



## Public Competition Assessment

11 March 2016

### Royal Dutch Shell's proposed acquisition of BG Group

#### The ACCC's decision

1. On 19 November 2015 the Australian Competition and Consumer Commission announced its decision not to oppose the proposed acquisition of BG Group plc (**BG**) by Royal Dutch Shell plc (**Shell**).
2. The ACCC decided that the proposed acquisition would be unlikely to contravene section 50 of the *Competition and Consumer Act 2010* (the **Act**).
3. Section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.
4. The ACCC considered the competitive effects of the proposed acquisition in the following markets:
  - the wholesale supply of natural gas in eastern Australia
  - the wholesale supply of natural gas in Queensland.
5. The ACCC:
  - considered that the proposed acquisition would not substantially reduce the supply of gas, or reduce competition to supply gas, to domestic customers in Queensland and eastern Australia by changing Shell's incentives. With or without the proposed acquisition, Shell's incentives in developing its Arrow reserves would be structured around supplying gas to LNG producers.
  - was not satisfied that the loss of potential future competition between Arrow and BG for the supply of gas to domestic users was likely to be substantial in the relevant market(s), given the uncertainty about the amount and timing of future industry gas supplies.
6. This Public Competition Assessment outlines reasons for the decision by the ACCC not to oppose Shell's proposed acquisition BG.
7. As the proposed acquisition raises important issues, the ACCC is issuing this Public Competition Assessment to outline the reasons for its decision.

8. Please note that this and other public competition assessments are subject to the following qualifications:
- the ACCC considers each transaction on a case-by-case basis and so the analysis and decision outlined in one assessment will not necessarily reflect the ACCC's view of another transaction even where that other transaction may involve the same or a related market; and
  - as assessments are brief and also do not refer to confidential information provided by the merger parties or other market participants, assessments do not set out all of the issues and information considered by the ACCC, nor all of the analysis and reasons of the ACCC.

## The ACCC's East Coast Gas Inquiry

9. Separate to its review of this proposed acquisition, and pursuant to a Ministerial direction under Part VIIA of the Act, the ACCC is also undertaking a broader assessment of the competitiveness of wholesale gas supplies and prices, and the structure of the upstream, processing, transportation, storage and marketing segments of the gas industry in eastern Australia (the East Coast Gas Inquiry). As part of that inquiry, the ACCC released an issues paper in June 2015 and has conducted public hearings. The East Coast Gas Inquiry is scheduled to deliver its final report to the Minister in April 2016.
10. During its review of the proposed acquisition, the ACCC received a large number of submissions from market participants that expressed their concerns about the impact of the merger in the context of issues that are being considered by the East Coast Gas Inquiry. The ACCC carefully considered all submissions it received about the proposed acquisition. However, its decision in this review was based only on the likely competitive impact of the proposed acquisition itself. The ACCC continues to consider many of the other issues raised about the structure of the industry as part of the East Coast Gas Inquiry.

## The parties and the transaction

The acquirer: Royal Dutch Shell plc

11. Shell is a global group of energy and petrochemicals companies. Shell operates upstream exploration businesses and downstream refining, manufacturing and marketing businesses in a number of countries.
12. Shell currently has a 50% interest in Arrow Energy Pty Ltd (**Arrow**), a joint venture with PetroChina (on behalf of the China National Petroleum Company, **CNPC**). Arrow is a Queensland coal seam gas (**CSG**) company involved in the exploration and development of CSG fields in the Surat and Bowen Basins, gas production and sales, and some electricity generation activities.
13. Arrow's reserves constitute a significant proportion of the non-LNG aligned gas reserves in eastern Australia. For the purposes of this paper, the ACCC uses the expression 'LNG aligned' where one or more parties have significant ownership interests in both gas resources and LNG facilities.

14. Arrow, or joint ventures in which Arrow is involved, supply gas to domestic customers that include:
- Incitec Pivot, which receives gas from the Moranbah Gas Project,<sup>1</sup> a 50/50 joint venture between Arrow and AGL (Bowen Basin)<sup>2</sup>
  - Queensland Nickel, which receives gas from the Moranbah Gas Project (Bowen Basin)<sup>3</sup>
  - Moranbah and Townsville Power Stations, which receive gas from the Moranbah Gas Project (Bowen Basin)<sup>4</sup>
  - Alinta's Braemar 1 power station (Surat Basin)<sup>5</sup>
  - related parties of Arrow, including the Daandine and the Braemar 2 Power Stations (Surat Basin)<sup>6</sup>
  - CS Energy's Swanbank E Power Station which receives gas from Arrow's Kogan North JV with CS Energy (Surat Basin)<sup>7</sup>.
15. Most of Arrow's domestic supply contracts are contracts that Arrow entered into prior to Shell and PetroChina's acquisition of Arrow in 2010. Since this acquisition, Arrow has entered into few new contracts for the wholesale supply of gas.
16. Arrow previously intended to develop an LNG export facility in Gladstone. However, these plans were delayed in 2014 and publicly cancelled in January 2015.
17. Prior to the announcement of the proposed acquisition, Arrow had been actively exploring options for commercialising its reserves through a large scale development involving commercial arrangements with an LNG project, which would secure a significant foundation volume. Documents supporting this were provided to the ACCC during the course of the review.
18. Currently, Arrow's Bowen Basin reserves are only connected to the North Queensland Gas Pipeline (which runs between Moranbah and Townsville). Without a pipeline to take Arrow's gas south from the Bowen Basin, Arrow is currently unable to deliver gas from its Bowen Basin fields to either the LNG plants at Gladstone or to southern domestic gas users. Arrow is currently considering the development of a transmission pipeline from the Bowen region to Gladstone, having called for expressions of interest for the design and construction of its proposed Arrow-Bowen pipeline; the proposed route is shown in **Figure 1** below.
19. While Arrow's Surat Basin reserves are not currently directly connected to a high-pressure transmission pipeline, there are a number of existing transmission pipelines close to Arrow's Surat Basin fields, including transmission pipelines to the

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<sup>1</sup> SMH, Moranbah gas supply problems to hit Incitec Pivot profit, 8 July 2015, <http://www.smh.com.au/business/moranbah-gas-supply-problems-to-hit-incitec-pivot-profit-20150707-gi7dxf.html>

<sup>2</sup> AGL, ASX & Media Release, 11 February 2015, [http://www.agl.com.au/~media/AGL/About%20AGL/Documents/Investor%20Centre/2015/150211\\_REsults\\_Presentation.pdf](http://www.agl.com.au/~media/AGL/About%20AGL/Documents/Investor%20Centre/2015/150211_REsults_Presentation.pdf)

<sup>3</sup> Arrow, Arrow Bowen Gas Project EIS, p. 3. [https://www.arrowenergy.com.au/\\_data/assets/pdf\\_file/0017/3824/Section\\_01-Introduction.pdf](https://www.arrowenergy.com.au/_data/assets/pdf_file/0017/3824/Section_01-Introduction.pdf)

<sup>4</sup> Arrow, Our operations, <https://www.arrowenergy.com.au/our-company/our-projects>

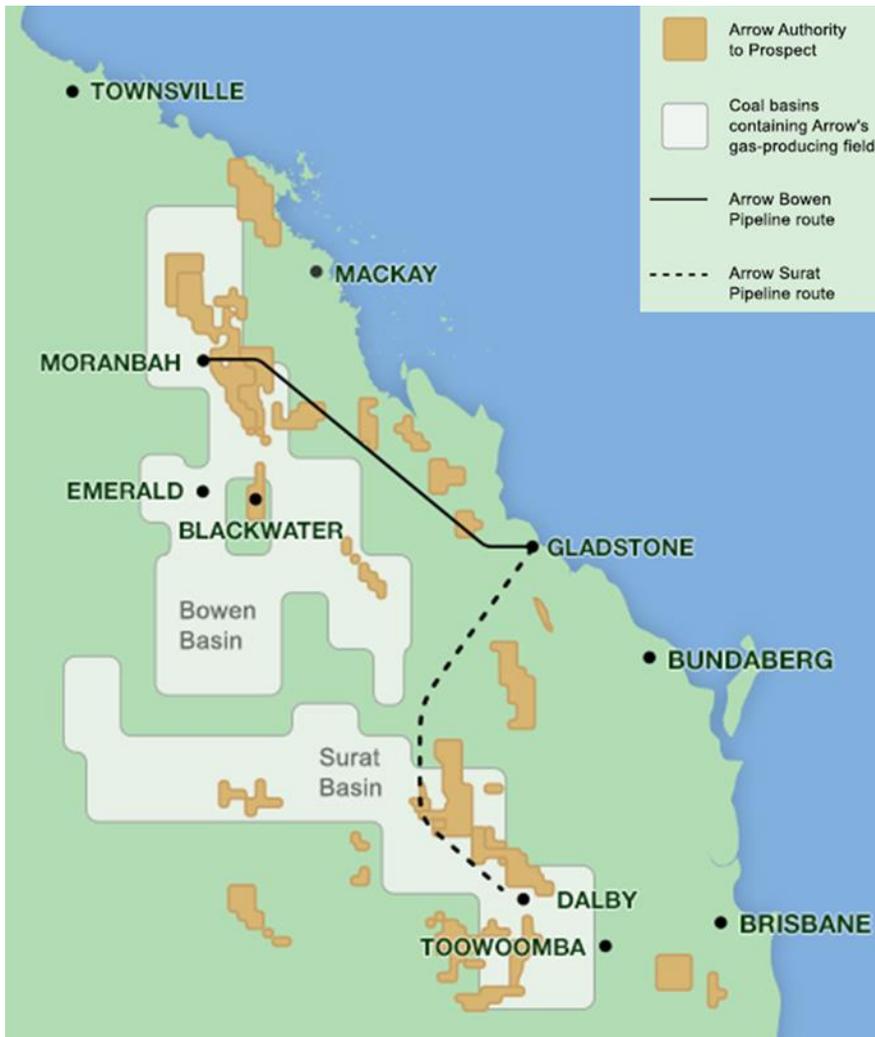
<sup>5</sup> Ibid

<sup>6</sup> Ibid

<sup>7</sup> Ibid

LNG projects in Gladstone (including to BG's QCLNG Project) and the Roma to Brisbane pipeline (these pipelines are shown in **Figure 3**). The ACCC understands that Arrow currently uses small capacity pipelines, or obtains access to existing pipelines, to transport gas to domestic customers located near Dalby and Ipswich. Arrow has also been considering developing a pipeline between its Surat reserves and Gladstone; the proposed route is shown in **Figure 1** below.

**Figure 1: Arrow's tenements and proposed pipeline routes**



Source: Arrow Energy, [www.arrowenergy.com.au/our-company/our-projects](http://www.arrowenergy.com.au/our-company/our-projects), August 2015.

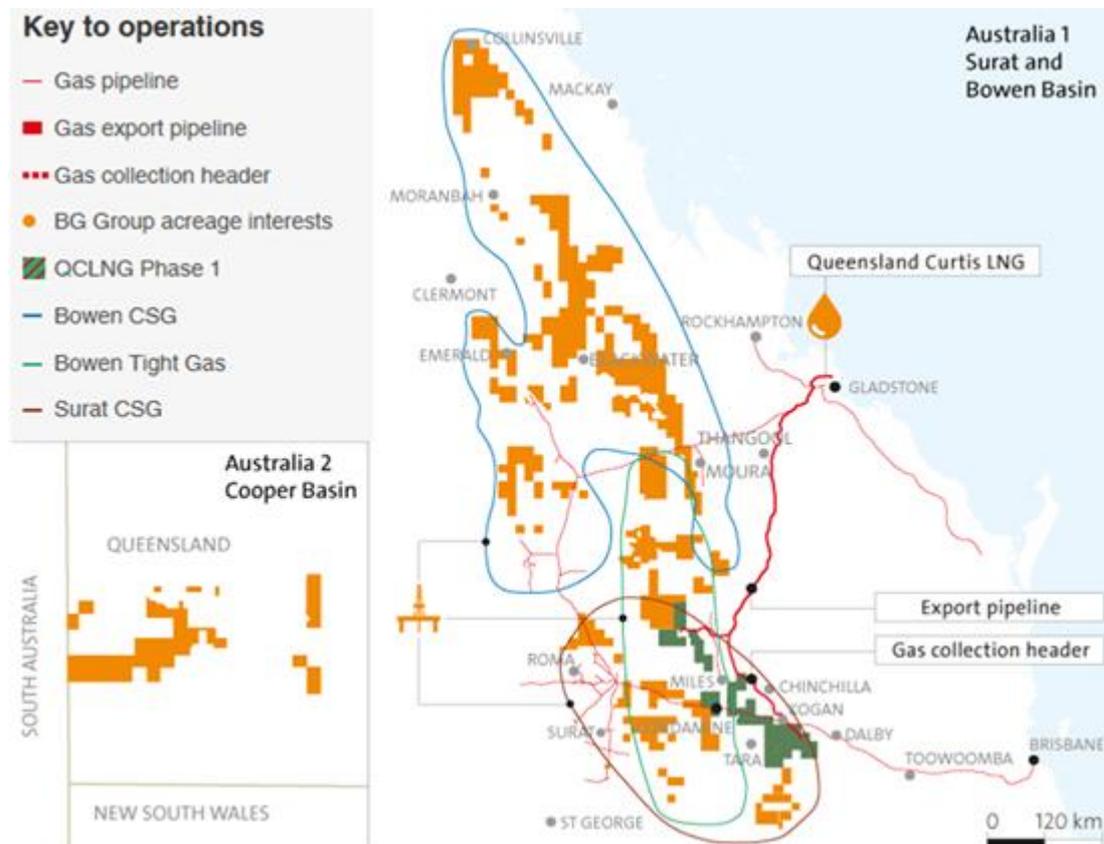
The target: BG Group plc

20. BG is an international explorer and producer of oil and gas, and supplier of LNG.
21. BG's major Australian interests are held by QGC Pty Ltd (**QGC**), a wholly owned subsidiary which BG acquired in 2008. QGC holds interests in natural gas tenements and production facilities in the Surat Basin in Queensland, and exploration rights in the Bowen and Cooper Basins (see **Figure 2**).
22. QGC also has a majority interest (74%) in an LNG plant on Curtis Island (**QCLNG**) with China National Offshore Oil Corporation (**CNOOC**) and Tokyo Gas. The plant currently converts gas sourced from production wells in the Surat Basin into LNG

for shipment to export markets. See Table 1 (on page 9) for more detail on QCLNG.

23. BG (through QGC) currently has domestic gas contracts with power stations, industrial users and gas retailers and supplies about 20% of Queensland's gas demand. However its main focus appears to be on LNG exports through QCLNG. The ACCC understands that the domestic contracts BG has entered into in recent years have been short term contracts for the supply of 'ramp' gas, which is produced during the commissioning phase of LNG plants.
24. BG's Surat Basin reserves are connected to the east coast pipeline network.

**Figure 2: BG's east Australian tenements**



Source: BG Group, [www.bg-group.com/assets/files/cms/CountryData/BG\\_Data\\_Australia.pdf](http://www.bg-group.com/assets/files/cms/CountryData/BG_Data_Australia.pdf), 2015

### The transaction

25. On 8 April 2015, Shell announced its intention to acquire the entire share capital of BG by way of a court-sanctioned scheme of arrangement under Part 26 of the *Companies Act 2006* (UK).
26. The proposed acquisition would involve Shell acquiring a range of global assets, including in particular in Brazil, North America, Kazakhstan, the North Sea and Australia. Shell's stated rationale for the transaction is to improve its global portfolio of productive assets, particularly in the sectors of deep water and liquefied natural gas.

## Review timeline

27. The following table outlines the timeline of key events in this matter.

<b>Date</b>	<b>Event</b>
<b>11 June 2015</b>	ACCC commenced review under the Merger Process Guidelines. <sup>8</sup>
<b>9 July 2015</b>	Closing date for submissions from interested parties.
<b>3 September 2015</b>	Former proposed decision date of 3 September 2015 delayed by ACCC to allow additional time to consider the proposed acquisition.
<b>17 September 2015</b>	ACCC published a Statement of Issues outlining preliminary competition concerns.
<b>8 October 2015</b>	Closing date for submissions relating to Statement of Issues.
<b>22 October 2015</b>	Former decision date of 12 November 2015 delayed by ACCC to allow additional time to consider the proposed acquisition.
<b>19 November 2015</b>	ACCC announced it would not oppose the proposed acquisition.

28. The total elapsed time from start to finish was just over five months. However, the total period net of time taken by the parties to submit information or documents was 93 business days.

## Market inquiries

29. The ACCC conducted market inquiries with a range of industry participants, including competitors, potential competitors, domestic gas users, industry bodies, other regulatory agencies and other interested parties. Submissions were sought in relation to the substantive competition issues.

## Industry background

30. The main potential competition issues considered by the ACCC relate to the wholesale supply of natural gas to domestic gas users.

31. Natural gas is mainly used for generating electricity, heating, cooking, as a fuel for vehicles and as a feedstock in the production of plastics, chemicals, fertilisers, explosives and other goods. It can also be transformed into LNG for export by liquefying the gas in a production facility called an LNG train.

32. In eastern Australia, most natural gas is produced from either sedimentary basins (conventional gas) or from coal seams (CSG). Conventional gas is predominantly produced from offshore Victoria in the Gippsland, Bass and Otway Basins, and

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<sup>8</sup> Shell provided its initial written submission to the ACCC on 4 June 2015.

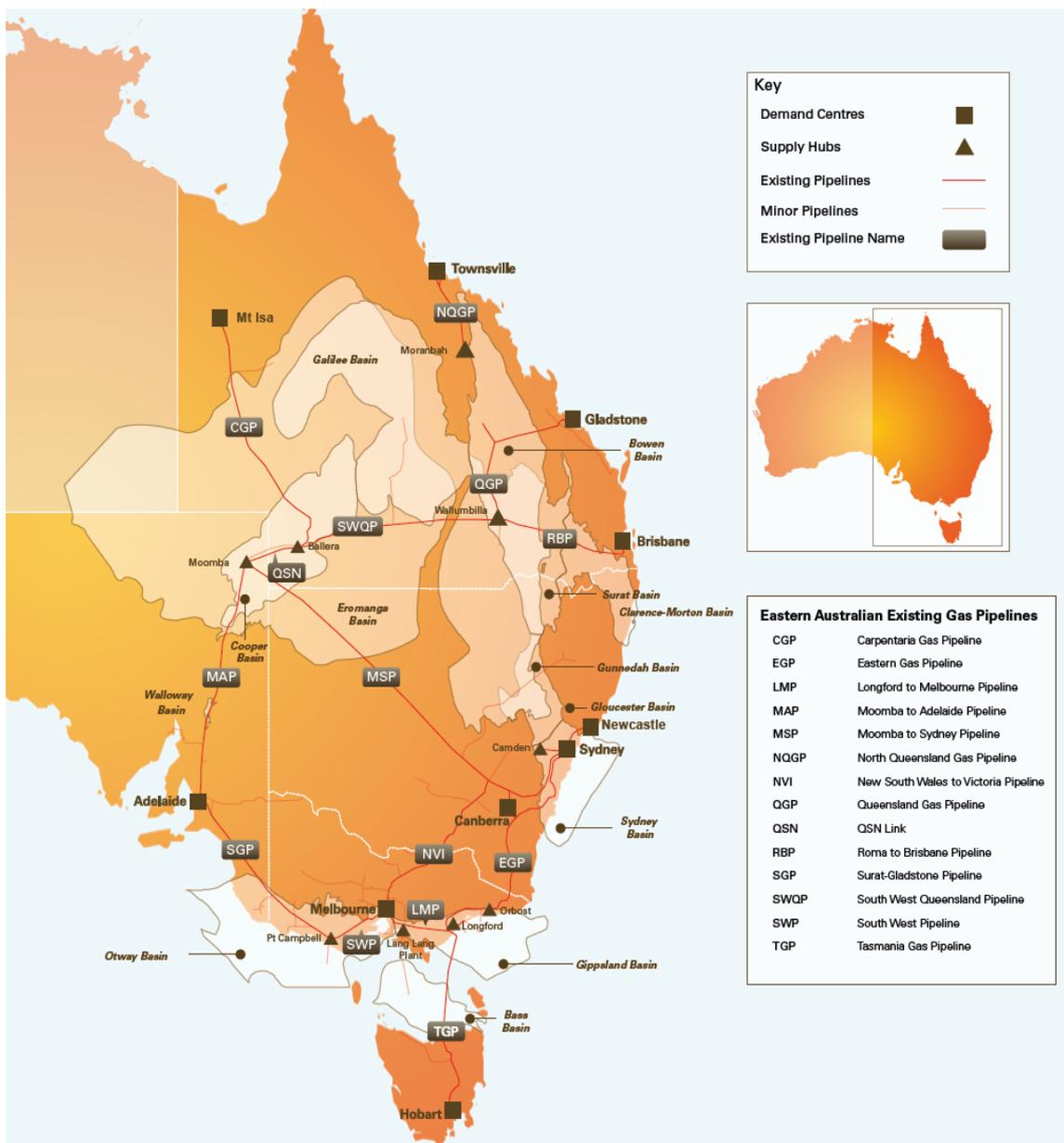
onshore in the Cooper Basin. Current CSG production is limited to Queensland and a small amount in New South Wales. Other unconventional gas resources (shale, deep coals and tight gas<sup>9</sup>) are in sedimentary basins across Australia although much of these resources are not currently commercially or technically recoverable.

33. Extracted gas is processed before being transmitted from gas fields to customers via high pressure transmission pipelines. As shown in **Figure 3**, an interconnected transmission pipeline system links the major gas basins in southern and eastern Australia to demand centres. While gas tends to be purchased from the closest possible source to minimise transport costs, pipeline interconnections have the potential to enhance supply competition in the market by enabling gas customers to source gas from different producers or gas basins, either physically or through entering into gas swap arrangements.

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<sup>9</sup> Tight gas is natural gas produced from reservoir rocks with such low permeability that hydraulic fracturing is necessary to produce the well at economic rates.

**Figure 3: Eastern Australian gas basins and infrastructure**



Source: Core Energy Group, *Gas reserves and resources: Eastern and South Eastern Australia*, February 2015, p. 26.

### Liquefied natural gas and changing market dynamics

34. There are currently three LNG joint ventures with facilities in Gladstone—QCLNG, Gladstone LNG (**GLNG**) and Australia Pacific LNG (**APLNG**). Details of the three LNG joint ventures and their ownership interests are shown in **Table 1**. These joint ventures also own upstream infrastructure facilities and gas reserves (listed in **Table 2**).

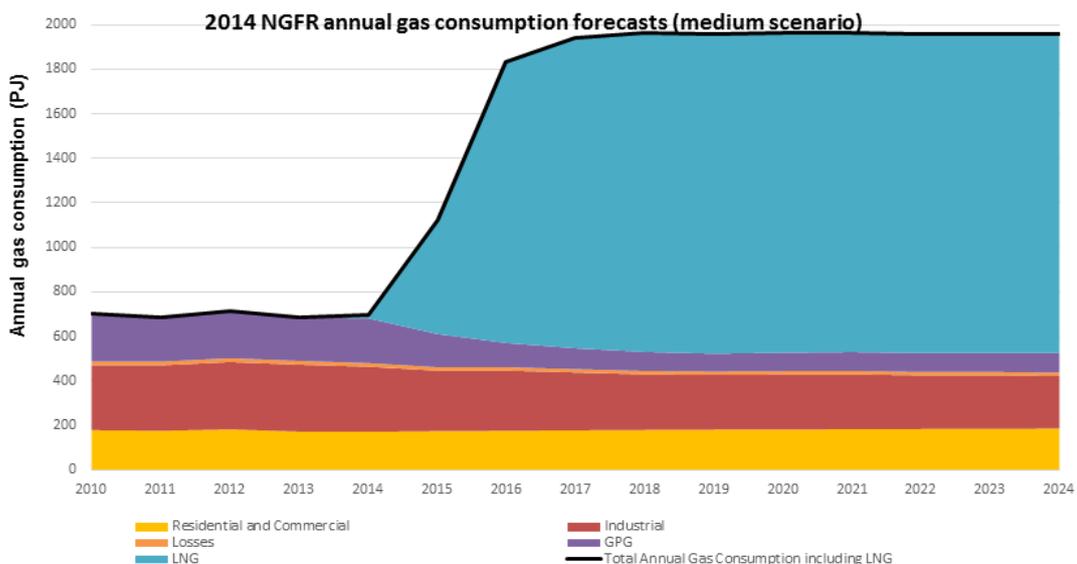
**Table 1: Gladstone LNG projects**

Project	QCLNG	GLNG	APLNG
Participants	BG (50% Train 1, 97.5% Train 2) China National Offshore Oil Corporation (CNOOC) (50% Train 1) Tokyo Gas (2.5% Train 2)	Santos (30%) Petronas (27.5%) Total (27.5%) KOGAS (15%)	Origin (37.5%) ConocoPhillips (37.5%) Sinopec (25%)
Production capacity	2 Trains (8.5Mtpa)	2 Trains (7.8Mtpa)	2 Trains (9Mtpa)

Note: Mtpa = million tonnes per annum. For comparison, the production of 1 million tonnes of LNG requires around 55 PJ of gas.

35. The LNG projects are significantly altering the supply and demand dynamics in the domestic gas industry in eastern Australia. Domestic gas users in Eastern Australia have been exposed, for the first time, to international gas prices and there are uncertainties about the amount of gas that will be available for domestic use in eastern Australia in the future.<sup>10</sup>
36. Once the three LNG plants reach a steady state of production in around 2018-19, they will require around 1350–1450 petajoules (PJ) of gas per annum to meet their export obligations over the duration of their long-term LNG export agreements. At the same time, the Australian Energy Market Operator has (AEMO) forecast that demand for domestic gas in eastern Australia will fall from approximately 680 PJ in 2014 to around 520 PJ per annum by 2019.<sup>11</sup> The decrease is mainly driven by forecast falls in the use of gas for electricity generation (GPG).

**Figure 4: Forecast annual gas consumption (including LNG exports) in eastern Australia**



<sup>10</sup> ACCC East Coast Gas Inquiry, *Issues Paper*, p. 3.

<sup>11</sup> AEMO, *National gas forecasting report 2014*, December 2014, p. 14.

## Other industry participants

37. A number of wholesale gas producers and suppliers have operations in eastern Australia. Due to the high costs and risks associated with gas projects, the majority of domestic gas projects are joint ventures.
38. Other industry participants include the Gippsland Basin joint venture (owned by ExxonMobil and BHP Billiton), the Cooper Basin joint ventures (between Santos, Beach Energy and Origin), large energy generators and retailers with upstream gas portfolios (such as AGL Energy), and a number of smaller gas developers and producers (such as Beach Energy, Senex Energy, Drillsearch Energy and Strike Energy).<sup>12</sup>
39. **Table 2** below lists the main producers and suppliers with operations in eastern Australia (with their ownership interests, current gas production and shares of production and proven and probable (**2P**) gas reserves). The reserve positions included in Table 2 are as at May 2015, and the production figures are for the 12 months to May 2015. This was the most recent data that was available to the ACCC at the time that it reached its decision.
40. When considering the figures in Table 2, it is important to bear in mind that:
- As the three LNG projects have been increasing their gas production and will continue to do so until they reach steady-state levels around 2018-19, shares of gas production for the 12 months to May 2015 are unlikely to be representative of the expected shares of future gas production.
  - Reserves are a final stage in the process of petroleum resource categorisation:
    - The full process of resource development commences with exploration for prospective resources. In the event of discovery, these may then be classified as sub-commercial contingent resources. Then, if there is a firm intention by a company to develop the resources for a specific project and within a reasonable time frame (often associated with a final investment decision on that project) they may be reclassified as reserves.<sup>13</sup> Thus by the time resources are classified as reserves, they have been subject to substantial appraisal and investment.
    - Proved and probable (2P) reserves is an estimate of the quantity of reserves; it implies a 50% probability that the volumes of gas actually produced from the reserves will equal or exceed the 2P estimate.<sup>14</sup>
    - A full picture of the ownership of east coast gas resources would also include contingent resources and prospective resources. However, the ACCC does not have comprehensive data on these categories.

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<sup>12</sup> At the date of the ACCC's decision, Drillsearch Energy and Beach Energy had announced a proposed merger.

<sup>13</sup> Society of Petroleum Engineers, *Petroleum Resources Management System: Guide for Non-Technical Users*, p.3 [http://www.spe.org/industry/docs/PRMS\\_guide\\_non\\_tech.pdf](http://www.spe.org/industry/docs/PRMS_guide_non_tech.pdf)

<sup>14</sup> Society of Petroleum Engineers, *Petroleum Resources Management System 2007* p.11 [http://www.spe.org/industry/docs/Petroleum\\_Resources\\_Management\\_System\\_2007.pdf](http://www.spe.org/industry/docs/Petroleum_Resources_Management_System_2007.pdf)

- The ACCC has chosen to organise the data in Table 2 by project, rather than by individual project owners. This does not imply that all projects listed in Table 2 market their gas output on a joint basis.
- ‘LNG alignment’ indicates that one or more parties has significant ownership interests in both gas reserves and LNG facilities; however, this does not necessarily mean that all gas in an LNG aligned project is destined to supply an LNG plant.
- The ACCC obtained the data on 2P gas reserves and production used in Table 2 from EnergyQuest – an industry consultant. EnergyQuest obtains its data from a combination of public sources and its own estimates based on industry knowledge. Other than providing the data, EnergyQuest had no input into how the data would be used or presented.

**Table 2: Eastern Australia gas production and reserves (by project)**

Project	Ownership / JV Interests	LNG aligned?	Production	Share of production	2P reserves	Share of reserves
			PJ	%	PJ	%
Arrow	Shell 50% PetroChina 50%	No	31	4	8,844	18
<b>Queensland LNG plants <sup>a</sup></b>			<b>366</b>	<b>44</b>	<b>28,701</b>	<b>60</b>
APLNG	Origin 37.5% (operator upstream) ConocoPhillips 37.5% (operator downstream) Sinopec 25%	Yes	173	21	13,778	28
GLNG	Santos 30.0% (operator) PETRONAS 27.5% Total 27.5% KOGAS 15.0%	Yes	36	4	5,603	12
QCLNG	BG 74% upstream resources and infrastructure (operator) CNOOC 24.5% Tokyo Gas 1.5%	Yes	157	19	9,320	19
<b>Other Queensland Coal Seam Gas</b>			<b>12</b>	<b>1</b>	<b>4,335</b>	<b>9</b>
AGL Qld	AGL (share of Moranbah with Arrow)	No	6	1	1,257	3
Santos other CSG	Santos holds permits in own right (not as part of GLNG)	Yes	0	0	471	1
PetroChina	PetroChina holds permits in own right (not as part of Arrow JV)	No	0	0	435	1
Origin Ironbark	Origin holds permits in own right (not as part of APLNG)	Yes	0	0	256	1
Senex CSG	Senex 100%	No	0	0	473	1
Meridian	Landbridge and Mitsui	No	2	0	680	1
Other CSG	Various companies with small interests		3	0	763	2
<b>NSW Coal Seam Gas</b>			<b>5</b>	<b>1</b>	<b>1,280</b>	<b>3</b>
Santos Narrabri	Santos 80% (operator) Energy Australia 20% (in development) <sup>b</sup>	Yes	1	0	777	2
AGL NSW	AGL 100% Camden Project (operating) and Gloucester Project (in development) <sup>c</sup>	No	4	1	503	1

Project	Ownership / JV Interests	LNG aligned?	Production	Share of production	2P reserves	Share of reserves
			PJ	%	PJ	%
<b>Conventional Gas Onshore</b>			<b>94</b>	<b>11</b>	<b>1,662</b>	<b>3</b>
<b>Cooper Basin JVs</b>	Two separate JVs (SA and Western Qld) with Santos, Beach <sup>d</sup> and Origin	Yes	88	11	1,425	3
<b>Other Cooper Basin</b>	Drillsearch <sup>d</sup> , Senex, Strike Energy	No	3	0	119	0
<b>Other Qld Conventional Gas</b>	Various small interests		3	0	118	0
<b>Conventional Gas Offshore</b>			<b>328</b>	<b>40</b>	<b>3,913</b>	<b>8</b>
<b>Gippsland Basin JV</b>	ExxonMobil 50% (operator) BHPB 50%	No	217	26	2,484	5
<b>Kipper Gas</b>	ExxonMobil 32.5% (operator) BHPB 32.5% Santos 35% (in development first gas 2016) <sup>e</sup>	Yes	0	0	622	1
<b>Longtom</b>	Seven Holdings 100%	No	7	1	0	0
<b>BassGas</b>	Origin 42.5%, AWE 35%, Toyota Tsusho 11.25%, Prize Petroleum International 11.25%.	Yes	12	1	158	0
<b>Otway</b>	Origin 67.23%, Benaris 27.77% and Toyota Tsusho 5%	Yes	43	5	280	1
<b>Casino/Henty</b>	Santos 50% (operator), AWE 25%, Mitsui 25%.	Yes	26	3	216	0
<b>Minerva</b>	BHP Billiton 90% (operator), Santos 10%	No	24	3	82	0
<b>Origin (Halladale)</b>	Origin 100% (no production developed)	Yes	0	0	71	0
<b>Total</b>			<b>835</b>	<b>-</b>	<b>48,735</b>	<b>-</b>

Source: Energy Quest data, August 2015 (numbers may not add up due to rounding).

Notes:

a Reserve figures in this section are reserves held by the LNG joint ventures themselves; reserves held by members of those joint ventures in their own right are listed separately.

b On 6 February 2016, Santos announced that it had written down the remaining book value of its Narrabri assets and had moved its 2P reserves into the contingent resources category.

c On 4 February 2016, AGL announced that it would not proceed with the Gloucester Project, and that it would progressively decommission wells at the Camden Gas Project prior to ceasing production in 2023.

d Drillsearch Energy and Beach Energy announced a proposed merger on 23 October 2015.

e On 9 November 2015 Santos announced a sale of its 35% interest in the Kipper project in the Gippsland Basin to Mitsui

## Market definition

41. The focus of the ACCC's review was on Shell's and BG's gas operations in Queensland and in eastern Australia more broadly. While Shell also has oil and gas interests offshore in Western Australia and the Northern Territory, all of BG's Australian interests are in eastern Australia.
42. The relevant markets were considered to be:
  - the wholesale supply of natural gas in eastern Australia, or
  - the wholesale supply of natural gas in Queensland.
43. In the context of this review, 'wholesale supply' includes the activities of exploration, production and supply.
44. The ACCC formed the view that substitution options for purchasers of wholesale gas are limited. Where gas is used as a feedstock in a production process switching from gas to other fuels is not possible. For other customers that use gas as an energy input, the ACCC's market inquiries suggested that the costs involved in changing fuels are such as to make substitution to an alternate energy source uneconomic as a response to a small but significant increase in the price of gas.
45. The ACCC did not consider it necessary to reach a concluded view in relation to the geographic dimension of the relevant market because this would not have led to a different view about the likely competition effects of the merger. The ACCC considered the broader competitive dynamics in each of the possible markets, taking into account on-going and likely changes in these dynamics and the current uncertainty about how the industry will develop. In considering the broader competitive dynamics, the ACCC took into account the Northern Territory Government's November 2015 announcement of the successful applicant to construct the North East Gas Interconnector (**NEGI**), the planned route of the pipeline and its expected capacity. At the time of the ACCC's decision, the expected date for the first shipment of gas over the NEGI was 2018.

## Competition analysis

### With/without test

46. Section 50 of the 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 proposed acquisition pursuant to section 50 of the Act, the ACCC considers the effects of the acquisition by comparing the likely future competitive environment if the acquisition proceeds (the "with" position) to the likely future competitive environment if the acquisition does not proceed (the "without" position) to determine whether the proposed acquisition is likely to substantially lessen competition in any relevant market.
47. In this instance, the future environment if the acquisition does not proceed is likely to be a continuation of the status quo, in that BG and Shell (and Arrow) are likely to continue to operate under current ownership.

## Overview

48. The ACCC considered three different ways in which the proposed acquisition could potentially substantially lessen competition. The ACCC considered the effect of the proposed acquisition on:

- Arrow's incentives to compete to supply gas to domestic users
- future competition between Arrow and BG to supply gas to domestic users
- Arrow's and BG's incentives to develop their gas resources and explore for additional gas.

49. The ACCC formed the view, however, that Shell's proposed acquisition of BG would be unlikely to have the effect of substantially lessening competition in the relevant market(s). The ACCC's competition analysis is set out below.

### Effect of the proposed acquisition on Arrow's incentives to compete to supply gas to domestic users

50. A key issue for the ACCC was whether the proposed acquisition would reduce the supply of gas, and reduce competition to supply gas, to domestic customers in Queensland and eastern Australia by changing Arrow's incentives.

51. The proposed acquisition would align Shell's interest in Arrow with BG's interest in QCLNG. The ACCC considered whether:

- as a 50% owner of Arrow, Shell would be able to control or influence the choice of customers with which Arrow signs gas supply agreements (including by exercising negative control)
- as a result of the alignment between Shell's interest in Arrow and BG's interest in QCLNG, Shell would have an incentive to direct the supply of Arrow's gas to the QCLNG project ahead of other (domestic) gas users.

52. The ACCC was concerned that if, as a result of the proposed acquisition, Shell had a greater incentive to act in this manner, the impact on the Queensland or eastern Australian gas market(s) could have been substantial, given Arrow's potential to act as a significant new source of supply to domestic customers. As illustrated in Table 2 (on page 12):

- The vast majority (about 68%) of eastern Australian 2P gas reserves are held by market participants that are aligned with the LNG plants. The ACCC understands that the primary purpose of LNG plant owners holding gas resources is to secure supply for their own LNG projects, rather than for supply to domestic users. The percentage of eastern Australian 2P gas reserves that would be held by market participants that are aligned with the LNG plants would increase to about 86% if Arrow's reserves became aligned to QCLNG.
- A significant proportion of production by non-LNG aligned producers is currently accounted for by one producer - the Gippsland Basin JV between ExxonMobil and BHPB.
- While there are a number of smaller gas suppliers in the market, their collective market share is small both as a proportion of production and as a proportion of reserves.

- Arrow's reserves represent a substantial proportion of gas reserves that are currently not aligned with an LNG plant.<sup>15</sup>

53. The ACCC considered whether, as a result of the above, a likely consequence of the proposed acquisition would be higher domestic gas prices and more restrictive non-price contractual terms relative to the situation without the proposed acquisition.

54. The ACCC concluded that the proposed acquisition would not change Arrow's incentive to supply LNG customers. Arrow would have a strong incentive to supply a significant proportion of its gas to a foundation LNG customer, both with and without the proposed acquisition because:

- Arrow will have to incur significant capital expenditures to develop its extensive reserves and transport the gas to customers.
- Arrow will have a commercial incentive to reduce its risks in undertaking large, long-term capital expenditures by securing high volume, long-term contracts to underpin those expenditures.
- Domestic supply agreements are unlikely to be of sufficient scale to provide the foundational contract(s) that are needed to underpin development of Arrow's resources.

55. Evidence was presented to the ACCC that Arrow has not been active in new sales to domestic customers since it was purchased by the Shell/PetroChina joint venture in 2010. As mentioned above at paragraph 17, prior to the announcement of the proposed acquisition, Arrow had been actively exploring options for commercialising its reserves through a large scale development involving commercial arrangements with an LNG project. Therefore, the ACCC concluded that in the scenario without the proposed acquisition, Arrow would still seek a foundation LNG customer and be focussed on LNG supply.

56. As neither Arrow nor Shell are currently focussed on supplying domestic customers, and appeared unlikely to be so in the future, the ACCC concluded that aligning Shell's interest in Arrow with an interest in an LNG operator would not change competition for the supply of gas to domestic customers.

### Effect of the proposed acquisition on future competition between Arrow and BG to supply gas to domestic users

57. Another important issue for the ACCC's review was whether the proposed acquisition would be likely to substantially lessen competition for the supply of gas to customers in the relevant market(s) by removing the *potential* for competition between Arrow and BG to supply domestic customers. A key aspect of this issue was the likelihood and extent to which Arrow and BG would be competitors in the absence of the proposed acquisition.

58. An important consideration was whether, in the absence of the proposed acquisition, Arrow and BG would both have 'excess' gas above the amount required to satisfy their likely contractual commitments to LNG customers and whether they would offer that excess gas to domestic customers.

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<sup>15</sup> While the points made in paragraph 52 have been described in terms of 2P reserves, the ACCC considers that the position is likely to be similar in respect of gas resources more broadly.

59. At the time of publishing the Statement of Issues, the ACCC held the preliminary view that BG is unlikely to be a potential supplier of new long-term gas supply agreements to domestic gas users irrespective of the proposed acquisition. That view was based on information provided by market participants suggesting that at present QCLNG does not have access to sufficient gas to satisfy its existing LNG supply agreements.
60. At the time of making its final decision, based on further information received during the review, the ACCC considered that BG would be likely to have 'excess' gas (above the amounts required to meet its existing contractual commitments) for a period and, during that period, it may compete to supply domestic gas users in the absence of the proposed acquisition. The ACCC still considered that in the absence of the proposed acquisition, BG's prime focus would be on supplying gas to the QCLNG project. However, its updated view was that one potential supply option for any 'excess' gas held by BG was to supply that gas to domestic gas users. Other options available to BG in the absence of the proposed acquisition would include liquefying any excess gas to supply the LNG spot market, or supplying the gas to other LNG operators in Gladstone (APLNG or GLNG).
61. However, the ACCC considered that there was also considerable uncertainty about the amount and timing of Arrow's and BG's future gas supplies as well as those of its potential future competitors.
62. Given this level of uncertainty about the future circumstances of the domestic gas industry, the ACCC could not be satisfied that any loss of potential competition between Arrow and BG would be likely to substantially lessen competition in either of the relevant markets.

#### Effect of the proposed acquisition on Arrow's and BG's incentives to develop their gas resources and explore for gas

63. The ACCC also considered whether the proposed acquisition would reduce Shell's incentives to explore for gas and develop Arrow's and BG's resources in a timely manner. If the relative cost of producing gas from Arrow's resources was lower than producing gas from BG's resources (or other alternative sources of gas for the QCLNG plant), Shell *may* have an incentive post-acquisition to substitute cheaper Arrow gas for gas that would otherwise have been produced from BG's existing resources. It may therefore defer development of BG's higher-cost resources. The ACCC was concerned that if this were to occur, it could have a substantial impact on the level of competition in relevant gas market(s).
64. However, the ACCC considered there was too much uncertainty about the relative costs, quantity and timing of future gas supplies to conclude that the proposed acquisition would be likely to result in the substitution of Arrow gas for gas that would otherwise have been produced from BG's resources, or in a reduction or deferral of gas exploration by the merged entity relative to total exploration by Arrow and BG separately.
65. As stated above at paragraph 54, Arrow would have a strong incentive to supply a significant proportion of its gas to a foundation LNG customer, both with and without the proposed acquisition. The ACCC recognised that all of the LNG operators will have commercial incentives to meet their LNG export commitments from the cheapest available source of gas. In the scenario without the acquisition, Arrow's foundation LNG customer (whoever it is) may itself have incentives to substitute Arrow gas for gas that would otherwise be produced from its own

resources (or other alternative sources of gas) if it were profitable to do so. Given this, even if the proposed acquisition resulted in a net decrease in the volume of gas produced from existing QCLNG sources, it was not clear to the ACCC that this would be a net reduction in total market supply relative to the likely situation without the proposed acquisition.

66. Another relevant consideration was that post-acquisition, Shell would not generally have the ability to make decisions on the timing and scale of exploration and development decisions on its own. Major decisions on Arrow's and BG's gas development, production and exploration activities are likely to require the agreement of Shell's joint venture partner in Arrow and BG's joint venture partners in the QCLNG project, respectively.
67. Further, the ACCC considered that any decision by the merged entity to reduce these exploration and development activities would risk consequences under the Queensland Government's regulatory regime for tenure management, such as loss of some tenure.

## **Possible undertakings**

68. During its review, the ACCC received a large number of submissions from market participants concerned about the competition effects of the proposed acquisition and the current state of the east Australian gas market.
69. Some market participants urged the ACCC to approve the acquisition, but only if the merger parties provided undertakings to offer greater quantities of gas to domestic customers. These market participants considered that the proposed acquisition may provide a 'route to market' that allows Arrow's gas to be developed more quickly, and that undertakings of this kind would serve to protect the requirements of domestic gas users.
70. The ACCC considered the potential undertakings suggested by market participants. However, the ACCC can only accept undertakings where competition concerns arise from the acquisition and it finds that certain undertakings can effectively address those concerns. For the reasons discussed above, the ACCC did not find merger-specific competition concerns that required a remedy.

## **Conclusion**

71. Based on the above analysis, the ACCC concluded that the proposed acquisition of BG Group by Royal Dutch Shell would not be likely to have the effect of substantially lessening competition in any market.