Anticipated acquisition by Talisman Energy Resources Limited of Paladin Resources plc

The OFT's decision on reference under section 33 given on 5 December 2005. Full text of decision published on 12 December 2005.

Please note that square brackets indicate information that has either been excised or replaced by a range at the parties' request.

PARTIES

1. **Talisman Energy Resources Limited (Talisman)** is an indirect wholly owned subsidiary of Talisman Energy Inc., an independent Canadian oil and gas company with global operations. In 2004, Talisman Energy Inc. had a UK turnover of £893.1 million.

2. **Paladin Resources plc (Paladin)** is an independent UK oil and gas exploration and production company. It has a portfolio of assets, with around three quarters of its reserves and production in North Sea sectors (Norwegian, UK and Danish). It also has production and exploration assets in Australia, Indonesia, Tunisia, Gabon and Romania. In 2004, Paladin's UK turnover was [ ].

TRANSACTION

3. On 20 October 2005, Talisman announced a cash offer for the whole of the issued and to be issued share capital of Paladin. The merger was notified on 7 November 2005 and the 20 working day statutory deadline expires on 5 December 2005.

JURISDICTION

4. As a result of this transaction Talisman and Paladin will cease to be distinct. The UK turnover of Paladin exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in

contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

5. Paladin and Talisman Energy Inc. overlap in the UK Continental Shelf (North Sea) in the exploration, development, production and sale of crude oil, natural gas and natural gas liquids (NGLs) and, to a more limited extent, in transportation and processing of oil and gas, and oil storage. The parties have proposed market segmentation of these activities as follows:[1]

- exploration of crude oil and natural gas on a worldwide basis
- development, production and sale of crude oil on a worldwide basis
- development, production and sale of natural gas on an EEA-wide basis (possibly including Algeria and Russia)
- development, production and sale of NGLs on an EEA-wide basis (possibly including Algeria and Russia)
- transportation of gas in the UK Northern North Sea (NNS)[2] and the UK Southern North Sea (SNS)
- gas processing in the UK NNS and the UK SNS
- crude oil infrastructure (transportation and processing) in the UK NNS and the UK SNS, and
- crude oil storage (geographic scope left open).

Exploration of crude oil and natural gas

6. Exploration concerns the licensed search for new energy reserves (it not being known until discovery whether these will be oil or gas). Third party opinion suggests oil and gas exploration may constitute a relevant frame of reference separate from activities such as development, production and sale but given that no competition concerns arise at this level, it has not been necessary to conclude on the relevant product frame of reference.

7. As no competition concerns arise on UK, EEA-wide and worldwide exploration share of supply estimates, it is also unnecessary to reach a firm conclusion on the relevant geographical frame of reference.

[1] This is based on market definition segmentations proposed by the European Commission in previous merger decisions, e.g. Comp/M1383 Exxon/Mobil, (29.9.1999).
[2] North of 55° latitude.

Development, production and sale of crude oil, natural gas, and NGLs

8. Development concerns the setting up of infrastructure (such as pipelines and terminals) for oil and gas reserves so production can be commenced. As development, production and sales are interlinked, it may be appropriate to consider them together, albeit separately for each of oil, gas and NGLs (in light of such factors as different applications and trading conditions). However, given that no competition concerns arise at any level, it has not been necessary to conclude on the relevant product frame of reference.

9. As no competition concerns arise on UK, EEA-wide (including Russia and Algeria) and worldwide development, production and sale share of supply estimates, it is also unnecessary to reach a firm conclusion on the relevant geographical frame of reference.

Crude oil and gas transportation and processing

10. Oil and gas pipelines are typically run as joint ventures by owners of fields in close proximity.[3] As well as main offshore/onshore pipelines, interfield 'tie-in' pipelines exist linking these to other fields and platforms. Pipelines can be operated on an 'undivided rights' or a 'divided rights' basis. The former allows owners to veto decisions to allow spare capacity available to third parties, while the latter only allows the exercise of capacity rights corresponding to equity interest. Once the oil or gas has been transported by pipeline, it is subject to processing at terminals.

11. It appears appropriate to distinguish infrastructure for oil and gas (since they have different compositions impacting on pipeline and terminal operations), and it may also be appropriate to distinguish pipelines and processing terminals. However, given that no competition concerns arise at any level, it has not been necessary to conclude on the relevant product frame of reference.

12. The parties submit that both gas and oil infrastructure should be divided into the NNS and SNS. Although in general third parties confirm that NNS and SNS pipelines are not interchangeable, some see oil and gas transportation as North Sea wide. However, as both parties are only active in the NNS and as no competition concerns arise at even the NNS level, it has not been necessary to reach a firm conclusion on the relevant geographical frame of reference.

[3] Transportation can also be effected through tankers, which are generally run by independent shipping operators from whom transportation capacity is hired by oil and gas companies. As Talisman is only active in tanker transportation in the UK through charter hire, it is not considered further.

Crude oil storage

13. Crude oil is pumped through pipelines to storage tanks at terminals, which can be ancillary to oil processing activities. Both parties are active in oil storage in the NNS. However, given that no competition concerns arise for crude oil storage, it has not been necessary to conclude on the relevant product or geographic frame of reference.

HORIZONTAL ISSUES

Market shares

14. The parties estimate that the merged entity will account for less than 10 per cent of oil (including NGLs) and [0-5 per cent] of gas consumed in the UK in 2004.

Exploration of crude oil and natural gas

15. There are a number of different measures that could be used for the calculation of market share for exploration. The merged entity's combined share for exploration based on oil and gas reserves will be less than 10 per cent (increment [0-5 per cent]) in the UK, EEA, and worldwide.[4] In the UK, estimates of the merged entity's share of total licensed exploration area based on equity interest or capital expenditure in exploration will be no more than around [0-10 per cent] and [10-20 per cent] (increments around [0-5 per cent], respectively.

Development, production and sale of crude oil, natural gas, and NGLs

16. The merged entity's share for development, production and sale of each of oil, natural gas, and NGLs will be less than 10 per cent (increment [0-5 per cent] in the UK, EEA-wide and worldwide.[5]

Crude oil and gas transportation and processing

17. The parties have small (below 10 per cent) interests in one main offshore/onshore UK Continental Shelf gas pipeline each. These are held on an undivided basis and do not confer control over the use of spare capacity [by third parties] in the pipelines so the merged entity could not foreclose access post-transaction. Talisman also has various 'tie-in' gas pipeline interests in the NNS, some of which have spare capacity available to third parties, estimated to account for less than 5

[4] Estimated shares of supply by volume (millions of barrels and billions of cubic feet) for 2004. These include proven reserves, which analysis of geological and engineering data suggests are recoverable with reasonable certainty, and also Paladin's probable (less certain than proven) reserves.

per cent of spare NNS gas pipeline capacity. However, Paladin only has a (below 5 per cent) interest in one tie-in pipeline out of 83 in the NNS and has no veto rights over spare capacity in this respect.

18. In relation to oil transportation, Talisman has interests in two onshore/offshore oil pipelines and a number of tie-in pipelines estimated to account for less than 10 per cent of spare oil pipeline capacity in the NNS area. Paladin has approximately [ ] per cent interests in [ ] oil tie-in pipelines out of 132 in the NNS, in none of which it makes available spare capacity to third parties precluding the possibility of access being foreclosed post-merger.

19. The parties overlap to a limited extent for gas processing. The parties have small (below 10 per cent) interests in one NNS onshore gas processing module each. Together, these are estimated to account for less than 5 per cent of gas processing (increment [0-5 per cent]) in the NNS.[6] There are also minimal overlaps between the parties' activities in oil processing. Talisman operates two oil processing terminals, but Paladin only has a negligible interest on a divided basis in the offshore Triton Vessel, which provides (inter alia) oil processing facilities in the NNS prior to transportation to onshore terminals. The parties have confirmed that Paladin has no veto rights over spare capacity in any processing facilities it has interests in.

Crude oil storage

20. Talisman has four oil storage tanks, while Paladin has a negligible interest on a divided basis in oil storage ancillary to processing activities at the Triton Vessel, where capacity is not currently available to third parties.

21. In summary, the combined shares of supply will remain low in relation to each segment considered, and the increments to shares are also small. The upstream oil and gas sector is characterised by the presence of large state-owned companies and multinational vertically integrated private companies (e.g. BP, ExxonMobil and Shell), in addition to the existence of numerous smaller non-integrated players such as the parties. The merger does not increase the equity interest of the parties in any one pipeline or processing terminal. Further, the parties argue that foreclosure of competitors by preventing third parties access to transportation and processing facilities is not a possibility in practice due to the existence of the Code of Practice on Access to Upstream Oil and Gas Infrastructure on the UK Continental Shelf, which regulates industry practice in

[5] Estimated shares of supply by volume (barrels and millions of cubic feet per day) for 2004.
[6] Estimated shares of supply by capacity and expected processing throughout (millions of cubic feet per day) for 2004.

this respect.[7] In addition, Paladin has no veto rights over spare capacity in any pipelines or processing facilities in which it has interests.

Barriers to entry and expansion

22. Third parties have indicated that although this is a high risk and capital intensive sector, entry is possible if a company has the necessary resources and expertise. There is evidence of previous entry. For example, around a quarter of North Sea exploration licences offered in the latest UK Oil and Gas Licensing Round were to new North Sea entrants.

Buyer power

23. In general, third parties consider that buyer power does not exist due to the Code of Practice on Access referred to above and prevailing oil and gas trading conditions. However, one third party suggests that large buyers of gas may be able to exert buyer power as they purchase from a wide range of sources.

VERTICAL ISSUES

24. No vertical issues arise from this transaction due to the small overlaps and low shares of supply for the parties' upstream oil and gas activities and as the parties are not active in the downstream oil and gas sector (e.g. refining and marketing fuels and various petrochemical activities).

THIRD PARTY VIEWS

25. Third party enquiries revealed no concerns about this transaction.

ASSESSMENT

26. Paladin and Talisman's parent company (Talisman Energy Inc.) overlap in the UK North Sea, in relation to the exploration, development, production and sale of crude oil, natural gas and NGLs and, to a more limited extent, in transportation and processing of oil and gas, and oil storage. For the reasons outlined above, the product segmentation adopted by the parties has been considered as separate frames of reference for the purpose of this assessment. In any event, as shares of supply are low in this case, firm conclusions on market definition are considered unnecessary.

[7] This is a non-statutory Code adopted in 2004 which sets out principles and procedures to guide industry in negotiating third party access to oil and gas infrastructure on the UK Continental Shelf.

27. Based on the evidence provided, the parties do not appear to be any more important a competitor to each other than a number of other significant players (including BP, ExxonMobil, and Shell) that will provide sufficient actual rivalry to constrain the merged entity's post-transaction behaviour. Furthermore, the threat of new entry may act as a viable competitive constraint. The risk of foreclosure to access to pipelines and processing facilities appears small, taking into account that Paladin has no veto rights over spare capacity in any pipelines or processing facilities in which it has interests.

28. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom

DECISION

29. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.