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EUAA
ENERGY USERS ASSOCIATION OF AUSTRALIA

Mark Rakers
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Australian Competition & Consumer Commission
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BY EMAIL: mergers@accc.gov.au

Dear Mark

SUBMISSION RE: PROPOSED ACQUISITION OF ORIGIN BY BG

We are writing to you following an invitation to respond to your assessment of BG's possible acquisition of Origin Energy.

The EUAA is concerned that this acquisition will, or is likely to, result in a substantial lessening of competition for the sale of coal seem methane (CSM) in the southern Queensland market.

BG's joint venture with QGC may give it a degree of control over QGC that is commonly associated with ownership. If this is the case, then approval of BG's acquisition of Origin will give it control over more than three-quarters of Queensland's CSM. The EUAA is concerned that such dominance could lead to a substantial lessening of competition in supply to the south Queensland gas market.

Even if the ACCC decides that BG's joint venture with QGC does not provide BG with significant influence over QGC, the EUAA has calculated that, if BG"s acquisition of Origin Energy is approved, then BG will still have direct ownership of 60% of Queensland's uncommitted 2P reserves. While this market share is less than the three-quarter share described above, the EUAA is concerned that this could still lead to a substantial lessening of competition.

The EUAA strongly urges that the ACCC review the detail of BG's joint venture with QGC to assess the EUAA's concerns.

The EUAA's submission is attached.

Yours sincerely

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Executive Director

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The Energy Users Association of Australia (EUAA) welcomes this opportunity to provide a submission in response to the Australian Competition and Consumer Commission's (ACCC) request for responses on the proposed takeover by BG or Origin Energy. In developing this submission, the EUAA has considered the merger test in s. 50 of the *Trade Practices Act* and the matters set out in the ACCC's letter seeking views on the proposed merger. It has also consulted with its members on the matter and undertaken a range of market inquiries.

The EUAA is the national association of energy users (electricity and gas) in Australia. It has over 100 members, including many of Australia's largest energy users. Our members include Queensland's biggest gas users.

Geographic, temporal and functional definition of the market

The EUAA agrees with the geographic definition of the market – southern Queensland – that the ACCC used in its decision to reject Santos' acquisition of QGC. While a pipeline linking Moomba and Ballera now exists, the capacity of this pipeline is too small in relation to the demand in Queensland to have a significant impact on the competitiveness of the southern Queensland market. In addition we note that this pipeline has been configured to flow gas out of Queensland, rather than to bring it in. An increase in capacity and reversal of flows would, we understand, require investment expenditure.

With regard to the temporal definition of the market, the EUAA is aware of the normal 5 year horizon used. On the basis of available information, it is difficult to be too precise about the usefulness of this for this matter. We note, for example, that this horizon is at the likely starting point for any LNG export facility and that there is significant uncertainty about other gas market development in Queensland even within this time frame. This also supports the need for further investigation of the proposed takeover by the ACCC.

The EUAA also agrees with the ACCC's analysis in its Santos/QGC decision that well -established gas producers such as Santos, Origin, QGC and Arrow should be distinguished from the many smaller CSM explorers and producers. Smaller explorers – who together account for 10% of 2P reserves – are not able to provide the certainty of supply on long term contracts, that Queensland's major gas consumers, who together account for the majority of consumption, require. This should be taken into account when evaluating market shares. We have done this in the analysis presented in this submission.

Does BG's Joint Venture with QGC give BG commercial control of QGC?

In February, BG and QGC agreed to form a joint venture to develop an LNG terminal and related infrastructure. As part of the transaction, BG purchased 9.9% of QGC's equity for $250m, and obtained one seat on QGC's Board. In addition, BG paid $415m for 20% of QGC's existing Walloons coal seam acreage, with an option to purchase a further 10% of this acreage for an undisclosed price, on condition that QGC achieves 2P reserves of 7000 PJ, or a Final Investment Decision (FID) is made by the JV to proceed to the development of one or more LNG facilities. As part of the JV, BG has first rights to acquire all LNG produced by the JV on pre-agreed terms related to oil prices in south east Asia.

The JV also specified percentage ownership of the LNG facility and ancillary infrastructure such as pipelines. BG will contribute the majority (70%) of the capital for this.

The JV provides strong incentives for QGC to focus its attention on proving sufficient 2P reserves to ensure that it will be possible to proceed to Final Investment Decision on the LNG terminal. An early manifestation of this incentive, is QGC's recent announcement that almost doubled its 2P reserves.

In addition to the incentives created through the JV, on the basis of the publicly available information, we conclude that through the JV, BG is in a very strong position to influence QGC's strategy and operations. In particular:

- BG has LNG development expertise and the capital needed to ensure that an LNG terminal can be developed. QGC could not successfully develop an LNG terminal without BG's involvement;
- The terms of the purchase by BG of LNG to be produced by the Joint Venture have already been agreed. This contrasts with the Shell/Arrow JV and the Santos/Petronas JV where the terms for the purchase of LNG to be produced by their respective JVs appears, on the basis of publicly available information, to be a matter for negotiation on the basis of the guideline that such purchase should take place at "market rates";
- BG has secured significant change-of-control provisions that would force QGC to sell a further 10% of its interest in the Walloons coal seam gas acreage at a pre-agreed price and that BG could terminate the alliance, the joint marketing of gas and cause QGC to be removed as operator of the underlying joint venture.
- In its investor briefing material explaining this transaction, QGC heralded the JV as "by far the most significant milestone in QGC's history" and described the JV as "likely to provide tremendous value for our shareholders";

For these reasons, the EUAA is concerned that through the JV, BG has obtained a level of strategic and commercial control over QGC normally associated with majority ownership.

BG can be expected to have been fully aware of the ACCC's refusal to approve Santos' acquisition of QGC. If it had acquired majority ownership of QGC this would have substantially increased the likelihood that its acquisition of Origin Energy would not be approved by the ACCC, on the basis of the precedent set by the ACCC's refusal to approve Santos' acquisition of QGC. By structuring its relationship with BG as a joint venture, the EUAA is concerned that the transaction would provide the appearance of QGC's continued independence whereas such independence may effectively have been forsaken for the reasons set out above.

The EUAA suggests that the ACCC needs to analyse the JV in detail to assess whether the EUAA's fears are well-founded. In particular, the EUAA suggest that the ACCC should assess:

- Whether key commercial terms such as the price at which the JV buys gas from QGC and sells it to BG are already substantially settled;
- QGC's ability to influence the JV's Final Investment Decision to proceed to develop the JV, and any constraints on its ability to refuse approval;
- The existence of break-clauses, termination payments and change of control provisions that will affect QGC's ability to renegotiate key terms of the agreement;
- The status of joint marketing arrangements between QGC and BG for domestic gas supply and LNG sales.

Implications of BG's acquisition of Origin Energy if BG is concluded to have commercial influence over of QGC

If the ACCC concludes that BG does indeed have significant commercial influence over QGC, then QGC's reserves should be counted with Origin's reserves when assessing BG's share of the southern Queensland CSM market if its acquisition of Origin Energy is approved.

There are different ways of counting these reserves. One way does not differentiate committed reserves (i.e. that have been contracted for sale) from uncommitted reserves (reserves that are available but have not yet been contracted for sale). Another way is to focus only on uncommitted reserves.

The argument for focusing on uncommitted reserves only is that these reserves are still available for sale. The argument for counting both committed and uncommitted reserves, is that the degree of commitment of some committed reserves can be uncertain and so although committed gas may already have been sold, this does not mean that it will not be sold again before its is actually used. In such cases committed gas should legitimately be counted in the analysis of the available supply.

We have calculated Origin Energy and QGC's reserve shares in Table 1 based on total 2P reserves (column 2), committed reserves (column 3) and uncommitted reserves (column 4).

Table 1. Committed and uncommitted reserves (PJ)

	Aggregate reserves (2P) and % of total		Committed reserves (2P) and % of total		Uncommitted reserves (2P) and % of total	
Origin Energy	4715	51%	2215	56%	2500	50%
QGC	2370	26%	1100	28%	1270	26%
Santos	1573	15%	0	0%	1035	21%
Arrow	791	9%	632	16%	158	3%
Total	9449	100%	3947	100%	4963	100%

* This excludes Petronas' share of Santos' reserves.

Table 1 shows that of the 9449 PJ of total 2P reserves held by the four largest Queensland CSM producers (Origin, QGC, Santos and Arrow) – which together account for over 90% of total 2P reserves, approximately 4000 PJ is committed and 5000 PJ is uncommitted.

Origin Energy and QGC's committed reserves account for approximately 84% of total committed reserves, and their uncommitted reserves together account for 76% of uncommitted reserves. It is clear from this that whether calculated on the basis of committed or uncommitted reserves, the combination of Origin and QGC would have a dominant share of the southern Queensland CSM market. Analysis of Origin and QGC's 3P or contingent CSM reserves in Queensland will yield similar conclusions on the dominant share of Queensland resources held by the combination of these businesses.

Such dominance over available reserves would allow BG to co-ordinate exploration, pipeline development and expenditure on LNG infrastructure in a way that maximizes the value of the total gas resource it owns. The EUAA is concerned that such dominance could lead to a substantial lessening of competition in supply to the south Queensland gas market, in two ways:

- It may decrease supply to the south Queensland gas market: BG's ownership of Origin and control of QGC could mean that it is able to manage reserves so that a greater proportion of its reserves could be exported than would be the case if the companies were not jointly controlled. For example, as stand-alone businesses, QGC and Origin could individually have insufficient reserves to justify investment in an additional LNG plant and so would compete to sell these "stranded" reserves into the Australian market. But if such reserves were jointly controlled by BG, it may be possible to justify an expansion in LNG capacity[1] thus reducing supplies into the Australian market, and thereby affecting the competitiveness of the Australian market.
- It will provide greater opportunity to exercise market power: The control of more than three-quarters of total supply by BG can be expected to significantly enhance BG's ability to extract higher prices for sale to the Australian market.

Competition issues to be considered if the ACCC conclude that the QGC/BG JV means that BG does not have significant influence over QGC

If, after reviewing the nature of the BG/QGC JV, the ACCC decides that this joint venture does not give BG effective commercial control of the JV, the EUAA remains concerned that BG's ownership of reserves purchased from QGC combined with Origin Energy's reserves means that BG will still have a dominant share of the Queensland CSM Market.

[1] This is what BG has suggested in its Bidders Statement for the acquisition of Origin Energy lodged with ASIC on 10 July 2008, where it has said that "The acquisition of Origin would offer BG Group the opportunity to combine production from Origin's CSG acreage with gas production under BG Group's alliance (with QGC) to potentially increase liquifaction capacity in the future."

BG bought 20% of QGC's 2P reserves. The latest information is that QGC's 2P reserves are 2370 PJ. Therefore BG has purchased 20% of 2370 PJ, which equals 474 PJ based on currently announced 2P reserves. If BG acquires Origin it will acquire 2500 PJ of uncommitted 2P reserves. Combining this with the 474 PJ acquired from QGC means that BG will have ownership of 60% of the currently known uncommitted 2P reserves of the four largest gas companies in Queensland, which together have 90% of the Queensland CSM reserves. BG's share of uncommitted reserves could increase even further since it has rights to acquire a further 10% of QGC's reserve under certain conditions. While this market share is less than the three-quarter share described earlier, the EUAA remains concerns that a 60% share could lead to a substantial lessening of competition for the reasons described above.

Finally, the EUAA is concerned that BG's seat on QGC's Board, combined with its 9.9% shareholding in QGC, will provide BG with information that it could use to its benefit and customers' detriment, if it successfully acquired Origin Energy.