UPSTREAM OIL AND GAS MARKETING AGREEMENTS: TRADE PRACTICES ISSUES

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Joint marketing agreements between joint venturers have long been a feature of upstream oil and gas projects in Australia, as have long-term take-or-pay contracts with a single purchaser accounting for a substantial portion of the production of gas joint ventures.

Both kinds of agreements have a sound commercial rationale: joint marketing agreements overcome practical difficulties with separate marketing by oil and gas joint venturers and enable the joint venturers to leverage off economies of scale and the particular expertise of one joint venture party. Similarly, long-term take-or-pay contracts provide joint venturers with an assurance of cash flow to service exploration and development costs and consumers with long-term security of supply.

Until relatively recently, competition law regulators in Australia and New Zealand have sanctioned such arrangements, though they may prima facie breach restrictive trade practices laws, on the ground that they have been necessary for the development of oil and gas reserves, thereby giving rise to public benefits that outweigh their anti-competitive detriment. In recent years, however, regulators on both sides of the Tasman have become more reluctant to accept such arguments, instead articulating a more pronounced preference for separate marketing by oil and gas joint venturers and for less restrictive protection of cash flows than large-scale long-term take-or-pay contracts.

After a brief introduction to some basic principles of Australian competition law and the relevant statutory provisions, this article considers the potential for joint marketing, long-term take-or-pay contracts and other commonly encountered features of upstream oil and gas joint ventures to breach Pt IV of the Trade Practices Act 1974 (Cth). Special features of upstream oil and gas markets are then examined before the authorisation process, and its implications for oil and gas joint ventures are discussed.

The article concludes by observing that changing downstream market configurations, particularly deregulation of natural gas markets in Australia, are rendering obsolete much of the traditional learning as to the public benefits of co-operative marketing by oil and gas joint venturers and long-term take-or-pay contracts with gas customers. Upstream oil and gas joint venturers will in future need to do more than simply assert such arrangements are necessary for their project to proceed in order to obtain immunity from Pt IV of the Trade Practices Act by regulatory authorisation.

1. COMPETITION AND MARKETS

1.1 'Competition'

Restrictive trade practices law, or competition law as it is described below, is in Australia principally embodied in Pt IV of the *Trade Practices Act 1974* (Cth) (the TPA).[1] Also found in statutory form in most other market based economies, such laws are aimed at preserving and

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1 The prohibitions in Pt IV of the TPA are replicated in State law: in WA, for example, see the *Competition Policy Reform (Western Australia) Act 1991*. For the sake of brevity, only the TPA provisions are referred to herein.

enhancing the allocation of scarce resources by means of a process of competitive rivalry for the supply of goods or services to Australian consumers.

Before discussing the implications of Pt IV for oil and gas joint agreements, a number of key concepts and processes will be considered.

The first of these is 'competition'. Economic theorists tend to define competition by contrasting two opposed market configurations. The first, known as perfect competition is based on a number of assumptions, for example, that all participants in the market have free and instantaneous access to all relevant information about the market, that the products traded in the market are homogenous, that there is a sufficient number of sellers in the market, that no one seller can influence the price and that the factors of production are perfectly mobile.

At the other extreme is a market characterised as a monopoly. In this situation, it is assumed that there is only one seller who determines the price. A monopsony market, in which there is only one buyer, also lies at this end of the spectrum.

When these two market configurations are contrasted, it becomes apparent that in a monopoly market, most consumers pay more for the product, because the monopolist will seek to raise prices to maximise his or her profit. Further, in such a market, some consumers who would have purchased the product at a lower price in a perfectly competitive market will not do so because of the increased price. In short, economic theory postulates that the effect of a monopoly market is a misallocation of resources and, accordingly, a dead-weight loss to the entire community.

In theory, then, the economic justification for laws which promote competition or proscribe monopolies is clear. When it comes to implementing that preference for competition over monopoly in laws, however, the theoretical contrast between perfect competition and monopoly is less useful, principally because the assumptions made in the theoretical modelling are rarely replicated in the real world of commerce. It is rare, for example, for all firms in a market to have free access to all relevant information and the factors of production are hardly ever perfectly mobile.

While economists can afford to discuss these matters from a theoretical perspective, whereas lawyers need to apply the theory to real world disputes. Not surprisingly, therefore, the Australian courts have taken a pragmatic view of the kind of competition which Pt IV is designed to protect. In essence, the Australian perspective is that competition laws are directed at the maintenance of *workable competition*. The source of this approach is the decision of the Trade Practices Tribunal in *Re Queensland Co-operative Milling Association and Defiance Holding Ltd (QCMA)*:

> 'The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements.' [2]

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[2] (1976) ATPR 40-012 at 17,245-6, citing the report of the US Attorney General's National Committee to Study the Antitrust Laws (1955). This approach has been endorsed by the High Court: see, for example, *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1986) 167 CLR 177 at 188 per Mason CJ and Wilson J and 200 per Dawson J, where the concept of 'market power' was explicated in similar terms. As to the various approaches taken in competition law, particularly in the USA, to the concept of competition, see, for example, Corones, *Competition Law in Australia* (2nd ed, 1999), Law Book, Ch 1.

In *Re QCMA*, the Tribunal also provided what has proved to be an influential description of the considerations that will be relevant to assessing the state of competition in a particular market for the purposes of Pt IV of the TPA:

> 'Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the market in which they operate. The elements of market structure that we would stress as needing to be scanned in any case are these:
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> (i) the number and size distribution of independent sellers, especially the degree of market concentration;
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> (ii) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
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> (iii) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion;
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> (iv) the character of the "vertical relationships" with customers and with suppliers and the extent of vertical integration;
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> (v) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.
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> Of all these elements of market structure, no doubt the most important is (ii), the conditions of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive activity.'[3]

The effect that particular conduct has on competition, particularly whether the conduct lessens competition and thus runs the risk of breaching Pt IV of the TPA, will be determined by a consideration of the manner in which the conduct impacts, or is likely to impact on these various elements of the relevant market's structure. In the language of Smithers J, in order to ascertain the consequences for competition of conduct impugned under Pt IV:

> 'it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening (of competition) … one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition.'[4]

This approach, which is widely employed in competition law analysis, is often described as 'the "future with and without test"'.[5]

1.2 Markets

The TPA defines the word 'market' in s 4E as follows:

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3 Ibid, at 17,246.

4 *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40-315 at 43,887-43,888 (FC).

5 See, for example, *Mereenie Producers/Gasgo Sales Agreements*, Australian Competition and Consumer Commission, 7 April 1999, accessible at http://www.accc.gov.au/gas/fs-gas.htm (references below to page numbers in this determination are to the PDF version of the document found at that URL), p 5.

> 'For the purposes of this Act, unless a contrary intention appears, "market" means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with the first-mentioned goods or services.'

Once again, the Tribunal's decision in *Re QCMA* contains the classic exposition of the concept of a 'market' for competition law purposes:

> 'A market is the area of *close competition* between firms or, putting it a little differently, the field of rivalry between them ...
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> Within the bounds of a market there is *substitution* between one product and another and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.
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> Whether such substitution is feasible or likely depends ultimately on *consumer attitudes, technology, distance and cost and price incentives*.
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> It is the possibilities of such substitution which set the limits upon which a firm's ability to "give less and charge more". Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to "give less and charge more" would there be, to put the matter colloquially, much of a reaction? And if so, from whom?
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> In the *language of economics*, the question is this: From which products and which activities could we expect a relatively high demand or supply response to price change, ie a relatively high cross elasticity of demand or cross elasticity of supply?'[6]

In competition law, markets are generally regarded as having a number of dimensions. First, and usually the most significant, is the *product dimension*, ascertained by asking what goods or services would consumers be likely, in the medium to long term, to substitute for those in issue (the demand side) and what producers of other goods or services would be likely to switch to producing those in issue (the supply side) in the event of a small but significant price rise for the subject goods or services.

The second is the *geographic dimension* in which the area from which consumers would be likely to source alternative sources of supply (the demand side) and from which producers might provide supply (the supply side) in the event of a small but significant price rise for the goods or services in issue.[7]

The third, the *functional dimension*, which will be significant in some but not all Pt IV matters, is concerned with the level of the market in which the trader(s) in issue operate (eg manufacturing, wholesale, retail).

Markets also have a *temporal dimension* in that they are constantly changing in response to, amongst other things, changes in supply and demand, regulatory change and technological innovation.[8] Caution must, therefore, be exercised before extrapolating into the present market

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6 Op cit , n 2 at 17,247 (emphasis added).

7 In view of s 4E, referred to in 1.2 above, the broadest geographic scope of a 'market' for Pt IV purposes is Australia.

8 See, for example, the description of recent changes in eastern Australian natural gas markets in *Re AGL Cooper Basin Natural Gas Supply Agreements* (1997) ATPR 41-593 at 44,211 (Tribunal). As to this

analysis in previous decisions of the regulator and the courts. Nevertheless, those decisions provide useful guidance regarding matters of particular relevance where oil and gas markets are to be analysed for competition law purposes.

2. OVERVIEW OF CONDUCT PROHIBITED BY PART IV OF THE TPA

The prohibitions in Pt IV of the TPA can be conveniently grouped into four categories.

First, Pt IV proscribes a variety of contracts, arrangements or understandings between persons who are direct competitors. These are often referred to as *prohibitions on horizontal agreements or arrangements* because they are directed at collusion between persons at the same functional level in the market (eg between two manufacturers or two retailers).

The principal prohibition of horizontal agreements or arrangements is s 45(2), which proscribes the making or giving effect to contracts, arrangements or understandings which have the purpose or effect of substantially lessening competition. Pursuant to s 45A(1), contracts, arrangements or understandings between competitors which have the purpose or effect of *fixing, controlling or maintaining prices* in a market are deemed to have the effect of substantially lessening competition. Similarly, s 45 provides that exclusionary provisions are prohibited irrespective of their effect on competition.

Second, the Act prohibits certain vertical contracts, arrangements or understandings between *persons who operate at different functional levels of the market*. Exclusive dealing, such as the supply or acquisition of goods or services on the condition that the purchaser or seller not deal with others, for example, is proscribed by s 47. While most forms of exclusive dealing are prohibited only if they substantially lessen competition, some such conduct (in particular what is generally known as third line forcing) is prohibited irrespective of its effect on competition.[9]

Third, by s 46 the Act prohibits unilateral conduct by a firm having a substantial degree of power in a market, irrespective of whether such conduct concerns persons at the same or different functional level of a market (s 46).

Fourth, s 50 of the Act prohibits the substantial lessening of competition by the acquisition of shares or assets, such as by a merger. This prohibition will also operate irrespective of whether the acquisition extends the market power of the purchaser at the same or different functional level of a market.

The first two categories are of particular relevance to oil and gas joint ventures and will, therefore, be the focus of this paper.

3. CONDUCT EXEMPTED FROM THE OPERATION OF PART IV

3.1 The Export Exemption

The Act itself provides that certain conduct is exempt from the operation of Pt IV.

Perhaps the most significant exemption for the oil and gas industry is that by which *provisions of contracts, arrangements or understanding that relate exclusively to the export of goods from*

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decision, see, generally, Dinnick, 'Re: AGL Cooper Basin Natural Gas Supply Arrangements: Application for a Review of a Determination of the Australian Competition and Consumer Commission' (1997) 16 AMPLJ 258.

9 TPA, s 47(6), (7), (10).

Australia are immune from Pt IV.[10] This exemption will only operate if full and accurate particulars (other than prices but including any method of fixing, controlling or maintaining prices) are provided to the Australian Competition and Consumer Commission[11] within 14 days of the relevant contract etc being entered into.[12]

For a topical example of the export exemption in operation, see the Commission's *North West Shelf Project* determination, in which it was noted that, in view of the export exemption, only certain of the North West Shelf joint ventures required authorisation. [13]

In the absence of case law or Commission rulings as to the matter, doubt remains as to what degree of connection a contract etc must have with the export of goods or services in order to come within the immunity.[14]

3.2 Conduct of Governments

Certain conduct of governments is also exempt from Pt IV of the TPA. Pursuant to s 2A of the TPA, the Crown in right of the Commonwealth and of the States and Territories is bound by Pt IV of the Act insofar as it *carries on a business*.

In recent cases, the courts have taken a narrow view of when governments carry on a business, thereby exempting significant aspects of governmental activity from the reach of Pt IV.[15]

Due to the ongoing role of Australian governments in the energy sector,[16] the Crown's amenability to Pt IV of the TPA remains significant in that context. In *NT Power Generation Pty Ltd v Power & Water Authority*,[17] for example, the Full Federal Court held that two NT Government entities were not carrying on a business by purchasing gas and in negotiating access agreements for access to the State's electricity grid.[18]

3.3 Conduct Authorised by Other Statutes

Pursuant to s 51(1) of the TPA, 'anything specified in or specifically authorised by' a Commonwealth, State or Territory Act or regulation is to be disregarded in determining whether

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10 TPA, s 51(2)(g).

11 The Commonwealth Government body charged with administering Pt IV of the TPA. The phrase '*the Commission*' is used below to refer to the ACCC and its predecessor, the Trade Practices Commission.

12 Information of this kind provided to the Commission in a notification for the purposes of the export exemption are not available for public inspection: TPA, s 166(3).

13 29 July 1998. The Determination is accessible at http://www.accc.gov.au/gas/fs-gas.htm. References below to page numbers in this determination are to the PDF version of the document found at that URL. As to the export exemption, see p 8. The decision is also reported at (1999) ATPR (Com) 50-269. See also Rose and Grave, 'Authorisation of Joint Venture Marketing: North West Shelf Project Authorisation' (1998) 17 AMPLJ 379.

14 See, further, National Competition Council, *Review of Sections 51(2) and (3) of the Trade Practices Act*, 1999, (accessible at http://www.ncc.gov.au), Steinwall, 'The Legislative Basis of the Act' in Steinwall et al, *Butterworths Australian Competition Law* (2000), Butterworths, para 1.100.

15 See Lockhart, *The Law of Misleading or Deceptive Conduct* (2nd ed, 2003), Butterworths [1.10]-[1.12].

16 In many states, for example, government entities are major purchasers of natural gas.

17 [2002] FCAFC 302.

18 Although the gas purchase agreements in issue were found to have been outside the scope of Pt IV because of an exemption which protected contracts existing at the time of the commencement of the *Competition Policy Reform Act 1995* (Cth), by which the States and Territories were expressly made subject to Pt IV to the extent they carried on a business: see [2002] FCAFC 302 at [103]-[107] per Branson J (with whom Lee J agreed as to this issue: at [29]).

Pt IV of the TPA has been contravened. The significance of this exemption has been reduced somewhat as a result of amendments to s 51 that have narrowed the range of conduct that may be said to be specifically authorised by another statute or regulation and by the repeal or amendment in recent years of many restrictions on competition in State and Territory statutes and regulations pursuant to the Competition Principles Agreement between the Commonwealth, State and Territory governments.[19]

Nevertheless, the exemption may be of importance in relation to some oil and gas joint projects for which a State or Territory government has previously legislated to encourage development.[20]

3.4 The Joint Venture 'Exemption'

Joint venture parties who negotiate or enter a joint marketing agreement run a serious risk of breaching s 45 of the TPA. Such agreements invariably require consensus as to price and terms amongst persons who might otherwise compete for the sale of the joint venture product. Given the importance of price as an indicator of the interplay between supply and demand in a market, agreements as to price will generally have a significant impact on the competitive process. It is not surprising, therefore, that such agreements are viewed as being particularly inimical to competition.

As noted above, s 45A(1) of the TPA deems contracts, arrangements or understandings between competitors, or putative competitors to fix, control or maintain prices to substantially lessen competition, thereby breaching s 45. The deeming effect of s 45A(1) is not absolute, though, particularly for joint venturers.

By s 45A(2), agreements as to price arrived at for the purposes of a joint venture are not subject to s 45A(1) to the extent that they relate to the joint supply, by two or more parties to the joint venture in proportion to their respective interests in the joint venture, of goods produced by all of the parties in pursuance of the joint venture.

A 'joint venture' for the purposes of this exemption is:

> 'an activity carried on in trade or commerce
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> (i) carried on jointly by two or more persons, whether or not in partnership; or
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> (ii) carried on by a body corporate formed by two or more persons for the purpose of enabling those persons to carry on the activity jointly by means of their joint control, or by means of their ownership of shares in the capital of that body corporate.' [21]

These provisions provide useful protection from what would otherwise be a strict liability for breach of s 45 of agreements between joint venturers as to price.[22] Nevertheless, the provisions only apply to the deeming effect of s 45A(1): they do not immunise such agreements totally from the Act. Notwithstanding s 45A(2), such agreements may contravene Pt IV if they have the purpose or effect of substantially lessening

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19 See, generally, the National Competition Council's August 2002 review of the implementation of the Agreement, accessible at http://www.ncc.gov.au.

20 In *Re AGL Cooper Basin*, op cit, n 8, for example, the Australian Competition Tribunal considered an agreement between certain producers in the Cooper Basin, aspects of which were specifically exempted from the TPA by the *Cooper Basin (Ratification) Act 1975* (SA) (see, particularly, 44,166). See also *Australian Gas Light Company* (1996) ATPR (Com) 50-114. The question of amenability to Pt IV may also arise in this state, in which many major resource projects are the subject of statutes ratifying agreements between the owners and the State Government.

21 TPA, s 4J.

22 See, further, Rose, 'Resource Joint Ventures and the Trade Practices Act 1974' (1991) 9 *Journal of Energy and Natural Resources Law* 95 at 104-110.

competition. It is necessary, therefore, to consider how such agreements between oil and gas joint venturers are likely to be analysed by the Commission and the courts for their effect on competition.

4. POTENTIAL BREACHES OF PART IV BY AGREEMENTS ARISING OUT OF OIL AND GAS JOINT VENTURES

4.1 General

Of the variety of agreements that oil and gas joint venturers might enter, two types of agreements give rise to particular competition law concerns.[23] First, *agreements between joint venture parties* as to joint marketing of the venture's product may amount to an attempt to fix, control or maintain prices, or otherwise substantially lessen competition in a market and thereby breach s 45. Second, *agreements between joint venturers and their customers*, such as take or pay agreements, the grant of pre-emptive rights over uncommitted production of the joint venture or restrictions on the joint venture parties selling to other customers or customers purchasing from other producers may also substantially lessen competition and thereby breach s 45 or amount to exclusive dealing in contravention of s 47.

4.2 Joint Marketing Agreements

There are a number of reasons why joint venturers may wish to co-operatively marketing the venture's product. These include 'the nature of the product' which 'may demand a joint approach to distribution and sale', a 'low volume of total production or of an individual participant's proportionate share' or to 'take advantage of the marketing facilities or expertise offered by a particular joint venture or a jointly appointed selling agent'.[24]

Co-operative marketing arrangements between joint venturers that involve agreements or understandings as to the price of the venture's product (or as to the means of fixing that price) will prima facie be caught by s 45A(1) and thereby deemed to substantially lessen competition. As previously noted, however, many such agreements will also fall within the 'joint venture' exemption from s 45A(1) found in s 45A(2)[25] and, accordingly, will only breach s 45(2) if they have the purpose or effect of substantially lessening competition.

Price rivalry is generally regarded as one of the fundamental elements of effective competition. In *Mereenie Producers/Gasgo Sales Agreement*, for example, the Commission recently commented that 'separate marketing of gas by joint venture producers, wherever feasible, will be more competitive than co-ordinated marketing and likely to provide a wider variety of supply options than would better meet market demands'. [26]

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[23] Competition law issues may also arise from area of mutual interest, assignment and non-competition clauses in joint venture agreements, which lie outside the scope of this paper. See, further, Rose, ibid, at 104-110. As to competition law and joint ventures generally, see also Williamson, 'Trade Practices Law-Its Implications for Mining and Petroleum Joint Ventures' (1977) 1 AMPLJ 59 and Rose, 'Long Term Gas Sales Agreements: Trade Practices Act Implications' (2001) 20 AMPLJ 166.

[24] All quotes, Rose, op cit, n 22 at 111.

[25] Compare New Zealand Commerce Commission, *Decision 505* (accessible at http://www.comcom.govt.nz/adjudication/s58.cfm) paras 257-258 (analogous NZ provisions). Rose speculates that a co-operative marketing agreement between the members of an exploration or production joint venture may not be entered into *for the purposes of the joint venture* and, hence, not be entitled to the s 45A(2) exemption: ibid at 115.

[26] *Mereenie Producers*, op cit, n 5 at p 32. The decision is also reported at (1999) ATPR 50-271. See also *North West Shelf*, op cit, n 13 at p 31, NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 208.

By eliminating producer rivalry on price, therefore, co-operative marketing will, all other things being equal, tend to reduce competitive pressures in the market for the joint venture's product.

The question of whether any particular joint marketing agreement is likely to *substantially* lessen competition will require a detailed consideration of the particular market(s) impacted by the agreement. The various elements of the market's structure, outlined above,[27] will need to be examined, including the number of independent sellers and buyers in the market, which may include whether 'parties to competing joint ventures have common ownership',[28] whether the joint venture will facilitate the entry of a new supplier into the market and the size of the venture in issue in comparison to other established or potential producers.[29] The degree of vertical integration and the height of barriers to entry into the market will also be relevant and perhaps decisive considerations.

As most Australian gas markets are characterised by a small number of independent sellers and very high barriers to entry,[30] there is a substantial risk that co-operative marketing of the product by joint venturers will be being perceived as substantially lessening competition.

4.3 Take or Pay Arrangements

Given the substantial capital required for the development of oil and gas reserves, financiers will often require production joint ventures to demonstrate that the joint venture will be able to generate sufficient cash flow to service its borrowings. The joint venture partners themselves will also be concerned to ensure that the project's cash flow will be sufficient to provide an adequate return on capital.

One very common means by which these concerns are addressed, particularly in gas joint ventures, is for the joint venturers to enter long-term take or pay contracts with customers, thereby 'locking in' a source or future revenue for the venture and limiting 'opportunistic behaviour by contracted purchasers'.[31] In some circumstances at least, entry into such contracts will be a prerequisite to obtaining finance for a joint venture's development of a gas field.[32]

While arrangements of this kind are not between competitors and, hence, are not subject to the deeming effect of s 45A(2), take or pay agreements may, depending on their size and the structure of the relevant market, substantially lessen competition in a market.

In *Re AGL Cooper Basin*, the Tribunal commented that:

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27 See 1.1.

28 *North West Shelf*, op cit, n 13 at p 27.

29 In *Santos Ltd* (1988) ATPR (Com) 50-074 at para 3.5, for example, the Trade Practices Commission concluded that a proposed joint marketing agreement between oil joint venturers would be likely to have only a minimal impact on competition in the relevant markets due to the 'small proportion of the overall market that is held by [the oil field in issue]'. See also *BHP Petroleum Pty Ltd* (1990) ATPR (Com) 50-096 (oil joint venture).

30 See, for example, the Commission's comments concerning the WA natural gas market in *North West Shelf*, op cit, n 13 at p 34.

31 *Re AGL Cooper Basin*, op cit, n 8 at 44,184. Such contracts will 'ordinarily provide for the purchaser to hold over for later delivery, without further payment, any product quantities that thereby are paid for but not delivered' (op cit). The Commission also noted in *Re Cooper Basin* that confidential evidence produced to it instanced 'a number of recent contracts for gas sale and gas haulage capacity with take or pay provisions at 80% of contract quantities or higher' (op cit). Note also that '[f]inancing of major gas using projects may also require long term supply contracts to be written' (op cit).

32 Ibid at 44,183-44,184.

> 'A distinction can be drawn between those long term contracts that are necessary to sustain long-lived sunk investments … and those … that create no such social utility but are, rather, an instrument of foreclosure.'[33]

The question of whether a particular arrangement is of one kind or the other will turn to a large extent on the structure of the market in which the take or pay agreement operates. In *Re AGL Cooper Basin*, for instance, the Tribunal contrasted the effect of such contracts upon 'wide and open markets, as they occur in the US' and 'small markets, containing very few contestants (as in [NSW]) and with large capital investments in relation to the size of the markets concerned'. [34]

In the latter market configuration, the Tribunal added, 'vertical agreements can have a market foreclosing effect'.[35]

As many Australian gas markets display the characteristics of small markets as described by the Commission,[36] there are real risks that an Australian gas production joint venture's entry into a long-term take or pay agreement with major customers will be likely to substantially lessen competition and to thereby breach s 45. That risk will be magnified where the take or pay agreement involves a quantity that is substantial in the context of the market or involves the dominant customer(s) in the market.

4.4 Pre-Emptive Rights/Rights of First Refusal

On the other hand, a customer may, in exchange for entering a take or pay arrangement, require a pre-emptive right from the joint venture over some or all of the joint venture's product in excess of the amount subject to the take or pay obligation. Producers may also require a customer to give them a right of first refusal for the supply of any gas above the quantity the customer is obliged to purchase.[37]

In *Mereenie Producers*, the Commission commented that pre-emptive rights 'have the potential to hinder or prevent the entry of additional buyers seeking gas'[38] and added that, even where the right is not exercised, the 'mere existence of the … pre-emptive right may potentially deter entry by alternative gas buyers'.[39] The Tribunal has also noted the potential for a right of first refusal given to the producers to dampen competition in that it may 'compel [the customer] to disclose to the producers the details of offers from alternative suppliers. In the Australian context, this is a plain inhibition on alternative suppliers disclosing their hand'. [40]

Once again, the likelihood of such obligations having a substantial adverse effect on competition will turn on the nature of the market upon which they impact, including the number of independent buyers and sellers, the amount of the joint venture's production or potential production that is covered by the right and the time over which the right subsists. The Commission's comments in

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33 Ibid at 44,216. See also *Mereenie Producers*, op cit, n 5 at pp 34-37.

34 Both quotes, op cit, n 8 at 44,216.

35 Ibid at 44,217.

36 See, for example, *North West Shelf*, op cit, n 13 at p 34.

37 Both of these types of agreements were considered in *Re AGL Cooper Basin*, op cit, n 8. See also *Mereenie Producers*, op cit, n 5 at p 12 (user's pre-emptive right).

38 Op cit, n 5 at p 35.

39 Ibid at p 36. In *Mereenie Producers*, authorisation was not sought for a pre-emptive right granted by a prior agreement. The Commission commented that '[h]ad the pre-emptive right been contained in the agreement' under consideration, authorisation would not have been granted and that entry into and giving effect to the right 'may well be a breach of Part IV of the [TPA]' (both quotes, ibid at p 42).

40 *Re AGL Cooper Basin*, op cit, n 8 at 44,218.

Mereenie Producers, suggest, though, that those entering into or giving effect to such agreements in many Australian gas markets today need to account for the risk that they may thereby breach s 45.

4.5 Exclusive Dealing

Joint venturers may also require a customer to agree to deal exclusively with them, either for all of their requirements or up to a certain quantity. Where the customer has entered a 'take or pay' agreement, an exclusive dealing agreement may relate to quantities in excess of that required to be taken or paid for.[41]

Such agreements will contravene s 47 if they have the purpose or effect of substantially lessening competition. While many of the matters already discussed concerning other potentially anti-competitive agreements will also be relevant to that issue, it is noteworthy that, in determining the effect on competition of an exclusive dealing clause, account will be taken of whether it was interdependent with a take or pay clause.[42]

In view of the importance of market analysis in determining the likelihood of breach of Pt IV by the various kinds of agreements discussed above, certain features of Australian oil and gas markets will now be considered.

5. DEFINING OIL AND GAS 'MARKETS'

5.1 General

The parameters and competitive character of Australian oil and gas markets are essential elements of the context in which the capacity of agreements involving oil and gas joint venturers to lessen competition will be assessed. Accordingly, matters that have to date been considered significant in comprehending those markets will now be discussed.

5.2 Oil

In the relatively small number of Australian authorisation decisions concerning upstream arrangements between oil joint venturers, the relevant market has been defined as that for the sale and purchase of crude oil in Australia.[43]

Although the decisions do not deal expressly with the matter, the definition of the product dimension-crude oil-seemingly also encapsulates the functional dimension of the market thereby identified. Due to crude oil's essential character as a substance that requires refining before it becomes useful, the market for its sale must by definition be to refiners, or to intermediaries who will ultimately sell to a refiner.

5.3 Natural Gas

There is less certainty as to the boundaries of the natural gas market. In the early authorisation decisions,[44] it appears to have been assumed that the relevant *product dimension* was natural gas.

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41 See, for example, ibid at 44,190.

42 Ibid, at 44,218. The Tribunal also commented that 'if a two part tariff had been used to protect cash flows [rather than a take or pay obligation] … the exclusive dealing clause [in issue] would have [had] no justification' (op cit).

43 See, for example, *Bridge Oil Ltd* (1988) ATPR (Com) 50-073, para 3.3, *Santos*, op cit, n 29 at para 3.3, *BHP Petroleum* , op cit, n 29 at para 3.3.

44 See, for example, *Woodside Petroleum Development Pty Ltd* (1977) ATPR (Com) 35-200, *Esso Exploration and Production Aust Inc & Western Mining Corporation Ltd* (1978) ATPR (Com) 35-340.

In 1986, however, in *Australian Gas Light*,[45] the Trade Practices Commission found that there was some substitutability between natural gas and other energy sources. The Commission identified the two relevant groups of actual or potential customers for natural gas in NSW as domestic and industrial/commercial consumers. In each group, natural gas was seen to compete with coal, LPG, various forms of processed crude oil and electricity for energy needs[46] although it was also noted that such competition was restricted by the ability of users to cost effectively switch between energy sources.[47] Accordingly, the Commission defined the product dimension of the market as natural gas, with competition at the margins from other energy sources, a view that has also been taken in more recent authorisation decisions.[48]

The characteristics of natural gas impact on the *geographic dimension* of the market for its sale. The product cannot easily be stored and, at present can only be economically transported to Australian users by pipeline.[49] Accordingly, the geographic scope of Australian gas markets has generally been defined as those areas that are connected to the gas field(s) in issue by a pipeline.[50]

Due to a lack of interconnection between natural gas pipelines, consumers of natural gas in Australia have traditionally been restricted to a single source, usually within the same State or Territory or, in the case of NSW, in adjacent SA.[51] In more recent years, though, the construction of more pipelines and some interconnection, particularly in the eastern states of Australia, may have expanded the geographic dimension of some Australian gas markets.[52]

On occasions, a distinction has been drawn between different *functional markets* for natural gas in Australia[53] but authorisation decisions have more often than not proceeded without consideration of the matter.

6. SPECIAL FEATURES OF OIL AND GAS MARKETS

6.1 General

Both the oil and gas markets in Australia have undergone significant structural change over the past decade or so, with consequences for the nature of competition therein.

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45 (1996) ATPR (Com) 50-114.

46 See, for example, ibid, paras 29, 33.

47 See, for example, ibid, paras 33-35.

48 See, for example, *North West Shelf*, op cit, n 13 at pp 23-25, *Mereenie Producers*, op cit n 5, p 35, *Re AGL Cooper Basin*, op cit, 8 at 44,210-44,211. See also NZ Commerce Commission, *Decision 505*, op cit, n 25 at paras 240-244.

49 See, for example, *Australian Gas Light*, op cit, 20 at para 25.

50 See, for example, *Delhi Petroleum Ltd* (1988) ATPR (Com) at para 5.1 (field in south-west Qld, market encompassed Qld, SA, NSW and the ACT), *North West Shelf*, op cit, n 13 at p 22 (fields off north-west coast of WA, market encompassed most of WA, *Mereenie Producers*, op cit, n 5 (fields in NT, market encompassed most of NT).

51 *Re AGL Cooper Basin*, op cit, n 8 at 44,201-44,203.

52 See, for example, ibid at 44,201-44,208 and, in the context of the National Gas Code, *Duke Eastern Gas Pipeline Pty Ltd* [2001] A Comp T 2 at [77] and Commonwealth Minister for Industry, Tourism and Resources, Decision of 19 November 2003 re Revocation of Coverage for the Moomba to Sydney Gas Pipeline, accessible at www.ncc.gov.au) in which the Minister, overturning the National Competition Council, found that ruled that 'both upstream and downstream transportation services between Moomba and Sydney' are capable of being provided by the 'integrated gas transmission systems in south-east Australia' (both quotes, Statement of Reasons at [60]).

53 See, for example, *Australian Gas Light*, op cit, n 20 at para 18 (wholesale and retail markets distinguished), *Re AGL Cooper Basin*, op cit, n 8 at 44,211 (production, processing and distribution distinguished). See also NZ Commerce Commission, *Decision 505*, op cit, n 25 paras 245-249.

In relation to *oil*, in 1988 the Commonwealth Government abandoned its Crude Oil Allocation Policy and other regulation of the sale of crude oil, removing requirements that refineries absorb particular quantities of Australian crude oil and ending the Commonwealth's fixing of the price of crude oil at the Import Parity Price. Crude oil producers have since then been able free to negotiate directly with refiners concerning the price and quantity at which crude is to be sold.[54]

In relation to *natural gas*, in recent years, most Australian states and territories have, with the aim of stimulating competition, reduced or removed statutory barriers to entry to the gas sales market and enacted a national Code regulating access to gas transmission and distribution infrastructure.[55] The concurrent discovery of significant new fields by a more diverse range of owners and the construction of new pipeline infrastructure[56] has also altered the competitive dynamics of Australian gas markets.

As a result, Australian natural gas markets are currently in transition from an environment of heavy regulation which often entrenched the dominant market position of very few large scale sellers and buyers, the latter often being government utilities that also owned the transmission and distribution infrastructure, to a more openly competitive configuration where a number of gas producers compete to supply various users through direct negotiation.

6.2 Oil and Gas Production

In many markets, producers have their own, discrete sources of supply. Particular characteristics of oil and gas, however, make that difficult. Exploration and appraisal of prospective fields requires 'very large capital expenditure' which is 'a sunk cost that is expended whether a commercial discovery is made or not'.[57] Accordingly, 'co-operative arrangements are necessary to mitigate the high risk sunk costs that are associated with these activities'[58] and 'the oil and gas exploration and production industry worldwide has adopted joint ventures to efficiently manage [these] risks'.[59]

The Commission recognised this economic imperative in its very early decision in *Woodside Petroleum Development Pty Ltd*, in which it commented, in relation to the original North-West Shelf development, that the project was 'dependant in a real sense on the [proposed] joint venture arrangement and would be unlikely to proceed without it'.[60]

The production of oil and gas in Australia through joint ventures has not since received significant attention from the regulator.

6.3 Oil and Gas Marketing

Notwithstanding those similarities between the approach generally taken to oil and gas production, the two products present different marketing challenges.

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54 See, for example, *Bridge Oil*, op cit, n 43 at para 1.2.

55 See, for example, *Re AGL Cooper Basin*, op cit, n 8 at 44,191-44,194, *North West Shelf*, op cit, n 13 at p 41, Council of Australian Governments, *Towards a Truly National and Efficient Energy Market*, 2002, Department of Industry Tourism and Resources.

56 See, for example, *Duke Eastern Gas Pipeline*, op cit, n 52.

57 *Re AGL Cooper Basin*, op cit, n 8 at 44,183.

58 NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 154. The Commission also commented that it had been informed that 'the average geological success rate of frontier [oil and gas] basin exploration wells worldwide is between 1 in 10 and 1 in 15' (at para 153).

59 I bid at para 156.

60 See, for example, *Woodside Development*, op cit, n 44, at para 24. See also *Esso Exploration*, op cit, n 44 at para 8, *Australian Gas Light*, op cit, n 20 at paras 23, 27, *Delhi Petroleum*, op cit, n 50 at para 5.2.

Marketing of *natural gas* must take account of the nature of the product, namely that the substance 'cannot readily or easily be stored' and is 'raised, treated [and] distributed in a continuous flow without a break point that may be divided into distinct lots for separate marketing'.[61] Consequently, there are clear operational and scale advantages to marketing the output of a natural gas joint venture through a single entity.

In the early Australian authorisation rulings concerning natural gas marketing, these features of the product were regarded as necessitating collaborative marketing by production joint venturers, who might otherwise compete to sell their share of the venture's output.[62] On that view, agreements to jointly market gas produced by a joint venture, even those as to price, may enhance competition in the relevant market for the gas by facilitating the entry of a new supplier into that market.

While applicants for authorisation of such agreements have continued to assert that co-operative marketing is essential for the development of the natural gas reserves in issue,[63] in more recent years, the Commission has taken the view that the extent to which joint marketing is a truly necessary feature of the natural gas project will turn upon the characteristics of the market in which the gas is to be sold.[64] Natural gas markets that would support separate marketing by the parties to a production joint venture have been described by the Commission as follows:

> 'Gas markets where separate marketing by joint venture producers is the norm, such as in the USA and UK, operate as commodity markets with much of the gas produced and brought to market for sale. The physical production and delivery of gas is separated from the contractual sales, with a variety of trading, swapping and hedging practices helping to achieve a more efficient allocation of the gas supplied to the various end customers.
>
> These markets have a number of highly competitive suppliers and buyers operating within a framework that provides for a wide range of contract types and length. There are active aggregators and brokers, who bring together otherwise diverse sale and purchase requirements. Within these broader gas markets, dynamic short term markets have developed allowing buyers and sellers to deal with discrepancies between their contractual and actual usage quantities. Futures exchanges allow producers to sell, and customers to buy, their gas months ahead of actual production or supply and hedge against price fluctuations. Gas storage facilities exist near major consumption centres allowing producers and retailers to bring gas close to the point of use during times of low demand in order to sell in peak times. Storage also allows producers who are not currently able to find a buyer for their share of jointly produced gas to build up a marketable parcel or to wait for the right opportunity to sell.' [65]

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61 Both quotes, *Delhi Petroleum*, op cit, n 50 at para 2.2 (applicant's submissions). See also Rose, op cit, n 22 at 117.

62 See, for example, *Woodside Petroleum Development*, op cit, n 44 at para 25, *Esso Exploration*, op cit, n 44 at para 8, *Delhi Petroleum*, op cit, n 50 at paras 5.1-5.7. Compare *BHP Petroleum*, op cit, n 29 at para 7.1 (oil joint venture).

63 See, for example, *North West Shelf*, op cit, n 13 at pp 19-21, 34.

64 See, for example, *North West Shelf*, op cit , n 13 p 31, *Mereenie Producers*, op cit, n 5 at p 32.

65 *Mereenie Producers*, op cit, n 5 at p 32. See also *North West Shelf*, op cit, n 13 at pp 46-47. Where gas joint venturers separately market their share of the venture's output, there will also be a need for a gas balancing agreement to address the consequences of one or more of the venturers 'under-lifting' or 'over-lifting' their share of that output: see, further, NZ Commerce Commission, *Decision 505*, op cit, n 25 at paras 159-162.

Pursuant to the Commission's current approach, the effect upon competition of a marketing agreement between natural gas joint venturers will turn largely on the extent to which the geographic market within Australia into which the joint venture's product is sold displays these characteristics.

Where the relevant market lacks such features, joint marketing agreements are likely to continue to be viewed as essential to the venture's development and their effect on competition in that market, along with their public benefit will be assessed accordingly. In recent determinations, the Commission has found that the WA[66] and the NT[67] markets lacked sufficient maturity to support separate marketing by natural gas joint venturers. Each of these markets, it was said, were 'best described as a 'contract' or 'project' market-where gas is only produced to meet specific contractual obligations, often for large stand alone projects',[68] rather than the commodity gas markets in the USA and the UK referred to above.

It is noteworthy, though, that, since those determinations, separate marketing arrangements have been employed by the parties to certain Victorian natural gas joint ventures.[69] The impact of that development upon the attitude of the Commission to joint marketing arrangements in the natural gas industry remains to be seen, but it may presage a finding in the not too distant future that separate marketing of gas produced by a joint venture is feasible in some Australian gas markets, which in turn will lead to much closer scrutiny of the anti-competitive impact of co-operative marketing.

Even if separate marketing of natural gas is found to be feasible, assessment of the anti-competitive effect of a proposed joint marketing agreement will need to take account of the degree of co-ordination as to marketing that would be necessary if the joint venturers were to individually market their share of the venture's output.[70] If significant co-operation would in any event be required, competition may not be significantly harmed by joint marketing.

As *oil* does not share these characteristics of natural gas, in the sense that it can be stored and separated into quantities owned by each member of the production joint venture, 'it may not only be feasible but also desirable [for competition law purposes] that individual marketing be

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66 *North West Shelf*, op cit, n 13.

67 *Mereenie Producers*, op cit, n 5.

68 *North West Shelf*, op cit, n 13 at p 46. See also *Mereenie Producers*, op cit, n 5 at p 32, NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 341 (NZ gas market).

69 The Geographe/Thylacine and Yolla developments, described in NZ Commerce Commission, *Decision 505*, op cit, n 25 at paras 182-195. Although in *Decision 505* the NZ Commission ultimately authorised the agreement for the joint marketing of gas in issue therein, it seems to have proceeded on the basis that separate marketing was feasible: see, for example, para 286. As to the draft determination that preceded the Commission's decision, see Thomson and Welson, 'Joint Marketing of Gas from a Joint Venture: The Commerce Commission's Draft Determination on Pohokura Gas' [2003] AMPLA Yearbook 623 and as to the Commission's final decision see (2003) ARELJ 433. Note also that the recent Council of Australian Governments' review of Australian energy markets made recommendations that there be mandatory notification to the Commission of all future joint marketing arrangements (op cit, n 55 at 56) and that separate marketing 'should be considered as part of [an] overall package to improve the competitive nature of the natural gas market' (ibid at p 200).

70 See, for example, NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 371 (gas joint venturers who separately market their share of the venture's output are unable to unilaterally increase their share of output or change the timing of gas uptake and gas balancing agreements may lead to all joint venturers being aware of prices charged by the others.

encouraged, particularly where individual joint venture parties have marketable portions of product'.[71] Joint marketing may, however, enhance competition or cause minimal anti-competitive detriment where separate marketing of small quantities of oil produced by a joint venture is not feasible or efficient.[72]

7. AUTHORISATION OF CONDUCT PROHIBITED BY PART IV OF THE TPA: GENERAL ISSUES AND PROCESS

7.1 Grant of Authorisation

The TPA also provides that conduct that would otherwise contravene many of the prohibitions in Pt IV may be authorised by the Commission. Conduct that is so authorised will not amount to a breach of the Act.[73]

Upon an application being made to it,[74] the Commission may authorise contracts' arrangements or understandings that would otherwise breach s 45, even those containing exclusionary provisions[75] or that amount to exclusive dealing.[76]

Before authorisation may be granted, the Commission must give the public notice of the application,[77] take account of any submissions made in relation to it by interested persons,[78] issue a draft determination[79] and provide all interested persons with the opportunity to request the Commission hold a conference in relation to the draft determination.[80]

The Commission may authorise a provision of a contract, arrangement or understanding that would otherwise breach s 45 (other than a provision that is or may be an exclusionary provision) if it is satisfied that the proposed contract, arrangement or understanding would result, or be likely to result in a *benefit to the public that would outweigh the detriment to the public constituted by any lessening of competition* that would result from the proposed conduct.[81]

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71 *BHP Petroleum*, op cit, n 29 at para 7.2. Hence, it is not uncommon for oil and gas joint venturers to exclude products other than natural gas produced by the venture from their joint marketing arrangements: see, for example, NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 4.

72 See, for example, *Santos*, op cit, n 29, *Bridge Oil*, op cit, n 43.

73 See particularly, s 88(1), (8). The Act also permits persons contemplating engaging in exclusive dealing contrary to s 47 to *notify* the ACCC of their intention to do so. If the Commission does not object to the proposed conduct within 14 days of the notification, and until the Commission does so object, the conduct will not breach s 47. Immunity arising from a notification relating to third line forcing does not come into effect until 14 days after the notification is lodged, provided the Commission has not objected by that date. As the notification procedure is not available in relation to potential breaches of s 45, which is the prohibition of most relevance to agreements between oil and gas joint venturers, notification will not be discussed further herein. As to notification, see generally, ACCC, *Authorisations and Notifications*, 1999 (accessible at http://www.accc.gov.au/pubs/catalog.htm), Steinwall et al, op cit, n 14 at paras 9.37-9.51, Corones, op cit, n 2 at para 2.16.

74 In relation to the submission of confidential information with an authorisation application, see TPA, s 89(5)-(5E).

75 TPA, s 88(1)(a) and (b).

76 TPA, s 88(8).

77 TPA, s 89(2).

78 TPA, s 90(2).

79 TPA, s 90A(1).

80 TPA, s 90A(2).

81 TPA, s 90(6).

A provision of a contract, arrangement or understanding that is or may be an exclusionary provision or amount to exclusive dealing prohibited irrespective of its effect on competition may be authorised by the Commission if it is satisfied that the proposed contract, arrangement or understanding would result, or be likely to result in such a *benefit to the public that* it should be allowed.[82]

Although there does not seem to be any express reference to the practice in the Act,[83] the Commission takes the view (and it has been widely accepted) that it may authorise conduct subject to conditions 'as a means of ensuring that public benefits outweigh anti-competitive detriment'.[84]

An authorisation may be extended to persons who become parties to the proposed contract, arrangement or understanding after it is made or authorised.[85]

The Commission may also grant an interim authorisation[86] but is unlikely to do so 'where the effect of allowing the proposed conduct to occur would prevent the market being able to return substantially to its pre-interim authorisation state if the Commission later denied authorisation'.[87]

Authorisation may be granted for a limited time only, [88] in which case the authorisation will be reviewed at the end of the specified period.

Decisions of the Commission with respect to authorisation may be reviewed by the Australian Competition Tribunal[89] upon the application of a person with a sufficient interest who is dissatisfied with the decision.[90]

7.2 Revocation of Authorisation

The Commission also has the power to revoke an authorisation where:

(a) the authorisation was granted as a result of evidence or information that was materially false or misleading;

(b) a condition of the authorisation has not been complied with; and

(c) there has been a material change in circumstances since the authorisation was granted.[91]

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82 TPA, s 90(8). The tests in ss 90(6) and 90(8) are 'in all material respects … the same': *Mereenie Producers*, op cit, n 5 at p 5. See also *Re Media Council of Australia (No 2)* (1987) ATPR 40-774 at 48,418 (Tribunal).

83 The TPA permits the ACCC to grant 'such authorisation as it considers appropriate' (s 90(1)(a)).

84 ACCC, *Guide to Authorisations and Notifications*, 1995, (accessible at http://www.accc.gov.au/fs-pubs.htm), p 31. References herein to page numbers of this document are to the PDF version of the document found at that URL. Enforceable undertakings may also be given to the Commission in order to obtain authorisation: see s 87B.

85 TPA, s 88(10), which may include successors or assigns: see, for example, *SAGASCO Resources Ltd* (1992) ATPR (Com) 50-118 at para 3.10.

86 TPA, s 91(2).

87 *Guide to Authorisations and Notifications*, op cit, n 84 at p 13.

88 TPA, s 91(1).

89 Described herein as 'the Tribunal', which includes the Competition Tribunal's predecessor, the Trade Practices Tribunal.

90 TPA, s 101. A review by the Tribunal is a rehearing of the matter that was before the ACCC (s 101(2)) at which the Tribunal has the same powers concerning authorisation as those possessed by the Commission (*Media Council of Australia (No 4)* (1996) ATPR 41-497 at 42,239 (Tribunal)).

91 TPA, s 91B(3). The power to revoke an authorisation is granted by s 91B(4). A person to whom an authorisation is granted may apply to the Commission for its revocation: s 91B(1).

For current purposes, the power to revoke authorisation on the basis of a 'material change of circumstances' is of greatest relevance. In that setting, 'material' refers to 'such a change in circumstances since the date of the original authorisation as will likely have a significant impact upon the balance of public benefit'.[92]

In *Re AGL Cooper Basin* the Tribunal found that there had been a material change in the NSW natural gas market between 1986 and 1997, noting that the 'competitive environment' in the market over that time was characterised by 'very substantial increases in demand' for natural gas, an 'evolving market structure' and a 'transition to increased competition'.[93] As many Australian gas markets continue to display those features, the prospect of the revocation power being exercised again in that context remains real.

At the same time, the Tribunal rejected the Commission's contention that, in deciding whether to revoke an authorisation for long-term agreements between arising out of an gas joint venture, the public benefits that accrued from the Cooper Basin developments that the agreements facilitated were to be viewed as '"sunk" and [therefore to] be disregarded'.[94] The 'social value in the preservation of contractual commitments' was noted and the Tribunal held that 'substantial benefit to the public [was] continuing'[95] from the agreements.

7.3 Variation of Authorisation

Minor variations of an authorisation may be made by the Commission if it is satisfied that the variation would not be likely to result in a reduction of the net public benefit of the agreements originally authorised.[96]

7.4 'Public Benefit'

In the absence of any express guidance in the Act as to what amounts to a 'public benefit' for authorisation purposes, the Commission and the Tribunal has interpreted the phrase broadly. In *Re 7-Eleven Stores Pty Ltd*, for example, the Tribunal commented that for authorisation purposes, 'public benefit' is

> 'anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of efficiency and progress.' [97]

Relevant benefits that have been identified to date include:

- economic development, such as encouragement of research and capital investment;
- fostering business efficiency, particularly where it results in improved international competitiveness;
- industrial rationalisation, resulting in more efficient allocation of resources and in lower or contained unit production costs;
- expansion of employment or prevention of unemployment in efficient industries;
- employment growth in particular regions;

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92 *Re AGL Cooper* Basin, op cit, n 8 at 44,209. Revocation decisions of the ACCC are subject to review by the Tribunal: TPA, s 101.

93 All quotes, ibid at 44,214. The Tribunal nevertheless held an authorisation granted in 1986 to an agreement between certain Cooper Basin producers should not have been revoked by the Commission.

94 Ibid at 44,216.

95 Op cit.

96 TPA, s 88.

97 (1994) ATPR 41-357 at 42,677.

- industrial harmony;
- assistance to efficient small business, such as guidance on costing and pricing or marketing initiatives which promote competitiveness;
- improvements in the quality or safety of goods and services and expansion of consumer choice;
- supply of better information to consumers and to business to permit informed choices in their dealings
- promotion of equitable dealings in the market;
- promotion of industry cost savings resulting in contained or lower prices at all levels in the supply chain;
- development of import replacements;
- growth in export markets
- steps to protect the environment.[98]

8. AUTHORISATION OF AGREEEMENTS BETWEEN OIL AND GAS JOINT VENTURERS

8.1 Introduction

As previously noted, joint marketing agreements, take or pay contracts, pre-emptive rights, rights of first refusal and exclusive dealing agreements arising out of oil and gas joint ventures may breach ss 45 and/or 47 of the TPA. Prudent joint venturers will, therefore, seek authorisation for such conduct before committing substantial capital to developing an oil or gas field.[99]

8.2 Relevant Issues

In view of the statutory provisions considered in section 7 above, the question of whether authorisation will be granted for such agreements will turn on:

(i) the extent to which the proposed agreement will substantially lessen competition;

(ii) the public benefits, if any, that are likely to flow from the agreement; and

(iii) whether that benefit outweighs the detriment arising from the agreement's anti-competitive effect.

Matters relevant to each question will be considered in turn.

8.3 Degree of Adverse Impact on Competition

Ascertainment of the anti-competitive impact of such agreements requires a detailed analysis of the agreements themselves and their impact on the markets in which they will operate in order to compare the likely state of competition with and without the agreement.[100]

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98 *Re ACI Operations Pty Ltd* (1991) ATPR (Com) 50-108 at 56,067.

99 See, for example, *North West Shelf*, op cit, n 13 at p 19: 'the applicants are seeking authorisation to provide certainty because of the significant financial and other commitments being dedicated to the proposed' project.

100 The NZ Commerce Commission's approach is consider the nature of competition in the relevant market if the proposed agreement is allowed to proceed (the 'factual') and 'what is likely to happen in the absence of the factual', known as the 'counterfactual' (see *Decision 505*, op cit, n 25 at paras 11-12).

While no decision of the Commission or the Tribunal will be determinative of the outcome of another (particularly in relation to Australian *gas* markets which, as noted above, have recently undergone significant structural change), the Commission's recent decision in *North West Shelf* is noteworthy as a statement of its views of the contemporary WA gas market. The Commission commented that:

> 'A number of factors have given rise a concentration of market power in the production and supply of natural gas in WA:
>
> - Coordinated marketing;
> - High barriers to upstream exploration, production and processing;
> - The significant acreages and reserves controlled by joint ventures;
> - The overlapping ownership interests in a number of actual and potential joint ventures; and
> - The underdeveloped state of secondary markets and of intermediary trading services in transmission and gas.' [101]

In a market of that kind, 'the degree of bargaining power purchasers have in dealing with … producers depends on the supply options open'[102] and, hence, restraints on upon rivalry between producers have the potential to significantly dampen competition.

Even in such a market, however, agreements which on the surface appear to significantly restrict competition may be seen as having a minimal adverse effect on competition, or even as pro-competitive, or if they are essential to the joint venture project proceeding and thereby facilitate an additional source of supply that will improve the competitive dynamics of the market.[103]

Hence the distinction drawn by the Tribunal in *Re AGL Cooper Basin* between 'long term contracts that are necessary to sustain substantial, long-term investments', without which a joint venture would presumably not proceed, and those that 'create no such social utility but are, rather, an instrument of foreclosure'.[104]

Similarly, in relation to the time over which long term restraints might operate without significantly compromising competition, the Tribunal commented in *Re AGL Cooper Basin* that

> '[I]n principle, we would wish the length of the contract to cover both the amortization of fixed assets and the generation of protected revenues that would give some security for the highly risky business of developing gas reserves'.[105]

Again, the underlying assumption appears to be some long-term contracts may not significantly damage competition if they enable the entry of a new source of supply.

An important determinant of the anti-competitive effect of agreements arising out of oil and gas joint ventures will, therefore, be whether, and the extent to which such agreements are necessary for the project to proceed. Further, it may be necessary to consider the extent to which the joint

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101 Op cit, n 13 at p 34. See also *Re AGL Cooper Basin*, op cit, n 8 at 44,212 (eastern Australian gas markets).

102 *North West Shelf*, op cit, n 13 at p 34. See also *Re AGL Cooper Basin*, op cit, n 8 at 44,212.

103 See, for example, *Esso Exporation*, op cit, n 44 at para 10, *Delhi Petroleum*, op cit, n 50 at para 5.9, *Mereenie Producers*, op cit, n 5 at p 39.

104 Both quotes, op cit, n 8 at 44,216.

105 Ibid at 44,219.

venturers would need to co-operate in their marketing activities even if they were separately marketing their share of the venture's output.[106]

The basis upon which the Commission has to date been prepared to find that co-operative marketing agreements are essential for the development of Australian natural gas joint ventures has already been discussed.[107]

Separate marketing by the parties to an *oil* joint venture will often not be as operationally difficult as it is for natural gas projects. Further, the Australian oil market does not display the same structural impediments to separate marketing as Australian gas markets currently seem to. Consequently, joint marketing will be less likely to be viewed as necessary for the development of oil reserves and evaluation of the anti-competitive effect of agreements restraining rivalry between oil joint venturers will be more complex. Relevant considerations will include the amount of oil that is the subject of the restraint,[108] particularly whether the field is large enough to provide participants with marketable quantities,[109] what substitutable sources of supply are available[110] and whether the particular operating environment makes separate marketing difficult.[111]

8.4 Public Benefits

In the various decisions of the Commission and the Tribunal regarding authorisation of agreements arising out of oil and gas joint ventures, the most significant issue that has arisen to date concerning public benefit has been whether the proposed restraints on competition are necessary for the particular development to proceed, an issue that has been discussed extensively above.[112]

If the Commission or Tribunal is satisfied that the joint venture project will not be developed without the proposed restraints, then the public benefits of the project as a whole will be weighed against any anti-competitive detriment likely to flow from the agreement. In such circumstances, the proposed limits on competition may be aptly described as 'intrinsic to the achievement of the associated public benefits'[113] of the project.

In the *North West Shelf* determination, for example, the applicants contended, and the Commission accepted that a proposed expansion of the gas production of the joint venture in issue would not proceed without collaborative marketing and, accordingly, that the following public benefits would flow form the joint marketing agreement under consideration:

- a broader range of opportunities for Australian business domestically and overseas;
- additional capacity for existing customers as well as capacity for new customers and projects
- increased exports and import replacement and increases in international competitiveness generally
- more efficient operations designed to meet current world-best standards of environmental management;

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106 See, for example, NZ Commerce Commission, *Decision 505*, op cit, n 25 at para 371.
107 See particularly, op cit, 6.3.
108 See, for example, *Santos*, op cit, n 29 at para 3.5 (Cooper/Eromanga oil joint venture), *Bridge Oil*, op cit, n 43 at para 6.2 (Surat Basin oil joint venture).
109 See, for example, *BHP Petroleum*, op cit, n 29 at para 7.4 (Challis oil joint venture).
110 See, for example, ibid at para 7.7.
111 Op cit.
112 See 6.3.
113 *Mereenie Producers*, op cit, n 5 at p 14.

- direct regional benefits in terms of increased employment and improved facilities as well as substantial contributions to the broader community through the taxation system;
- increased investment;
- environmental benefits, in particular, significantly lower carbon dioxide emissions resulting from increased use of natural gas;
- development of further technical expertise and skills; and
- an increase in Australia's GDP by $1.5 billion per annum. [114]

As previously noted,[115] however, the Commission will closely examine the relevant markets to ascertain whether or not joint marketing truly is a prerequisite to development of the natural gas project in issue. Although it has not yet given a negative answer to that question in an authorisation decision, and has recently ruled that separate marketing of natural gas by production joint venture parties is not yet feasible in the WA and NT gas markets, the prospect of the Commission coming to a different conclusion in the not too distant future cannot be discounted.

If separate marketing is in the future found to be viable for gas joint ventures in an Australian market, by analogy to authorisation determinations concerning joint marketing agreements between oil joint venturers (in relation to which collaborative marketing is not generally assumed to be essential to the viability of projects) public benefits that may be held to accrue from a co-operative marketing or gas may, in appropriate circumstances, include 'maintaining the viability of … relatively small producers',[116] the 'efficiencies that can be achieved by utilising the services of a single marketing'[117] entity, 'efficient utilisation of existing storage and transportation facilities'[118] and 'greater flexibility … by allowing the [joint venture parties] to market their product through terms contracts … which [may] prove all but impossible for the small lots of individual'[119] parties.

Where authorisation is sought for agreements between joint venturers and their customers, such as take or pay supply contracts, the critical issue will be whether proposed restraints on competition do more than is necessary to fulfil the joint venturers' legitimate need to lock in future revenues in order to finance the project.

In relation to that issue, it is noteworthy that in *Re AGL Cooper Basin*, the Tribunal commented that

> '[t]here are more efficient ways to ensure cash flows [than take or pay clauses], in particular the use of a two-part tariff, that is to say, a contract with a "standing", "reservation" or "capacity" clause coupled with a per unit price for the quantity of gas purchased, to reflect the marginal cost of supply'.[120]

Further, the Tribunal affirmed that, in considering whether to authorise long-term restraints on competition in gas sales agreements

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114 *North West Shelf*, op cit, n 13 at p 20. See also *BHP Petroleum*, op cit, n 29 at para 7.4 (oil joint venture).
115 See op cit, 6.3.
116 *Santos*, op cit, n 29 at para 6.1.
117 *BHP Petroleum*, op cit, n 29 at para 7.4.
118 *Bridge Oil*, op cit, n 43 at para 6.1.
119 *BHP Petroleum*, op cit, n 29 at para 7.4.
120 Op cit, n 8 at 44,218. See also *Mereenie Producers*, op cit, n 5 at p 35.

> '[i]f a less restrictive contract would suffice [to generate the public benefit claimed], both in respect of past and future obligations, the consequent detriment must be subtracted from the benefit created'.[121]

Applicants for authorisation of agreements containing take or pay clauses will, therefore, need to take care in articulating how their agreement is said to yield public benefits. Similar caution will need to exercised in relation to pre-emptive rights, rights of first refusal and exclusive dealing provisions.

8.5 Weighing Detriments and Public Benefits

If the Commission or Tribunal is satisfied that an oil or gas joint venture is dependant on restraints on competition between joint venturers and/or their customers, the task of weighing public benefit and anti-competitive detriment for authorisation purposes will be quite straightforward.

In those circumstances, the restraint will be viewed as having a minimal effect on competition, perhaps even be seen as pro-competitive, because it facilitates the entry of a new source of supply into the relevant market. Further, such restraints will be seen as giving rise to all of the public benefits that will flow from the project, such as increased investment and employment.

If the Commission or Tribunal is persuaded that the restraints are prerequisites to the joint venture proceeding, therefore, it is highly likely that they will be found to give rise to a net public benefit and will be authorised. That has been the outcome to date in Australia of decisions as to whether agreements arising out of oil and gas joint ventures should be authorised.

There are, however, clear indications, many of which have been discussed above, that the Commission and Tribunal are becoming less willing to accept the premise that restraints on competitive activity in oil and gas markets are necessary for production joint ventures to proceed. In future, therefore, oil and gas joint venturers will need to be pay close attention to the balance of competitive detriment and public benefits in preparing and presenting their claims for authorisation of such restraints.

8.6 Limited Authorisation

Although the Commission's expressed preference for separate marketing by natural gas joint venturers has not yet resulted in it refusing to authorise a gas joint marketing agreement, the Commission has used the more subtle weapon of limiting the time for which authorisation is granted as a means of signalling its intentions.

In *North West Shelf*, for example, the Commission, having noted significant recent developments in the WA gas market, restricted the period of authorisation for the joint marketing agreement in issue there to seven years and commented that: 'at the end of this period, [it] expects the market to have developed and changed in ways we cannot fully predict or anticipate.'[122]

The applicant's submission that changes in market conditions could be adequately accounted for by exercise of the power to revoke an authorisation was rejected,[123] although it was noted that the

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121 *Re AGL Cooper Basin*, op cit, n 8 at 44,216.

122 Op cit, n 13 at p 47. In relation to contracts entered into during that period, see p 42. See also *Mereenie Producers*, op cit, n 5 at pp 40-41, *Delhi Petroleum*, op cit, n 50 at para 7.4 (five year limit on authorisation).

123 *North West Shelf*, op cit, n 13 at pp 36-37. As to the revocation power, see, generally, op cit, 7.2.

power could be exercised if the WA gas market 'develops to the point where the Commission believes that separate marketing of gas … becomes viable'.[124]

The Commission's concern about concentration of ownership interests in gas production joint ventures in WA, particularly the prospect of collaboration between the parties to the various joint ventures operating in offshore north-west WA, also led to it refusing in *North West Shelf* to authorise a provision allowing for the substitution of new parties to the joint marketing agreements in issue.[125] Approval for such a provision may be forthcoming, however, where there is no realistic prospect of collaboration between the owners of independent joint ventures.[126]

Where the public benefits of an oil or gas development are dependant on the project commencing operation within a certain time, authorisation may be made conditional upon the commencement of a certain volume of production within that time.[127]

9. CONCLUSION

Joint marketing of an upstream oil and gas joint venture's product will generally involve agreement between actual or potential competitors as to price, giving rise to serious risks of a breach of competition law prohibitions. Accordingly, those entering such agreements will be unlikely to implement them without obtaining regulatory authorisation.

Australian and New Zealand competition law regulators have to date been able persuaded to authorise such joint marketing on the basis that it not only benefits the participants but also enhances public welfare by facilitating the entry of new sources of production of essential inputs to economic activity.

Recent regulatory rulings suggest, however, that upstream oil and gas joint venturers will find obtaining authorisation of joint marketing arrangements more difficult to obtain in future. The Australian Competition and Consumer Commission and the New Zealand Commerce Commission have lately noted the significant structural changes in upstream and downstream oil and gas markets, much of which has resulted from the actions of governments, and have begun to express a clear preference for the separate marketing of oil and gas.

The key determinant of the prospects of such authorisation being granted in future is the extent to which the Australian and New Zealand regulators conclude that oil and gas joint venturers are operating in commodity markets in which separate marketing is a feasible option. While that may have been true of oil markets for some time, the physical characteristics of gas and the rigidity of

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124 *North West Shelf*, op cit, n 13 at p 47.

125 Ibid at pp 35-37. As a result, when the Chevron interest in the North West Shelf joint venture was subsequently restructured, it was necessary to apply to the Commission for a minor variation of the authorisation, which was granted: see *Application for a Minor Variation of Authorisation: North West Shelf*, 14 August 2000, accessible at http://www.accc.gov.au/gas/fs-gas.htm. See also *Santos*, op cit, n 29 at paras 7.13, 8.2 (oil joint venture: authorisation extended to assignees being bound by existing contractual obligations of assignor; future discoveries excluded from authorisation), NZ Commerce Commission, *Decision 505*, op cit, n 25 at paras 549-566 (authorisation not extended to assignees).

126 See *Mereenie Producers*, op cit, n 5 at 39-40.

127 NZ Commerce Commission, *Decision 505*, op cit, n 25 at paras 531-532, 537-548. The Commission accepted that the gas joint venture in issue would have been delayed by up to one year if authorisation for joint marketing was refused and the joint venturers were required to negotiate agreements (such as gas balancing agreements) necessary for separate marketing (ibid at para 333) and held that, in the context of an impending shortage of gas in NZ, there was a significant public benefit in the gas field in issue being developed as soon as possible (ibid at paras 453-4, 514).

Australian and New Zealand downstream gas markets have traditionally been viewed by regulators in those countries as rendering separate marketing unviable.

There are clear signs in recent rulings, though, that the regulators are inclining to the view that upstream gas joint venturers can and will proceed in the absence of a joint marketing agreement, particularly in eastern Australia. While we still await the manifestation of that apparent sea change in attitude in the form of a refusal of an application for authorisation of arrangements for the joint marketing of gas, it is suggested that the time when such a refusal occurs cannot be far away.

Author's Note

On 24 June 2004, the *Trade Practices Legislation Amendment Bill 2004* was introduced into the House of Representatives. The Bill seeks to implement a number of the recommendations of the *Trade Practices Act Review 2003* (the Dawson Review).

In relation to the subject matter of this article, it is noteworthy that Schedule 5 of the Bill proposes a repeal of s 45A(2) of the TPA (the joint venture exemption discussed above, particularly at 3.4 and 4.2) and the introduction of a new s 76D into the Act that will provide a defence to proceedings for contravention of s 45(2) in relation to a provision of the kind referred to in s 45A(1).

The proposed defence will be limited to provisions that are for the purposes of a joint venture *and* that do not have the purpose or effect of substantially lessening competition.

The proposed amendments would, therefore, broaden the scope of the prevailing joint venture exemption from the operation of s 45A in that the existing focus of s 45A(2), which is upon agreements that relate to the joint supply of goods produced by the parties to a joint venture in proportion to their respective entitlements, would be replaced with a defence that encompasses any provisions entered into for the purposes of the joint venture which do not have the purpose or effect of substantially lessening competition. It is likely, therefore, that a wider variety of upstream oil and gas marketing agreements may be entitled to the benefit of an exemption from the deeming effect of s 45A if the proposed amendments are implemented.

As the proposed defence relates only to provisions entered into *for the purposes of a joint venture*, however questions will remain as to whether marketing arrangements entered into by exploration and/or production joint venturers are of that character (see above fn 25 and accompanying text).

Further, the proposed defence relates only to the deeming effect of s 45A. Accordingly, price fixing provisions falling within the scope of the proposed defence may nevertheless contravene s 45 if they have the purpose or effect of substantially lessening competition. In relation to that issue, the matters considered above concerning the impact of marketing agreements between upstream oil and gas joint venturers upon competition will remain relevant if the Bill is implemented.

SCHEDULE

LIST OF AUSTRALASIAN AUTHORISATION DECISIONS CONCERNING AGREEMENTS ARISING OUT OF OIL AND GAS JOINT VENTURES

Australian Competition Tribunal

1. *Re AGL Cooper Basin Natural Gas Supply Agreements* [1997] ACompT 2; (1997) ATPR 41-553

Australian Competition Tribunal/Trade Practices Tribunal

2. *Woodside Petroleum Development Pty Ltd* (1997) ATPR (Com) 35-200
3. *Esso Exploration and Production Australia Inc and Western Mining Corporation Ltd* (1978) ATPR (Com) 35-340
4. *Australian Gas Light Company* (1986) ATPR (Com) 50-114
5. *Delhi Petroleum Pty Ltd and Santos Ltd* (1988) ATPR (Com) 50-072
6. *Bridge Oil Ltd* (1988) ATPR (Com) 50-073
7. *Santos Ltd* (1988) ATPR (Com) 50-074
8. *BHP Petroleum Pty Ltd* (1990) ATPR (Com) 50-096
9. *SAGASCO Resources Ltd* (1992) ATPR (Com) 50-118
10. North West Shelf Project 29 July 1998 Accessible at http://www.accc.gov.au/gas/fs-gas.htm. Reported at (1999) ATPR (Com) 50-271
11. *Mereenie Producers/Gasgo Sales Agreement* 7 April 1999 Accessible at http://www.accc.gov.au/gas/fs-gas.htm. Reported at (1999) ATPR (Com) 50-271
12. *PNG Joint Venture Gas Marketing Arrangements* 13 October 2000 Interim Authorisation accessible at: http://www.accc.gov.au/authAndNotif/authorise/png/13_oct_00/interim_authorisation_13_oct_00.pdf

New Zealand Commerce Commission

13. *Decision 505* 1 September 2003 Accessible at http://www.comcom.govt.nz/adjudication/s58.cfm