

PUBLIC VERSION

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The Registrar
Business Acquisitions & Authorisations
Commerce Commission
P O Box 2351
WELLINGTON

**FORM OF APPLICATION FOR AUTHORISATION OF A RESTRICTIVE TRADE
PRACTICE PURSUANT TO SECTION 58 OF THE COMMERCE ACT 1986**

- 1 An application for authorisation of a restrictive trade practice is hereby made in terms of section 58 of the Commerce Act 1986 (*"the Act"*) by:

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- 2 All correspondence and notices in respect of this application should be directed in the first instance to:

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TRADE PRACTICE

Description of proposed arrangements

- 3 This application relates to a practice of a kind detailed in section 58(2) of the Act.
- 4 Preussag Energie GmbH ("*Preussag*"), Todd (Petroleum Mining Company) Limited ("*Todd*"), Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited ("*Shell*") (collectively the "*Pohokura JV parties*") seek authorisation to enter into arrangements to jointly market and sell gas produced from the Pohokura field. Specifically, authorisation is sought for the Pohokura JV parties:
 - 4.1 to discuss and agree on all relevant terms and conditions, including price, quantity, rate, specification and liability for the joint sale of gas from Pohokura; and
 - 4.2 to negotiate and enter into contracts for the sale of Pohokura gas jointly (i.e. as one seller).
- 5 Authorisation is not sought for gas supply contracts between the applicants and purchasers of the gas. The Pohokura JV parties have not yet settled upon the content of these proposed arrangements. The applicants and the purchasers will assess these contracts under the Commerce Act at a later point in time.
- 6 There is precedent for the Commerce Commission ("*the Commission*") to grant authorisation to the joint marketing and sale of gas prior to the parties entering into contracts for the sale of gas. The Australian Competition and Consumer Commission ("*the ACCC*") granted authorisation to the Northwest Shelf Producers for co-ordinated marketing of gas in the absence of gas supply contracts: see *Northwest Shelf Project Determination* (1998) ATPR (Com) 50-269.
- 7 Authorisation for joint marketing of gas is sought for the life of the field. Provided authorisation is granted, the Pohokura JV parties expect that Pohokura will commence long-term production in late 2004. Based on the estimated range of reserves and expected production rates, it is expected that Pohokura will produce until around 2020.
- 8 The Pohokura JV parties request that the authorisation extend to the respective successors and permitted assigns of a participating interest in Petroleum Exploration Permit ("*PEP*") 38459 (the Pohokura permit) and the PEP 38459 Joint Venture.

Background

- 9 The Joint Venture Operating Agreement in respect of Petroleum Exploration Permit 38459 (*"The Pohokura JVOA"*), **attached** as Appendix 1, empowers the Pohokura JV parties to jointly market and sell gas produced from the Pohokura field. The Pohokura JV parties are now well advanced in their discussions concerning internal organisational arrangements for this field. As yet, however, there are no concluded arrangements between the parties relating to the process of joint marketing and sales.
- 10 This application relates solely to the proposal of the Pohokura JV parties to jointly market and sell gas produced from the Pohokura field. Authorisation of joint marketing will enable the Pohokura JV parties to make decisions to develop the field in a timely fashion, and will result in the field being developed much sooner than would otherwise be the case.
- 11 Authorisation will also send a pro-competitive signal to the marketplace. An assurance that joint marketing of gas is permissible will act as an incentive to further participation in exploration and production.

Why the Pohokura JV parties are applying for authorisation

- 12 This application is made out of an abundance of caution. In terms of section 58(2) of the Act, the Pohokura JV parties apply for an authorisation on the basis that they wish to jointly market gas, to which sections 27 and/or 30 *might* apply.
- 13 The Pohokura JV parties do not consider that sections 27 or 30 of the Act apply to the proposed joint marketing. The Pohokura JV parties submit that:
- 13.1 the prohibition on price fixing contained in section 30 of the Act does not apply to joint marketing by virtue of the joint venture exemption (section 31 of the Act); and
- 13.2 the section 27 prohibition does not apply. The applicants submit that joint marketing has neutral or pro-competitive effects on competition when compared with any of the factual scenarios which may exist "but for" authorisation of joint marketing (*"the counterfactuals"*). Further details on the pro-competitive elements of this proposal are set out in paragraph 75 below.

- 14 However, for the purposes of this application only, the Pohokura JV parties concede that there is inevitably, in a matter of this kind, room for argument as to whether the proposed arrangements might be likely to have an anti-competitive effect and, given the significant costs involved in the development of the Pohokura field, they wish to ensure as far as practicable that joint marketing will be immune from legal challenge by a disaffected party. The applicants submit that any anti-competitive detriment is outweighed by the benefits to the public (including long term benefits to the competitive process arising from development of the field and further exploration) and are such that joint marketing should be given effect to. The benefits to the public that will result or are likely to result from the trade practice are described fully in the report prepared by Charles River Associates, (the "*CRA report*"), **attached** as Appendix 2.

The necessity for joint selling

- 15 Authorisation is sought for joint marketing as there is no other feasible means of marketing gas sourced from Pohokura.
- 16 The immaturity of the New Zealand gas market means that the practical problems the Pohokura JV parties would face in separately marketing gas would be difficult if not impossible to overcome. Substantial welfare losses will occur if joint marketing is not authorised. Absent joint marketing, a substantial delay in the development of the field is expected, at a time of scarcity of resource. In addition, separate marketing would result in significant extra transaction and production costs, and sub-optimal field depletion. This would impact significantly on the value of the field, and that effect would have the potential of significantly reducing exploration incentives in New Zealand.
- 17 This application is seeking authorisation for what is a standard industry approach to the marketing and sale of gas. There has been co-ordinated marketing of gas in all jointly owned New Zealand and Australian gas fields.¹
- 18 The ACCC has consistently recognised that separate marketing in the various Australian markets is not feasible, and that production would not commence unless joint marketing was authorised. The decisions of the ACCC, its predecessor the Australian Trade Practices Commission, and the Australian Trade Practices Tribunal are summarised in Appendix 3 **attached**. In all cases authorisation has been given.

¹ It is sometimes erroneously thought that Kapuni gas is separately marketed. However, all gas is purchased direct from the joint venture parties including gas purchased by Nova Gas Limited (a Todd subsidiary).

- 19 Indeed, in the Mereenie Producers – Gasgo Sales Agreement Determination, the ACCC considered that:

*the key issue in the context of this and other similar authorisation applications, however, is not necessarily whether separate marketing is **superior** to joint marketing, but rather whether separate marketing is **feasible** in the particular market.*

[emphasis added]

Mereenie Producers – Gasgo Sales Agreement Determination 1999:
para 6.2.2.

- 20 The ACCC decisions suggest that separate marketing is only common place in “commodity” gas markets such as the United Kingdom and North America, where the physical production and delivery of gas is separated from the contractual sales. The Australian gas markets are described in contrast as “contract” or “project” markets² where gas is only produced to meet specific contractual obligations. Like Australia, gas in New Zealand is only produced to meet specific contractual obligations.³
- 21 The ACCC in the *Northwest Shelf Project Determination* identified the market features necessary to support separate marketing:
- a large number of competitive suppliers;
 - a large number of customers;
 - a range of storage facilities close to demand;
 - gas brokers and aggregators;
 - gas related financial markets; and
 - significant short term and spot markets.

² Mereenie Producers – Gasgo Sales Agreement Determination: para 6.2.2.

³ For calendar year ended 2001: Maui produced 191.49 PJ of gas (net) 100% of which was committed to the Crown; McKee produced 8.59 PJ of gas (net), 100% of which was committed to Methanex New Zealand Limited; the TAWN fields produced 11.98 PJ of gas (net) of which 100% was committed to Contact Energy Limited; Kamiro and Ngatoro produced 1.64 PJ of gas (net) 100% of which was committed to Natural Gas Corporation; Kapuni produced 24.86 PJ of gas (net) 100% of which is committed to either Kapuni Gas Contracts Limited or to Nova Gas Limited; Mangahewa produced 3.13 PJ of gas (net), 100% of which was committed to Methanex New Zealand Limited.

- 22 None of these features are present in the New Zealand gas production industry. Nor are these developments likely to occur by the date of commencement of production from Pohokura, and probably for the expected life of the field.
- 23 We address the features identified by the ACCC in *Northwest Shelf*:
- 23.1 there are only a small number of participants in the gas production market. Shell, Todd, Swift Energy, Greymouth Petroleum, NZOG and Indo Pacific are the only current participants. On commencement of production from Pohokura, Preussag will be added to this list;
- 23.2 the demand side of the New Zealand gas production market is very thin. The main purchasers are Contact Energy Limited, Genesis Power Limited, Methanex New Zealand Limited, Natural Gas Corporation, Nova Gas Limited and Ballance (Kapuni) Limited (although the potential pool of participants is much larger including large industrials and co-generators);
- 23.3 there are no storage facilities for natural gas in New Zealand;⁴
- 23.4 there are no firms in New Zealand performing a gas broking or aggregating role;⁵
- 23.5 there is no gas related financial market in New Zealand which could offer futures and options contracts; and
- 23.6 there is no spot market of any significance in New Zealand. The limited depth of the New Zealand market, in terms of the small number of both suppliers and purchasers make it unlikely that a gas related financial market or a spot market (of the requisite depth) will develop.
- 24 In the absence of the market developments identified above, the Pohokura JV parties are unable to overcome the essential problems faced when gas is separately marketed. The essential problems arise from:
- 24.1 the need to co-ordinate development and operation;

⁴ While producing reservoirs could be considered, technically, storage facilities (on the basis that all gas not immediately extracted is stored) this is clearly not the consideration the ACCC had in mind.

⁵ Contact and NGC have performed a very limited aggregation role by purchasing gas from a number of fields and either using the gas for their own consumption or for resale to retailers and end-users in a limited capacity as wholesalers.

- 24.2 the need to co-ordinate substantial investment in the field;
- 24.3 the significant uncertainty in costs, revenues, deliverability and recoverable reserves over the life of the field (for example, the size of a field's economically recoverable reserves and hence high degree of risk);
- 24.4 the inevitable divergence between entitlement and off-take for each producer; and
- 24.5 the incentive to over extract leading to sub-optimal depletion. This difficulty arises from the "common property" characteristic⁶ of gas and oil reservoirs.
- 25 These features of gas production are set out more fully in section 2 of the CRA report.
- 26 In attempting to separately sell gas produced jointly, pursuant to contracts negotiated individually, the Pohokura JV parties would face a number of insurmountable problems. Contracts negotiated without co-ordination will consequently contain different extraction rates, quantity, term, etc. The practical problems faced by the Pohokura JV parties include determining how they would:
- apportion the costs of appraisal, development and operation;
 - apportion facilities access;
 - appropriately allocate risk, in particular reserves risk;
 - apportion uplift rights;
 - apportion field deliverability;
 - apportion all products recovered; and
 - appropriately adjust overlift and underlift.
- 27 In commodity or developed gas markets the divergence between entitlement and sales (the "overs" and "unders") can be mitigated by a gas balancing arrangement. Other mitigating circumstances include storage facilities and the ability of brokers to aggregate parcels of gas from

⁶ The common pool property is where no one party has the right or the ability to exclude another firm from using its portion of the resource. This has been shown to lead to opportunism, sub optimal depletion and over extraction.

different sources. A gas balancing arrangement can also assist in resolving conflicting interests caused by different gas sales contracts and hence the incentive to over extract.

- 28 Conceptually, there are three gas balancing arrangements which can correct this divergence:

28.1 gas storage;

28.2 cash balancing; and

28.3 in kind balancing.

- 29 The problems with these options are set out in section 5.3.2 of the CRA report. These problems are unlikely to be resolvable in New Zealand in the foreseeable future.

ARRANGEMENT NOT ALREADY ENTERED INTO

- 30 The application sought does not relate to a contract or arrangement which has already been entered into. Section 59 of the Act does not prevent the Commission from granting this application.

PERSONS AFFECTED BY THE PRACTICE

- 31 The persons directly affected by the trade practice are both the companies which enter into agreements to purchase gas from Pohokura and the unsuccessful bidders for gas from Pohokura. The names and addresses of companies which are potential purchasers of Pohokura gas, are set out in Appendix 4 **attached**.

- 32 Other parties likely to be affected by the practice include potential competitors to the Pohokura JV parties in both the gas production and wider energy markets.

- 33 Parties indirectly affected include the end users of gas produced from Pohokura. Such class of end user is likely to include gas and electricity users (industrial, commercial and domestic) and the purchasers of products produced by the industrial and commercial users of Pohokura gas.

MARKET AND COMPETITION CONSIDERATIONS

- 34 The competition analysis in this application proceeds in the following sections:

- market definition;

- the choice of counterfactual; and
- competition considerations arising from the application of sections 27 and 30.

Market Definition

35 Section 3(1A) of the Act defines a market as:

a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial commonsense, are substitutable for them.

36 As the Commission has previously noted, a market will be defined in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area within which the goods are supplied (the geographic extent); and
- the temporal dimension of the market (the time frame).⁷

Product

37 The Commission recently considered several clearance applications relating to the gas industry. In Decision Nos. 408 and 411, *Shell Exploration / Fletcher Challenge Energy* and Decision No. 443 *Shell Overseas Holdings / The Owner of the TAWN fields*, the Commission concluded that there is a discrete product market for gas as opposed to other forms of energy such as electricity. That is, different forms of energy are not generally substitutable for gas.

38 For the purposes of this application only, the Pohokura JV parties accept that the product market at issue is gas.

Function

39 In Decision No. 408 the Commission concluded that production and wholesaling functions in the gas industry involve separate market levels. Again, for the purposes of this application only, the parties accept that there are separate production and wholesale functional levels to this market. However, not all transactions involving gas sourced from Pohokura

⁷ Practice Note: 4 The Commission's Approach to Adjudicating on Business Acquisitions under the changed threshold in section 47 – A test of substantially lessening competition, paragraph 3.1.

will be supplied to wholesalers for the purpose of resale. This will depend on the identity of the companies which enter into gas supply agreements with the Pohokura JV parties.

Geographic

- 40 In Decision No. 408 the Commission concluded that the relevant markets were national. The applicants adopt this approach for the purposes of this application.

Time Dimension

- 41 The pre-2009 and post-2009 dichotomy adopted by the Commission in Decisions Nos. 408 and 411 is now inappropriate.
- 42 An inter-temporal split was adopted in Decisions Nos. 408 and 411 to reflect the distinct difference in gas supply which would be exhibited in different time periods due to the expected depletion of Maui and subsequent contractual adjustments by major acquirers leading up to the depletion.
- 43 The current estimates of total gas production per annum, set out in the gas production table **attached** as Appendix F to the CRA report, suggests that there is no longer an indicative point of a sharp change in competitive situation. The depletion of Maui has been well anticipated. Prospective purchasers are actively seeking contracts to secure a confirmed supply of gas from currently undeveloped fields to off-set the depletion of Maui. Electricity generators, petro-chemical manufacturers and wholesalers are all required to make decisions for long term development now which are conditional on a secured supply of gas.
- 44 Accordingly, the competitive effect of the proposed arrangements should be assessed in relation to the gas production market without an inter-temporal split.

The counterfactual

- 45 In carrying out an assessment of an application under section 58 of the Act, the likely competitive effects of the trade practice must be assessed. A benchmark is required to make this assessment. The benchmark is the counterfactual: a pragmatic and commercial assessment of what is likely to occur in the absence of the trade practice.
- 46 The Pohokura JV parties do not consider that separate marketing is feasible in the foreseeable future or for the expected life of Pohokura. Accordingly, no development is a counterfactual in the event that authorisation is not granted.
- 47 However, for the sake of completeness, if the Commission does not accept no development as the counterfactual the Pohokura JV parties consider two

forms of marketing, involving different degrees of co-ordination, that could be viable at some point in time. These options are only theoretical, and indeed are unlikely to eventuate. But, for the sake of completeness, these possibilities are nonetheless canvassed.

48 Accordingly, the Pohokura JV parties submit that the appropriate counterfactual to joint marketing is one of the following:

48.1 no development. This is the counterfactual adopted in the ACCC decisions;⁸

48.2 *Scenario 1 marketing* with development of the field delayed by *X* years.

Under scenario 1 marketing, the parties separately sell their proportion of gas *after* agreeing on parameters for the development of the field. This includes an optimal depletion path which may be described in terms of maximum daily, average daily and annual quantities. Within these constraints each joint venture party is able to separately sell its proportionate share of gas to buyer(s) on the basis of independently negotiated terms and conditions, including price; and

48.3 *Scenario 2 marketing* with development of the field delayed by *Y* years.

Under scenario 2, each joint venture party will separately sell its share of gas to buyer(s) on the basis of independently negotiated terms and conditions, including price, quantity, rate, specification and liability. The joint venture parties will then agree on appropriate development to support the sales contracts in place.

(Where $X < Y$)

49 The key theoretical distinction between scenario 1 and 2 is:

49.1 scenario 1 involves co-ordination on *all* contract terms (such as quantity, rate of extraction and quality) except for direct agreement on price, and accordingly cannot be considered separate marketing; and

49.2 scenario 2 does not involve co-ordination on any contract terms.

⁸ Summaries of these decisions are **attached** as Appendix 3. While there is no express identification of a counter-factual by the ACCC, no development is the outcome with which authorisation of joint marketing was compared.

- 50 Scenario 2 may be considered to amount to separate marketing as, in theory, there is no agreement on quantity or price. However, in this context, we point out that the term “separate marketing” is not capable of precise definition, and this term may not in fact convey the precise nature of the surrounding circumstances.⁹
- 51 While the term separate marketing may have connotations of no co-ordination between the joint venture parties, all forms of marketing from a common pool resource necessarily involve some degree of co-ordination. Joint venture parties will be required (before or after entering into gas contracts) to reach agreement on the development and operation of the field and the balancing of the parties’ rights and obligations necessary to support gas supply contracts negotiated individually. In the absence of agreed development and operational plans, the joint venture parties will be deterred from entering into contracts of the kind envisaged under scenario 2.
- 52 At the very least, both scenario 1 and scenario 2 marketing would involve significant delay as the Pohokura JV parties attempt to address the problems associated with separate marketing, such as the need for a gas balancing arrangement and the need to co-ordinate development and operation (in the absence of the market developments necessary to support separate marketing). The expected delay under scenario 2 is greater than the delay expected under scenario 1.

Competition Considerations

- 53 The applicants submit that the proposed arrangements involve no lessening of competition, in terms of sections 27 or 30 of the Act.

The trade practice does not fall within section 30 but if it does, is exempted by section 31

- 54 Section 30(1)(a) provides that:

Without limiting the generality of section 27 of this Act, a provision of a contract, arrangement, or understanding shall be deemed for the purposes of that section to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market if the provision has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services, that are-

⁹ The ACCC in *Mereenie* considered separate marketing as “...by which the partners to a joint venture negotiate individually with gas users and potential users”.

- (a) *Supplied or acquired by the parties to the contract, arrangement or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other ...*

- 55 Section 30 deems price fixing arrangements to contravene section 27 regardless of whether they have any anti-competitive purpose or effect. The High Court recently confirmed the deeming nature of section 30(1) in *Commerce Commission v Caltex New Zealand & Ors* (1999) TCLR 305 where Salmon J confirmed that the effect of an arrangement which falls within the deeming provision of section 30(1) is irrelevant.
- 56 Joint marketing necessarily involves the supply of gas at prices fixed by the Pohokura JV parties. Therefore, by virtue of the deeming operation of section 30, gas sales agreements entered into with the Pohokura JV parties collectively, will amount to price fixing in prohibition of the Act.
- 57 However, by virtue of section 31, section 30 does not apply in this case. Section 31(2) provides that:

Nothing in section 30 of this Act applies to a provision of a contract or arrangement entered into, or an understanding arrived at for the purposes of a joint venture, to the extent that the provision relates to-

- (a) *The joint supply by the parties to the joint venture, or the supply by the parties to the joint venture in proportion to their respective interests in the joint venture, of goods jointly produced by those parties in pursuance of the joint venture;*

- 58 We are not aware of any interpretation of this provision by either the courts or the Commission. Further there appears to be no authority on the Australian equivalent of this provision, section 45A(2) of the Trade Practices Act.
- 59 *Gault on Commercial Law* para 31.5 interprets the subsection (2)(a) exception as follows:

Subsection 2(a) permits the parties to an unincorporated joint venture to fix the price at which jointly produced goods are to be jointly marketed.

- 60 Three requirements are outlined in *Gault* for this exception to apply:
- 60.1 the joint venture marketing agreement must be linked to the production joint venture;

60.2 all the parties to the production joint venture must become parties to the marketing arrangement; and

60.3 each party must play a genuine role in the physical process of production.

61 The Pohokura JV parties will jointly produce gas pursuant to the Pohokura JVOA. The three Pohokura JV parties each hold an interest in PEP 38459, and all three will be party to any proposed arrangement. Accordingly, the joint venture price fixing exemption applies to joint marketing by the Pohokura JV parties.

62 While section 31 exempts joint marketing from the operation of section 30, the proposed arrangements still need to be considered under section 27 of the Act.

Proposed arrangements have neither an anti-competitive purpose or anti-competitive effect

63 Section 27(1) provides that:

No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

64 The purpose of joint marketing is to ensure that Pohokura commences production in a timely manner.

65 Further, joint marketing will not have the effect or likely effect of substantially lessening competition. Rather, the applicants submit that joint marketing will have a neutral or positive effect on competition when compared with any of the three counterfactuals.

First counterfactual – No development

66 Joint marketing clearly has a pro-competitive effect on competition when compared with the counterfactual of no development. If commencement of production from Pohokura is delayed indefinitely, the gas production market would not receive the competitive benefit of a new source of gas supply.

Second counterfactual - Scenario 1 marketing

67 For *X* years, joint marketing is clearly pro-competitive when compared with this counterfactual. The addition of a competing source of gas can only be viewed as having a positive effect on competition.

68 On the occurrence of *X* years, under scenario 1, once Pohokura commences production, there will, in theory be a form of intra-joint venture competition. However, under scenario 1, there is co-ordination on all terms

except price, including: the quantity of gas, the gas specification, quality extraction profile and level of “swing” each party can contract for.¹⁰

- 69 While the Pohokura JV parties will in theory be free to independently negotiate price within the constraints agreed to at the joint venture level, it is unlikely that in practice contracts will contain different prices as agreement on every non-price term, including the off-take of each party, means that any reduction in price from the market clearing price for the total quantity could only result in lower revenue. The prices are, therefore, highly likely to be parallel. This differs to other markets, where a firm could expect to gain market share from its competitors by cutting price. For further discussion see section 5.4 of the CRA report.
- 70 Further, the agreement between the Pohokura JV parties on the optimal depletion path, and subsequently all terms except price, would be likely to in itself breach either or both of sections 27 and 30, and hence be deemed to substantially lessen competition on the basis that these terms “control or maintain” the price of gas produced from Pohokura.

Third counterfactual – Scenario 2 marketing

- 71 While under this scenario there may be intra-joint venture competition (in theory), this is only once the Pohokura JV parties have found the means to address the practical difficulties associated with scenario 2 marketing. The difficulties with scenario 2 marketing are the same as those faced with separate marketing: the need to co-ordinate development and operation; the need to co-ordinate substantial investment in the field; the significant uncertainty in costs, revenues and reserves over the life of the field; the inevitable divergence between entitlement and off-take for each producer; and the incentive to over extract and sub-optimal depletion. These would at the very least result in extensive delay. Up until the point when the means of addressing these problems have been reached (for Y years), joint marketing is clearly pro-competitive when compared with this counterfactual through the introduction of a new competing source of gas.
- 72 Further, it is a very real prospect that the Pohokura JV parties would never reach agreement on feasible arrangements. Therefore the first counterfactual of no development may well be the outcome of an attempt at scenario 2 marketing.
- 73 If on the occurrence of Y years Pohokura commenced production under this counterfactual, there is the theoretical possibility of intra-joint venture

10 The level of “swing” in a gas contract refers to the difference between the minimum and maximum daily off-take. Swing is valuable because gas demand is variable, and gas cannot be stored in New Zealand. The greater the swing provided the greater the capacity of the facilities required to provide it, and the greater the capital cost to be allocated among the joint venture parties.

competition. But even on the occurrence of *Y* years there would be unlikely to be actual intra-joint venture competition. This is due to the exchange of information that would be required in order to agree on development, the *ex post* allocation of costs and the potential use of cash balancing which is expected to lead to highly similar terms. These factors are outlined in section 5.3 of the CRA Report.

- 74 Further, agreement on these terms and the gas balancing arrangement might also amount to a breach of section 30 and/or section 27 of the Act.

Pro-competitive effects of joint marketing

- 75 A number of pro-competitive benefits or features of joint marketing can be identified. In short, the features of the proposed arrangements which are pro-competitive are:

- 75.1 timely commencement of production from Pohokura which will occur under the proposed arrangements is crucial in current market circumstances given the scarcity of gas;
- 75.2 maintaining incentives to enter the exploration, and hence gas production market. If joint marketing is not authorised there will be a reduced likelihood of new entry into exploration and production. The risk of no development, creation of sub-economic parcels of gas, sub-optimal pool depletion and increased production and transaction costs would render gas exploration and production in New Zealand a less viable option. As noted in the CRA report, the Upstream Issues Working Group ("*UIWG*") in its report to the Australian and New Zealand Minerals and Energy Council stated:

that prohibiting joint marketing could raise the costs and/or increase the risks of entering gas production where separate marketing is not viable.

- 76 These pro-competitive effects are discussed further in section 5.5 of the CRA report.

NET PUBLIC BENEFIT

Detriments

- 77 As detailed above in paragraphs 63 to 74 the applicants submit that joint marketing does not have the effect of lessening competition in a market. Further, the applicants submit that joint marketing does not give rise even to theoretical detriment under section 30 of the Act by virtue of the joint venture price fixing exemption. Accordingly, no competitive detriment should be attributed to joint marketing.

78 If, however, the Commission reaches the view that joint marketing falls within the ambit of section 27 of the Act, the Commission must determine whether joint marketing will, or will be likely to result, in a benefit to the public which would outweigh the lessening in competition that would, or is likely to result, or is deemed to result from joint marketing.

79 This requires the Commission to balance any detriments caused by the proposal with the countervailing public benefits.

Public benefit

80 The public benefits that will result or are likely to result from joint marketing are summarised below. These benefits are described more fully in section 8 of the CRA report.

81 The public benefits that accrue from the proposal, when compared with the counterfactuals, can be analysed in terms of:

81.1 the public benefits that accrue from timely development of Pohokura. Authorisation of joint marketing will enable earlier development of, and production from Pohokura. The public benefits have been modelled on a conservative estimate that the delay in commencing production will be three years, under either scenario 1 or 2;

81.2 the other public benefits that result from joint marketing. Namely:

- significantly lower production and transaction costs. The sources of the higher costs under separate marketing are described in section 5 of the CRA report;
- optimal pool depletion i.e. increasing the quantity of recoverable reserves from Pohokura;
- increased exploration incentives and ultimately a greater supply of gas. The rewards for gas exploration are greater if joint marketing is allowed due to the increased value of the field;
- reduction in adverse effects on the environment. The most likely alternative to gas for electricity generation is coal. Coal has significantly more externalities than gas.

82 The CRA report has, at this stage, only quantified the public benefits that accrue from earlier development of, and production from, the Pohokura field. The other public benefits identified, set out in section 8.2.2 of the CRA report, are either more difficult to quantify (such as the optimal pool depletion), or are likely to be smaller in magnitude (such as the extra cost of each JV party having a separate arm for marketing of gas).

Nevertheless, CRA considers these benefits to be significant.

Timely Development of Pohokura

- 83 If joint marketing is permitted, the Pohokura JV parties expect production from Pohokura to commence in 2004. The production profile is set out in section 8.2.1 of the CRA report. However, as demonstrated in the CRA report, without joint marketing, development of Pohokura is likely to be significantly delayed, potentially indefinitely.
- 84 Qualitatively, it is clear that such a delay would result in significant welfare losses for New Zealand. It is likely that separate marketing would result in Pohokura not coming on stream when required by the depletion of Maui, increasing the scarcity of gas at a time when demand for gas is increasing.
- 85 CRA has quantified the welfare losses caused by a delay in commencement of production from Pohokura, and therefore the welfare gains or public benefits from joint marketing. Absent joint marketing, the delay is expected to be at least in the order of three years. Accordingly, if joint marketing was not authorised, Pohokura would not be expected to commence production until 2007. This quantification is conservative. The delay may well be longer and possibly indefinite. Further, as noted above, only those benefits accruing from timely production of Pohokura have been quantified.
- 86 As the impact of a delay in gas production from Pohokura is to some extent dependent on the demand for gas by Methanex, CRA has quantified the welfare loss in terms of two scenarios.
- 87 CRA's base case scenario is that in 2004 Methanex (and other petrochemical firms) take their full contracted gas amounts and in 2005 take 49 PJ plus any gas they can purchase for less than [] per GJ. After 2005, Methanex (and other petro-chemical firms) are assumed to operate plants at capacity if natural gas is available at less than [] per GJ, and at 50% of capacity if price is between [] per GJ. If the price is above [] per GJ, it is assumed that Methanex will shut down its New Zealand plant. The alternative scenario is if Methanex remains in the market and consumes at full production.
- 88 The analysis to assess the impact of the delay is carried out over a six year time frame.

Table 1: Public benefits arising from joint marketing

Year	Present value under base case scenario ¹¹	Present value if Methanex continues at full production ¹²
2004	\$51.0M	\$51.0M
2005	\$79.2M	\$102.0M
2006	\$27.7M	\$102.0M
2007	\$72.5M	\$187.0M
2008	\$36.5M	\$136.0M
2009	\$34.9M	\$136.0M
Present Value	\$204.1M	\$451.1M

- 89 The welfare losses caused by a delay in production from Pohokura (and the corresponding public benefits that accrue from joint marketing) are due to the loss caused by developing alternative more expensive sources of energy, and the reduction in total gas output. This is set out in section 8.2.1 of the CRA report. In the thin New Zealand gas production market, the welfare losses can be considered similar to those which would arise in a missing market.
- 90 Possibly the greatest impact would be on electricity generation. A significant rise in both gas and electricity wholesale prices would be expected, with blackouts a possibility.
- 91 The impact of a delay in Pohokura coming on-stream on wholesale electricity prices can be compared to the short-run response of the electricity market to the low hydro inflows in the winter of 2001. In combination with a cold winter that increased demand for electricity, the low inflows into the hydro lakes caused the wholesale market price for electricity to increase four to five times its normal level for the winter period. As set out in the CRA report, in some ways, the impact of a delay in Pohokura coming on-stream would engender a medium-run response as indicated by the short-run response of the electricity market to the low

¹¹ Discounted to 2002 at a rate of 10 percent.

¹² Discounted to 2002 at a rate of 10 percent.

hydro lake inflows in the winter of 2001 (see section 8.2.1 of the CRA report).

- 92 Further, low hydro inflows will exacerbate the effect of a delay in development of Pohokura. The combination of another dry year and a delay in commencement of production from Pohokura will lead to even greater welfare losses than those set out in Table 1.

CONFIDENTIALITY

- 93 Confidentiality is claimed in respect of the information which is deleted on the "Public Copy" of this application (to follow).
- 94 The information that has been deleted is commercially sensitive and contains valuable information which is confidential to the applicants. This includes information that would give an unfair advantage to the applicants' competitors. In this respect, the applicants rely on section 9(2)(b) of the Official Information Act 1982.
- 95 Confidentiality is claimed for the deleted information until the applicants notify the Commission in writing that particular information is no longer confidential to the applicants.

DECLARATION

THIS APPLICATION is made by Preussag Energie GmbH, Shell Petroleum Mining Company Limited, Shell Exploration Limited and Todd Petroleum Mining Limited.

I, David Salisbury, Vice President, New Zealand branch, Preussag Energie GmbH, am authorised to make this application on behalf of Preussag Energie GmbH.

I hereby confirm that:

- all information specified by the Commission has been supplied;
- all information known to Preussag Energie GmbH which is relevant to the consideration of this application has been supplied;
- all information supplied is correct as at the date of this application

I undertake to advise the Commission immediately of any material change in circumstances relating to the application

Dated this 20th day of December 2002

David Salisbury
Vice President, New Zealand branch
Preussag Energie GmbH

I, Murray Jackson, Commercial Executive of Shell Exploration New Zealand Limited, am authorised to make this application on behalf of Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited.

I hereby confirm that:

- all information specified by the Commission has been supplied;
- all information known to Shell (Petroleum Mining) Company Limited and Shell Exploration New Zealand Limited which is relevant to the consideration of this application has been supplied;
- all information supplied is correct as at the date of this application.

I undertake to advise the Commission immediately of any material change in circumstances relating to the application.

Dated this 20th day of December 2002

Murray Jackson
Commercial Executive
Shell Exploration New Zealand Limited

I, Richard Tweedie, Managing Director of Todd (Petroleum Mining) Company Limited am authorised to make this application on behalf of Todd (Petroleum Mining) Company Limited.

I hereby confirm that:

- all information specified by the Commission has been supplied;

- all information known to Todd (Petroleum Mining) Company Limited which is relevant to the consideration of this application has been supplied;
- all information supplied is correct as at the date of this application.

I undertake to advise the Commission immediately of any material change in circumstances relating to the application

Dated this 20th day of December 2002

Richard Tweedie
Managing Director
Todd (Petroleum Mining) Company Limited

APPENDIX 1
CONFIDENTIAL

APPENDIX 2
COORDINATED MARKETING OF POHOKURA GAS – AN ECONOMIC
ANALYSIS: CHARLES RIVER ASSOCIATES

APPENDIX 3
TABLE OF RELEVANT AUSTRALIAN DETERMINATIONS

1. Australian Competition Tribunal
2. Australian Consumer and Competition Commission/Australian Trade Practices Commission
3. Interim Australian Consumer and Competition Commission determinations

APPENDIX 4
POTENTIAL PURCHASERS OF GAS FROM POHOKURA

Ballance (Kapuni) Limited

Contact Energy Limited

Genesis Power Limited

Methanex New Zealand Limited

Natural Gas Corporation Limited

Nova Gas Limited

and other industrials and co-generators