgas component of the project and lower quantities of domgas may be produced and supplied to the market. It also found that these additional risks may increase the price of the domgas in order for the participants to meet the threshold rates of return for investment.

Public benefits

The ACCC found that authorisation would lead to a number of public benefits:

- the amount of gas supplied by the Gorgon project would be higher under joint marketing than separate marketing;
- under joint marketing, the Gorgon project may be able to better compete with the other major domgas-producing projects in WA; and
- it was not clear whether joint marketing would lead to higher or lower prices than separate marketing. To the extent that it leads to lower prices, that would be a public benefit.

Further, the ACCC considered that the following general benefits of the Gorgon project were likely to be enjoyed earlier with authorisation:

- the introduction of a new source of domgas into the WA market would result in "significant" public benefit, due to the excess demand in the market and the majority of current supply options appearing to be fully contracted; and
- increased efficiency, increased employment and import replacement.

Notably, the ACCC found that although separate marketing generally leads to better competitive outcomes than joint marketing, the WA domgas market did not "have the necessary features to make separate marketing feasible for the [participants]". For the same reason, although the ACCC found that the WA market would mature more quickly, should the participants market separately, that option was not realistically available to the participants. The ACCC also found that gas prices were unlikely to be significantly higher under joint marketing and it was possible that prices would actually be lower, and that therefore the proposed arrangements were unlikely to result in significant public detriment in the form of higher prices.

The ACCC also addressed alleged public detriments raised by third-party submissions. It rejected the argument that separate marketing by the participants would lead to increased competition and lower prices simply by virtue of the fact that there would be three sellers instead of one, finding that in the WA market the greatest benefits from competition were likely to result from competition between projects as opposed to between individual joint venture partners. It also recognised that the participants will, in any case, be subject to the same production cost base and will be jointly deciding production volumes and timing; therefore, they would not be able to compete with each other in a meaningful way under separate marketing.

On balance, the ACCC found that, subject to the conditions placed on authorisation (discussed below), the public benefits of authorisation outweighed the public benefits, and therefore granted authorisation until 31 December 2015.

Points of interest

Conditions of authorisation

In relation to potential concerns about information-sharing between the Gorgon project and other domgas projects in WA, the ACCC made authorisation conditional upon a detailed information ring-fencing regime to be overseen by an independent auditor. These conditions were stated by the ACCC to be designed to reduce any public detriment that might otherwise have arisen from potential information sharing.

Notably, the participants each already had extensive information ring-fencing arrangements designed to prevent the flow of commercially sensitive information between the Gorgon gas project and competing projects in which they had an interest. The ACCC sought to further minimise the potential for information sharing, and to demonstrate publicly the robustness of the procedures, by imposing a number of conditions on its authorisation:

- annual independent audits of the operation of the participants' information firewall;
- the provision of the auditor's report to the ACCC, a summary of which was to be placed on the ACCC's public register;
- the participants must implement any recommendations made by the auditor; and
- any non-compliance with the ring fencing arrangements must be reported to the ACCC within one week.

The ACCC's decision to require ring-fencing audits followed an earlier ACCC decision in September 2008 in respect of a notification lodged by Cooperative Bulk Handling Ltd (CBH).[2] In that matter, there was a concern from third parties that sensitive information would be shared between CBH and its subsidiaries, to the anti-competitive detriment of competitors of the subsidiaries. To address these concerns, CBH amended its ring-fencing policies to introduce an annual independent audit, and the appointment of a panel of independent arbiters to determine disputes in relation to the policy. The ACCC was satisfied that this would sufficiently limit the potential for information sharing between CBH and its subsidiaries.

Period of authorisation

The ACCC granted authorisation until 31 December 2015. It chose this period because it considered it possible, given recent market developments in WA and in the eastern States' gas market, that the WA domgas market could mature in the medium term to the point that it would support separate marketing. If that were to occur, joint marketing would no longer be in the public interest. In choosing this timeframe, the ACCC also took into consideration the participants' stated preference to separately market where it was commercially viable.

The ACCC rejected third-party submissions that any authorisation should be no longer than two years, or until the set-up of a "Gas Bulletin Board", because that period would not be long enough to provide sufficient certainty to the participants to allow them to address and underwrite the initial costs and risks of the domgas project.

Conclusion

In its decision, the ACCC has displayed that it takes a pragmatic approach in its application of the public benefit test, which recognises the commercial realities facing participants in an immature market and the substantial benefits of joint venture activity that can result in the faster commercialisation of gas resources.

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[2] Decision in respect of a notification lodged by Cooperative Bulk Handling Ltd (Notification No N93439), the ACCC (8 September 2008).