



26 October 2006

Statement of Issues — Santos Limited’s proposed acquisition of Queensland Gas Company Limited

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of Queensland Gas Company Limited by Santos Limited (**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. The ACCC anticipates completing market inquiries by 9 November 2006 and expects that it will make a final decision on 7 December 2006. 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, market participants 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 ascertain and 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.

The transaction

5. On 5 October 2006 Santos Limited (**Santos**) announced to the ASX an offer to acquire the shares of Queensland Gas Company Ltd (**QGC**).

The parties

Santos Limited

6. Santos engages in the exploration and production of oil and gas, with operations in every major Australian petroleum field. At the year end 2005, Santos had a total market capitalisation of approximately \$7.9 billion. In Queensland, Santos

supplies major gas users with conventional gas from its fields in South West Queensland Cooper Basin, Denison Trough, Roma Shelf and Churchie. It supplies coal seam gas from fields at Fairview and Scotia, and has exploration permits at Comet Ridge and the Bowen Basin.

Queensland Gas Company Limited

7. QGC was formed in 2000 to explore coal seam methane gas deposits in the Surat Basin in Queensland. QGC is currently supplying 8 petajoules of gas per annum from its Berwyndale South gas field. It has interests in producing fields at Argyle and Lauren, and a number of other exploration tenements. QGC has 2P (Proven and Probable) reserves of around 420 PJ.

Other industry participants

8. Origin Energy is the other major producer and supplier of gas in Queensland. In addition to Origin, there are also a number of other companies with smaller gas reserves in Queensland, including Anglo Mitsui, Arrow Energy, BHP Billiton, Molopo Australia Ltd and Mosaic Oil.

Market inquiries

9. Following the announcement of the proposed acquisition on 5 October 2006, the ACCC will conduct market inquiries until 9 November 2006.

Market definition

10. The ACCC invites submissions regarding the geographic dimension of the relevant market in which to consider this proposed acquisition.
11. In its consideration of Santos' acquisition of Tipperary, the ACCC considered the relevant market to be the supply of wholesale gas in Queensland, that is, the market for the supply of gas by gas producers in Queensland. In that matter, the ACCC found that concerns raised during market inquiries were localised to the Queensland region. Further, the ACCC found that the existing Queensland gas fields and transmission network are not currently interconnected to other gas markets in Australia. The ACCC notes that market conditions may have changed since its assessment of Santos' acquisition of Tipperary.
12. It has been suggested to the ACCC that there is a geographically broader eastern Australia wholesale gas market. A key issue for the ACCC in establishing the geographic dimension of the relevant market is the actual or potential constraints imposed on Queensland gas producers by gas producers in the south-eastern states of Australia.

13. The ACCC understands that, due to Queensland not being interconnected to other gas markets in Australia, gas producers in south-eastern Australia do not supply gas to users in Queensland. However, the ACCC notes the potential for the construction of a new gas transmission interconnect, which would link the gas fields and gas transmission pipelines currently operating in Queensland to those in south-eastern Australia.
14. The ACCC further understands that through gas swap transactions, gas producers outside Queensland can market gas to customers within Queensland. It has been suggested to the ACCC that gas swaps (or the potential for gas swaps) also enables south-eastern gas producers to act as a constraint on Queensland gas producers. The key issue is whether the potential for gas swaps enables south-eastern gas producers to effectively constrain Queensland suppliers. The ACCC's current understanding is that gas swaps do not increase the physical supply of wholesale gas available to Queensland gas users, but merely alter the identity of the ultimate supplier. In other words, gas swaps of the above kind, which are not common practice in any case, do not comprise the actual physical exchange of gas volumes on an interstate basis.
15. To assist its market definition analysis, the ACCC seeks further information, having regard to the above, on:
 - the likelihood of greater interconnectivity of Queensland gas fields with south-eastern Australia through the construction of gas transmission pipelines, including:
 - the likelihood that gas transmission pipelines will be constructed connecting Queensland to south-eastern Australian gas fields and the expected timing of those gas transmission pipelines being constructed;
 - the likely capacity for any potential gas transmission pipelines; and
 - the direction in which gas will flow (i.e. from Queensland gas fields to users in south-eastern states, or from south-eastern gas fields to users in Queensland).
 - the likelihood of greater interconnectivity of Queensland gas fields with south-eastern Australia through greater use of gas swap transactions, including:
 - the motivation for gas swaps;
 - the effect gas swaps have on the physical supply of gas by region; and
 - the scope (if any) for gas swaps to constrain the merged entity (including a detailed explanation of how this constraint will work in practice).
 - the potential ability for non-Queensland gas producers to constrain

producers of gas in Queensland, including:

- whether there are any differences in the prices of gas delivered to users in Queensland and users in south-eastern Australia;
- whether gas producers in south-eastern Australia, not physically present in Queensland, actively market wholesale supply of gas to customers in Queensland; and
- whether the proposed acquisition itself is likely to have implications for the prospects of trade in gas between Queensland and the south-east.

Overview of competition issues

16. In the course of its assessment of the proposed acquisition, the ACCC has identified the following potential areas of concern. The ACCC invites submissions from interested parties and market participants regarding the concerns identified below and any other competition issues that may arise.

The merger will increase ownership concentration for the supply of wholesale gas in Queensland (that is, sales of gas by gas producers)

17. The ACCC understands that there is already a high level of concentration in the ownership of gas fields in Queensland, with the two major suppliers of wholesale gas — Santos and Origin — supplying a significant proportion of gas in Queensland. The remaining gas supply is met by a large number of smaller producers.
18. The ACCC understands that as a result of the relatively dynamic nature of the exploration and development of coal seam gas fields, there may currently be a high degree of vigorous competition in the supply of wholesale gas.
19. The ACCC understands that QGC, although a small coal seam gas producer, is a relatively vigorous competitor. The ACCC has concerns that the proposed acquisition will remove a key source of competitive tension for the supply of wholesale gas.
20. The ACCC understands that some gas users use multiple sources of gas supply to meet their gas requirements and mix their gas supply between coal seam gas and conventional gas. The ACCC has concerns about the ability to form portfolio supply arrangements as the number of gas suppliers is reduced.
21. More generally, the ACCC has concerns about the availability of alternative suppliers of conventional and coal seam gas for customers, particularly the availability of alternative suppliers of sufficient size to meet the requirements of large volume customers.
22. To assist the ACCC in its analysis of the likely effect on competition potentially resulting from the increase in ownership concentration, it seeks further information on the:

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- increase in Santos' ownership of gas fields in Queensland and the potential for this to limit the competitive tension in the relevant market.

In considering the potential for the competitive tension in the relevant market to be reduced, the ACCC is particularly interested in understanding the current environment for negotiating supply contracts and the role that QGC and other small gas producers play in those negotiations.

- potential for the existing smaller suppliers of gas to expand current operations and the potential for new entry into the production of gas in Queensland or elsewhere in south-eastern Australia.

In considering the potential for expansion or new entry, the ACCC is interested in understanding any barriers or impediments that a new entrant may face in establishing a gas production facility, or any barriers or impediments existing smaller gas producers may face in seeking to expand their gas production capabilities.

- ability or potential for new and existing suppliers of coal seam gas and conventional gas to competitively constrain the pricing of the merged entity in the supply of wholesale gas to customers.
- ability of customers to switch suppliers of wholesale gas or otherwise form portfolio supply arrangements.

The potential for the PNG gas pipeline to pose a competitive constraint on the wholesale supply of gas in Queensland

23. The ACCC notes that there is the potential for conventional gas to be imported into Queensland via the proposed PNG Gas Pipeline Project. The ACCC understands that some market participants may consider that the PNG Gas Pipeline Project to be a 'shadow competitor' which influences the competitive tension between existing gas producers.
24. The ACCC understands that it is expected that the PNG Gas Pipeline Project will import significant volumes of conventional gas into Queensland. However, the ACCC has concerns about the likelihood of the PNG Gas Pipeline Project proceeding in the short to medium term and notes that there have been delays with the project. The ACCC has concerns about the potential and the likelihood of the PNG Gas Pipeline Project to act as a constraint on the merged entity and has concerns that any constraint may be limited due to the timing of the PNG Gas Pipeline Project and the possibility that it may not proceed.
25. The ACCC invites submissions regarding the proposed PNG Gas Pipeline Project and the potential and ability for it to constrain the merged entity. In particular, the ACCC seeks information on the likelihood of the PNG Gas Pipeline Project proceeding and the likely timing of construction. The ACCC is particularly interested in understanding whether an acquisition by Santos of QGC may affect the proposed PNG Gas Pipeline Project, given media reporting and other indications that the participation by Santos in the Project may be an important

factor in its prospects and that Santos may be less likely to participate if it acquires QGC. The ACCC is interested in relevant implications in terms of the timing of construction of the pipeline, as well as current and future volumes of contracted gas.

26. The ACCC also seeks further information regarding the volumes that are likely to be imported via the PNG Gas Pipeline Project and the pricing structures for the supply of such gas. The ACCC seeks further submissions as to whether the proposed PNG Gas Pipeline Project currently acts as a 'shadow competitor' in negotiations over the wholesale supply of gas.

ACCC's future steps

27. The ACCC will finalise its view on this matter after it considers market responses and submissions invited by this Statement of Issues.
28. The ACCC now seeks submissions from market participants in relation to 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.
29. Submissions must be received by the ACCC no later than 9 November 2006. The ACCC will consider the submissions received from the market and the merger parties in light of the issues that have been identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
30. The ACCC intends to publicly announce its final view on 7 December 2006. 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.