



## Statement of Issues

2 October 2015

### APA Group – proposed acquisition of EnergyAustralia's Iona Gas Plant

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#### Purpose

1. This Statement of issues aims to:
  - give the Australian Competition and Consumer Commission's (**ACCC's**) preliminary views on competition issues arising from APA Group's proposed acquisition of EnergyAustralia's Iona Gas Plant (**Iona**)
  - identify areas of further inquiry
  - give all interested parties an opportunity to comment, and
  - invite interested parties to submit information to assist us in our assessment of the issues.

#### Overview of ACCC's preliminary views

2. The legal test which the ACCC applies in considering the proposed acquisition is in section 50 of the *Competition and Consumer Act 2010*. Section 50 prohibits acquisitions that substantially lessen competition in a market, or are likely to do so.
3. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. In the current review, the ACCC has identified three issues that may raise concerns.

#### Issues that may raise concerns

##### Consolidation of gas storage in Victoria

4. The proposed acquisition may raise competition concerns in relation to the horizontal consolidation of Iona and APA's existing gas storage infrastructure. If APA were to acquire the Iona Gas Plant (**Iona**), there would be just two independent alternative storage options for customers in Victoria, the Eastern Gas Pipeline (**EGP**) and the Tasmanian Gas Pipeline (**TGP**). Consequently, APA may have the ability and incentive to unilaterally raise the price associated with the supply of storage to gas retailers.

##### APA's incentive to allow DTS congestion to persist

5. The ACCC's preliminary view is that APA's increased vertical integration in the Victorian gas market through ownership of Iona along with the Victorian

Declared Transmission System (**DTS**), may, in the long run, substantially lessen competition for the supply of gas and storage services in Victoria by altering APA’s incentives with respect to any future expansion of the capacity of the DTS.

Conglomerate effects in the east coast gas market(s)

6. The ACCC’s preliminary view is that the proposed acquisition may raise competition concerns in relation to the consolidation of Iona with APA’s large existing portfolio of gas infrastructure throughout the east coast. This may manifest through
  - APA being able to extract additional rents on various routes, services or pipelines (compared to an alternative acquirer of Iona)
  - information disadvantages for APA’s rivals that may impact on their ability to compete for development of any future pipeline augmentations or new pipelines, and
  - a greater ability for APA to bundle services, which may significantly foreclose competition from rival storage and/or transmission providers.

## **Making a submission**

7. The ACCC is seeking submissions from interested parties on these issues, which are explained in more detail below, along with specific questions.
8. Interested parties should provide submissions by no later than 5pm on 16 October 2015. Responses may be emailed to [mergers@acc.gov.au](mailto:mergers@acc.gov.au) with the title: *Submission re: APA Groups’ proposed acquisition of EnergyAustralia’s Iona Gas Plant - attention Andrew Gallagher/Lisa Campbell*. If you would like to discuss the matter with ACCC officers over the telephone or in person, or have any questions about this letter, please contact Andrew Gallagher on (02) 9230 9129 or Lisa Campbell on (02) 9230 9183.
9. The ACCC anticipates making a final decision on 5 November 2015. However, this timeline can change. 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.acc.gov.au/mergersregister](http://www.acc.gov.au/mergersregister).

## **Confidentiality of submissions**

10. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the *Competition and Consumer Act 2010*. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, if the information provided to the ACCC is of a confidential nature, please indicate as such. Our [Informal Merger Review Process Guidelines](#) contain more information.

## **About ACCC ‘Statements of Issues’**

11. 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.

12. 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.

## Timeline

Date	Event
14 August 2015	ACCC commenced review of the proposed acquisition
2 October 2015	ACCC publication of statement of issues
16 October 2015	Deadline for submissions from interested parties in response to this Statement of Issues
5 November 2015	Anticipated date for ACCC final decision

## The parties

### APA Group

13. APA Group (**APA**) is Australia’s largest natural gas infrastructure business. Its energy assets which are most relevant to the proposed acquisition include:
  - the Victorian Declared Transmission System (**DTS**),
  - the Dandenong LNG Storage Facility (**DLNG**),
  - a 50% share in the South East Australia Gas Pipeline (**SEA Gas**),
  - the Moomba Sydney Pipeline (**MSP**),
  - the Victoria – New South Wales Interconnector, and
  - the South West Queensland Pipeline (**SWQP**).

### EnergyAustralia

14. Iona is owned by EnergyAustralia. EnergyAustralia is an energy retailer in addition to operating a portfolio of energy generation and storage facilities including coal, gas and wind assets. It is owned by Hong Kong-based CLP Group.

## Industry background

### Operation of the DTS

15. The DTS includes high pressure gas transmission pipelines in Victoria that transport gas from the Longford gas treatment plant, the Otway Basin gas fields and underground storage in Victoria. Almost all of the natural gas that is consumed in Victoria is transported through the DTS.
16. The DTS is owned by APA and operated by the Australian Energy Market Operator (**AEMO**). AEMO manages the receipt, transport, and delivery of gas as part of the Victorian wholesale gas market. APA makes the DTS available to

AEMO under a Service Envelope Agreement and makes available a single reference service comprising a Tariff Transmission Service.

17. The amount of gas that can be stored on the DTS is quite small and cannot be relied upon to manage significant deviations between demand and contracted supply. These physical characteristics of the DTS, coupled with the fact that the demand for gas in Victoria exhibits a significant degree of seasonal and daily variability, mean that the DTS must be closely managed to ensure that gas flows in the manner required and the integrity of the system is maintained. The physical characteristics of the DTS also increase the need for access to gas storage facilities for shippers and retailers to manage demand.
18. The Authorised Maximum Daily Quantity (**Authorised MDQ**) is a withdrawal right for customers, which together with Authorised Maximum Daily Quantity Credit Certificates (**AMDQ CC**) are transportation rights in the DTS collectively known as AMDQ. AMDQ is an input to determining congestion uplift charges payable by a market participant for each scheduling interval of a gas day to fund ancillary payments that are made when additional injections of gas are required. AMDQ also assists to tie breaking rights when scheduling equal priced injections or withdrawal bids, and in determining the order of curtailment in the event of an emergency.<sup>1</sup> The ACCC is aware that APA currently prices AMDQs above the reference tariff set by the AER on points of interconnect on the DTS

### Victorian Gas Production

19. Victoria’s gas is primarily sourced from fields in the Gippsland, Otway and Bass Basins, although some supply in Victoria comes from other states. Extracted natural gas is purified at processing plants prior to use. Iona, in addition to supplying storage, is a processing plant. In Victoria, the Longford, Lang Lang, Minerva and Otway Plants also process gas for injection into the DTS, or transport interstate.

### Gas storage

20. The three sources of gas storage for injection into the DTS are Iona, storage within other pipelines (or ‘linepack’), and DLNG.

#### Iona

21. Iona is a large underground storage facility located in Port Campbell, Victoria and provides gas storage, processing and compression services, supplying gas directly into the Victorian gas market via the South West Pipeline (**SWP**) (part of the DTS) and into the South Australian market via SEA Gas. Iona is primarily used by gas retailers to manage their seasonal base load. Iona is the only underground gas storage facility in Victoria. It has a capacity of approximately 23,500TJ.

#### Pipeline storage

22. Underutilised pipelines can be used as storage for a number of days in advance and the gas then used on peak days. The MSP, Eastern Gas Pipeline (**EGP**), Tasmanian Gas Pipeline (**TGP**) and SEA Gas, can be used for small amounts of storage. Currently, no individual pipeline offers more than 150TJ of contracted storage.

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<sup>1</sup><http://www.aemo.com.au/Gas/Metering-and-Settlements/Victorian-Declared-Wholesale-Gas-Market/Authorised-Maximum-Daily-Quantity-AMDQ>

23. The TGP transports gas from Longford to Tasmania, with the pipeline running under the Bass Strait. The EGP transports gas from the Gippsland Basin in Victoria to Sydney. Both are available to store small amounts of gas for injection into the DTS.
24. SEA Gas, running between Iona and Adelaide, is used for storage in the South Australian market. It is possible that this pipeline could be used to provide storage services to the DTS in the future.

#### DLNG

25. DLNG is a storage facility that provides a peaking service, which is used to meet extreme peaks in demand when there is insufficient supply in the DTS. It has a capacity of 700TJ.

### **The proposed transaction**

26. Energy Australia sought bids in a competitive sale process. If APA is successful in this process, it would own and operate Iona.
27. APA, or an alternative successful bidder, will inherit a contract with EnergyAustralia to secure EnergyAustralia’s continuing use of the Iona facility.

### **Market definition**

28. The ACCC’s starting point for delineating relevant markets to assess the competitive effects of the proposed acquisition involves identifying the products or services actually or potentially supplied by the merger parties. The ACCC then considers what other products or services constitute sufficiently close substitutes to provide a significant source of constraint on the acquirer.
29. Based on the information obtained in the course of market inquiries to date and other information that it has before it, the ACCC’s review is currently considering the effects of the proposed acquisition on the following markets:
  - the supply of gas storage services (including withdrawal and injection services) in Victoria. This market encompasses underground storage, pipeline storage and LNG storage for gas injection into Victoria, and
  - one or more broader markets in eastern Australia (East Coast Gas Market(s)), encompassing gas storage and/or transportation.
30. APA and Iona overlap in their provision of gas storage services as a result of APA’s existing ownership of DLNG and its supply of pipeline storage on the MSP. Market participants provided conflicting information to the ACCC regarding the extent to which Iona, pipeline storage (outside the DTS) and/or DLNG are functional alternatives for one another when gas retailers are making decisions about gas injection and withdrawal to manage demand in Victoria and South Australia. However, based on the information before it, the ACCC considers that pipeline storage and DLNG may be used as alternatives to Iona to some degree during peak periods of demand.
31. Competition between gas storage providers does not occur on the day gas is used but at the time the storage is contracted. Nevertheless, in Victoria the extent of substitutability of Iona, pipeline storage and DLNG during peak levels of demand will influence competition between storage providers and contractual terms offered to storage customers when new contracts are entered into.

### **Producers’ swing services**

32. The ACCC is still considering the extent to which suppliers of gas storage services also compete with gas producers offering ‘swing services’ – that is, the flexibility for a customer (a gas retailer) to take more gas on a day than the average daily contract quantity (up to the Authorised MDQ) to assist in meeting peak demand.
33. Market participants have submitted to the ACCC that this flexibility is limited on a peak demand day when the marginal source of supply is often gas from storage facilities. Also, MDQ flexibility is effectively capped by the annual contract quantity, which stipulates the maximum volume of gas that will be made available by the producer each year. Moreover, the ACCC understands that the contractual flexibility offered by producers is declining.
34. Accordingly, based on market inquiries, the ACCC considers that there is little ability for retailers to switch from storage to producers’ swing services in order to meet fluctuations in demand.

### **Geographic market**

35. The ACCC’s market inquiries generally identified the geographic scope of the relevant gas storage market as storage for supply of gas to Victoria. However, it was also submitted to the ACCC that, due to Victorian gas infrastructure being connected to other pipelines in eastern Australia, the proposed acquisition may affect the supply of gas more broadly, particularly in South Australia for which Iona is a significant source of gas storage.
36. While the ACCC’s review is focussed on the likely competition effects of the proposed acquisition in Victoria, based on market feedback, the ACCC is also considering any impact the proposed acquisition may have on any broader East Coast Gas Market (as explained below at paragraphs 54 - 65).

### **Preliminary view - relevant markets**

37. Based on the information obtained in the course of market inquiries to date and other information that it has before it, the ACCC is currently considering the impact of the proposed acquisition on:
  - the market for the supply of gas storage services in Victoria, and/or
  - a broader East Coast Gas Market, encompassing storage and/or transportation.

The ACCC invites comments from market participants on its preliminary views about the relevant markets for assessing the likely competition effects of the proposed acquisition. In particular, market participants may wish to comment on the following:

- the constraint on gas storage that is provided by gas producers offering swing services, and in particular any examples of retailers switching, or threatening to switch from storage to swing services as a result of price, and
- the availability of swing services from producers, including the extent to which this has changed and how it is likely to change in the future.

### **Issue that may raise concerns: consolidation of gas storage in Victoria**

38. The ACCC’s preliminary view is that the proposed acquisition may raise competition concerns in relation to the horizontal consolidation of Iona and APA’s existing gas storage infrastructure, which includes:

- DNLG
  - the MSP, which is currently used to store small volumes of gas for supply into Victoria, and
  - a 50 percent interest in SEA Gas, which is not currently used to provide storage services in Victoria but could potentially be used for this purpose in the future if the pipeline was expanded, or if the term of the foundation contracts on this pipeline are not extended.
39. If APA was to acquire the Iona facility, there would be just two independent alternative storage options for customers in Victoria, the EGP and the TGP.

#### **Current competition between Iona and DLNG**

40. In the ACCC’s market inquiries, some market participants identified competition concerns arising from the consolidation of Iona and APA’s DLNG. The ACCC’s preliminary view is that there is currently limited competition between Iona and DLNG, but the ACCC will accept further submissions on this point.
41. The ACCC understands that Iona and DLNG perform different functions, with Iona used to manage variability in seasonal demand and DLNG used on a limited number of days in the year to manage critical peaks in demand in the DTS. DLNG is able to play this critical peak storage role in the Victorian market because it is located in closer proximity to Melbourne than Iona and has a relatively high injection capacity.
42. DLNG is unable, however, to play the same role as the Iona facility, because:
- it is a far more expensive form of storage, because it uses LNG as a feedstock, which is more expensive to produce and store than natural gas, and
  - it takes some time to rebuild supply capacity once it has been used.
43. Nevertheless, the ACCC is considering whether, despite their differences, Iona and DNLG place any competitive constraint upon each other.

#### **Current competition between Iona and APA’s Moomba to Sydney Pipeline**

44. Based on market inquiries, the ACCC considers that a horizontal competition concern may arise from the proposed acquisition due to the consolidation of Iona and the MSP, both of which are currently used to provide seasonal ‘swing’ in the Victorian market.
45. The ACCC understands that Iona has a very large storage capacity and is primarily designed to build reserves in order to manage seasonal demand, whereas pipeline storage is comparatively limited in volume. However, based on information before the ACCC, it appears that linepack on the MSP is used as an alternative to storage at Iona for small volumes of gas.
46. The ACCC understands that the other pipeline storage alternatives for injecting gas into the Victoria market, which include the EGP and shortly the TGP, only provide for the storage of small volumes of gas. Given the relatively small size of the storage services provided by these pipelines, the ACCC is concerned that they may not provide an effective competitive constraint on APA’s pricing of gas storage services, post-acquisition.
47. The ACCC is also concerned that the proposed acquisition may eliminate the competitive tension for smaller second-tier retailers that may be able to store gas at both Iona and the MSP.

### **Preliminary view: consolidation of gas storage in Victoria**

48. For the reasons outlined above, the ACCC’s preliminary view is that the proposed acquisition may raise competition concerns in relation to the horizontal consolidation of Iona and APA’s existing gas storage infrastructure.

The ACCC invites comments from market participants on its concerns in relation to the horizontal consolidation of gas storage in Victoria. In particular market participants may wish to comment on the following:

- the extent to which retailers can use linepack as an alternative to storage at Iona, rather than in addition, including examples where customers have made a gas storage decision at either based on price
- the extent to which retailers can use DLNG as an alternative to storage at Iona, rather than in addition, including examples where customers have made a gas storage decision at either based on price
- the extent to which APA’s ownership of Iona would increase information asymmetry in the market, and how this could in practice affect competition, and
- whether, in comparison to an alternative owner of Iona, APA would be less likely to offer gas storage services on innovative and bespoke terms, and why.

### **Issue that may raise concerns: APA’s incentives to expand the DTS in the long-term**

49. The proposed acquisition would increase APA’s vertical integration in the Victorian gas market. APA’s ownership of Iona along with the DTS, may, in the long run, distort APA’s incentives in relation to where it chooses to expand the DTS and substantially lessen competition for the supply of gas and storage services in Victoria.
50. As a result of owning Iona, APA may in the long run have an increased incentive to expand the DTS near its Iona facility and a decreased incentive to expand other parts of the DTS, notably on the eastern side of Melbourne. APA’s expansion decisions in relation to the DTS may benefit APA’s Iona operations by leading shippers to seek to increase their Iona storage reserves and/or to paying a higher price for storage services, in order to avoid congestion on the DTS.
51. Market feedback suggested that, post-acquisition, APA may have the ability to allow congestion to persist (and ultimately increase the value of storage services) where there is insufficient capacity at an injection point into the DTS to meet the demand to inject gas at that point. For example, market participants expressed concern that APA may allow the SWP, which is connected to Iona, to congest in order to raise prices at Iona.
52. The ACCC understands that there is currently greater injection capacity at Iona than transmission capacity on the SWP. Following on from this, the ACCC’s preliminary view is that APA may actually have an *increased* incentive to expand the capacity of the SWP. By expanding the SWP, APA would be in a position to raise revenue from injections into the DTS through Iona as well as increased sales of gas transportation via the SWP (and earn increased revenue from a return on capital expenditure associated with the addition of the expanded SWP asset to its DTS asset base).
53. However, in the long-run, the proposed acquisition may result in an increased incentive for APA to favour the Iona storage asset when expanding the DTS. The ACCC has concerns that the current regulatory framework would not preclude



APA from acting on this incentive such that APA could choose to expand in a way which favours its Iona asset, to the detriment of non-APA assets. This potential concern arises in the context that, although significant expansion on the DTS (outside the SWP and NSW Victoria Interconnect) may currently not be required, it is difficult to predict where and when congestion on the DTS may arise in the future with any degree of certainty.

54. Accordingly, the ACCC’s preliminary view is that the proposed acquisition may, in the long-term, provide APA with an increased ability or incentive to allow congestion to persist on a part of the DTS and/or otherwise act in its own interests when choosing where to expand the DTS. Ultimately, this could increase the value of storage services and the price APA would be able to charge customers for these services, such that the proposed acquisition may result in a substantial lessening of competition in the supply of gas storage services in Victoria.

The ACCC invites submissions from interested parties on this issue and will further consider potential competition concerns. In particular the ACCC would welcome submissions on:

- whether the proposed acquisition may, in the long-term, provide APA with an increased ability or incentive to allow congestion to persist on a part of the DTS and/or otherwise to act in its own interests when choosing where to expand the DTS, and how this would be likely to affect competition.

### **Issue that may raise concerns: conglomerate effects in the east coast gas market**

55. The ACCC’s preliminary view is that the proposed acquisition may raise competition concerns in relation to the consolidation of Iona with APA’s large existing portfolio of gas infrastructure throughout the east coast.
56. In the ACCC’s market inquiries, some market participants submitted to the ACCC that, compared with Iona being acquired by an alternative purchaser with fewer existing interests in gas infrastructure in eastern Australia, APA’s proposed acquisition may substantially lessen competition as it may result in greater information asymmetry in the market and an ability to leverage its ownership of one asset (such as Iona) to limit competition faced by APA in respect of another asset (such as a pipeline). This may manifest through:
- APA being able to extract additional rents on various routes, services or pipelines (compared to an alternative acquirer of Iona)
  - information disadvantages for APA’s rivals that may impact on their ability to compete for development of any future pipeline augmentations or new pipelines, and
  - a greater ability for APA to bundle services, which may significantly foreclose competition from rival storage and/or transmission providers.
57. The ACCC is examining the extent to which the addition of Iona to APA’s portfolio of infrastructure would increase its market power in any market, or its ability to leverage its market power into any other market, and whether sufficient competitive constraints would remain post-acquisition to prevent APA exercising unilateral market power.

### **Rent extraction**

58. The ACCC is concerned that the addition of Iona to APA’s existing east coast gas infrastructure may mean APA is in a better position to extract the highest possible rent from its assets. As the owner of both Iona and a large number of transmission pipelines, APA would know exactly how high its fees are on both, so it could charge just below the point where a shipper would refuse to acquire its services and, in so doing, extract a higher economic rent than if it only owned one of the assets.
59. The ACCC notes that the DTS is a regulated service. Tariffs on the DTS are approved by the AER, are public, non-discriminatory and paid by shippers on a volume used basis. Therefore, whether APA owns Iona or not, DTS tariffs are known by all market participants.
60. However, APA’s interests in a range of other non-regulated or lightly-regulated pipelines and storage assets throughout the east coast could afford APA a detailed understanding of customers’ requirements, to an extent not matched by any other market participants. The increase in information provided by Iona, even if only incremental, would enable it even greater visibility of customers’ requirements and potentially their rent limits, which may raise competition concerns.

### **Pipeline augmentation and development**

61. ACCC market inquiries also identified concerns that the proposed acquisition would give APA greater insight and confidence on future gas flows and that this could provide APA with a competitive advantage in the funding of any future pipeline augmentations or development of new pipelines, and in the delivery of services across the east coast gas market.
62. For example, if APA has informational advantages then it may mean that there is either:
  - a smaller number of parties that are willing to compete for the development of the augmentations, and/or
  - that the competition that does occur is less effective and, as a consequence, APA is not as constrained as it may otherwise have been.

### **Bundling of gas storage and transportation**

63. The ACCC’s market inquiries also identified that some market participants are concerned that the proposed acquisition would enable APA to package or ‘bundle’ storage at Iona with other storage or gas transmission services throughout the east coast.
64. The ACCC notes that if APA were to only offer storage at Iona as part of a bundle (whether that be a bundle of storage, or of storage and transmission, either in Victoria or across various states), this could be anti-competitive if it resulted in significant foreclosure of competition from alternative transmission and storage providers. For example, alternative storage providers may be foreclosed from supplying storage services to customers if, compared to accepting a bundle offered by APA, it is not economically viable for customers to source transmission services from APA and standalone storage services from those alternative providers.
65. The ACCC is seeking more views from market participants on the impact that bundling in the east coast gas markets would have on competition.

### **Preliminary view: conglomerate effects in the east coast gas market**

66. For the reasons outlined above, the ACCC’s preliminary view is that the proposed acquisition may raise competition concerns in relation to the consolidation of Iona with APA’s large portfolio of gas infrastructure throughout the east coast.

The ACCC invites submissions from interested parties on this issue and will further consider potential competition concerns. In particular the ACCC would welcome submissions on:

- whether the addition of Iona to APA’s existing portfolio of gas infrastructure would materially increase information asymmetry in the east coast gas market and how this would be likely to affect competition
- the incentives for pipeline augmentations, and the extent to which informational disadvantages would realistically affect other parties’ abilities to compete for the development of pipeline augmentations or new pipelines, and
- how competition would be affected if APA were to bundle storage at Iona with other services.

### **ACCC's future steps**

67. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.
68. As noted above, 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. Submissions are to be received by the ACCC no later than 16 October 2015 and should be emailed to [mergers@acc.gov.au](mailto:mergers@acc.gov.au).
69. The ACCC intends to publicly announce its final view by 5 November 2015. 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.