

CABINET - SUBJECTS FOR CONSIDERATION, 24 NOVEMBER 1997 11:00 AM

Not Relevant

9. **MPNR11/97CS**

Review of Cooper Basin (Ratification) Act 1975

REFERRED BACK TO THE MINISTER

Premier and Minister

9

CABINET COVER SHEET

1. **TITLE:** REVIEW OF COOPER BASIN (RATIFICATION) ACT 1975
2. **MINISTER:** Rob Kerin
Minister for Primary Industries, Natural Resources and Regional Development
3. **PURPOSE:** To seek Cabinet approval for the public release of the recently completed Ratification Act review.
4. **RESOURCES REQUIRED FOR IMPLEMENTATION:** Nil
5. **RELATIONSHIP TO GOVERNMENT POLICY:** The undertaking of the review was approved by Cabinet on 7 November 1996 and meets the State's obligations under the Competition Principles Agreement and the CoAG 1994 agreement on free and fair trade in gas.
6. **CONSULTATION:** Consultation has been undertaken with the Department of Premier and Cabinet, Treasury and the Attorney General's Department.
7. **FAMILY IMPACT STATEMENT:** See 8 below.
8. **SMALL BUSINESS AND REGIONAL IMPACT STATEMENT:** Nil at this stage. If a decision is taken to implement the recommendations of the review, facilitation of competition in the gas industry will bring benefits to the community through improved gas supply conditions and additional investment in exploration for gas, particularly in the Cooper Basin.
9. **URGENCY:** Urgent. The report has been with Government since 11 September and there is a commitment to its public release.
10. **RECOMMENDATIONS:** It is recommended that Cabinet:
 - 4.1 agree to the public release by the Minister for Primary Industries, Natural Resources and Regional Development of Mr Dyki's review of the Cooper Basin (Ratification) Act 1975 with a covering letter along the lines set out in Attachment 5; and

4.2 note the conflict of contractual obligations between the CoAG agreements and the Cooper Basin (Ratification) Act and Indenture.

4.3 endorse the Minister for Primary Industries, Natural Resources and Regional Development as lead Minister, the Premier and the Attorney General overseeing negotiations with the Cooper Basin Producers (and others as necessary) on the preferred method of implementation of the Dyki recommendations with the objectives of ensuring the State's competition payments are not jeopardised, competition in the gas industry is facilitated and any necessary amendments to the Ratification Act are negotiated with the Cooper Basin Producers to the maximum extent possible.

4.4 note that the proposed method of implementing the recommendation of the review of the Ratification Act will be brought back to Cabinet following receipt of further submissions and negotiations with the parties concerned.

**SIGNATURE OF MINISTER:
PORTFOLIO:**

DATE:

12/11/97



**MINISTER FOR PRIMARY INDUSTRIES,
NATURAL RESOURCES AND REGIONAL
DEVELOPMENT**

TO: THE PREMIER FOR CABINET

RE: REVIEW OF COOPER BASIN (RATIFICATION) ACT 1975

1. PROPOSAL

To seek Cabinet endorsement for:

- 1.1 The public release of the Dyki review of the Cooper Basin (Ratification) Act; and
- 1.2 The Premier, the Minister for Primary Industries, Natural Resources, Regional Development and the Attorney General to oversee negotiations on the preferred methodology of implementation of the recommendations of the review.

2. BACKGROUND

- 2.1 The Cooper Basin (Ratification) Act 1975 and Indenture establishes the legislative framework which has underpinned commercial development of Cooper Basin gas reserves. Among other things, the Act provides Trade Practices Act exemption for a number of agreements; establishes rights with regard to construction of facilities and a particular form of production tenement; establishes the method for royalty calculation and provided freehold title to land at Moomba.
- 2.2 On 7 November 1996, Cabinet approved a public review of the Cooper Basin (Ratification) Act and Indenture to fulfil the State's obligations under the Competition Principles Agreement and to determine if the Act constitutes a barrier to free and fair trade in gas, in terms of the CoAG agreement of February 1994, as alleged by the ACCC. The review was brought forward from the originally planned timeframe of 1998 to forestall a National Competition Council independent review. The process which has been followed is outlined in Attachment 1.
- 2.3 The review was undertaken by Mr Nick Dyki, an independent consultant with wide experience in commercial and legal issues with respect to gas in South Australia. The terms of reference for the review are set out in Attachment 2 and address the State's obligations under the Competition Principles Agreement (to reform restrictions on competition where the public benefits are outweighed by the anti-competitive detriment) and South Australia's responsibilities under the CoAG Agreement of February 1994 to eliminate legislative barriers to free and fair trade in gas.

- 2.4 Santos, on behalf of the Cooper Basin Producers, neither supported nor opposed the undertaking of the review but have been naturally concerned that the outcome may affect their existing rights.
- 2.5 Submissions were called for on 16 April 1997 via direct invitations or by newspaper advertisements and a Ministerial Press Release. A total of 18 submissions were received, plus four supplementary submissions (from the ACCC (2), Santos and MESA), commenting on arguments put forward by a number of parties.
- 2.6 Mr Dyki handed down his report on 11 September 1997. As a consequence of the calling of the election on 13 September, no action was taken on the release of the report while the Government was in caretaker mode.
- 2.7 The Government, at the time submissions were called, gave an undertaking to publicly release the report.

3. DISCUSSION

- 3.1 The report is to be treated as a draft in so far that Mr Dyki may decide to make amendments if any interested party demonstrates that an error of fact has been made which has influenced the recommendations. No copies of the report have been released outside of the South Australian Government to date.
- 3.1.1 The Executive Summary and Recommendations of Mr Dyki's report are set out in Attachment 3, together with a commentary on the recommendations in Attachment 4. In summary, he has recommended that certain gas sales contracts and agreements should continue to be exempted or be granted exemption from the Trade Practices Act, providing identified anti-competitive elements are removed, the Unit Agreement is amended to allow separate marketing and that a third party access regime be implemented for Cooper Basin facilities (such a regime would be welcomed by other jurisdictions and the industry at large). The anti-competitive elements identified in the Letter of Agreement are clause 10 ("delivery point"), clause 12 ("first right of refusal") and clause 20 ("exclusive dealings"). Mr Dyki has identified two barriers to trade in that Santos can apply for production tenements without meeting the 'economic viability' criteria in the Petroleum Act, and in that the Ratification Act effectively grants exemption from the access provisions of the Petroleum Act for their pipelines. Although outside of the terms of reference, he also recommends that Trade Practices Act exemption be granted for the 1989 gas sales contracts with NGASA, providing they are disaggregated. Mr Dyki indicates that he does not believe that subsequent contracts should be authorised by the State under Section 51 of the Trade Practices Act. The Crown Solicitor's Office has advised that the State should not agree to any "sectoral" carve out from its CoAG agreed rights to grant Section 51 exemptions.

- 3.1.2 Mr Dyki's report is considered competent and professional although in some instances he asserts a restriction on competition without providing a cost/benefit analysis (the ACT similarly provided few details of cost/benefit analysis in their determination - see 3.1.5 below). His recommendations are broadly supported in that they will facilitate competition in the gas industry and their implementation will honour the State's commitments under agreements with the Commonwealth and other jurisdictions. Most of the focus to date in the gas reform process has been on the downstream sector of the industry. It is now realised by all jurisdictions that reform of the upstream industry is vital if full benefits are to flow to the community. Mr Dyki's recommendations would achieve facilitation of upstream competition which could reverse the trend to increasing gas prices. (Santos are apparently seeking more than \$2.90/GJ ex-plant for a new contract for Cooper Basin gas, while selling gas from their WA interests where competition has been achieved for \$1.80/GJ).
- 3.1.3 Implementation of the recommendations would require amendments to the Cooper Basin (Ratification) Act which, if not agreed to by Santos and Partners, would raise sovereign risk and related considerations. Mr Dyki advises that he took into account the sovereign risk issue raised by unilateral amendments to Indenture legislation. In his report he states 'the costs of a restriction must be overwhelming, and not easily remedied, if it is to negate the very essence of an arrangement agreed to by the State'. The Ratification Act has been amended on two previous occasions when all or some of the parties have not agreed - the Natural Gas (Interim Supply) Act 1985 and the Cooper Basin (Ratification) (Royalty) Amendment Act 1991.
- 3.1.4 On March 27 1996, the Australian Competition and Consumer Commission determined that a number of clauses of the AGL Letter of Agreement (which governs the sale of SA Cooper Basin gas to NSW) were anti-competitive. The ACCC revoked a 1986 authorisation of the Letter of Agreement and substituted a 3 year limited authorisation for the agreement less three 'anti competitive' clauses. This decision was appealed to the Australian Competition Tribunal (ACT) by Santos and partners. On 14 October 1997 the ACT determined that the ACCC's revocation of the original authorisation be set aside. The ACT determined that although there was a number of anti-competitive clauses in the contract, the future benefit to the public of the Letter of Agreement outweighs the future detriment. The ACT did not provide a detailed analysis as to how they reached their conclusions. The ACT's viewpoint was very similar to that of Mr Dyki except Mr Dyki, as implicitly required by his terms of reference, recommended removal of individual anti-competitive features where this would not compromise the overall agreement. In contrast, the ACT treated the contract as a single entity and determined whether it has net benefit or net detriment. The ACT's determination was a major victory for Santos and will be used by them to mount pressure on Government not to implement certain of Mr Dyki's recommendations. Mr Dyki has advised that after reviewing the ACT determination he sees no reason to amend his recommendations.

3.1.5 One of the two barriers to trade in gas identified by Mr Dyki (for which repeal under the CoAG agreement of February 1994 is mandatory) is the Indenture right to require issue of a Petroleum Production Licence (PPL) on application. This right was employed by Santos to obtain PPLs over the Nappamerri Trough. This issue is discussed in a separate Cabinet Submission ('Strategy for Improved Gas Supply Conditions'). The Premier has obtained an undertaking from Santos not to exercise this right in future.

3.2 Under Clause 5 of the Competition Principles Agreement the State is obliged to reform any restrictions upon competition found to exist in legislation, where the public benefits of the restriction cannot be shown to outweigh the anti-competitive detriment of the restriction. Failure to reform legislation which contains such restrictions upon competition, may result in a recommendation by the National Competition Council that competition payments be withheld from the State. Reform may take the form of amendment or repeal.

3.2.1 The Competition Principles Agreement draws no distinction between restrictions of a serious nature or those of merely a minor nature. The State, however, has adopted a pragmatic, policy approach to the reform of restrictions of only a minor nature. Hence, the State may consider that the repeal or amendment of legislation is not justified due to the minor nature of a restriction.

3.2.2 Under the CoAG Agreement of February 1994, the State is obligated to remove any identified legislative or regulatory barriers to free and fair trade in gas. There is no provision in the CoAG Agreement for the public interest to be taken into account in determining whether or not to remove a legislative or regulatory barrier. It should be noted, however, that the concept of a "barrier" is a much higher constraint upon a market, than a "restriction" upon competition. Where a barrier has been identified, therefore, it should be removed from the legislation.

3.2.3

<p>Clause 10(1) Legal Professional Privilege</p>
<p>Clearly the best outcome is agreed amendment to the Ratification Act.</p>

3.2.4 It will be necessary to negotiate the preferred method of implementing the recommendations of the review with Santos and Partners. Such negotiations are likely to be difficult, notwithstanding the fact that some of the recommendations may be welcomed by the joint venturers and the main impact

will be to facilitate competition in the upstream gas industry, rather than impose potentially compensable burdens on the Cooper Basin joint venture. A Santos tactic appears to be to attempt to delay resolution of any issue as long as possible if there is a risk to any reduction in their monopoly powers. It will be important in negotiations with Santos to maximise the Government's negotiating position by not indicating that the option of unilaterally amending the Indenture will not be taken.

- 3.2.5 In order to retain the initiative and forestall any Commonwealth action (eg. on upstream access or in undertaking a review of South Australian gas contracts) it is desirable to move rapidly in negotiating and implementing Mr Dyki's recommendations once these are finalised. Public release of the report will be accompanied by a call for submissions to be lodged within 4 weeks on any errors of fact, as well as for comments on implementation of the recommendations. If Mr Dyki decides to amend any of his recommendations, these should be available within 2 weeks of the closing date for submissions.

3.3

3.3.1 **Economic, financial and budget implications.**

If the Government decides not to implement the recommendations, it would need to put strong and convincing public interest arguments to avoid risk to its competition payments. It may be necessary to negotiate some compensation with Santos and Partners as a consequence of amending the Ratification Act and Indenture, although the

Clause 10(1) Legal Professional Privilege

3.3.2 **State development, social, environmental and other impacts**

Any unilateral amendment to the Indenture will raise sovereign risk and related concerns in industry, particularly if accompanied by a vigorous public campaign by the Producers opposing such action.

3.3.3 **Staffing implications**

Nil

3.3.4 **Consultation**

The Departments of Premier & Cabinet, Treasury and the Crown Solicitor's Office have been consulted and concur with the recommendations in this Submission. Extensive consultation with industry (by way of written submissions) took place during the Ratification Act review process.

3.4 **Executive Council**

Executive Council approval is not required.

4. RECOMMENDATIONS

It is recommended that Cabinet:

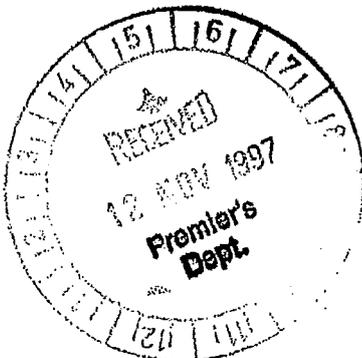
- 4.1 Agree to the public release by the Minister for Primary Industries, Natural Resources and Regional Development of Mr Dyki's review of the Cooper Basin (Ratification) Act 1975 with a covering letter along the lines set out in Attachment 5; and
- 4.2 Note the conflict of contractual obligations between the CoAG agreements and the Cooper Basin (Ratification) Act and Indenture.
- 4.3 Endorse the Minister for Primary Industries, Natural Resources and Regional Development as lead Minister, the Premier and the Attorney General overseeing negotiations with the Cooper Basin Producers (and others as necessary) on the preferred method of implementation of the Dyki recommendations with the objectives of ensuring the State's competition payments are not jeopardised, competition in the gas industry is facilitated and any necessary amendments to the Ratification Act are negotiated with the Cooper Basin Producers to the maximum extent possible.
- 4.4 Note that the proposed method of implementing the recommendation of the review of the Ratification Act will be brought back to Cabinet following receipt of further submissions and negotiations with the parties concerned.

Rob Kerin

**Rob Kerin
MINISTER FOR PRIMARY INDUSTRIES,
NATURAL RESOURCES AND REGIONAL DEVELOPMENT**

DATE: *12/11/97*

*Return to Minister
A 24.11.97*



PROCESS/TIMETABLE OF EVENTS

REVIEW OF THE COOPER BASIN (RATIFICATION) ACT 1975

- 2/1994 CoAG agrees to eliminate all legislative barriers to free and fair trade in gas by July 1996.
- 4/1995 Competition Policy Agreement comes into effect committing jurisdictions to review all legislation and amend where detriments due to restrictions on competition outweigh the public benefit of the restriction.
- 27/3/96 The ACCC revoke their previous authorisation for the AGL Letter of Agreement which they consider contains 3 anti-competitive clauses. As the Letter of Agreement is exempted by the Ratification Act, the ACCC says the relevant authorisation in the Act should have been repealed by July 1996 in accord with the CoAG agreement of February 1994.
- 7/1996 SA proposes to undertake competition policy review of the Ratification Act in 1998.
- 10/1996 The NCC advises their intent to undertake an independent economic and legal analysis of the ramifications of the Ratification Act in the context of the CoAG February 1994 agreement.
- 1/11/96 Santos advised that the SA Government is considering bringing forward Ratification Act review for 1998 to 1997 to forestall the NCC review.
- 5/11/96 Santos advise that they reserved their position on the proposal to review the Ratification Act.
- 1/11/96 SA Cabinet decides to bring forward the competition policy review of the Ratification Act from 1998 to 1997.
- 11/11/96 NCC advised of SA's decision to review the Ratification Act forthwith.
- 13/11/96 Santos verbally reiterated an earlier offer to give up Letter of Agreement clauses 12 and 20 as outcome of the review process.

Santos asked if they have any objections to Mr Dyki undertaking the review. They subsequently verbally advise that Dyki is acceptable, although perhaps a person of higher profile/weight should be the "figurehead" under whom Dyki would work.

- 10/12/96 Santos comment on draft terms of reference for the review received.
- 24/12/96 Redraft of terms of reference sent to NCC for comment. In January 1997 they verbally indicated concurrence.
- 24/2/97 ACCC asked for comment on draft terms of reference.
- 25/2/97 Draft call for submissions provided to Santos for comment. Draft terms of reference provided to interested parties for comment (including AGL, Optima etc).
- 2/4/97 Santos asked for comments on draft Issues Paper.
- 7/4/97 ACCC asked for comment on redraft of Issues Paper.
- 15/4/97 Public submissions sought by 5 June 1997 on the review of the Ratification Act by direct invitation, press release and newspaper advertisements.
- 25/6/97 A total of 18 submissions received by this date.
- 30/6/97 Copies of all 18 submissions sent to any party who had expressed interest with a request for comments by 25 July 1997.
- 8/8/97 Four supplementary submissions received by this date from ACCC, Santos and MESA and forwarded to interested parties.
- 25/8/97 A further submission received from the ACCC.
- 11/9/97 Mr Dyki hands down his report.
- 14/10/97 Australian Competition Tribunal hands down their determination on Santos' challenge to the ACCC's revocation of authorisation for the AGL Letter of Agreement.

In summary, the process has been transparent and consultative with parties (especially Santos) being given adequate opportunity to comment on matters of significance to them.

ATTACHMENT 2

REVIEW OF THE COOPER BASIN (RATIFICATION), ACT 1975

TERMS OF REFERENCE

In the context of the Competition Policy Intergovernmental Agreements and the Council of Australian Governments resolutions in respect of the gas sector, the terms of reference are:

- (a) from the legislation, the attendant agreements and after consultation with the relevant Parties, identify and record clearly (clarify) the objectives of the Cooper Basin (Ratification) Act 1975 and Indenture (the Ratification Act);
- (b) identify agreements, sales contracts and arrangements authorised for the purposes of the Trade Practices Act 1974 by the Ratification Act;
- (c) identify the nature of any past, present or potential:
 - restriction on competition, and
 - benefit to the community as a wholecontained within the Ratification Act or within any agreement, sales contract or arrangement identified in (b);
- (d) analyse the likely effect of any past, present or potential restrictions and benefits identified in (c) on competition in relevant markets, on the South Australian economy and on the Australian economy as a whole;
- (e) assess and reach a conclusion on balance of the costs and benefits of any past, present or potential restrictions and benefits applying to the relevant markets and to the South Australian economy and the Australian economy as a whole;
- (f) if a conclusion is reached under (c) above that the costs of any exemption under Section 51 of the Trade Practices Act outweigh its benefits, consider and report whether any conduct that is exempted under Section 51 should have its exemption removed in whole or in part, or propose arrangements to supplement the benefit or minimise the detriment, to establish a position of net benefit;
- (g) consider whether the objectives of the Ratification Act can be achieved by means including non-legislative approaches (such other means should not restrict competition);
- (h) determine if any provision of the Ratification Act constitutes a barrier to the free trade of gas both within and across South Australia's boundaries in terms of the Council of Australian Government's Agreement of February 1994.

**REVIEW OF THE COOPER BASIN (RATIFICATION) ACT
REPORT BY N DYKI - SEPTEMBER 1997**

EXECUTIVE SUMMARY

This is a review of the Cooper Basin (Ratification) Act 1975 under clause 5 of the Competition Principles Agreement. The Ratification Act provides concessions to the Cooper Basin Producers and exempted certain agreements from the operation of the Trade Practices Act.

The terms of reference, reflecting clause 5 of the Competition Principles Agreement, require the review to identify, analyse and assess:

- any restrictions on competition contained within the Ratification Act or any of the agreements exempted by the Ratification Act;
- the costs of any such restrictions, ie their effect on competition;
- the benefits to the community of the restrictions;
- reach a conclusion on the balance of the costs and benefits; and
- if costs outweigh the benefits propose arrangements which establish a net public benefit.

In short the review must assess and balance the costs and benefits of any restriction.

The review of the Ratification Act occurs against a background of significant change in the gas industry in Australia and, of particular relevance to this review, in South East Australia. Some of the significant changes and salient features of the industry are:

- the concerted effort by the Commonwealth and the States (as evidenced in CoAG resolutions, the Intergovernmental Agreements and recent Commonwealth and State legislation) to increase industry, including the gas industry, efficiency through increased competition;
- the development of third party access regimes to apply to transmission and distribution pipelines;
- the imminent introduction of contestability in the downstream sector of the gas industry;
- the removal of government from the gas industry through the sale of transmission, distribution, retail and producing assets;

- the proposed construction of two major transmission pipelines linking Bass Strait to Sydney, and
- the limited competition which exists at the producer level in South East Australia where supply is dominated by two producing basins (and effectively two joint ventures) with one participant having significant interests in both basins.

This contrasts with the position of the gas industry in South East Australia in 1975. At that time there was a monopoly supplier and a monopsonist purchaser, the State, in each of Adelaide and Melbourne. The 1975 Cooper Basin arrangements resulted in a sole supplier to AGL. Moreover, the States were heavily involved in the ownership of transmission, distribution, retail and producing assets. The Commonwealth was shortly to become the owner of the Moomba to Sydney pipeline.

A legislation review and, in particular, the assessment of public benefits is not straight forward in the case of legislation, like the Ratification Act, which gives effect to, and is the result of, an agreement. The difficulty with such an assessment is that the benefits and the objectives of such legislation may have accrued shortly after it was passed or, at least, by the time the review is undertaken.

In the case of the Ratification Act the main related objectives were to facilitate a major development in SA which development exploited SA's petroleum reserves. The development, moreover, held out the prospect of significant future gas and liquids developments. These objectives, and benefits, have been achieved. They are past benefits or historic benefits.

Other claimed public benefits on a forward looking basis are not true public benefits. Thus, given the infrastructure now in place, new agreements and structures can be developed to replace the existing Cooper Basin agreements and structures. In short, it cannot be said that the current arrangements are more beneficial than alternative arrangements which may be structured to avoid anti-competitive elements. This is true of security of supply. Moreover, in the current climate of a more competitive gas industry co-operative Producer arrangements can lead to substantial producer benefit but not public benefit. Consumers will pay the market price for gas which may be higher than it would be but for the co-operative arrangements.

However, there are substantial public benefits in continuing concessions and exemptions previously granted even if the objective of the legislation has been achieved. This arises through a State continuing to honour the commitments it has made. Not to do so can have an effect on future investment, create uncertainty and engender lack of confidence in business dealings with governments. For a State to adhere to commitments is a considerable public benefit. This is even more so where third party agreements are involved.

Against this legal framework and industry background the restrictions on competition in the Ratification Act and the exempted agreements were identified and assessed and balanced in terms of the costs and benefits to the community.

Ratification Act

Two relatively minor restrictions were identified and amendments proposed. Leaving aside S.16 which exempts various agreements from the operation of the Trade Practices Act, none of the other sections confer any ongoing advantage to Producers which can in any sense be regarded as a restriction on competition.

Exemption of the Indenture Agreement

Nothing in the Indenture Agreement has been identified as requiring the Indenture Agreement to be the subject of a S.51(1) exemption. Accordingly the review recommends the removal of this exemption.

Exemption of the Unit Agreement

Two significant restrictions on competition were identified where the costs outweighed the public benefits. The first arises because of the lack of a third party access regime in relation to the Unit facilities. The second because the Unit Agreement effectively precludes separate marketing by the Cooper Basin Producers.

It is recommended that these restrictions be removed as a condition of the continued exemption of the Unit Agreement from the operation of the Trade Practices Act. These conditions require the implementation of a third party access regime to the Cooper Basin facilities (either by legislation or by an Industry Code) and the amendment of the Unit Agreement to incorporate a workable mechanism which permits a Producer to separately market if it so desires.

It is also recommended that only amendments to the Unit Agreement which are approved by the Minister should continue to be exempted.

Exemption of the Letter of Agreement

Seven restrictions on competition were considered. It was found that the costs outweighed the benefits in respect of three of the restrictions. Accordingly it is recommended that the AGL Letter of Agreement continue to be exempted subject to the removal of the tying provisions (clauses 12 and 20) and the amendment of the single delivery provision (clause 10). It is also recommended that the exemption of amendments to the Letter of Agreement be removed.

Exemption of the Liquids Contracts

It is recommended that this exemption in the Ratification Act be removed as such contracts are exempted by the Stony Point (Liquids Project) Ratification Act 1981.

Exemption of acts or things done thereunder

It is recommended that the current words be replaced with words which exempt all contracts, acts or things which give effect to rights and obligations under the exempted agreements.

Exemption of the 1989 Gas Sales Agreements

These agreements are not exempted by the Ratification Act but are currently authorised. However, it would not be inappropriate for the State to grant exemption to disaggregated NGASA contracts provided that the terms and conditions of the disaggregated contracts largely reflected the current NGASA contracts.

Exemption of the 1996 Gas Sales Agreements

These agreements are not exempted by the Ratification Act nor are they authorised. The State should not grant exemption to gas sales contracts which are not currently the subject of a State exemption or ACCC authorisation.

Exemption of the Fixed Factor Agreement

The Fixed Factor Agreement is not exempted. It is not inappropriate for the State to grant an exemption provided that a third party access regime is implemented and a mechanism which permits separate marketing is introduced in the manner discussed earlier.

In summary, the result of the review are recommendations which provide:

- the Ratification Act (other than S.16) remains in place with two relatively minor amendments proposed to the Ratification Act and the Petroleum Act;
- the S.51(1) State exemption of the Unit Agreement and the AGL Letter of Agreement continue but subject to conditions which remove the adverse effect upon competition of these agreements, and
- for the removal of other State exemptions as unnecessary.

RECOMMENDATIONS

1. Clause 16 of the Ratification Act be replaced with a new clause which for the purposes of the Trade Practices Act authorises and approves:
 - (i) the provisions of the Unit Agreement as those provisions are amended with the consent of the Minister (subject to recommendation 2);
 - (ii) the provisions of the Letter of Agreement (subject to recommendation 3); and
 - (iii) such contracts acts or things which give effect to the rights and obligations of the parties pursuant to the Unit Agreement or the Letter of Agreement.

2. The provisions of the Unit Agreement be exempted provided that:
 - (i) the State implements a third party access regime to the Cooper Basin facilities either by legislation or an Industry Code. The access regime must provide for non discriminatory access, published tariffs and terms, compulsory dispute resolution, separate accounting in relation to the facilities and the ability for an appropriate regulator to monitor tariffs; and
 - (ii) the Unit Agreement be amended to incorporate a mechanism which permits, but does not require, a Cooper Basin Producer to separately market.
3. The AGL Letter of Agreement be exempted provided that Clauses 12 and 20 are removed and Clause 10 is amended so as to permit delivery into either the Sydney or Adelaide pipelines.
4. S.9 of the Ratification Act or S.27(1a) of the Petroleum Act be amended to ensure that a Petroleum Production Licence shall not be granted to the Producers if the quantity or quality of the petroleum is not sufficient to warrant production.
5. S.80L of the Petroleum Act be amended so that the section applies to pipelines between Petroleum Production Licences which are not licensed.
6. This recommendation is closely related to the subject matter of the review but is strictly outside the terms of reference:
 - (i) a S.51(1) State exemption be granted, if requested, to disaggregated NGASA contracts provide that the terms and conditions of such contracts reflect the existing contract:
 - (ii) a S.51(1) State exemption be granted to the Fixed Factor Agreement, if requested, but only on the condition that a third party access regime applies to the Cooper Basin facilities and a mechanism exists which permits a Cooper Basin Producer to separately market; and
 - (iii) a S.51(1) State exemption should not be granted to existing gas sales agreements not currently authorised or future gas sales agreements. Such authorisations should be left to the ACCC.

ATTACHMENT 4

REVIEW OF DYKI'S RECOMMENDATIONS

(Note Dyki recommendations are given in italics)

1. *Clause 16 of the Ratification Act be replaced with a new clause which for the purposes of the Trade Practices Act authorises and approves:*
 - (i) *the provisions of the Unit Agreement as those provisions are amended with the consent of the Minister (subject to recommendation 2);*
 - (ii) *the provisions of the Letter of Agreement (subject to recommendation 3);*
and
 - (iii) *such contracts acts or things which give effect to the rights and obligations of the parties pursuant to the Unit Agreement or the Letter of Agreement.*

This recommendation is supported in so far as Santos are not able to provide convincing evidence that removal of exemption for liquids sales contracts or the Indenture will have a significantly deleterious effect. In addition the option to authorise the 1996 and Special Purchase Gas Agreements should also be retained (See 6(iii) below).

2. *The provisions of the Unit Agreement be exempted provided that:*
 - (i) *the State implements a third party access regime to the Cooper Basin facilities either by legislation or an Industry Code. The access regime must provide for non discriminatory access, published tariffs and terms, compulsory dispute resolution, separate accounting in relation to the facilities and the ability for an appropriate regulator to monitor tariffs;*
and
 - (ii) *the Unit Agreement be amended to incorporate a mechanism which permits, but does not require, a Cooper Basin Producer to separately market.*

Recommendation 2(i) is supported in that a third party access arrangement be put in place. Providing that Santos adopt a self regulatory code which is satisfactory (non-discriminatory access; published tariff establishment principles; published spare capacity calculation principles; compulsory dispute resolution limited to the grounds that Santos has not complied with the Code) then legislated regulatory involvement could be a negative feature. It should be borne in mind, however, that the

Clause 10(1) Legal Professional Privilege

Recommendation 2(ii) is supported in principle except it may not be necessary to require a detailed 'borrow and loan' mechanism to be incorporated within the Unit Agreement. As much of the existing gas reserves are committed to existing contracts (and perhaps over-committed), there is little opportunity for additional contracts in the short term. Potentially all that may be necessary is a Unit Agreement clause which clearly establishes the rights of a Party to separately market and commits the Unit Parties to promptly negotiate in good faith in the event a Party seek to do so. However this can be offset by the argument that competition in the upstream industry is needed as soon as possible, as experience in Australia has shown that price reductions for new contracts rapidly follow. Therefore, anything that facilitates such competition (including borrow and loan agreements) should be facilitated.

3. *The AGL Letter of Agreement be exempted provided that Clauses 12 and 20 are removed and Clause 10 is amended so as to permit delivery into either the Sydney or Adelaide pipelines.*

The ACCC has identified that clauses 10, 12 and 20 of the AGL Letter of Agreement are anti-competitive. Santos has previously indicated that they may be agreeable to the removal of clauses 12 and 20 (exclusive dealings and first right of refusal).

It is clear that clause 10 is anti-competitive and its authorisation should be revoked (or have Santos agree to allow customer discretion in defining point of supply in all gas sales contracts).

4. *S.9 of the Ratification Act or S.27(1a) of the Petroleum Act be amended to ensure that a Petroleum Production Licence shall not be granted to the Producers if the quantity or quality of the petroleum is not sufficient to warrant production.*

Santos have agreed not to use Section 9 of the Ratification Act to seek PPLs outside of the Nappamerri Trough, so the amendment of this clause may be non contentious.

5. *S.80L of the Petroleum Act be amended so that the section applies to pipelines between petroleum Production Licences which are not licensed.*

This recommendation is supported but would be redundant if Santos implements a self regulatory access regime and/or the State legislates to this end. One option would be to repeal S.80L in its entirety (it will need modification on introduction of the national access regime in any event).

6. *This recommendation is closely related to the subject matter of the review but is strictly outside the terms of reference:*
 - (i) *a S.51(1) State exemption be granted, if requested, to disaggregated NGASA contracts provide that the terms and conditions of such contracts reflect the existing contract:*

- (ii) *a S.51(I) State exemption be granted to the Fixed Factor Agreement, if requested, but only on the condition that a third party access regime applies to the Cooper Basin facilities and a mechanism exists which permits a Cooper Basin Producer to separately market; and*
- (iii) *a S.51(I) State exemption should not be granted to existing gas sales agreements not currently authorised or future gas sales agreements. Such authorisations should be left to the ACCC.*

Recommendation 6(i) is supported. It may be that disaggregation negotiations will be protracted. In addition, Santos is seeking compensation for increased risk due to substitution of a State entity, (NGASA), by Boral and Envestra who have greater credit risk. Therefore it may be of benefit to exempt existing contractual arrangements. In addition, it is likely that the ACCC will turn its attention to reviewing its interim authorisation of the 1989 gas sales contracts shortly. If the State moves to exempt the contract while a review is in progress or well advanced, the Commonwealth may be tempted to disallow the exemption. This could lead to the gas contracted for use in SA being secured interstate if the ACCC succeeded in having existing contracts invalidated. The alternate view is that the Dyki recommendation can be used as a lever to facilitate a speedy disaggregation exercise, as the task of converting the NGASA contract to two separate Envestra and Boral contracts is a simple exercise if there is goodwill between the parties or the Government can exercise effective pressure.

Recommendation 6(ii) is supported.

Recommendation 6(iii) is not supported. The State should retain its powers to grant exemptions and in particular exempt the 1996 gas contracts as well as the Special Purchase Agreement (if relevant), to eliminate the potential for the ACCC to declare them invalid.

ATTACHMENT 5

Dear

REVIEW OF COOPER BASIN (RATIFICATION) ACT

Please find attached the report by the Independent Investigator, Mr Dyki, on his review of the Cooper Basin (Ratification) Act. This report was received shortly before the calling of the State election on 13 September which prevented any action being taken on the report while the Government was in caretaker mode.

As you are no doubt aware, the review was commissioned to honour the Government's commitments under the Competition Principles Agreement and the CoAG Agreement of February 1994 on free and fair trade in gas.

If you consider that the report contains any errors of fact which in your view would require amendment to any of the recommendations, could you please bring these to Mr Dyki's attention. If he considers that the report should be amended as a consequence of any submission received, (all of which will be made publicly available) you will be provided with a copy of the amended report. If you have information you wish to bring to Governments attention in regard to implementation of the recommendations, please address this separately in your submission. Any submissions should be lodged by 1997 to:

Mr Nick Dyki
Independent Investigator
Cooper Basin (Ratification) Act
c/- Petroleum Group
Mines and Energy Resources
Department of Primary Industries and Resources
GPO Box 2355
ADELAIDE SA 5001

Yours sincerely

Rob Kerin
**MINISTER FOR PRIMARY INDUSTRIES,
NATURAL RESOURCES AND REGIONAL DEVELOPMENT**

Attach