

Greenfields Applications
National Competition Council
Level 9
128 Exhibition Street
Melbourne
VIC, 3000

15 April 2010

gqccapplication@ncc.gov.au

Dear Sirs

QCLNG Pipeline – draft recommendation

We act for Santos Limited.

Thank you for meeting yesterday with us and Patrick Ronan of Santos.

Santos welcomes the opportunity to comment on the draft recommendation dated 23 March 2010 in relation to the application by QCLNG Pipeline Pty Ltd (**QCLNG**), a wholly-owned subsidiary of BG Group, for a 15-year no coverage determination (**Draft Recommendation**).

1 LNG in the Gladstone area

Santos, in joint venture with Petronas, is developing an LNG project in the Gladstone area. The GLNG project involves the following major components:

- Exploration and production of coal seam gas (**CSG**) in the Surat and Bowen Basin gas fields.
- The construction and operation of a 435 kilometre pipeline from the gas fields to Gladstone.
- The construction and operation of an LNG plant on Curtis island.

The pipeline is expected to commence approximately 40 kilometres east of Injune and travel north up to the eastern side of the Arcadia Valley. Where practicable, the pipeline will run parallel to the existing Roma to Gladstone pipeline.

Pipeline construction is expected to take approximately 21 months, from about March 2011 to early 2013. The first LNG cargoes are expected to be exported from the LNG plant in 2014.

As the Council is aware, a number of other LNG projects are also proposed for the Gladstone area.

- Queensland Curtis Island Project: QGC, a wholly-owned subsidiary of BG Group plc, is proposing to transport CSG from the Surat Basin to an LNG plant on Curtis Island via a gas transmission pipeline. The transmission pipeline (**Pipeline**) is the subject of the Draft Recommendation.

4645444

- Australia Pacific LNG Project: Origin and ConocoPhillips are in a joint venture which is proposing to transport CSG from the Surat Basin to an LNG plant on Curtis Island via a gas transmission pipeline.
- Shell Australia LNG Project: Shell and Arrow are proposing to transport CSG from the Surat and Bowen Basins to an LNG facility on Curtis Island via a gas transmission pipeline.

All of these projects, if they proceed, will be located in the same geographic area. The gas fields are located in the Bowen and Surat Basins. The LNG facilities are proposed for Curtis Island.

The proponents of each project will be competitor suppliers of LNG. Because of the nature of the projects and the critical need to enter into long-term supply arrangements with customers, that competition is taking place now, not just at a time in the future.

Each of the proponents is now seeking to persuade buyers that a project has sufficient gas resources, which can be transported to the LNG facility and safely converted into LNG. Thus, each is in the process of seeking to sign long term LNG supply contracts to underpin the investment of the large sums of money required for the successful development of each project. For example:

- Santos has signed a 20 year contract to supply LNG to Petronas.
- BG recently announced that it had signed a 20 year LNG contract with CNOOC, the Chinese state-controlled oil producer, worth approximately \$40 billion.

There has been speculation in the media over the past year, including comments by Santos, that not all of these projects are likely to proceed and that some form of consolidation would be desirable in the industry.

2 The Council's task

Santos does not oppose the QCLNG application. However, Santos does wish to draw to the Council's attention the particular context in which it is undertaking its task when making a recommendation. That context has the following important characteristics:

- There is current competition between the proponents of the various LNG projects.
- It is possible that not all of the LNG projects successfully complete.
- More than one of the proponents are investing in the construction of pipelines and more than one might apply for no coverage declarations.
- The grant by the Minister of a no coverage declaration can affect the current state of competition between the proponents.

It is the submission of Santos that the Council (when making a recommendation) and the Minister (when making a determination), must in the proper exercise of their discretion take this context into account. The Council and the Minister should, within a relevant market period, treat each of the proponents in a competitively neutral manner.

A regulatory immunity should not itself be something that confers a competitive advantage upon the market competitors. Nor should it confer a competitive disadvantage upon other competitors.

The discretions and powers under the National Gas Law (**NGL**) are given to the Council and the Minister in order to achieve the objects and purposes of the NGL. They must be exercised by the Council and the Minister in a manner that is intended to achieve those objects and purposes.

It is a basic principle underlying the whole of National Competition Policy, as reflected in the NGL, that regulation should restrict competition only where clearly articulated national interests are demonstrated to outweigh the detriments of doing so. The NCC has a clear

way of avoiding the restriction of competition by taking into account the matters that are stated in this letter.

Thus, the fact alone that QCLNG or another LNG project proponent lodges an application for a no coverage declaration should not affect the process of competition to develop LNG facilities in the Gladstone region of Australia. A regulatory process, particularly one designed to promote efficient investment, should not affect the competitive process. Those who succeed in developing LNG facilities in the Gladstone region of Australia should be those with the most efficient projects judged on their individual merits, not by virtue of an advantage gained through a regulatory process.

The time period of the market is obviously important in this analysis. When considering an application for no coverage declarations, the Council must apply at least a 15 year time horizon: *Council Guide Part D Greenfields pipeline incentives*. The long term nature of LNG supply contracts (typically 20 years) and the importance of current competitive activity in seeking out those contracts, reinforce the need for the Council to adopt a long term approach when conducting its analysis.

The NGL requires the Council to have regard to the national gas objective when considering whether the pipeline coverage criteria are satisfied. The national gas objective is to promote efficient investment in, and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas. That objective is also promoted when the most efficient producer is allowed to develop its facilities in a competitively neutral environment.

Thus, the Council should, when considering the application by QCLNG, take into account the effect that granting a no coverage declaration for QCLNG may have on other applications which are likely to be made with respect to the same market period.

If a no coverage declaration for QCLNG is likely to adversely affect Santos' prospects of obtaining a no coverage decision, Santos does have objections to the Draft Recommendation. Such an outcome would distort the process of competition as Santos and other proponents of LNG projects currently seek long-term commitments for the supply of LNG.

If the Council were to make a decision which adversely affected that competition, it would be an improper application of the coverage criteria and an improper exercise of the Council's discretion in exercising its functions.

3 The GLNG Project pipeline

Santos intends to apply for a no-coverage declaration with respect to its pipeline.

Santos is carefully considering the appropriate time to make this application. This is an important commercial decision. In particular, an application for a no coverage declaration cannot be made too early given the timing issues outlined below.

4 The Santos application

The NGL provides that a greenfields pipeline incentive lapses if the pipeline for which it was granted is not commissioned within 3 years after the incentive was granted, although Regulations may, in a particular case, extend the period: section 173. A pipeline is commissioned when it is first used for the haulage of natural gas on a commercial basis: section 12.

Santos will make an application for a no coverage declaration at the appropriate time having regard to its commercial operations. The first LNG cargoes are expected to be exported from the LNG plant in 2014. Obviously, Santos intends to commission the pipeline before then.

Freehills

Santos notes that the QCLNG application states that construction of the LNG plant, pipelines and gas fields is scheduled to conclude in the third quarter of 2013, with train 1 being commissioned in late 2013: section 2.7 of the application. Under the standard consultative procedure, a final no coverage decision by the Minister in relation to the Pipeline is due by the end of June 2010. That is, more than 3 years before the QCLNG application states that train 1 will be commissioned.

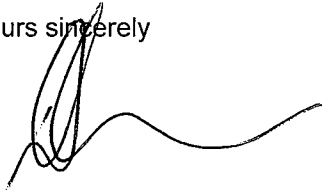
This raises an apparent problem for QCLNG in that the declaration, if made, will have no utility. There is nothing in the application or the draft decision which indicates how QCLNG will overcome this difficulty.

The Council should inquire why the application is being made by QCLNG at this time. It should disclose the reasons for the decision by QCLNG to make its application now and how, if at all, QCLNG intends to deal with the apparent timing difficulties.

The Council should ensure that the application is not being made for a purpose not intended by the NGL.

Santos will liaise with the Council in relation to the timing of its application.
Please do not hesitate to contact us if you would like additional information.

Yours sincerely



Donald Robertson
Partner
Freehills

+61 2 9225 5523
+61 414 275 523
donald.robertson@freehills.com

Matthew Bull
Senior Associate
Freehills

+61 3 9288 1582
+61 448 259 556
matthew.bull@freehills.com