



Australian
Competition &
Consumer
Commission

30 March 2012

Statement of Issues — APA Group proposed acquisition of Hastings Diversified Utilities Fund

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of Hastings Diversified Utilities Fund by APA Group (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by **13 April 2012** and anticipates making a final decision on **26 April 2012**. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 13 April 2010, the ACCC commenced a public informal review of APA Group's (APA) completed acquisition of a 14.9% interest in Hastings Diversified Utilities Fund (HDF).
6. During the course of the ACCC's review, APA increased its interest in HDF to 16.8%.

7. On 27 July 2010, the ACCC decided not to oppose APA's completed acquisition of 16.8% of HDF, concluding that the acquisition was unlikely to substantially lessen competition.
8. Between July 2010 and November 2011 APA increased its interest in HDF to 21.11%.
9. On 14 December 2011, APA announced a takeover offer for the remaining units in HDF. On the same day the ACCC commenced a public informal review of APA's proposed acquisition after receiving a submission from APA seeking clearance from the ACCC for the proposed acquisition.

The parties

APA Group

10. APA is comprised of the Australian Pipeline Trust and APT Investment Trust and is one of Australia's major energy transmission companies. It owns more than \$8 billion worth of major gas transmission and distribution assets (further information provided below in paragraph 90) including:
 - the Victorian Transmission System (**VTS**) comprising the South West Pipeline (**SWP**), the Principal Transmission System (**PTS**) and the Interconnect;
 - the Moomba to Sydney Pipeline (**MSP**);
 - the Roma to Brisbane Pipeline (**RBP**);
 - the Carpentaria Gas Pipeline (**CGP**); and
 - a 50% interest in the SEA Gas Pipeline (**SEA Gas**).
11. APA also has interests in a number of distribution networks and minority interests in energy infrastructure vehicles.

Hastings Diversified Utilities Fund

12. HDF is listed on the Australian Stock Exchange and owns 100% of Epic Energy Pty Ltd (**Epic**). Epic, through a number of subsidiaries, owns a number of major Australian gas transmission pipelines (further information provided below in paragraph 90) including:
 - the South West Queensland Pipeline (**SWQP**);
 - the Queensland to South Australia/New South Wales Link (**QSN**);
 - the Moomba to Adelaide Pipeline (**MAPS**); and
 - the Pilbara Energy Pipeline (**PEPL**) in Western Australia.

Other pipeline operators

13. Jemena is an Australian infrastructure company that is 100% owned by Singapore Power International, a large international utilities company owned by the sovereign wealth fund of Singapore.
14. Jemena owns and manages the following eastern Australian gas infrastructure:
 - the Queensland Gas Pipeline (**QGP**);
 - the Eastern Gas Pipeline (**EGP**);
 - the VicHub facility;
 - the Colongra Gas Pipeline and storage facility;
 - the Jemena Gas Network in New South Wales; and
 - 50% ownership share of the ActewAGL gas distribution business.
15. Jemena Asset Management (a Jemena entity) also manages the Central Ranges Pipeline on behalf of APA, and the South Gippsland Natural Gas Pipeline and Multinet Gas on behalf of the DUET Group.

The proposed acquisition

16. APA currently holds a 21.11% interest in HDF. On 14 December 2011, APA announced a takeover offer for the remaining stapled securities in HDF.
17. APA's bid for 100% of HDF is subject to a number of conditions including obtaining informal clearance from the ACCC and approval from the Foreign Investment Review Board.
18. Post acquisition, APA will own more than 80% of the transmission pipelines in eastern Australia on the basis of both length and volume.

Industry background

19. The diagrams below illustrate the major gas production basins, transmission pipelines and demand centres in eastern Australia pre and post acquisition.

Figure 1 – Eastern Australian gas transmission pipelines pre acquisition

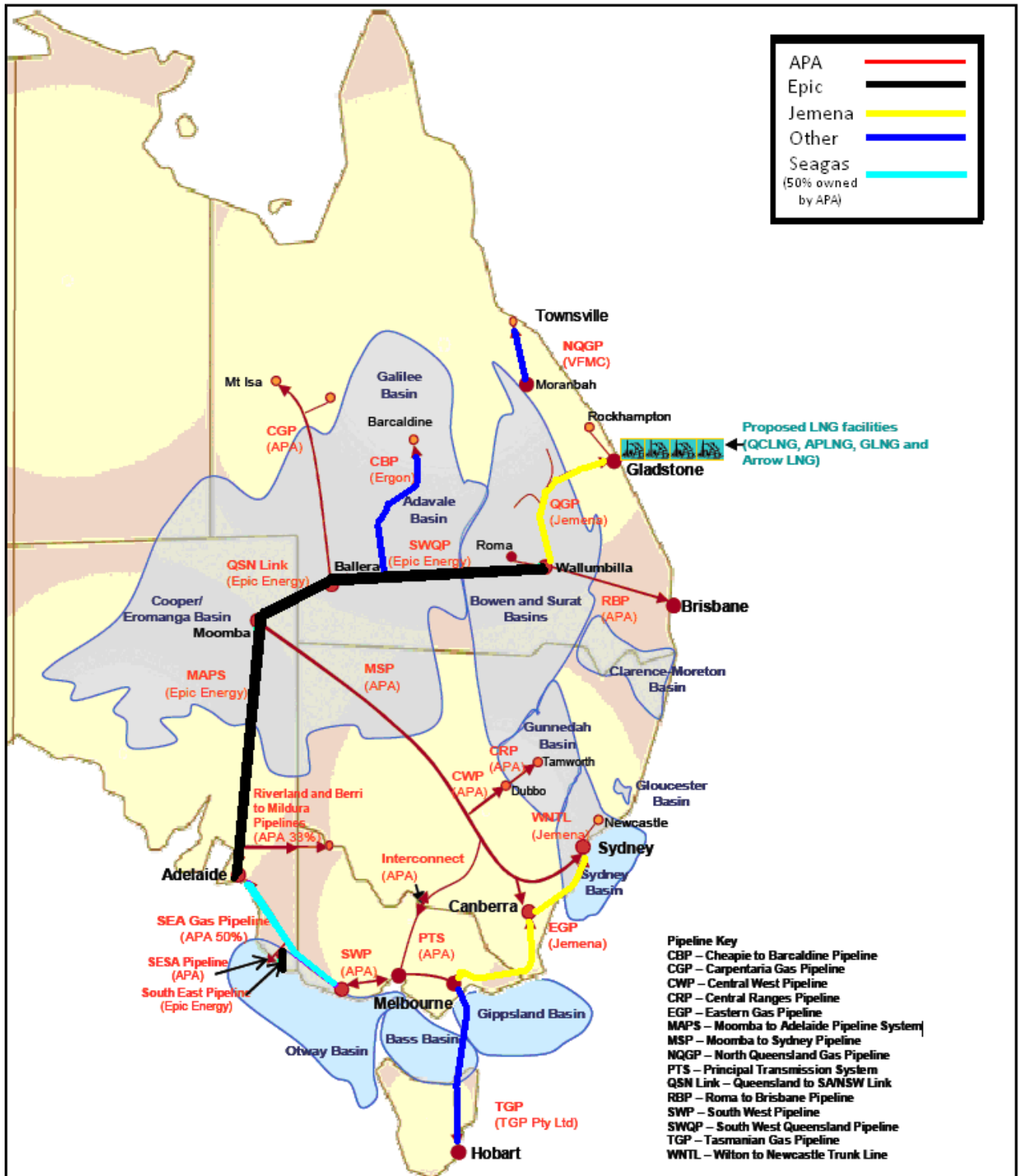
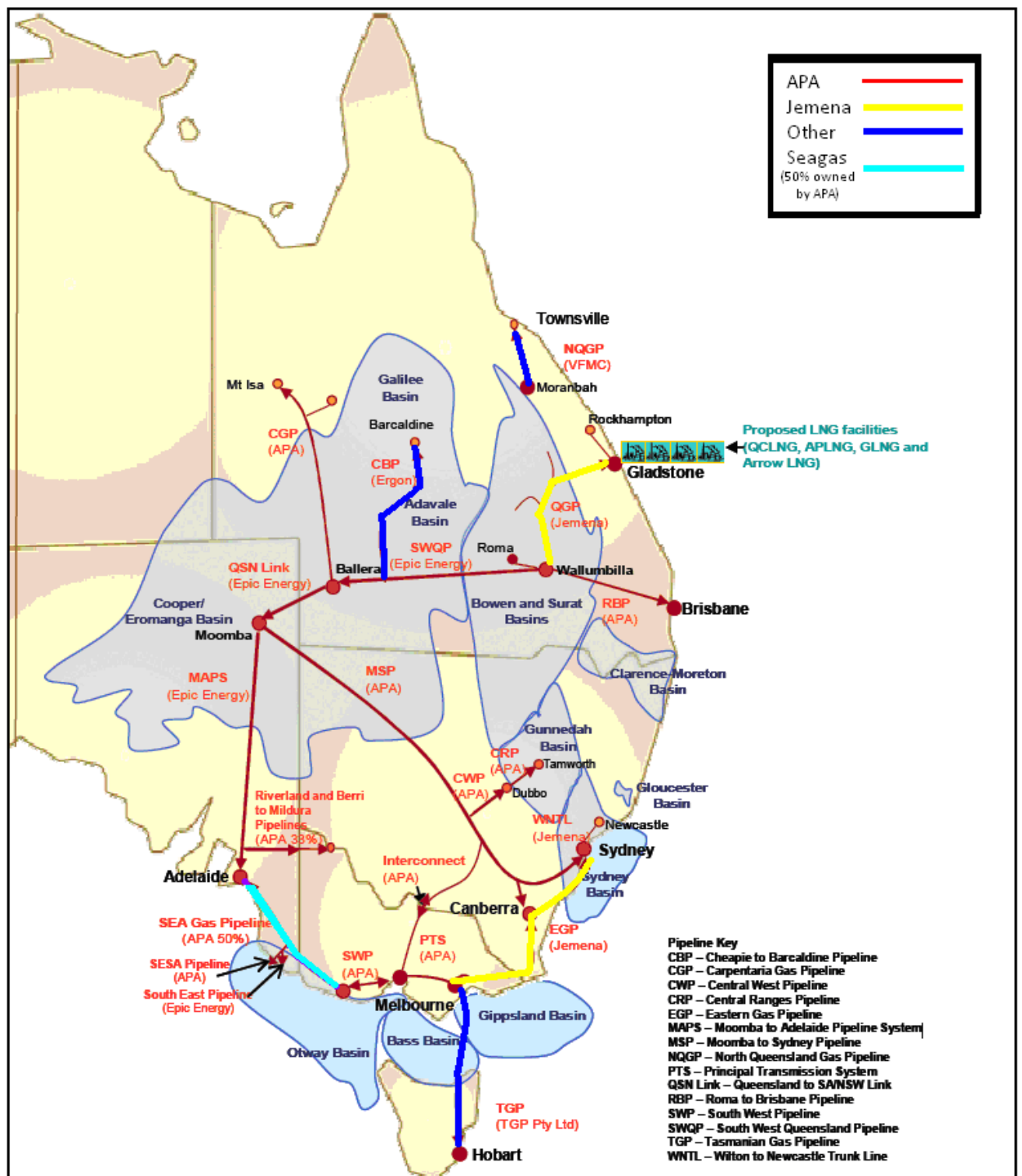


Figure 2 – Eastern Australian gas transmission pipelines post acquisition



The gas supply chain

Production

20. Gas producers (**producers**) explore for and extract raw natural gas from petroleum reservoirs and coal seams. Producers then process the raw gas into pipeline quality natural gas for the domestic market or liquid natural gas (**LNG**) for export.
21. Parties that contract for the transmission of gas along pipelines are referred to as **shippers**. Shippers include retailers, wholesalers, electricity generators and industrial users.
22. Producers usually sell gas to shippers at the production point. The shipper then contracts with the transmission pipeline operator for the transmission of the gas. The ACCC is aware that, in some instances, producers also contract to acquire transmission themselves to enable them to sell gas to user parties at the point of delivery. In these circumstances the producer is also the shipper.
23. Gas producers in Australia include Santos, Exxon-Mobil, BHP Billiton, AGL Energy and Origin Energy.
24. It is common for oil and gas producers to establish joint ventures to help manage risk. For instance:
 - Cooper Basin Joint Venture – a joint venture led by Santos in relation to the production in South Australia’s Cooper Basin. The other participants are Beach and Origin Energy. The same companies participate with slightly different shares on the Queensland side of the Basin;
 - Longford gas production – a joint venture between Esso and BHP Billiton in relation to the production in the Gippsland Basin; and
 - Bass Gas – a joint venture between Origin Energy and Australian Worldwide Exploration in relation to the production in the Bass Basin.

Transmission

25. The gas transmission sector involves, among other things, the transportation of processed natural gas through high pressure pipelines from processing facilities to the entry point (‘city gate’) to the distribution system (which is discussed below in paragraph 27), or major manufacturing/power generation sites. Gas transmission pipelines typically have high operating pressure to optimise shipping capacity and can act as storage vessels as well as modes of transportation.
26. APA, Epic and Jemena are the major pipeline operators in eastern Australia.

Distribution and retail

27. The gas distribution sector operates a lower pressure gas network for the transportation of gas from city gate delivery stations to residential, commercial and industrial sites. The gas retail sector sells the delivered gas to end users (both retail and wholesale). Gas distributors/retailers can be categorised as intermediaries, who transport gas from the city gate to end users of gas.
28. At a national level, natural gas consumption is dominated by the electricity generation and manufacturing sectors, however, consumption varies between states. The electricity, manufacturing and mining sectors typically do not require the services of natural gas distributors or retailers and, with their substantial volumes, pay significantly lower prices per unit of natural gas than do residential customers. Larger users often negotiate directly with producers to purchase gas, and then negotiate with transmission pipeline operators for the delivery of gas. As the unit prices are lower for large users, transmission charges account for a higher proportion of the price.
29. Major users of gas who purchase gas after transmission but prior to entry into the distribution system, include Xstrata, Rio Tinto, Visy, AGL Energy and Origin Energy.
30. Major gas retailers who purchase gas from producers, utilise the transmission system, and then on-sell gas to residential, commercial and industrial users through the distribution systems, include TRUenergy, Lumo Energy, Alinta Energy, AGL Energy and Origin Energy.
31. Due to the vertically integrated nature of their businesses and involvement in electricity generation and retailing operations, parties such as AGL Energy and Origin Energy are producers, shippers, retailers, wholesale customers and major users of gas.

Gas supply and transportation contracts

32. Generally shippers in the gas industry need to enter:
 - Gas Supply Agreements (**GSA**) with one or more gas producers for the supply of gas at a point of production; and
 - Gas Transportation Agreements (**GTA**) with one or more transmission pipeline operators for the transportation of their gas from one or more points of production to one or more points of demand.
33. The ACCC understands that smaller shippers tend to contract with a limited number of producers and pipeline operators. In contrast, larger shippers enter a diverse portfolio of GSAs with various geographically disparate supply basins and various GTAs in respect of various transmission pipelines.
34. The ACCC understands that for smaller shippers the delivered price of gas is likely to be the principal determinant of which pipeline(s) are used to supply a specific point of demand.

35. In contrast, the ACCC understands that for larger shippers the minimum cost to service the shippers' portfolio of demand will be the principal determinant as to which pipeline(s) are used to supply a specific point of demand. This means that a large shipper may not necessarily seek to minimise the delivered cost to a single point of demand, but rather seeks to minimise its costs across its portfolio of contracts.
36. The length and terms of GSAs and GTAs vary depending on the parties, basins and pipelines involved. The ACCC understands that shippers tend to enter into long term GSAs and GTAs for firm forward haulage 'base load supply' (as described below in paragraph 37). 'Base load supply' contracts may include some ancillary service provisions (discussed below in paragraph 49). Shippers also enter into shorter term contracts on an as needed basis to address short term variations in demand or supply, for example during periods of supply basin or pipeline disruption or maintenance.

Gas transportation services

Forward haul

37. Forward haul consists of 'base load supply' and involves the transportation of gas downstream from a point of production to a point of demand via one or more pipelines. Shippers are generally required to pay for a fixed amount of capacity on a pipeline (expressed as \$/Maximum Daily Quantity (**MDQ**)) and a volume charge (based on GJ of gas actually transported). The proportion of the MDQ and of the volume charge in the total transportation price depends on the conditions agreed in each GTA. Forward haul services can be provided on a firm, as available or interruptible basis.
38. Firm capacity refers to the contractual right of a shipper to use gas within a pipeline. Other than in exceptional circumstances (such as during a force majeure) this firm capacity is expected to be available at all times and enables shippers to inject/withdraw at one or more points.
39. In circumstances where the pipeline has unused capacity after satisfying the firm capacity, that capacity can be on sold by the pipeline operator for use by other shippers. This is called "as available" capacity.
40. Another type of non-firm capacity is 'interruptible capacity' which has similar characteristics to 'as available' capacity, but has the lowest priority in the event there is insufficient capacity to service all users' nominations.

Back haul

41. Back haul involves the contractual right to the transportation of gas in a direction opposite to the aggregate physical flow of gas molecules in a pipeline.
42. The ACCC understands that back haul services are generally provided on a firm capacity basis, except when the pipeline is not bi-directional (discussed at paragraph 48).

Compression

43. Compression involves increasing the pressure of gas by reducing the volume it occupies. Compression is mainly used to expand the capacity of a pipeline allowing the transportation of an additional volume of pressurised gas. The maximum pressure of transmission pipelines is approximately 15 Mpa, however some pipelines operate at lower pressures.
44. For pipeline operators to be able to sell additional capacity provided by compression, they need to have compressor stations available on their pipeline. These stations may be owned by the pipeline operator or by a third party.
45. Shippers can also use compressor stations installed at the supply basin by either the shipper, producer or a third party.
46. Therefore, the ACCC understands that compression services are not “pipeline specific”, meaning that compression services can be contracted on one pipeline in order to make it possible for shippers to use another connected pipeline for the transportation of the pre-pressurised gas.

Flow direction

47. Gas travels down a pipeline from an origin of higher pressure to a destination of lower pressure. The aggregate flow of a pipeline will therefore be in one direction (the flow direction), from the place where the majority of gas is injected into the pipeline to the place where the majority of gas is withdrawn from the pipeline.
48. The ACCC understands that a number of pipelines are ‘bi-directional’ because they possess compression capacity at both ends of the pipeline. These compression facilities would allow the pipeline to reverse the flow direction if there is sufficient demand to make it profitable to do so. The ACCC further understands that uni-directional pipelines can be made bi-directional by installing compression facilities at both ends of the pipeline.

Ancillary services

49. While gas production facilities tend to have a relatively flat supply profile, gas demand tends to fluctuate over daily, weekly and seasonal periods. Fluctuations in gas demand occur for a range of reasons (such as weather) which cannot be accurately predicted in advance. Transmission pipeline operators offer ancillary services to assist shippers in managing the differences between supply and demand.

Imbalance services

50. GTAs typically provide shippers with some degree of flexibility to manage the variability in the demand for gas by end-users. The provisions that confer this flexibility include:
- *The imbalance provisions* – an imbalance will occur when the volume of gas injected by the pipeline operator differs from the volume of gas withdrawn by the shipper. The terms on which imbalances are dealt with differ across pipelines and GTAs. The ACCC understands that some pipelines may allow an imbalance up to a specified threshold before imposing imbalance charges.
 - *The overrun provisions* – an overrun will occur when the volume of gas withdrawn by the shipper exceeds the Maximum Hourly Quantity (MHQ) or the MDQ specified in the shipper's GTA. The terms on which overruns are dealt with differ across pipelines and GTAs. The ACCC understands that some pipelines allow overruns up to a specified threshold before imposing charges. The ACCC further understands that the charges payable for an overrun may be lower on some pipelines if the shipper informs the pipeline operator prior to the receipt or withdrawal of the gas and the overrun is authorised.

Storage

51. *Storage* – allows a shipper to inject more gas into a pipeline than it takes out on a particular day, up to a specified threshold (imbalance allowance) without incurring imbalance charges. The additional gas supplied into the pipeline (positive imbalance) may be withdrawn by the shipper at a later point in time.
52. *Storage and loan* – allows a shipper to inject less gas than it takes out on any given day (negative imbalance) up to a specified level without incurring imbalance charges. The additional gas taken by the shipper (the 'loan') must be repaid within the time specified in the contract.
53. If a shipper exceeds the positive or negative allowance provided by the storage and/or storage and loan services then the shipper will incur imbalance charges.
54. The terms and conditions of ancillary services vary across pipelines and contracts. There can be variations in:
- the price of the services;
 - time period – ranging from short term (days or weeks) to very long term (10 + years);
 - liability – in relation to which party (producer/shipper or pipeline operator) is liable in the scenario of an overrun or where the pipeline or supply basin is unavailable; and
 - how imbalances are dealt with, the imbalance percentage allowed and over what period.

55. *Lateral storage* – shippers can procure the construction of a dedicated pipeline lateral (storage vessel) in close proximity to the point of demand that can be used to store gas during non-peak periods and to supply the gas to the point of demand during peak periods.
56. *Long term storage* – there are dedicated underground storage facilities, such as the Western Underground Storage facility in Victoria, that allow a shipper to store gas that it purchases during the non-peak demand periods and access that gas during peak demand periods.

Other services

Construction, connection, extension and maintenance

57. *Construction and connection* – includes the construction of new ‘traditional’ pipelines from a point of production to a point of distribution and the construction of a lateral pipeline connecting an existing transmission pipeline to a point of distribution or storage.
58. *Extension* – involves lengthening an existing pipeline to traverse a greater distance.
59. The ACCC understands that there are limits above which gas cannot be compressed. In order to increase capacity once the maximum level of compression has been reached pipeline operators can procure the construction of a ‘pipeline loop’. The ACCC understands that ‘pipeline looping’ involves the duplication of one or more portions of pipeline.
60. The ACCC understands that the merger parties both procure and supply services for the construction and extension of pipelines. The merger parties also procure and supply services for the ongoing maintenance services to both laterals and transmission pipelines owned by third parties.

Short Term Trading Market

61. The Short Term Trading Market (**STTM**) is a day-ahead gas market that establishes a market price at a hub. Currently there are STTM hubs in Sydney, Adelaide and Brisbane. The STTM is a compulsory gross market – this means that all gas supplied to and acquired at a specific hub is transacted in the STTM, including gas that is supplied under existing long-term contracts.
62. The market participants in the STTM are defined as follows:
 - *Market operator* – the Australian Energy Market Operator (**AEMO**) operates the STTM and operates a contingency gas scheme to balance supply and demand (but has no statutory responsibility to manage gas quality or system security).
 - *Shippers* – offer gas for sale and have contractual rights to haul gas on a hub-connected distribution network.

- *Network users* – purchase gas (retailers or large customers) and have a contractual right to take gas from a hub-connected distribution network.
 - *Pipeline operators* – operate gas transmission pipelines. Pipeline operators maintain pressures at the network gates within agreed operating ranges and may also have a role in managing supply shortfall.
 - *Network operators* – manage and operate the distribution network and are responsible for operation of the network during a supply shortfall.
63. The STTM applies different prices to gas transacted under different forms of allowed transactions:
- *Ex-ante market transactions and ex-ante market price* – Shippers place offers to sell gas and network users place bids to buy gas on a given day. Gas is scheduled from the lowest to highest price and, a day ahead, the market operator determines the market price and issues a market schedule of gas flows. Gas that is supplied and withdrawn in accordance with the market schedule is settled at the ex-ante market price.
 - *Imbalance and ex-post imbalance price* – If the quantity of gas that flows to and from the hub does not match the market schedule then the imbalance is settled at an imbalance charge – not the market price.
 - If the shipper supplies more gas than scheduled then it will receive an imbalance payment that is materially lower than the market price. If a shipper provides less gas than scheduled then it will pay an imbalance charge that is materially higher than the market price. Shippers may use intra-day nomination services to address imbalances.
64. The ACCC understands that the market risk represented by the imbalance charge encourages large shippers to diversify their portfolio of GSAs and GTAs to ensure that they are able to minimise imbalance costs.

Victoria

65. Victoria established a spot market for gas in 1999 to manage gas flows on the VTS. The VTS, comprising the SWP and PTS and the Interconnect, is the primary system for the transmission of natural gas at high pressure in Victoria. The VTS is not a traditional point to point pipeline as there are a number of injection and withdrawal points.
66. The market allows participants to trade gas supply imbalances, based on injections and withdrawals, on a daily basis. The AEMO operates both the wholesale market and the VTS.

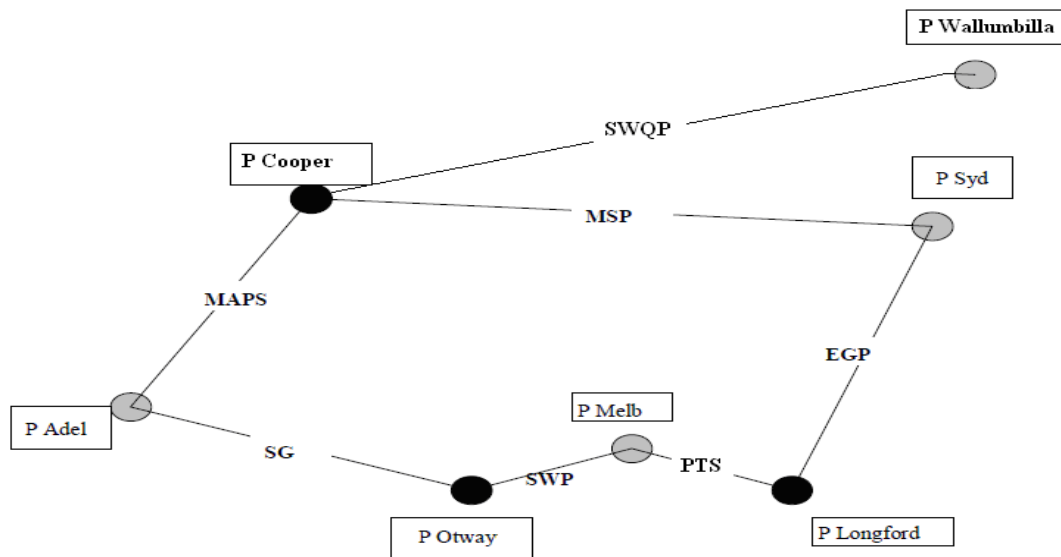
Gas swaps

67. Gas swaps are a mechanism that producers and shippers can use in order to bypass or minimise the use of transmission pipelines.

68. At its simplest, a swap involves shippers utilising their portfolio in a manner that will minimise transportation costs to obtain a lower portfolio cost.
69. Swaps can be conducted internally within a shippers' portfolio or externally through negotiation between two shippers.
70. An effect of a swap may be lost revenue to a pipeline or pipelines. This effect is materially higher where parties can totally avoid the capacity charges of a new or existing pipeline.
71. The complexity and risk involved in a swap depends on a number of factors including the volume of gas, timeframe and distance.
72. The ACCC understands that the term 'swap' can encompass a variety of meanings within the gas industry. The ACCC has used the following terms when referring to swaps:
 - *internal swap* – a restructure of a shipper portfolio in a manner which will minimise delivered and/or transmission costs to obtain a lower portfolio cost; and
 - *external swap* – a restructure of a shipper portfolio in coordination with another producer/shipper in a manner which will overcome transportation costs to obtain a lower delivered cost of gas.
 - The ACCC understands that internal and external swaps can be a:
 - *pure swaps* – a swap at points of production; or
 - *partial swaps* – a swap at points of demand.
73. The ACCC considers that the ability of a shipper to perform a pure/partial internal swap will depend on the level of diversity in their portfolio.
74. The ability of a shipper to perform a pure/partial external swap will depend on whether a counterparty can be found that has an existing obligation to provide gas to a location that can also be provided by the shipper seeking to enter into the swap. The ability to enter into a swap will also depend on whether the arrangement can be structured so that the counterparty is no worse off as a result of entering into the swap.
75. From the perspective of the shipper seeking to enter into the swap, a swap will only constitute a viable alternative to transporting the gas via an existing pipeline if the overall cost of entering into a swap is less than or equal to the charges that would be levied by the pipeline operator.
76. The ACCC considers that a swap is a mechanism that allows competition between both connected and unconnected pipelines.

Figure 3 - Example of a partial external gas swap

The example below illustrates how gas swaps can be practically used to bypass the MSP.



Suppose that Retailer A has procured a gas supply from Moomba at a price P_{Moomba} , and is required to service demand in Sydney. Retailer A can do this by taking this gas to service their Sydney demand centre using forward haul along the MSP (Total profit_{Retailer A} = $P_{\text{Syd}} - P_{\text{Cooper}} - P_{\text{MSP}}$).

Suppose that Retailer B has procured a gas supply from Otway at a price P_{Otway} , and is required to service demand in Adelaide. Retailer B can do this by taking this gas to service their Adelaide demand centre using forward haul down SEA Gas (Total profit_{Retailer B} = $P_{\text{Adelaide}} - P_{\text{Otway}} - P_{\text{SEA Gas}}$).

Given a scenario where MSP raises its prices, Retailer A may wish to bypass use of the MSP. They can do this by coordinating a swap agreement with Retailer B (assuming Retailer A will pay Retailer B an amount equivalent to P_{Swap}) such that:

- Retailer A can send the gas that they purchased from Moomba along MAPS to Adelaide to service Retailer B's demand (Total profit_{Retailer A} = $P_{\text{Syd}} - P_{\text{Moomba}} - P_{\text{MAPS}} - P_{\text{Swap}}$).
- Retailer B can send the gas that they purchased from Otway along SWP, and up the EGP to Sydney in order to service Retailer A's demand (Total profit_{Retailer B} = $P_{\text{Adelaide}} - P_{\text{Otway}} - P_{\text{SWP}} - P_{\text{PTS}} - P_{\text{EGP}} + P_{\text{Swap}}$).

This swap agreement has allowed for Retailer A to bypass the use of MSP.

The swap is commercially viable when the total profit the retailers are both able to attain in its absence is less than the total profit they are both able to attain whilst using the swap.

It is clear that the swap is more likely to be materially effective if the price on MSP is relatively high.

With/without test

77. Section 50 of the *Competition and Consumer Act 2010* (**Act**) prohibits mergers or acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a market. In assessing a merger pursuant to section 50 of the Act, the ACCC must consider the likely effects of the proposed acquisition by comparing the likely future competitive environment if the acquisition proceeds (the “with” position) to the likely competitive environment if the acquisition does not proceed (the “without” position or “counterfactual” position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
78. Based on the information currently available, the ACCC considers that the most likely counterfactual will involve a situation where there is no change to the ownership of transmission pipelines.
79. Market participants have advised the ACCC that the Australian gas industry is in a state of flux with potentially significant changes occurring over the coming years. While these developments are likely to occur with or without the proposed acquisition, it remains necessary for the ACCC to have regard to these matters in its assessment of the proposed acquisition. Some of the more significant developments are set out below.

LNG exports

80. The ACCC understands that the commencement of LNG exports out of Gladstone in 2014 is expected to drive significant increases in the demand for gas. This will increase the demand for gas transmission and may require pipeline expansions and potentially changes in flow directions of certain pipelines.
81. Market participants have advised the ACCC that the increased demand for gas likely to arise from the commencement of LNG exports in 2014 has the potential to alter the net direction of gas haulage from south to north as opposed to the current landscape where gas moves south from Queensland and north from Victoria.

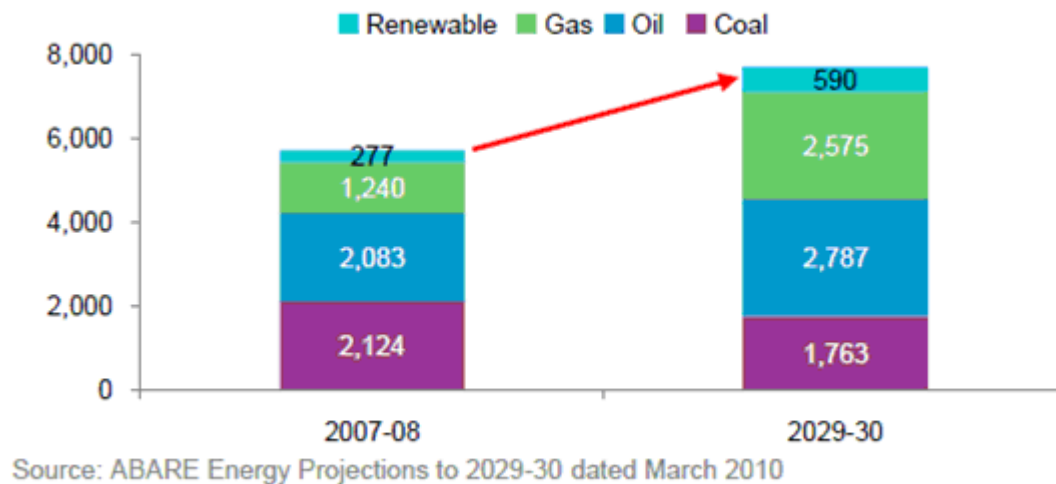
New gas reserves

82. Market participants have indicated that new pipeline developments are likely to be required for the transportation of natural gas from the emerging Gunnedah supply basin to both domestic demand centres and export facilities in Gladstone.
83. Market participants have also indicated that new gas transmission pipelines duplicating the RBP and the SWP may be feasible.

Implementation of a Carbon Pricing Mechanism

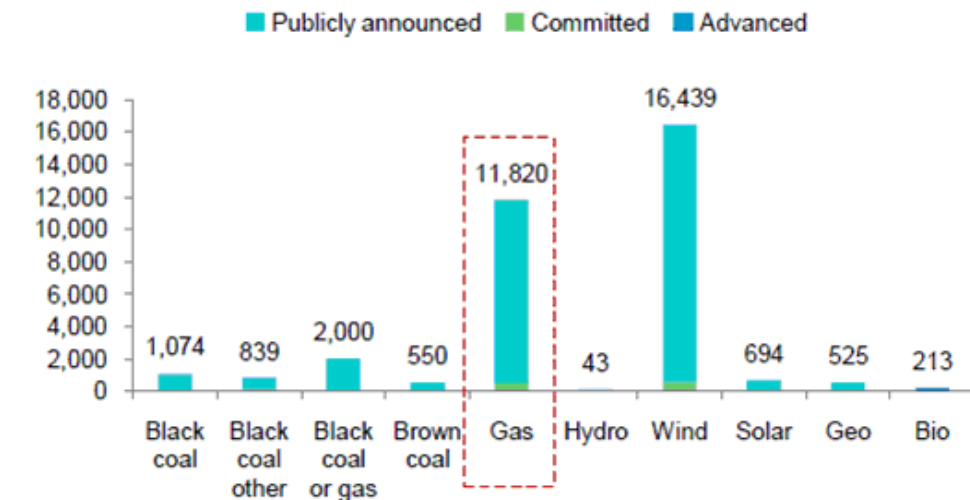
84. The ACCC understands that the implementation of a carbon pricing mechanism is likely to drive greater demand for natural gas as a fuel for electricity generation due to its lower emissions profile compared to coal.
85. The ACCC notes that the Australian Government has announced specific measures to remove 2,000 megawatts of coal-powered generation capacity by 2020 under the Contracts for Closure component of the Energy Security Fund. This will require equivalent capacity to be generated from other fuel sources, with a large percentage of this expected to come from natural gas.
86. The ACCC notes Australian Bureau of Agricultural and Resource Economics (**ABARE**) predictions quoted by HDF in its Target Statement and reproduced below in Figure 4 as indicative of the likely growth in natural gas demand.

Figure 4 – Evolution of energy consumption by energy source



87. The ACCC also notes AEMO predictions quoted by HDF in its Target Statement and reproduced below in Figure 5 as indicative of the likely growth in demand for natural gas as a fuel source for electricity generation.

Figure 5 – Capacity of committed and proposed electricity generation projects by energy source



Source: AEMO Electricity Statement of Opportunities 2011

The ACCC invites interested parties to comment on the likely developments impacting on the demand for, and supply of, gas and how these developments may affect the demand for pipeline capacity, flows on pipelines and competitive constraints on the merged firm.

In particular, the ACCC would welcome views on:

- the potential impact on the Australian gas industry resulting from developments in:
 - LNG exports;
 - diminishing gas reserves in existing gas basins;
 - new gas reserves in existing and new gas basins;
 - changes in domestic gas demand;
 - a reversal in flow of one or more pipelines; and
 - other relevant future changes; and
- whether, and to what extent, any market changes identified above will change the incentives for new entry into the relevant market(s).

Market inquiries

88. On 16 December 2011, the ACCC commenced market inquiries regarding the proposed acquisition. Responses were received from a range of interested parties including producers, shippers and retailers, and parties with interests in gas transmission pipelines.

Market definition

89. The purpose of market definition is to identify the close competitive constraints on the pipeline(s). That is, to identify potential close substitutes or alternatives available to gas producers and shippers that may constrain the pricing of the services provided by each pipeline. In providing comments on market definition, it would be helpful if parties could provide examples of which alternatives would likely be utilised by market participants, both in the short term (within the life of current contracts) and the long term (once current contracts expire) in response to an increase in the prices charged by individual pipelines.
90. The proposed acquisition will result in the aggregation of ownership of the following transmission pipelines:
- the SWQP, which is used for the transportation of gas from Wallumbilla to the entry point of the QSN Link at Ballera;
 - the QSN Link, which is used for the transportation of gas from Ballera to the entry point of both the MSP and the MAPS;
 - the MSP, which is used for the transportation of gas from Moomba to Sydney, Canberra, and regional locations in New South Wales and Victoria (via the Interconnect);
 - the MAPS, which is used for the transportation of gas from Moomba to Adelaide and regional locations in South Australia;
 - the RBP, which is used for the transportation of gas from Roma to Brisbane;
 - a 50% interest in the SEA Gas, which is used for the transportation of gas from Port Campbell to Adelaide and regional locations in South Australia; and
 - the VTS, comprising the SWP, PTS and the Interconnect, which is used for the transportation of gas from a number of supply basins to Melbourne.

Product dimension

91. The ACCC understands that both APA and Epic are involved in:
- gas transmission;
 - supply of ancillary services; and
 - construction, connection, extension and maintenance of gas transmission pipelines.

The ACCC invites interested parties to comment on the appropriate product dimension of the relevant markets.

In particular, the ACCC would welcome views on:

- whether transmission of gas and ancillary services are correctly characterised as separate product markets or should be included in the same product market.
- whether substitution occurs between:
 - specific products on different pipelines (e.g. back haul services on one pipeline and ancillary services on another); or
 - bundles of services on different pipelines (e.g. combinations of back haul services, ancillary services and firm forward haulage).
- whether, and to what extent, the demand for ancillary services on one pipeline is independent from the demand for the transmission of gas on the same pipeline.

Geographic dimension

92. The ACCC is yet to form a view on the appropriate geographic dimension of the relevant markets.

Eastern Australia

93. The eastern Australian gas transmission pipeline system became fully connected in 2009 with the completion of the QSN. This created an integrated pipeline network between the three main supply regions (Victoria, the Cooper Basin and eastern Queensland) and each of the major demand centres (Adelaide, Melbourne, Sydney, Brisbane and Canberra).
94. Some market participants submit that the existence of multiple routes from a given supply centre to a given demand centre and the use of gas swaps mean that competition between pipelines should be analysed in an eastern Australian market for gas transmission and ancillary services.

Individual markets for each demand and supply centre

95. Some market participants have advised that competitive tension exists for the supply of gas transmission services from individual supply basins and to individual demand centres. The ACCC is considering whether the relevant markets might be more appropriately characterised as the transmission of gas to particular demand centres, and/or the transmission of gas from particular supply centres.

The ACCC invites market participants to comment on the appropriate geographic dimension of the relevant markets.

In particular, the ACCC would welcome views on:

- whether it is commercial, or likely to be commercial, for shippers to ship gas from a different basin to the same demand centre in response to an increase in transmission pricing.

For example, if prices were to rise on the MSP, would shippers seek to acquire gas from producers in the Gippsland Basin (rather than the Cooper Basin) and ship it to Sydney via the EGP?

- whether it is commercial, or likely to be commercial, for shippers to use alternative transmission routes between a particular single supply basin and demand centre.

For example, to get gas from the Cooper Basin to Adelaide, if prices were to rise on the MAPS, would a shipper find it feasible to utilise the alternative transmission route of the MSP, the Interconnect, the PTS, the SWP and SEA Gas?

- whether it is likely that producers would seek to supply gas to customers in a different demand centre in response to a price increase on one or more pipeline.

For example, if prices were to rise on the MSP, would producers in the Cooper Basin actively seek more customers at Gladstone or in Adelaide?

- the extent to which internal and external swaps provide the scope for shippers to substitute between gas pipelines in response to increases in transmission prices.

For example, if a shipper has contracted secure gas supply from the Cooper Basin, can the shipper meet contracted demand in Sydney and avoid the use of the MSP through the use of 'swaps'?

In providing views on the above matters, please consider what is likely to be profitable in both the short term (within the life of current contracts) and the long term (once current contracts expire).

Functional dimension

96. The functional dimension of a market captures the vertical elements of the production chain over which competition or substitution occurs.
97. Some market participants have suggested that the functional dimension of the market should include both gas production and gas transmission. This seems to be based on the argument that substitution only occurs at demand centres in response to differences in the delivered price of gas. That is, competition occurs between different gas producer/pipeline combinations serving the same demand centre.
98. The ACCC notes however, that gas production and gas transmission are separate activities and involve discrete transactions in the supply chain, and there is little overlap in the ownership of gas production facilities and gas pipelines. In order to combine gas production and transmission into a single relevant functional market, substitution between sources of gas supply (transported via different pipelines) would need to be sufficient to constrain gas transmission prices.

The ACCC invites interested parties to comment on whether the relevant markets to assess the competitive effects of the transaction should encompass both gas production and transmission.

Market definitions currently being considered

99. The ACCC is currently considering a number of market definitions that may be relevant to the consideration of the proposed acquisition:
- An integrated market for the transmission of gas and supply of ancillary services, via one or more pipelines from eastern Australian points of production to eastern Australian points of demand.
 - An integrated market for the transmission of gas via one or more pipelines from eastern Australian points of production to eastern Australian points of demand.
 - An integrated market for the supply of ancillary services to facilitate the transmission of gas via one or more pipelines from eastern Australian points of production to eastern Australian points of demand.
 - A number of markets for the transmission of gas via one or more pipelines to end users in, relevantly:
 - i) Sydney;
 - ii) Canberra;
 - iii) Adelaide;
 - iv) Regional locations serviced by the MSP;

- v) Regional locations serviced by the MAPS; and
 - vi) Regional locations serviced by SEA Gas.
- A number of markets for the supply of ancillary services on one or more pipelines to facilitate transmission of gas via one or more pipelines to end users in i – vi above.
 - A number of markets for the transmission of gas and supply of ancillary services, via one or more pipelines, to end users in i-vi above.
 - A market for the supply of construction, connection, extension and maintenance services for gas transmission pipelines in Australia.

The ACCC invites interested parties to provide views on the appropriate markets in which to assess the proposed acquisition.

- Interested parties are encouraged to provide examples of the alternative services which market participants would be likely to use both in the short term (within the life of current contracts) and in the long term (once current contracts expire) in response to a price increase.

The relevant consideration is what substitution options operate to constrain pricing and how and when this substitution occurs.

- Which substitution options are likely to effectively constrain prices?

Statement of Issues

100. For the purposes of this Statement of Issues, the issues in this matter are divided into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to pose concern'.

Issues of concern

Aggregation of ownership of gas transmission pipelines

101. The ACCC's key concern is that the proposed acquisition will result in APA owning the majority of the gas transmission pipelines in eastern Australia. In particular, post acquisition, APA will own:
- all of the pipelines servicing the Cooper Basin; and
 - all of the pipelines servicing Adelaide.
102. Consequently, shippers may have limited alternatives to dealing with APA for the transportation of gas. In these circumstances, the ACCC is concerned that, post acquisition, APA will have an increased incentive and/or ability to:

- raise transportation charges on the MSP;
- raise transportation charges on the MAPS;
- standardise pricing and service offerings; and
- raise the price of ancillary services.

Increased incentive and/or ability to raise transportation charges on the MSP

103. In assessing the potential effect of the proposed acquisition on the incentive and/or ability for the merged firm to increase transmission charges on the MSP, the ACCC has commenced from the premise that substitution options available to both users of gas **and** producers of gas can potentially constrain the exercise of market power by a pipeline operator.
104. In the event that the operator of the MSP increases the price of transporting gas from the Cooper Basin to Sydney, the ACCC considers it likely that both:
- the delivered price of gas in Sydney (delivered from the Cooper Basin) will increase; and
 - the price of gas at the production point at the Cooper Basin (to be delivered to Sydney) will decrease.
105. The first outcome will encourage users in Sydney to seek alternative sources of supply (e.g. gas from the Gippsland Basin shipped to Sydney via the EGP). The second outcome will encourage gas producers in the Cooper Basin to seek customers in either or both Adelaide (via the MAPS) and Wallumbilla/Gladstone (via the SWQP/QSN). Both types of substitution will act to constrain the price charged on the MSP.
106. Whether it is profitable for the operator of the MSP to raise transportation charges on that pipeline will depend on a number of factors including:
- the decrease in volumes on the MSP resulting from the price increase;
 - the increase in per unit margin on the MSP from the price increase; and
 - any subsequent increase in gas flows on other pipelines owned by the firm resulting from the price increase.
107. The ACCC considers that an increase in transportation charges on the MSP is likely to result in:
- less flows on the MSP;
 - more flows on the EGP; and
 - more flows on the SWQP/QSN and/or the MAPS.
108. Pre-acquisition, APA gains no benefit from the additional flows on the EGP, the MAPS and/or the SWQP/QSN.
109. Post acquisition, APA will gain a benefit from any increase in flows on either of the MAPS or the SWQP/QSN.

110. In light of this, the ACCC considers that APA will have an increased incentive and/or ability to increase transportation charges on the MSP post acquisition.

The ACCC invites interested parties to comment on whether the proposed acquisition is likely to increase the incentive and/or ability of APA to raise transportation charges on the MSP.

In particular, the ACCC would welcome views on:

Constraints from pipelines leaving the Cooper Basin

- whether, and to what extent, gas producers in the Cooper Basin would seek contracts with customers to increase flows on the MAPS and the SWQP/QSN in response to an increase in the price of transport on the MSP;
- the average duration of the current GTAs for gas leaving the Cooper Basin and when these contracts will terminate or be open to renegotiation;
- whether, while the current GTAs are in place, shippers still negotiate with APA and Epic for the provision of “as available” forward haul services on the MAPS, the SWQP/QSN and the MSP;
- whether current prices (per GJ/km) for the transportation of gas on the MAPS, the SWQP/QSN and the MSP are significantly different. If this is the case, please provide your views as to the reasons for the different pricing;
- whether, and to what extent, the common ownership of the MSP, the SWQP/QSN and the MAPS would reduce shippers’ bargaining power;
- whether any single shipper uses more than one of the different routes from the Cooper Basin and, if this is the case, what factors influence the allocation of gas to be transported out of the Cooper Basin using the different routes;

Constraints from pipelines servicing Sydney

- to what extent would shippers seek to acquire gas from producers in the Gippsland Basin and ship it to Sydney via the EGP in response to an increase in the price of transportation on the MSP;
- whether the indirect routes to transport gas from the Cooper Basin to Sydney, using the MAPS, impose a constraint on the transport prices of the MSP and provide shippers with some level of bargaining power;
- whether shippers would consider and be able to transport gas from the Cooper Basin to Sydney via routes that avoid or partially avoid the MSP, in response to an increase in transport prices on the MSP;
- whether the proposed acquisition is likely to result in APA having the incentive and/or ability to increase the price charged to transport gas from the Cooper Basin to Sydney; and

- whether an increase in the cost of transport for gas originating in the Cooper Basin is likely to result in an increase in the delivered price of gas in Sydney.

In providing views on the above matters, please consider what is likely to be profitable in both the short term (within the life of current contracts) and the long term (once current contracts expire).

Increased incentive and/or ability to raise transportation charges on the MAPS

111. The ACCC considers that if the operator of the MAPS increases the price of transporting gas from the Cooper Basin to Adelaide, it is likely that both:
- the delivered price of gas in Adelaide (delivered from the Cooper Basin) will increase; and
 - the price of gas at the production point at the Cooper Basin (to be delivered to Adelaide) will decrease.
112. The first outcome will encourage users in Adelaide to seek alternative sources of supply (i.e. gas from the Otway Basin to Adelaide via SEA Gas). The second outcome will encourage gas producers in the Cooper Basin to seek customers in either or both Sydney (via the MSP) and Wallumbilla/Gladstone (via the SWQP/QSN). Both types of substitution will act to constrain the price charged on the MAPS.
113. Whether it is profitable for the operator of the MAPS to raise transportation charges on that pipeline will depend on a number of factors including:
- the decrease in volumes on the MAPS resulting from the price increase;
 - the increase in per unit margin on the MAPS from the price increase; and
 - any subsequent increase of gas flows on other pipelines owned by the firm resulting from the price increase.
114. The ACCC considers that an increase in transportation charges on the MAPS is likely to result in:
- less flows on the MAPS;
 - more flows on SEA Gas; and
 - more flows on the MSP and/or the SWQP/QSN.
115. Pre-acquisition, the current operator of the MAPS (Epic) gains no benefit from any additional flows on the MSP and no benefit from increased flows on SEA Gas.

116. Post acquisition, APA will own the MAPS, the MSP and 50% of SEA Gas. Hence it will gain a benefit from any increase in flows on the MSP and SEA Gas as a result of increased prices on the MAPS.
117. In light of this, the ACCC considers that APA, as the new operator of the MAPS, will have an increased incentive and/or ability to increase transportation charges on the MAPS post acquisition.
118. While SEA Gas is currently fully contracted to foundation shippers (and will be until the end of 2018), the ACCC is concerned that post acquisition, as the 50% owner of SEA Gas, APA may:
 - have an increase incentive and/or ability to block the expansion of the current capacity of SEA Gas, in order to force greater utilisation of the MAPS;
 - after the expiry of the foundation contracts, have the incentive and/or ability to refuse to contract with shippers, other than the foundation shippers, in relation to SEA Gas, with the MAPS being the only other alternative;
 - have an increased incentive and/or ability to prevent foundation shippers from trading their future contracted firm haulage capacity with other shippers on the SEA Gas pipeline, with the MAPS becoming their only alternative to supply Adelaide; and

- know the price for the transportation of gas and available capacities of the two pipelines entering Adelaide. This is likely to reduce the bargaining power that current and potential shippers may have and/or would have after the cessation of the current foundation shipper contracts. Shippers would no longer be able to play SEA Gas and the MAPS off against each other, given that APA would negotiate knowing, and being able to influence, the transportation prices on both these pipelines.

The ACCC invites interested parties to comment on whether the proposed acquisition is likely to increase the incentive and/or ability of APA to raise transportation charges on the MAPS.

In particular, the ACCC would welcome comments on:

Constraints from pipelines leaving the Cooper Basin

- whether, and to what extent, gas producers in the Cooper Basin would seek contracts with customers to increase flows on the MSP and the SWQP/QSN in response to an increase in the price of transport on the MAPS;

Constraints from pipelines servicing Adelaide

- whether an expansion of the SEA Gas pipeline is likely to be necessary in the short, medium and/or long term;
- whether APA, post acquisition, would have the incentive and/or ability to block the expansion of SEA Gas;
- whether, and to what extent, the proposed acquisition would reduce the bargaining power of both existing and potential shippers of gas to Adelaide;
- whether a reduction in competition between SEA Gas and the MAPS is likely to result in an increase in the transmission price of gas into Adelaide;
- the extent to which an increase in the transmission price of gas into Adelaide is likely to result in an increase in the delivered price of gas in Adelaide and of the intra-day nomination prices on SEA Gas and the MAPS; and
- whether any expected new pipeline development in the future is likely to constitute an alternative to SEA Gas and the MAPS for the transportation of gas to Adelaide.

Increased incentive and/or ability to standardise pricing and service offering

119. The ACCC is concerned that, post acquisition, APA will have an increased incentive and/or ability to seek to operate all of its pipelines in much the same manner as APA currently operates the VTS. That is, shippers would be required to pay a fixed charge to inject gas into and withdraw gas from the system.

120. The ACCC is concerned that an 'injection withdrawal model' would be likely to:
- move supply flexibility and control from the shipper to the merged firm;
 - reduce the transparency of transport costs; and
 - reduce the number of possible counterparties with equal and opposite supply and customer demand requirements that could be considered for an external swap.

The ACCC invites interested parties to comment on the extent to which customers can bypass APA's network, particularly in relation to:

- the ability to utilise pure external/internal gas swaps;
- the ability to utilise partial external/internal gas swaps;
- the ability to utilise gas transmission services ; and
- other strategies/methods which may currently be utilised to bypass APA's network.

The ACCC encourages interested parties to provide examples of:

- how swaps have been utilised in the past to bypass one or more pipeline(s); and
- how the proposed acquisition will affect the ability of shippers to engage in swaps in the future.

121. The ACCC is concerned that other current or future pipeline operators would not be able to compete with, or provide substitutes for, APA's product and service offers.
122. The ACCC is concerned that, without the ability to develop or adjust their portfolios to effectively manage their market risk, shippers may be forced to accept a less efficient mix of and/or redundant, gas transportation and/or ancillary services.
123. Market participants submit that they currently have a range of alternative combinations of services and routes to meet the demand requirements in any given location. These options include:
- forward haul;
 - back haul;
 - imbalance services;
 - storage services; and

- swaps.
124. Market inquiries indicate that competition for the transmission of gas and supply of ancillary services provides incentives for pipeline operators to find ways to utilise their assets to deliver innovative and flexible offers to shippers.
125. Market inquiries indicate that, since the completion of the QSN Link, shippers have access to several potential supply sources through an interconnected network. Market participants submit that this facilitates inter-basin competition and competition for the transmission of gas and encourages pipeline operators to offer an efficient mix of services across pipelines, allowing shippers to effectively manage market risk.
126. Market inquiries indicate that shippers are currently able to combine the above elements in a range of ways utilising both APA and Epic owned pipelines. In particular, market participants indicate that if APA were to raise its prices, whilst some use of an APA pipeline would likely be required, the majority of other elements could be obtained from other pipeline operators.
127. In this way, competition may exist for each element of the ‘package’ required to transmit gas to a particular demand centre, given that shippers can contract different and autonomous services from different pipeline operators, to optimise their contracted pipeline capacity for the transportation of gas between Victoria, South Australia and NSW and to access Queensland.
128. Market inquiries indicate that the incentive and/or ability of APA to adopt an ‘injection withdrawal model’ and/or bundling strategy is likely to increase post acquisition, because:
- APA would own and control most of the pipelines in eastern Australia (more than 80% of all transmission pipelines in eastern Australia, by length and by throughput) and some of these pipelines are interconnected;
 - other pipeline operators would not be able to offer ‘bundled’ packages to compete with APA’s offer; and a combination of the ‘unbundled’ offers of other pipeline operators would not be an alternative to APA’s bundled offer.

The ACCC invites interested parties to comment on the likely effect of the proposed acquisition on the ability and incentive of the merged firm to adopt a bundled or ‘injection withdrawal’ model across pipelines.

In particular, the ACCC would welcome views on:

- how different pipeline operators currently offer an efficient mix of services across pipelines;
- whether the proposed acquisition would give or increase APA’s ability to adopt an ‘injection withdrawal model’ and/or bundling strategy across pipelines;
- whether, and to what extent, an ‘injection withdrawal model’ and/or bundling strategy across pipelines affects the ability of shippers to manage transportation costs

or exercise bargaining power; and

- whether the adoption by APA of a model of this kind would affect the delivered price of gas.

The ACCC encourages interested parties to provide detailed examples to support their comments on these points.

Increased incentive and/or ability to raise the price of storage and other ancillary services

129. The ACCC understands that customers generally have two different purposes in acquiring pipeline storage and other ancillary services.
130. The first purpose of storage is for use in gas-fired peaking plants. This storage enables power stations to accumulate gas over time at a point near the power station. The storage is typically drawn down rapidly during high price periods in the National Electricity Market (**NEM**). Storage for this purpose must be located in close proximity to the peaking plants. The ACCC understands that dedicated lateral storage is typically used for this purpose.
131. The second purpose of storage and other ancillary services is for use by retailers to service peaks in gas demand at an end retail demand centre. These are the storage and storage and loan services (discussed in paragraphs 51 and 52).
132. The ACCC considers that existing APA and Epic pipelines do not compete in providing storage for gas-fired peaking plants. However the ACCC considers that APA and Epic do compete for the provision of storage, storage and loan and other ancillary services for use by retailers to service peaks on at least the following pipelines:
- the MSP and the MAPS; and
 - the MSP and the SWQP/QSN

The MSP and the MAPS

133. The ACCC understands that shippers who have GTAs on both the MSP and the MAPS substitute storage, storage and loan and other ancillary services between the two pipelines.
134. Market participants indicate that a shipper intending to store gas on the MSP could respond to a price increase of this service by choosing to store gas on the MAPS and vice versa. The ACCC understands that when the shipper later decides to utilise the stored gas, the shipper could transport it via the MAPS or the MSP.

The MSP and the SWQP/QSN

135. The ACCC is considering whether shippers who have GTAs on both the MSP and the SWQP and/or the QSN could substitute storage, storage and loan services and other ancillary services between these pipelines.
136. Market participants indicate that currently if APA were to raise its storage prices on the MSP, storage on the SWQP/QSN could be obtained from Epic and vice versa.
137. The ACCC is concerned that post acquisition APA may have an increased incentive and/or ability to raise the price of storage and other ancillary services on the MSP, the MAPS and the SWQP/QSN as post acquisition shippers would have no alternative but to utilise APA owned pipelines for storage of gas from the Cooper or Surat Bowen Basins.
138. The ACCC recognises that this kind of storage and other ancillary service substitution requires shippers to possess GTAs that include storage and other ancillary services on more than one of the MSP, the MAPS, the SWQP and the QSN.

The ACCC invites interested parties to comment on whether the proposed acquisition is likely to increase the incentive and/or ability of APA to increase the price of ancillary services on the MSP, the MAPS, the SWQP and the QSN.

In particular, the ACCC would welcome views on:

- substitutability between the ancillary services provided on the following pipelines:
 - MAPS and MAPS; and
 - MSP and SWQP/QSN;
- whether there are alternatives that are likely to constrain APA from increasing ancillary service prices on these pipelines; and
- whether the proposed acquisition is likely to lead to an increase in the price of these ancillary services.

Effect of storage prices on Adelaide and Sydney STTMs

139. The ACCC understands that the STTM ex-ante market price is determined when shippers place offers to sell gas and network users place bids to buy gas on a given day. Gas is scheduled from the lowest to highest price, and, a day ahead, the market operator determines the market price and issues a market schedule of gas flows.

140. The ACCC is considering whether, if the price of storage rises as a result of the proposed acquisition, shippers would then raise the offer price they place in the STTM in order to reflect their higher cost.
141. The ACCC is considering whether a higher offer price by shippers would translate to a higher level of gas prices in the STTM.

Barriers to entry

142. The ACCC is concerned that there are significant barriers to entry in the relevant markets that are likely to deter new entrants. Therefore new entry is unlikely to provide a constraint on the exercise of increased pricing discretion discussed above.
143. The ACCC notes that entry can occur through either:
- i. the construction of a new pipeline that duplicates an existing pipeline on a route between a particular production centre and a particular demand centre; or
 - ii. the construction of a new pipeline on a route between a particular production centre and a particular demand centre that is not currently serviced by a pipeline.
144. The ACCC notes that pipelines that run from particular production centres to particular demand centres may be natural monopolies. This may make entry by a new pipeline uneconomic on a particular pipeline route that is already serviced.
145. Further, large sunk costs increase the entry risk for a new pipeline operator, particularly when faced with a competing pipeline that has already incurred these costs.
146. In addition, new entrants would have to obtain relevant planning and environmental approvals, gain access to easements and interconnect with existing pipelines.
147. There are significant asymmetries between the incumbent and a new entrant such that the new entrant faces the following entry deterrents:
- significant costs that will become sunk;
 - significant time taken for entry;
 - significant regulatory barriers;
 - a need to achieve a minimum efficient scale; and
 - a need to develop or obtain sufficient expertise.
148. The ACCC notes that new pipelines are generally underwritten by foundation contracts to supply and ship new gas. This helps pipelines overcome the risks associated with entry. Nonetheless, it is likely that any new production volume

would need to be substantial to make the entry of a new pipeline on a route already serviced economic.

149. Taking all of the above together, the ACCC considers that barriers to entry for new pipelines are substantial and the threat of new entry is unlikely to constrain the exercise of any increased market power by APA post acquisition.
150. The ACCC understands that existing firms can add additional capacity at a lower cost than new entry due to the ability to make alterations to existing pipelines through looping sections and adding additional compression. Both of these options are far cheaper than the only alternative available to a new entrant: constructing a new pipeline.

The ACCC invites interested parties to comment on barriers to entry.

In particular, the ACCC would welcome views on:

- the relevance of the following factors on the decision to enter the transmission pipeline industry:
 - costs required to build a new transmission pipeline;
 - regulatory barriers;
 - the time required for new entry; and
 - difficulty in attaining the technical knowledge required for the construction of gas transmission pipelines that meet Australian standards and state and federal government regulations;
- whether a new entrant is able to timely enter the market in order to effectively constrain APA; and
- the current ability of APA to inhibit or restrict interconnection from a new pipeline to their transmission network.

Issues that may raise concern

Increased barriers to entry and expansion

151. The ACCC is concerned that there is a risk that barriers to entry and expansion will increase as a result of the proposed acquisition.
152. As discussed, foundation contracts between pipeline owners and foundation suppliers allow pipeline owners to manage the risks associated with new entry. The ACCC notes that a number of new pipelines underpinned by foundation contracts have been constructed in the last decade.

153. Major pipelines are generally built on the premise that they will be able to connect into the existing gas transmission network in order to deliver gas to various locations throughout the network. However, the ACCC understands that there are exceptions, for example there are pipelines that transport gas directly from its point of production to Gladstone for LNG processing.
154. The ACCC notes that post acquisition, APA will own a large majority of the gas transmission pipelines in eastern Australia. The only significant remaining transmission pipeline operator would be Jemena.
155. Market participants have raised concerns that post acquisition the greater aggregation of pipelines owned by APA and their ability to service all major geographic points will reduce APA's incentive to facilitate cost-effective connections into its existing network for new (and potentially competing) pipelines.
156. During market inquiries, the Gunnedah Basin has been identified as an example of an emerging supply point that will generate demand for a new transmission pipeline which would potentially require interconnection to an APA owned pipeline.
157. The Gunnedah Basin is predicted to be an emerging source of significant volumes of gas. While there is the potential for a route to Wallumbilla and through the QGP to a Gladstone export facility that would not require use of APA pipelines post-acquisition, market participants have advised that this gas may, at least partially, be required to service domestic demand centres.
158. The concerns are that post-acquisition, APA's ownership of the MSP and the majority of the pipelines connected to the Wallumbilla hub may potentially lock other potential pipeline owners out of the market for the construction and operation of a pipeline servicing the Gunnedah Basin. This concern is based on an assumption that to be able to service domestic demand centres, the new pipeline would potentially connect to the MSP or the SWQP, which prior to the proposed acquisition may have competed to secure connection of the new pipeline. Post acquisition, common ownership will decrease the number of owners that may compete for the connection of new pipelines.
159. Post acquisition, APA will be able to service most major demand and supply centres. Whereas pre-acquisition, large shippers currently tend to contract with a number of pipeline operators as no pipeline operator provides routes connecting all demand and supply points, post acquisition APA would be in a position to bundle services across different parts of its interconnected network to incentivise shippers to only contract with APA.
160. Due to the increased level of coverage of supply and demand centres, APA will be in a more advantageous position to manage its asset risks as compared with Jemena and new entrants. This may increase the asset risk to non-APA assets particularly due to the increased risk of asset stranding. In turn, market participants have indicated that the increased risk profile of the non-APA owned

assets would naturally translate into the asset operator requiring a higher rate of return to warrant carrying the increased level of risk attached to the investment.

The ACCC invites interested parties to comment on the extent to which barriers to entry and expansion would increase as a result of the proposed acquisition.

In particular, the ACCC would welcome views on:

- whether, post-acquisition, APA would have the incentive and/or the ability to inhibit or restrict interconnection from a new pipeline to its transmission network, for example the potential for connection of future pipelines out of the Gunnedah Basin to MSP or the SWQP;
- whether, post-acquisition, APA would be in a more advantageous position to manage its asset risks as compared to existing and potential pipeline operators;
- the likelihood that post acquisition, APA will have the ability and/or incentive to strand non-APA owned pipelines; and
- the likelihood that the proposed acquisition will increase the difficulty that a new entrant constructing a new pipeline would have in securing foundation shippers.

Increased incentive and/or ability to raise transportation charges to Gladstone

161. The ACCC understands that APA and Epic may currently compete for the transmission of gas to Gladstone. That is, Gladstone can currently be supplied with gas that moves via back haul north through the APA-owned MSP or Epic-owned MAPS from south-east basins to Moomba, then via back haul using the Epic-owned QSN and the SWQP, and then forward haul up the Jemena-owned QGP.
162. Market inquiries suggest that in the future it is possible that some of South Australian and Queensland produced gas may begin to be shipped to Gladstone to supply LNG export projects. This would place a greater reliance on Victorian produced gas to satisfy domestic demand and may cause a reversal in flow direction of both the MSP and the MAPS.
163. The ACCC considers that if a reversal in flow were to occur, the MAPS and the MSP would compete for the transmission of gas to Gladstone by forward haul.
164. The ACCC is concerned that, post acquisition, competition for the transmission of gas from southern basins to Queensland demand centres, via Moomba, may be reduced, as APA would control the only two pipelines (the MSP and the MAPS) that are able to transmit gas from south-east basins to Moomba.

165. Although Moomba is not a final demand centre, an increase in the price of gas transmission from the south-east into the Moomba hub is likely to result in an increase in the delivered price of gas in Gladstone.
166. The ACCC understands that these pipelines would need to be reconfigured to physically reverse flow and that the costs involved in this reconfiguration may be high.
167. Furthermore, market inquiries indicate that the transportation of gas via back haul north from southern basins to Queensland demand centres may involve some technical issues (e.g. connection between the MAPS/SEA Gas and the MSP/EGP; additional compression in from the Cooper Basin), which can increase the cost of using this route.

The ACCC invites market participants to comment on whether/how the proposed acquisition would lessen competition for the provision of back haul or forward haul services from the south-east basins (Otway, Bass and Gippsland Basins) to Gladstone.

In particular, the ACCC invites interested parties to comment on the issues below:

- the technical viability of using the MAPS and the MSP for the transportation of gas from southeast basins, namely whether it would require expansion of pipelines, specific connections and pipeline configurations and whether these are feasible;
- whether there are significant costs involved in configuring the MSP and the MAPS to physically reverse flow and if this is the case, whether, and to what extent, it would be economically viable to have north flows on the MSP and the MAPS;
- whether the delivered price of gas transported from south-east basins to Gladstone would be competitive with the delivered price of gas transported through other routes from other basins;
- whether and to what extent – in a short term and long term scenario - LNG proponents are likely to use south-east basins to supply Gladstone or prefer other available options;
- whether the proposed acquisition would reduce competition for gas transmission from the southeast basins to the Moomba hub and result in an increase in the delivered price of gas in Gladstone; and
- whether any new pipeline development is expected to create an alternative to the MAPS and the MSP routes for the direct transportation of gas from southeast basins to the Moomba hub.

Issues unlikely to pose concern

Reduction in transparency affecting other pipelines

168. It has been suggested by market participants that the competitive and highly visible prices of the pipelines in eastern Australia constrain prices on pipelines in other Australian markets. That is, customers gain some level of negotiating power through access to information on the pricing structures of a competitive market(s).
169. This would be particularly the case for customers operating in both eastern Australia and on unconnected pipelines like the pipelines servicing the Northern Territory and Western Australia given the likelihood that shippers would have options with APA in both markets and may co-ordinate negotiations for prices on its pipelines.
170. The ACCC's further market inquiries suggest that this is not likely to be an issue directly resulting from the proposed acquisition. Although APA might not publish pricing for the SWQP and the MAPS, shippers would have other sources of information from which they would be able to estimate the transmission pricing of eastern Australia pipelines.
171. For instance, the Gas Bulletin Boards and the Weekly NEM Review Bulletin contain information regarding: (a) medium to long term demand for natural gas and for pipeline services; (b) supply and pipeline capacity to meet existing and foreseeable demand for natural gas and pipeline services; and (c) the outlook for the natural gas industry, including likely long term shortfalls in natural gas reserves, and production or transmission constraints.
172. Furthermore, the information available on the AEMO site regarding the daily delivered gas pricing in the STTM also provides further information from which transmission pricing can be determined.
173. The ACCC understands that pricing structures differ from pipeline to pipeline. Pricing is determined on the basis of a number of factors particular to each individual pipeline, including the size, age of the pipeline and associated facilities, the operating cost and utilisation of the pipeline.
174. Considering that tariffs vary considerably across pipelines, the ACCC is continuing to investigate what inferences can be drawn by shippers from published pricing of APA's pipelines in eastern Australia, to pricing in Northern Territory or Western Australia.

The ACCC invites market participants to comment on the likelihood of the proposed acquisition resulting in less transparent gas transmission prices in eastern Australia and how this would reduce the bargaining power of shippers in relation to Northern Territory and Western Australia pipeline operators, including APA.

Vertical integration

175. A number of market participants are concerned that post acquisition APA would have an increased ability and/or incentive to foreclose gas-powered electricity generators that operate in markets where APA currently operates electricity generation assets.
176. Foreclosure could occur through restricting customers' ability to either access the APA pipelines or increasing the price or reducing the quality upon which that access occurs.
177. While the ACCC notes that APA's current electricity generation assets do not appear to be significant, market participants are concerned that APA may increase its electricity generation asset holding in the short to medium term.
178. APA's existing gas-fired power generation activities include:
 - Dandine: a 27 MW power station located at Kogan, west of Brisbane, that is powered by coal seam gas, transported through the RBP, from Arrow Energy's gas field, located in south-east Queensland; and
 - X41: a power station, consisting of 11 individual gas-fired engine/generator sets, each holding around 3 MW capacity, which is fuelled by natural gas transported on the Carpentaria Gas Pipeline to Mt Isa for the purpose of supplying Xstrata's mine.
179. The ACCC understands that APA is currently developing the Diamantina Power Station (a 242 MW combined cycle plant) for the purposes of supplying energy users in Mt Isa and surrounding regions.
180. Taking into account the size of APA's gas-fired power generation assets and its likely possible further investment in power generation assets, the ACCC considers it unlikely that the proposed acquisition would increase APA's incentive and/or ability to foreclose competing gas-powered electricity generators.
181. The ACCC is considering whether, post acquisition, APA would be incentivised to adopt a foreclosure strategy, given that:
 - APA would lose transmission revenues that would be gained from third-party generators;
 - the loss on transmission revenues would not be offset by any increase in revenues from the power generation business as the output from APA's electricity generation assets are contractually committed to particular customers and does not directly compete with electricity generated from other power stations; and
 - even if APA were to run its generators at capacity there would be sufficient left over gas available such that APA would continue to be incentivised to sell the excess gas to other power generators.

The ACCC invites market participants to comment on the likelihood of the proposed acquisition increasing APA's ability and incentive to foreclose competing gas-powered electricity generators, by restraining their access to its pipelines.

Proposed section 87B undertaking

182. APA has initiated discussions with the ACCC regarding a possible undertaking pursuant to section 87B of the Act to address what APA perceives to be the competition concerns raised during the ACCC's initial market inquiries.
183. APA advises that the undertaking currently being contemplated may contain the following features:
- the divestiture of APA's 50% interest in SEA Gas to a purchaser approved by the ACCC;
 - the specification of a price ceiling for retail storage services on the MAPS for a period of five years from the date on which APA acquires control of HDF;
 - a five year window from the date on which APA acquires control of HDF during which shippers can contract for back haul services on the MAPS up to a price ceiling. Shippers entering into a contract within that period would be entitled to contract back haul services up to the price ceiling for each year of the contract until 31 December 2024; and
 - a negotiate/arbitrate process for the purposes of access seekers negotiating the price and terms on which access to these services would be provided.
184. It is understood that the price ceilings referred to above would be based on the MAPS' published rates, adjusted annually for CPI and may be increased for carbon costs.
185. The ACCC is continuing its assessment of the proposed acquisition to determine whether the proposed acquisition would be likely to have the effect of substantially lessening competition in any market—this has involved further market inquiries and now the release of this Statement of Issues with a further round of inquiries to follow. The ACCC is therefore not currently in a position to form a concluded view as to the necessity, efficacy or acceptability of an undertaking of the kind being foreshadowed by APA.
186. However, based on the competition concerns arising from its inquiries to date, the ACCC's preliminary view is that the remedy being put forward by APA would not address the competition concerns outlined in this statement of issues.
187. Market inquiries will not be commenced unless and until the ACCC is satisfied that any undertaking put forward by APA is in a form that is capable of consultation.
188. However, in the interests of streamlining the process, the ACCC is seeking preliminary market feedback on the key undertaking terms currently foreshadowed by APA. In particular, whether and to what extent the

undertaking is capable of addressing the competition concerns raised by the proposed acquisition.

The ACCC invites high level comments on the undertaking terms put forward by APA. In providing a response, you may wish to consider:

- the utility of such an undertaking, particularly in light of the ACCC's competition concerns outlined above;
- the potential risks associated with the undertaking terms put forward by APA; and
- any other comments you have in relation to the terms of the undertaking put forward by APA.

Areas under further investigation

189. The ACCC is seeking information and evidence from market participants in relation to the preliminary competitive analysis outlined in this Statement of Issues, and in particular, whether there are further factors that should be taken into consideration by the ACCC in forming a concluded view.

ACCC's future steps

190. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
191. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
192. Submissions are to be received by the ACCC no later than **13 April 2012**. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view in light of the issues raised above.
193. The ACCC intends to publicly announce its final view by **26 April 2012**. However the anticipated timeline may change in line with the Merger Review Process Guidelines. A public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.