

26 August 2008

Tim Grimwade  
General Manager  
Merger and Asset Sales Branch  
Australian Competition and Consumer Commission  
GPO Box 3131  
Canberra ACT 2601



Dear Mr. Grimwade

I am responding to your letter of 19 August 2008 inviting our response to BG's proposed undertakings to change aspects of its relationship with QGC, in their attempt to secure the ACCC's agreement to their proposed purchase of Origin Energy.

The EUAA considers that BG's undertakings are of little value in addressing the main competition concerns arising from BG's proposed acquisition of Origin Energy. The EUAA is even more concerned about this following QGC's recent offer to acquire Sunshine Gas. The rest of this letter explains our concerns.

#### **QGC does not compete with BG**

A premise underlying BG's proposed undertakings is that, after the undertakings are implemented, QGC will compete with BG for the sale of CSM to the Australian market. It is clearly in BG's interest to argue this in order to bolster the apparent significance of their undertakings.

But, QGC and BG are partners in a very significant joint venture whose success is important to both organizations, particularly QGC<sup>1</sup>. The purpose of the joint venture is to develop and operate an LNG train. This will require capital outlays of tens of billion dollars, and will expose BG and QGC to substantial risks. The success of this venture will depend on a very high degree of cooperation and trust between QGC and BG.

The scale and nature of this venture has established deep inter-dependency between QGC and BG. For this reason it is not realistic to suggest that QGC and BG would compete to sell to Australian CSM customers, but at the same time co-operate to sell to the export market.

At the moment and for the foreseeable future, QGC has strong incentives to maximize the amount of gas that is available to the joint venture. This is because it is only once QGC's reserves have reached a certain point that the joint venture will be able to proceed to Final Investment Decision.

A 3-4 million tonnes per annum LNG train can be expected to require reserves of more than 5,500 PJ over a 20 year life.<sup>2</sup> At the moment QGC has proven and probable (2P) reserves of 1,932 PJ – around 60% of which is already understood to be contracted for sales to customers in Australia.

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<sup>1</sup> For example, QGC's Managing Director said that the joint venture "... transforms QGC from an explorer and producer to a fully integrated energy company with outstanding growth potential. The project is likely to provide tremendous value for our shareholders over the coming two decades and the creation of hundreds of jobs in Queensland ... this transaction is by far the most significant milestone in QGC's history ..." See QGC Press Release, 3 February 2008.

<sup>2</sup> The terms of the joint venture provide that the project will be eligible to proceed to Final Investment Decision if 2P reserves available to the JV exceed 7,000 PJ. The Final Investment Decision may be made even if reserves are less than this amount, but it is highly unlikely that a decision on investment

After the purchase of Sunshine Gas, QGC's reserves will rise to 2,401 PJ at the 2P level. Even if it is assumed that none of Sunshine Gas' reserves were already contracted, QGC will still only be around a fifth of the way to the minimum level of reserves needed to reach Final Investment Decision<sup>3</sup>.

For this reason QGC's main focus will be on expanding their reserves through exploration of their own tenements and acquisition of other gas explorers such as Roma and Sunshine Gas. It is reasonable to suggest that QGC will set aside all additional reserves for the joint venture rather than make them available to customers in Australia.

In this context, and taking account of the strong ties between QGC and BG, it is clear that BG and QGC will not compete to sell gas to Australian customers. Neither have an interest in expanding their operations in this market. An undertaking to dismantle proposed joint marketing arrangements between QGC and BG is therefore irrelevant.

**The relevant Trade Practices Act question is whether BG's bid for Origin Energy leads to *additional* substantial lessening of competition**

From the discussion above it is clear that after BG and QGC's joint venture was implemented in April 2008, QGC will have put to one side any attempt to expand its Australian sales of CSM. This has already occurred before and independently of BG's proposed acquisition of Origin Energy.

As mentioned in our earlier submissions on this matter, EUAA have been reporting difficulties in contracting for long term gas arrangements in Queensland, with the potential to export CSM gas being a contributing factor. In the context of developing our response to this request for additional comment from the ACCC, a member also reported to us on a confidential basis that they had recently had offers for supply of CSM gas from QGC withdrawn. **[This last sentence should be treated confidentially.]**

The relevant Trade Practices Act question on BG's acquisition of Origin Energy is therefore whether there is any *additional* substantial lessening of competition that may occur if BG's bid for Origin Energy is approved, beyond what has already occurred as a result of BG's joint venture with QGC.

The EUAA suggests that there is reason to believe that there will be additional substantial lessening of competition. The reason for this is that by bringing together its control of QGC's reserves, and its ownership of Origin Energy's reserves, BG will be in a better position to optimise the development of LNG capacity for export, and therefore reduce sales to the domestic market.

The enhancement in BG's LNG development ability can be attributed to:

- Better co-ordination of the exploration for CSM in tenements operated by QGC and Origin Energy;
- Co-ordinating the development of LNG trains fed by QGC's and Origin Energy's reserves, thereby allowing BG to develop more export capacity, and to better sequence the development of that capacity;
- Achieving economies in the development of LNG trains, pipeline capacity from the Surat and Bowen basins to Gladstone, and also in the significant support infrastructure needed to facilitate export (export terminals, electricity generating capacity, etc.).

These benefits can be described as economies of scale and economies of co-ordination. The effect of these economies will be to allow BG to:

- reduce development and operation expenditure; and
- reduce and manage better, LNG development and production risks;
- raise LNG revenue and achieve more certain supplies.

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into a project worth tens of billions will be made unless there is a very high degree of certainty that sufficient reserves – at least 5,500 PJ (at the 2P level) – are available.

<sup>3</sup> This is after taking account of reserves that have already been contracted for sale in the domestic market.

This will strengthen BG's competitiveness in exporting LNG and is the essence of the message that BG has communicated to Origin Energy's shareholders in its Bidders Statement.<sup>4</sup> EUAA specifically refers the ACCC to the study done by WoodMackenzie for BG as part of their Bidders Statement, and attached to that document as an appendix. Their analysis of the Petronas-Santos deal illustrates very clearly the enormous financial benefits that BG would derive through economies of scale for the development of more than one LNG terminal.

By combining its interests in QGC with ownership of Origin Energy, BG will be more effective in developing LNG capacity than it would be if it was working with QGC only, or if it owned Origin Energy only and the additional profitability of multiple developments would be highly significant.

In being able to lower its LNG risks and costs, and raise its LNG revenues, BG will have much less need or desire to sell CSM in Australia in order to diversify income and expenditure. In other words, if it is able to combine its control of QGC's resources with its ownership of Origin Energy, BG will place less value on the income and risk diversification that Origin Energy's Australian CSM business provides.

The effect of this will be a substantial lessening of competition and consequently significantly higher prices since the domestic market will be left to the remaining gas suppliers, who between them share just 24% of existing 2P reserves.<sup>5</sup> It should be noted that a large proportion of this 24% residual amount is accounted for by Santos, which is already far advanced in its LNG developments, and has no intention of making CSM available for sale in the Australian market. In other words, allowing BG's bid for Origin Energy to proceed has the very real prospect of a step change reduction in the supply of CSM to the Australian market. The remaining participants that may have any interest in meeting the domestic demand will be those that don't have a prospect of accessing the international market. These are only the small players who have limited or no record of delivery in the sorts of volume and with the certainty of supply that Queensland's major industrial customers demand.

It should be clear from this that allowing QGC to acquire Origin Energy is likely to lead to a very substantial lessening of competition.

### **Undertaking to Relinquish QGC Board Seat**

While this letter has focused principally on BG's undertaking to unwind joint marketing arrangements and to alter the provision of some information, to this point we have not specifically commented on BG's undertaking to relinquish its seat on QGC's Board. On this issue, as we made clear in our letter to the ACCC on upstream tenement sharing, there is some value to BG in its seat on QGC's Board, but Directors' fiduciary obligations under Corporations Law binds any QGC Director to act in QGC's best interests. As such, we suggest that BG's undertaking to relinquish its seat on the Board is not of great significance.

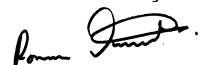
### **Appropriate remedy**

For the reasons set out above, the EUAA suggests that the appropriate remedy for approval of BG's bid for Origin Energy, should be to require BG to terminate its joint venture with QGC to develop an LNG train.

The nascent CSM industry shows the promise of future export revenue, profits and jobs. Energy users are concerned that they may inevitably have to pay higher prices once the export potential is realized. This makes it even more important that CSM industry is a vigorously competitive market. BG's acquisition of Origin Energy and its proposed undertakings to alter its relationship with QGC will reduce competition in this industry not secure it.

This is a very significant issue to the EUAA's members. We would be grateful if you would meet with us to discuss this further.

Yours sincerely



Roman Domanski  
**Executive Director**

<sup>4</sup> On page 36 of BG's Bidders Statement for the acquisition of Origin Energy, it says 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 liquefaction capacity in the future.*"

<sup>5</sup> See Table 1 of our initial submission to the ACCC on this matter.