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Applicants' Response to Submission of Power and Water Corporation

1 Executive Summary

This submission is provided by the Applicants for Authorisation (AA1000564-1) (in respect of joint marketing of gas produced from the Mereenie field) in response to the submission of Power and Water Corporation (***PWC***) dated 15 September 2021 (the ***PWC Submission***).

The Applicants consider they have clearly demonstrated that the public benefits of the proposed conduct will outweigh any detrimental effects, such that authorisation should be granted.

They also note that the only entity opposing the authorisation is PWC, the incumbent and dominant competitor which is the largest seller of gas in the Northern Territory, the largest seller of gas to the East Coast from the Northern Territory, the holder of all firm capacity on the Amadeus Gas Pipeline, the largest firm capacity holder on the NGP and natural supplier (given its Northern Territory government ownership) to the largest end customer in the Northern Territory, Territory Generation. PWC will face more effective competition from the Applicants for future gas marketing opportunities if the authorisation is granted, and any asserted disadvantage to a dominant incumbent supplier from such increased competition is not a detriment to competition itself.

Finally, as the ACCC is aware, much of the information the PWC Submission indicates has not been provided, has in fact already been provided to the ACCC. However, for the purposes of transparently addressing the PWC Submission on the public record, much of that information is now being reproduced in a public response below.

The Applicants trust this provides the ACCC with sufficient information to proceed with its consideration of the proposed authorisation.

2 Experience during the Previous Authorisation

2.1 Joint Gas Marketing

The PWC Submission suggests a lack of information has been provided in relation to marketing experiences during the preceding period.

As previously publicly announced,[1] the Mereenie joint venture participants jointly marketed and entered a major gas sales agreement with AGL to supply up to 21.9 PJ of firm and as available gas over 3 years into the East Coast market. The Applicants consider that this type of firm, higher volume contract is exactly the type of contract which could not have been entered without joint marketing, and will not be possible to repeat without the authorisation currently being sought. It is gas supply contracts of this nature which underwrite further investment and expansion of production in a way the short term as available arrangements which are possible with separate marketing cannot.

Other joint marketing has involved sales to [redacted] and PWC itself (typically supplied by one of the Mereenie participants and back to backed by a supporting supply arrangement from the other).

The Applicants note that joint marketing has allowed the Mereenie field's full capacity to be sold on a day largely on a firm basis by combining the total equity shares of gas available for sale, and with transparency of the lifting that is occurring accepting the maximum possible gas nominations from customers. This would be far less likely to occur if each party was limited to only being able to sell their equity share of gas on a day. Whereas with separate marketing, the greater difficulty experienced in contracting firm volume sales is more likely to result in sales on an as available basis to an aggregator like PWC, with a higher potential for Mereenie gas that is able to be producing going unsold.

[1] ASX Announcement and Media Release, Central Signs New Gas Supply Agreement and Supporting Mereenie JV Commercial Arrangements, 11 December 2019

For completeness the Applicants note that even though only a limited number of gas sales agreements were executed over the period, that is principally a feature of the illiquid and lumpy market circumstances that face the Mereenie field (and the high volume of the AGL contract). It is also worth noting that there will be a more material proportion of the Applicants' gas production uncontracted over the next few years as existing contracts expire.

2.2 Separate Gas Marketing

While the Applicants acknowledge that some limited sales have been made separately during the period of the authorisation, they have typically been for limited volumes and on an as available basis.

The arguable exception was an approximately 12 month contract Central Petroleum entered with Incitec Pivot, which is somewhat unique due to its connection to the joint venture entered in respect of the Range project between those parties.

The Applicants also note the difficulty they have faced in separate marketing since the expiry of the previous authorisation, with all potential commercial and industrial customers which have been marketed to which have entered a contract since that expiry doing so with other suppliers, [redacted]

Central Petroleum's and Macquarie Mereenie's experience of attempting to separately market is that potential customers are frustrated by the difficulties each have in sourcing the full volume the customer requires alone and the challenges they face in negotiating gas supply at a delivery point that is not ex-field (in contrast to the major competing supplier PWC who has no such issues due to surplus gas supplies, a monopoly on firm AGP capacity and substantial firm capacity on the NGP).

2.3 No Negative Impact on Competition

The ability to jointly market made the Applicants more competitive for gas sales than they would have been separately, and the Applicants consider that the increased level of competition provided by the Applicants marketing jointly is likely to have improved the terms on which gas is available to customers even where they ultimately contracted with other suppliers such as PWC.

The Applicants also note that numerous other jointly marketed proposals and offers have been made (both to customers within the Northern Territory and elsewhere in the East Coast), but the competition they face from PWC and East Coast producers has resulted in those proposals and offers not progressing to signed contracts.

The fact that the Applicants were not able to secure these contract opportunities clearly demonstrates:

(a) the competitiveness of the market they face (including that, contrary to the PWC Submission, real life evidence confirms that PWC's supply from Blacktip provides a strong competitive constraint); and

(b) that joint marketing has not resulted in the Applicants having the ability to increase price (i.e. they clearly remain price takers).

The Applicants also note the extensive information that the ACCC has available to it through its ongoing East Coast gas market inquiry, and is confident that information demonstrates that there was no detriment to competition caused by the previous period of joint marketing (either within the Northern Territory or the broader East Coast market), and that PWC remained able to make significant supplies.

2.4 Realisation of Public Benefits

As a consequence of the previous authorisation being granted:

(a) the Mereenie participants approved and invested in a $12 million processing plant upgrade which more than doubled the plant capacity of the Mereenie field;

(b) new gas supplies were made into the Northern Territory and East Coast (as discussed above) at a time of an East Coast gas market shortfall;

(c) further wells were drilled (as identified in the PWC Submission);

(d) as a result of the above greater royalties were paid to the Northern Territory government, and employment and indirect benefits were provided; and

(e) the gas imbalance between the Mereenie participants was materially reduced.

To the extent the PWC Submission suggests that such benefits were simply caused by the East Coast gas market shortfall, the Applicants note that concern over the East Coast gas market shortfall existed prior to the previous authorisation and yet the investments noted above were not made until the ACCC had granted the previous interim authorisation and/or authorisation.

Accordingly, the Applicants consider it is clear that many of the public benefits envisaged in the Applicants' submissions regarding the previous authorisation did eventuate from that authorisation being granted.

3 Public Benefits of the Proposed Authorisation

3.1 Facilitating Investment in the Mereenie Stairway

Investment in further appraisal and development of the Mereenie field, including through the 'Mereenie Stairway' would clearly provide a public benefit, both through the investment itself, the additional gas supply it would ultimately produce and the related economic benefits for employment, Northern Territory royalties and related indirect economic contributions.

The PWC Submission points to previous statements indicating consideration or planning in respect of the Mereenie Stairway by Central Petroleum and then seemingly assumes that such previous consideration means such investment will proceed irrespective of the joint marketing authorisation. That submission fails to appreciate the joint venture arrangements which apply to the Mereenie field, such that identified projects cannot proceed without joint venture approval (which requires approval of Macquarie Mereenie Pty Ltd as a 50% participant).

In that regard the Applicants note:

(a) while further appraisal and development of the Mereenie Stairway has been considered by the parties and 108PJ of contingent 2C resources identified, further appraisal and development drilling has not yet been approved by the Mereenie joint venture;

(b) given the significant capital costs involved in further drilling, approval is dependent on aligning the Mereenie participants' commercial interests, for which the joint marketing proposed to be authorised is required given Macquarie Mereenie has no commercial incentive to increase the reserves at Mereenie where it has no certainty it will be able to reliably commercialise those reserves rather than risking an increase in the existing lifting imbalance; and

(c) Central Petroleum's recent sell-down to New Zealand Oil and Gas and Cue Energy Resources has provided $40 million of funding which would potentially be available for such Mereenie expenditure, and strengthened Central Petroleum's financial position, ensuring that Central Petroleum has the financial capacity to progress such wells.

3.2 Facilitating Investment in the AMGP

Conduct that would facilitate the development of the proposed Amadeus to Moomba Gas Pipeline (the ***AMGP***) would clearly provide a public benefit, both through the investment itself, creating more efficient supply of Northern Territory gas to East Coast customers and related economic opportunities and gains.

The PWC Submission acknowledges that development of the AMGP 'will require considerable, firm and long term volumes of gas so that firm pipeline capacity can be booked'.[2] Yet the submission then questions the role Mereenie joint marketing would have in facilitating the AMGP's development.

In that regard, the Applicants note:

(a) as publicly announced in August 2020, Central Petroleum Projects Pty Ltd, Macquarie Mereenie Pty Ltd and Australian Gas Infrastructure Group (***AGIG***) had previously signed a Memorandum of Understanding to progress toward a final investment decision in respect of the AMGP premised on Central Petroleum parties and Macquarie Mereenie executing foundation gas transportation agreements – which strongly suggests AGIG saw the joint participation of the Mereenie participants as both critical and sufficient to progress the AMGP;[3]

(b) while the Applicants currently do not have sufficient uncontracted 2P reserves to underwrite the AMGP, where appraisal drilling converted Mereenie Stairway 2C reserves to 2P reserves, and the Applicants could aggregate their reserves through joint marketing, the Mereenie field itself would have sufficient reserves to underwrite the AMGP alone – this is evident based on Central Petroleum's publicly reported reserves for the Mereenie field;[4]

(c) to the extent that gas beyond the Mereenie field was needed to underwrite the AMGP, the Applicants note other Central Petroleum projects in the Amadeus Basin in which further appraisal or exploration is likely to occur to identify further reserves (such as Dukas, Palm Valley Deep or Dingo Deep), but this would be likely to still require material Mereenie volumes to be committed by both the Mereenie joint venturers – such that Mereenie joint marketing is critical – noting the $40 million funding component of the consideration from the Central Petroleum sell-down to New Zealand Oil and Gas and Cue Energy Resources could be utilised for the Palm Valley and Dingo targets; and

(d) to undertake the exploration, appraisal, and development of the Mereenie Stairway (as discussed earlier in this submission) the parties would need to be aligned given the significant financial commitment involved. Without joint marketing this becomes extremely difficult, given that it is difficult for either party to justify that investment, when the ability to reap the full rewards of that expansion are uncertain with the complexities and practical limitations of the imperfect balancing arrangements and illiquid marketing opportunities that exist.

The Applicants acknowledge that without Mereenie joint marketing, the AMGP could potentially still proceed, but under a much more delayed timeline. Without joint marketing, Mereenie ceases to be a viable source of foundation gas for the AMGP – because:

(a) neither party has the ability to commit anywhere near the volumes required separately;

(b) separate marketing would require a customer to negotiate separately with both parties or have multiple customers whose timing and volumes aligned such that both participants could make commitments at similar times – which the Applicants consider will not occur when such customers have simpler options available in the East Coast gas market; and

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[2] PWC Submission at 3.

[3] ASX Announcement and Media Release, Amadeus to Moomba Gas Pipeline – Proposed Boost to East Coast Gas Suppliers, 18 August 2020

[4] Central Petroleum Limited, 2021 Annual Report, 21 September 2021 at 8 and 10.

(c) the practical uncertainties and restraints under the lifting arrangements that would apply would make it extremely difficult to separately commit to firm volumes as would be required even in that scenario.

Without being underwritten with the Mereenie participants as a foundation customer, the AMGP would be dependent on other new significant production in the Northern Territory. That is most likely to occur from the:

(a) Beetaloo Basin, however, the Applicants consider that where development occurred in the Beetaloo Basin it would be more likely to be exported through the Northern Gas Pipeline to the Mount Isa region (given greater proximity to that infrastructure), and further displace Amadeus Basin gas or increase capacity of the Northern Gas Pipeline rather than underwrite the AMGP; or

(b) significant exploration success from the Palm Valley, Dingo and Dukas projects – which, without the Mereenie project – would not be available in the volumes required for many years.

Finally, the Applicants indicated in their initial application that AGIG was a relevant contact, and have no concerns with the ACCC contacting AGIG to confirm the importance of Mereenie gas and joint marketing for facilitating investment in and development of the AMGP.

3.3 Difficulties of Resolving the Imbalance Without Authorisation

The PWC Submission seeks to suggest the contractual arrangements to create alignment between the Mereenie participants should be 'no more time consuming or expensive than seeking authorisation'.

Based on the difficulties encountered to date in seeking to negotiate workable balancing arrangements (as discussed below), the Applicants consider the pre-requisites to being able to resolve such an arrangement are:

(a) removing the existing substantial lifting imbalance; and

(b) the marketing opportunities for the Mereenie field becoming more liquid.

The assertion in the PWC Submission reflects a lack of understanding of the difficulty of negotiating such arrangements, both generally and in the context of the Mereenie joint venture where a significant pre-existing lifting imbalance is present.

The initial 'Interim Lifting Imbalance Arrangements' were not negotiated between the Applicants – but rather a feature of the Joint Operating Agreement negotiated between Santos (as the previous owner) and Central Petroleum upon Central Petroleum's acquisition of 50% of the field in 2015.

These were only ever intended to be interim arrangements and were short-form in nature.

A lifting imbalance began to develop shortly after Central Petroleum's entry into the joint venture, but Santos and Central Petroleum and then from January 2017 Macquarie Mereenie and Central Petroleum, were, despite various attempts, never able to resolve an improved gas balancing arrangement.

The lifting imbalance and how to resolve it, continues to be a major point of contention between the Mereenie joint venturers.

Even with the impetus of the AGL contract, there was a prolonged negotiation period of over 6 months even to achieve the current 3 years balancing arrangement reflected in an Equalisation Deed which continues for the term of the AGL contract.

The Applicants consider that the key challenges facing the Mereenie joint venture in establishing gas balancing arrangements are:

(a) the very lumpy nature of sales opportunities that arise which give rise to significant imbalances very quickly in the event of separate marketing, with it being very difficult for the other participant to find a similar opportunity to address that imbalance;

(b) the limited duration, and non-firm nature, of many of the contracts which have been able to be entered to date (which limits the parties ability to use such a long term contract as a 'balancing' contract in the way the AGL contract has been able to be used); and

(c) the tension that has continued to exist between Macquarie Mereenie's desire to resolve the lifting imbalance and Central Petroleum's need as a junior and publicly listed company to continue to receive stable cash flows from the operations.

Taking into account those challenges, the Applicants consider it is clear that authorisation is required to align the Mereenie participants commercial incentives to further develop the Mereenie field, resolve the lifting imbalance and facilitate the development of the AMGP which, once developed will provide more efficient access to a wider range of East Coast gas customers and, as a result, materially improve the feasibility of separate marketing.

4 Capacity limitations in the AGP

It is not entirely clear how this section of the PWC Submission is considered relevant to the authorisation application.

However, the Applicants simply note:

(a) the AGP is not fully utilised the vast majority of the time, meaning an economic case for APA to invest in an expansion is unlikely;

(b) it is not economic for third parties to invest in a compression expansion of the pipeline to create firm transportation capacity in the absence of significant volume firm supply contracts (which would require the aggregated volume, and certainty of field offtake, provided by joint marketing), and the lead time for such an expansion would be well in excess of the typical contracting window for customers (months not years before they need the gas supply to commence) in any case;

(c) there is no firm transportation capacity on the AGP available for APA to contract, and access to any firm transportation capacity contracted by PWC requires agreement with PWC (as the most likely competing gas seller for the same sale); and

(d) [redacted]

5 Structure of the Northern Territory Market

The PWC Submission:[5]

(a) confirms the accuracy of the Applicants' submissions regarding the illiquid nature of marketing opportunities available for sales to Northern Territory customers; and

(b) acknowledges that joint marketing authorisation may be justified to cover foundation contracts for major investments.

[5] PWC Submission at 6.

While the PWC Submission suggests that 'care should be taken in relation to less lumpy investments', the nature of the most likely market opportunities that face the Mereenie field are that they are all lumpy (being commercial and industrial customers in the Northern Territory, the Mt Isa region through the Northern Gas Pipeline (***NGP***), and foundation customer sales to elsewhere in the East Coast market through the AMGP).

The only real exception to that is sales to PWC, which is in a unique position to act as an aggregator in the Northern Territory given its position as the largest gas buyer, largest and dominant incumbent gas seller, only firm capacity holder on the AGP, firm capacity holder on the NGP and natural supplier (given its Northern Territory government ownership) to the largest end customer in the Northern Territory, Territory Generation.

The purpose of the authorisation being sought is to make sales to third party customers. The authorisation will result in the Applicants more effectively competing with PWC for such contracts , and that is a clear public benefit in terms of increased liquidity and competition.

In relation to the commentary on the day-ahead auction, the Applicants simply note:

(a) the Northern Territory government has implemented a derogation from the day-ahead auction reforms and there is no suggestion of the timing for that derogation ceasing (such that speculation about what might occur without it is not a reasonable basis to oppose authorisation); and

(b) if PWC is suggesting there could only be one bidder for pipeline capacity in such auctions that suggestion does not account for the fact that:

    (i) authorisation permits joint marketing, but it does not prevent separate marketing, such that day-ahead capacity of this nature may well be to support the type of limited volume as available supply that can be made separately; and

    (ii) further Northern Territory gas development is likely to occur during the term of the authorisation (such as from the Beetaloo Basin), giving rise to other bidders.

6 Period of Authorisation

The Applicants continue to consider a 5 year period of authorisation is appropriate (rather than a shorter period as proposed in the PWC Submission).

The 5 year period sought is appropriate to ensure that sufficient time is available to:

(a) progress the AMGP to a final investment decision such that foundation gas supply and transportation contracts can be entered by the Mereenie joint venture participants in connection with it; and

(b) resolve the lifting imbalance between the Mereenie joint venture participants to ensure commercial alignment and potentially open the way for future feasible separate marketing to the East Coast through the AMGP.

A shorter period risks curtailing the anticipated public benefits, and is not justified when there is no evidence of any impact on competition from the proposed conduct and no anti-competitive impacts experienced from the recent previous period of joint marketing.

26 October 2021