15 February 2010

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

Our Ref: 018

blueenergy limited

Copy by email: qgcapplication@ncc.gov.au

Dear Sirs

RE: APPLICATION FOR 15 YEAR NO-COVERAGE DETERMINATION FOR QCLNG PIPELINE

I refer to the application lodged by QCLNG Pipeline Pty Ltd (**QCLNG**) under the National Gas Law for a 15 year no-coverage determination for the proposed QCLNG pipeline (**QCLNG Application**).

Blue Energy Limited (**Blue Energy**) opposes the QCLNG Application. Our reasons for opposition are set out in this letter.

Executive summary

Blue Energy is a Coal Seam Gas (CSG) exploration company working to develop CSG resources in a range of areas, including the Surat Basin. Our aspiration, like a number of other junior explorers in the region, is to supply gas to the Domestic and LNG export markets. Efficient exploitation of our resources requires access to a pipeline such as the proposed QCLNG pipeline. Approval of the QCLNG Application would therefore be likely to jeopardise the development of these resources or result in them being directed to uses that provide lower value to Blue Energy and to Australia.

QCLNG puts forward a range of arguments in its application why the coverage criteria for the QCLNG pipeline are not met. Blue Energy disagrees. A summary of the reasons we believe the coverage criteria for the QCLNG pipeline are not met is set out below:

- As a fully vertically integrated LNG producer, unless the QCLNG pipeline is covered by the access provisions of the National Gas Law, QGC will have strong incentives to deny junior CSG producers access to the QCLNG pipeline. This is because denying access allows QGC to prevent juniors from delivering gas or selling their exploration permits for full value to other buyers. Denying access therefore maximises the likelihood that QGC, and not another producer, will ultimately have the opportunity to exploit those reserves. It also suppresses the prices QGC may ultimately have to pay for those reserves. It is for this reason that the Parer Report recommended that no-coverage determinations should not be available to owners of vertically integrated pipelines such as the QCLNG pipeline.

- If follows from the issues described above that access, or increased access, to the QCLNG pipeline will be likely to promote competition in a range of markets. These include the market for wholesale supply of CSG, a 'tenements market' for sale of CSG exploration permits or interests in permits, and a market for toll manufacture of LNG.

- QCLNG argues that producers such as Blue Energy would not use the QCLNG pipeline, preferring to use the QGP or RBP instead. This is clearly wrong. Neither the QGP nor the RBP can be used to transport gas to any proposed LNG plant[1]. Even if they could, both the QGP and RBP are capacity constrained and could not meet Blue Energy's requirements without very large investment. By contrast, the QCLNG pipeline would meet all the foreseeable demand of Blue Energy and other similar producers with comparatively modest investment.

- QCLNG asserts that the QCLNG pipeline is economic to duplicate on the basis that the service it provides will be to transport of gas from across the whole of the Surat and Southern Bowen basins. In reality, connection costs mean that the area from which foreseeable demand for the QCLNG pipeline will be drawn is much narrower than this. The QCLNG pipeline should be assessed on a 'point to point' basis. Assessed on this basis, the pipeline has sufficient available capacity to meet foreseeable demand at far lower cost than construction of a duplicate pipeline.

- BG and QGC's decision to construct the QCLNG pipeline is based on QGC's anticipated internal tied demand for the services of that pipeline, not on any need to recover any given return on capital through third party access revenues. As a result, there appears to be no suggestion, even in QCLNG's Application, that BG's decision to construct the QCLNG pipeline will be in any way affected by whether or not no-coverage exemption is granted. The decision to build this pipeline is instead likely to rest on the broader business case for LNG production and export. Since granting exemption will have no material effect on BG and QGC's investment decision, granting this exemption creates no public benefit – indeed, it will have no effect other than to lock junior CSG producers out of the Gladstone LNG market.

- By contrast, third party access to the QCLNG pipeline would give rise to substantial public benefits. These include more efficient utilisation of infrastructure and the enablement of CSG projects that might not otherwise proceed, creating jobs, export earnings and investment for Australia.

Blue Energy therefore believes that the QCLNG Application should be declined.

Background to Blue Energy

Blue Energy is a rapidly evolving Coal seam Gas (CSG) exploration company with CSG assets throughout Queensland.

Blue Energy anticipates that its first gas will be supplied to domestic markets. Our desire in the medium term, however, is to produce LNG for supply export markets. To this end, Blue Energy executed a Heads of Agreement last year and is pursuing a strategic partnership with Korea Gas Corporation (**KOGAS**), the world's largest LNG importer.

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[1] ie, because the RBP doesn't go near a proposed LNG plant, and both the RBP and QGP carry a mix of CSG and conventional gas which means gas delivered from these pipelines will not be suitable for use in any proposed LNG plants.

A map showing Blue Energy's South East Queensland CSG exploration permits is annexed to this letter. The approximate path of the QCLNG pipeline relative to these permits is marked in green on that map. As can be seen from the map, the proposed QCLNG pipeline will run close to Blue Energy's ATP's 818P & 896P.

Based on exploration success, Blue Energy anticipates a 5 year time frame in which gas can be brought to market from ATP's 818P & 896P. Capacity constraints on Jemena's Queensland Gas Pipeline (**QGP**) mean that the QGP is unlikely to provide a viable transport option. Similarly, even if Blue Energy's aspiration was to supply domestic markets, APT's Roma to Brisbane Pipeline (**RBP**) is also capacity constrained. The QCLNG pipeline, however, would provide a viable means by which gas from ATP's 818P & 896P could be transported to Gladstone for conversion to LNG.

Pipeline Coverage Criteria

The Council must recommend to the Minister that the QCLNG Application should be rejected if the pipeline coverage criteria set out in section 15 of the NGL are satisfied. Blue Energy submits that each of these criteria is met. Each criterion is discussed in turn below.

Criterion (a) - Promotion of competition

The first pipeline coverage criterion is that access (or increased access) to pipeline services would promote a material increase in competition in at least one market other than the market for pipeline services.

Through its application for exemption from coverage, QCLNG is seeking to ensure that its pipeline can only be used for delivery of QGC controlled gas to a QGC controlled liquefaction facility. On an industry basis, such a vertically integrated structure creates the following consequences:

(a) Independent producers such as Blue Energy, who are otherwise capable of producing a consistent supply of gas suitable for supply to an LNG facility, are denied access to the most efficient way to transport their gas to LNG facilities. As a result, such producers must either direct their gas to lower value domestic markets, suppressing prices in those markets, or accept whatever price the vertically integrated producer is prepared to offer at source[2]. The vertically integrated LNG producer therefore attains power in the market to acquire gas for production of LNG.

(b) Since the options open to a junior producer are to sell its product to the vertically integrated LNG producer or accept lower returns in the domestic market, the vertically integrated LNG producer becomes the only potential purchaser able to extract maximum economic returns from a junior producer's exploration permits. The vertically integrated LNG producer therefore obtains power in the relevant market for tenements. The vertically integrated LNG producer has a clear incentive to take advantage of this power to suppress the prices it has to pay for reserves currently held by junior producers and maximise the likelihood that it, and not another producer, will be ultimately have the opportunity to exploit those reserves.

(c) Since vertically integrated LNG producers are able to control the supply of gas for LNG production, they are also able to prevent the entry of non-vertically integrated LNG manufacturers. They are therefore able to inhibit the development of a market for toll manufacture of LNG.

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2 Other options such as liquefaction on site followed by transport by road may also be explored. This is clearly, however, less efficient and provides less public benefit than transport by pipeline.

It is for these reasons that the Parer Report recommended that the 15 year economic regulation holiday now set out in Part 2 of Chapter 5 the National Gas Law should only be available to pipelines "*with sufficient vertical separation of control that the relevant pipeline owners would not have an incentive to reduce competition in upstream or downstream markets*"[3]. Clearly the QCLNG Application does not meet this requirement.

QCLNG claims that exemption of the QCLNG pipeline from coverage will not affect competition on the basis that the QCLNG pipeline will have no available capacity and potential users of the pipeline such as Blue Energy are likely to use other pipelines in any event. For reasons set out below, this is clearly incorrect.

QCLNG Claim	Blue Energy Response
Independent producers will sell to the domestic market	QCLNG's own analysis of likely growth in domestic demand illustrates that domestic markets will not absorb the quantities of CSG likely to be brought on stream by independent producers in the Surat and Bowen Basins. The business cases for these developments are likely to be dependent on being able to transport gas to manufacturing facilities in Gladstone for LNG export.
Blue Energy would most likely use the RBP	The RBP could only provide Blue Energy with access to lower value South East Queensland domestic markets, not the higher netback LNG export markets Blue Energy is targeting. Even if the highest value use for Blue Energy's product were the domestic market, the RBP is already running at or near capacity. RLMS's own estimate of Blue Energy's likely production from ATP's 818P & 896P is between 44PJ/a and 88PJ/a and the RBP has already been expanded through both compression and full looping to achieve a its total current capacity of 66-73PJ/a[4] It is therefore not feasible that the RBP could provide the capacity required by Blue Energy or any other similar producer.
Alternatively, Blue Energy and similar producers would use the QGP.	It is likely that any LNG facilities built in or around Gladstone will be tailored to the calorific value and composition of CSG. The QGP transports a mix of conventional gas as well as CSG. Accordingly, it is unlikely that the QGP could be used to transport gas for use in any LNG plant to be developed in Gladstone. Even if Blue Energy were to sell to lower value domestic markets, the QGP is also capacity constrained and unable to meet the capacity needs of Blue Energy (or, presumably, of any other similar producer)[5]
QCLNG pipeline will not have available capacity	QCLNG estimates that, with compression, its pipeline will have a capacity of 2,916TJ/day without looping. Of this, QCLNG expects to ultimately utilise in the order of either 1500TJ/day (if Curtis

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3 Council of Australian Governments Energy Market Review - *Towards a Truly National and Efficient Energy Market*, December 2002, at pages 37 and 213

4 ie, 180-200TJ/day. See minutes of Roma to Brisbane Roundtable held Tuesday 5 September 2006 at ACCC Brisbane Office - http://www.aer.gov.au/content/item.phtml?itemId=704521&nodeId=4d5df23f0ede6a68c48099b468d9d267&fn=Roundtable%20minutes%20-%205%20September%202006.pdf

5 QGP currently has a total capacity of just 32PJ/year. This is in the process of being expanded. RLMS cites a likely capacity of 52PJ/year. Jemema's own website quotes an expanded capacity of 49PJ/year. In either case, ACIL Tasman notes that any expanded capacity is largely already contractually committed

QCLNG Claim	Blue Energy Response
	Island expands to two trains) or 2,200TJ/day (if Curtis Island is ultimately expanded to 3 trains)[6]. On QCLNG's own submission, this leaves available capacity in the order of either 1,400TJ/day or 700TJ/day (ie, approximately 500PJ/a or 250PJ/a) – more than sufficient to meet the transport requirements of Blue Energy and other likely access seekers.
Access seekers couldn't use QCLNG pipeline because gas for the QGC LNG plant must meet narrow specifications.	Unlikely to present a barrier as Blue Energy's CSG is expected to be largely the same composition as QGC's CSG.
Connection to QCLNG pipeline would cost too much	Even if QGP could be expanded at an economically viable cost, connection to QGP would cost a similar or greater amount as connection to the QCLNG pipeline. We note that QCLNG's estimate of Blue Energy's cost to interconnect with the QCLNG pipeline is based on a 95km pipe (despite acknowledging elsewhere that the QCLNG pipeline comes within 50km of Blue Energy's tenements). Without knowing the line pressure Blue Energy would be required to compress to, it is difficult to provide an estimate of connection cost. Nevertheless, Blue Energy believes it is likely that QCLNG's estimate significantly overstates the cost of connection. It also assumes the quantity of gas to be supplied by Blue (and thus a rate) and therefore the diameter of pipeline required (assumed to be 450 mm). These assumption lead to a high capital cost estimate for Blue Energy's connection by QCLNG.

As a result of the issues discussed above, Blue Energy believes there are at least three markets in which access to the QCLNG pipeline would promote competition:

1. A market for toll manufacture of LNG;

2. A market for wholesale supply of CSG in the Gladstone and/or Surat and Bowen regions; and

3. A 'tenements market' for sale of CSG exploration permits or interests in the rights to exploit permits.

Further comments in relation to each are set out below.

<u>Market for toll manufacture of LNG</u>

The growth of the CSG industry in the Bowen and Surat Basins should encourage the creation of a market for toll manufacture of LNG. The development of this market will be constrained if potential suppliers are unable to gain third party access to a pipeline such as the QCLNG pipeline and therefore have no way to efficiently deliver gas to an independent LNG facility.

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6 s6.5 QCLNG Submission at P43.

As evidence of this, QCLNG notes that Impel (Southern Cross LNG) proposes to construct an open access LNG terminal on Curtis Island near QGC's facility. ACIL Tasman discusses this project and notes that Impel intends the concept to "*allow junior producers access to the international gas markets and provide them with the opportunity to realise an international netback price for their gas reserves*". ACIL Tasman also observes, however, that:

> *Given that most of the current independently certified proven and probable CSG reserves in the Bowen and Surat Basins are now controlled by proponents of other LNG projects, we find it difficult to see where the LNG Impel project will be able to secure committed gas suppliers at this stage.*[7]

Unless access is available to the QCLNG pipeline, ACIL Tasman's observation may well be correct. However, ACIL Tasman describes the proposed facility as a staged development of up to three trains, each of 0.7 to 1.3mtpa (37PJ/a to 69PJ/a) capacity. QCLNG's submission identifies likely output from independent tenement holders within 100km of the QCLNG pipeline of between 128PJ/a and 257PJ/a[8] - four times the supply needed for a proposal such as the Impel proposal to proceed. This suggests that if junior producers could obtain third party access to the QCLNG pipeline to transport gas to the Impel facility, a proposal (or multiple proposals) such as Impel's would be likely to succeed. Clearly, therefore, access to pipeline services provided by means of the QCLNG pipeline would be likely to promote the development of, and promote competition in, a market for toll manufacture of LNG. This, in turn, is critical for the success of junior producers such as Blue Energy.

<u>Market for wholesale supply of CSG in the Gladstone and/or Surat and Bowen regions</u>

As described above, if producers such as Blue Energy are unable to obtain access to the QCLNG pipeline, the only options available to those producers are to accept lower returns in the domestic market or sell their gas to QGC. By contrast, access to the QCLNG pipeline would enable any of the proposed LNG producers in Gladstone to compete for long term contracts to acquire gas from independent producers adjacent to the QCLNG pipeline.

Accordingly, access to the QCLNG pipeline would clearly facilitate greater competition in a market for wholesale supply of CSG in the Gladstone and/or Surat and Bowen regions

<u>Tenements market</u>

In the rail access applications by FMG in the Pilbara, the NCC has recognised the existence of separate markets for the sale of mining tenements or interests in tenements. For example, in its Robe Railway Final Recommendation, the Council stated:

> *The Council notes that the Pilbara iron ore tenements market is a market within Australia and involves the interests of parties that have explored for and identified iron ore reserves in the Pilbara and are seeking to develop these in their own right, enter into joint ventures or transfer the right on commercial terms set in a competitive market. In this market Rio Tinto Iron Ore and BHP Billiton Iron Ore are generally buyers. This market is distinct from the market for iron ore, which is a commodity that is traded in a competitive global market, and involves transactions primarily between large iron ore producers (including Rio Tinto Iron Ore and BHP Billiton Iron Ore) and a number of international steel makers.* [9]

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7 s3.1.5 ACIL Tasman Gas Demand Study P 47

8 Table 6, P57 QCLNG Submission

9 NCC *Final Recommendation in Application for declaration of a service provided by the Robe Railway under section 44F(1)of the Trade Practices Act 1974,* Paragraph 4.72

The Council went on to find that granting third party access to the transport infrastructure required to transport ore from tenements to port:

> …. will have a material effect on competition in the market for tenements. Access would generally allow significantly greater choice for tenement owners. It would allow them greater opportunity to develop their tenements and market iron ore. It would enable a greater array of potential purchasers of tenements and joint venture partners, reducing the scope for the exercise of market power in relation to the acquisition of tenements. This would likely increase the worth of tenements and stimulate exploration for iron ore, feasibility testing to define ore reserves, project construction and the production and export of additional iron ore. The Council also considers that the all points nature of the service to which access is sought may enhance the pro-competitive effects of access by increasing the number of tenements effected. Access would therefore be likely to promote a material increase in competition in the tenements market.

Equivalent findings were made by the Council in relation to each of the Hamersley Railway and Goldsworth Railway access applications, and were confirmed by the Treasurer in his decision to declare these services in the Pilbara[10].

In a directly analogous way, a separate market exists for the sale of exploration permits or rights to participate in the exploitation of exploration permits for CSG in the Surat Basin. QGC is an active purchaser in this market. For example, the ACIL Tasman Report notes that QGC has acquired interests in the nearby tenements of A J Lucas Limited, Victoria Petroleum NL and WestSide Corporation Limited[11]. If QGC is able to prevent such explorers from using its pipeline to transport gas to other potential toll manufacturers of LNG, it either becomes the only logical purchaser of such tenements, or at the very least, it gains a substantial advantage against any other potential purchaser. By contrast, access to the QCLNG pipeline would enable a range of bidders to compete for interests in such tenements, increasing competition in the relevant market.

Criterion (b) - Uneconomic to duplicate

Criterion (b) of s15 of the NGL requires that it must "*be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline*". The Council notes in its Coverage Guide that the Tribunal has explained this test in the *Duke EGP* decision as follows:[12]

> *[the] test is whether for a likely range of reasonably foreseeable demand for the services provided by means of the pipeline, it would more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one.*

The start point is therefore to identify the services provided by the pipeline and then assess the foreseeable demand for those services.

In its submission, QCLNG has asserted that the services provided by the QCLNG pipeline will be to transport gas to Gladstone from across the whole of the Surat and Southern Bowen basins. On this basis, it estimates total demand for such services in the region of 5,000TJ/day.

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10 eg, see the Treasurer's *Statement of Reasons Concerning the Application for Declaration of Services Provided by the Robe Railway Line,* 27 October 2008.

11 ACIL Tasman Report, P50

12 cited in NCC Coverage Guide at para 5.98

This is clearly false. Demand for the services provided by the QCLNG pipeline should be assessed on a realistic point to point basis. By way of illustration, the GLNG pipeline is substantially to the west of the region served by the QCLNG pipeline. Even if that pipeline were not to proceed, connection costs are such that producers in the region served by the GLNG pipeline would not be likely to consider the QCLNG pipeline a viable transport alternative.

QCLNG describes in its submission the high cost of connection to its pipeline across distances of more than 100km. For the purposes of assessing criterion (a), QCLNG therefore asserts that gas producers further from its pipeline than this would have no demand for services provided by use of its pipeline. For the purposes of criterion (b), the likely demand for services provided by the QCLNG pipeline should be assessed in the same way - only producers within a realistic connection distance of the pipeline should be included.

We note also that, even if demand for services around the downstream sections of the APLNG pipeline might make duplication of those sections economic, this does not mean that duplication of the upstream sections of the APLNG pipeline would be economic. For example, the APLNG pipeline, if it proceeds, is likely to start [at least] 80km short of where the QCLNG pipeline commences. Accordingly, it would not provide an alternative for producers around or to the south or east of the start of the QCLNG pipeline. Demand for services from this region should therefore be separately considered to determine whether the upper reaches of the proposed APLNG pipeline (ie, the section to which Blue Energy would connect) are economic to duplicate.

As QCLNG notes, the QGP passes through this region and may be considered to provide a similar point to point service[13]. The QGP, however, is at capacity and cannot be expanded without very large investment; nor can the RBP. By contrast, the QCLNG pipeline can be expanded to meet the needs of all potential independent producers in the region and through additional compression.

It is noted that Arrow Energy holds exploration permits in this region. If the Arrow project proceeds, however, Arrow Energy has stated that it will develop its own vertically integrated pipeline. Accordingly, gas from Arrow's permits will not form part of the reasonably foreseeable demand for the services provided by the QCLNG pipeline. Instead, the reasonably foreseeable demand for the services provided by means of the pipeline is likely to consist of demand from independent producers within, say, 100km of the QCLNG pipeline who are not aligned to either BG or Arrow. As described above, this demand could readily be accommodated by the QCLNG pipeline simply though compression.

Criterion (c) - No undue risk to human health or safety

Blue Energy is not aware of any reason that access to the QCLNG could not be granted without undue risk to human health or safety. QCLNG suggests nothing to the contrary in its submission.

Criterion (d) - Not contrary to public interest

Blue Energy does not believe that it would be in any way contrary to public interest for the QCLNG pipeline to be covered.

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13 As described above, however, that the fact that different quality gas is transported through the QGP means that the service it provides may not be suitable for transportation of gas for CSG dedicated LNG production.

The potential public benefit in granting exemption from coverage arises if the exemption enables an investment to proceed that would not have proceeded otherwise. For example, the Council notes in its guide to Greenfields Pipeline Incentives that "*the tenor of the extrinsic material places considerable emphasis on the granting of the exemption to allow investment to proceed in international pipeline projects.*"[14]

Similarly, the Council notes the Tribunal's comments in *Re: Application by ElectraNet Pty Limited*[15] which emphasised that minimising regulatory risk to promote efficient investment is a central part of the regulatory framework:

> *Efficient investment in the long term interests of consumers will not be promoted if investors perceive a significant risk that the rules will change and they will not be able to recover the opportunity cost of capital reasonably invested. The minimisation of regulatory risk, consistent with the promotion of efficient investment, is one of the tenets that has driven the development of regulatory regimes in Australia. That tenet is reflected in the objective of the Law and in the revenue and pricing principles embodied in the Law.*

The business case for QCLNG pipeline, however, appears to be supported entirely by QGC's anticipated internal tied demand. This has two important consequences:

(a) The business case for construction of the QCLNG does not depend on third party access revenues. Accordingly, regulatory rates of return do not affect QCLNG's investment decision and the question of whether or not exemption is granted will have no effect on QCLNG's ability to recover opportunity cost of capital reasonably invested in its pipeline. Questions of regulatory risk therefore do not arise for QCLNG the sense described in ElectraNet, where ElectraNet's returns from its independent transmission assets were dependent entirely on the rates of return it earns from third party usage of those assets.

(b) There appears to be no suggestion, even in QCLNG's own submission, that BG's decision to construct the QCLNG pipeline will be in any way affected by whether or not exemption is granted. The decision is instead likely to rest on the broader business case for LNG production and export.

Since granting exemption will have no material effect on QCLNG's investment decision, granting exemption creates no public benefit. On the other hand, facilitating third party access to the QCLNG pipeline would give rise to substantial public benefits, including:

- the more efficient utilisation of a substantial item of infrastructure;
- the development of CSG projects that might not otherwise proceed, creating jobs and investment for Australia;
- the avoidance of allocative inefficiency by enabling CSG to be directed to its highest value use through conversion to LNG for export rather than directed to lower value domestic markets; and
- increased export earnings and royalties for the benefit of the Australian economy.

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14 at para 5.6

15 (No 3) [2008] ACompT 3 (30 September 2008) at [201]

It follows that it would be in no way contrary to public interest for the QCLNG pipeline to be covered.

I trust this information is of assistance to the Council. I look forward to discussing our submissions with the Council further in due course.

Yours sincerely

John Phillips
Chief Operating Officer
Blue Energy Limited

Annexure

Blue Energy's Queensland CSG exploration permits