



MAJOR ELECTRICITY USERS' GROUP

28 February 2003

Mr Guy Launder
Chief Adviser
Market Behaviour Group
Business Competition Branch
Commerce Commission
PO Box 2351
WELLINGTON

By email to guy.launders@comcom.govt.nz

Dear Guy

Submission on Pohokura JV parties s58 application

This submission comments on the application by the Pohokura field owners of 20 December 2002 for clearance to market and sale Pohokura gas jointly should the Commission decide the proposal is a restrictive trade practice.

Does s27 or s30 apply?

MEUG has no comment on the applicability or otherwise of s27 or s30 of the Act apart from observing that the Australian cases cited are characterised by:

- A greater number of suppliers than the current New Zealand gas market.

Issues of market dominance therefore need to be considered more carefully as part of this application or any merger and acquisition activity in the New Zealand gas market; and

- An assumption that New Zealand's market structures (access to essential lines and volume balancing) will be the same as those in Australia.

The experience in the electricity market is that New Zealand has a much simpler (and theoretically more robust) ex post full nodal pricing structure than the mix of various state and national arrangements in Australia. This is not to understate the issue that we continue to have market dominance problems in the New Zealand electricity market. Therefore it is also possible that in New Zealand we will develop gas market structures much more conducive to separate marketing and selling strategies by JV owned fields than exist in Australia.

MEUG has not analysed the ACCC cases in detail and therefore there may be other aspects to be considered, eg whether the ACC had conditions on any authorisation for JV marketing and selling.

Market definition

PO Box 3643, Level 2, 5-7 Vivian Street, Wellington, New Zealand
Telephone (64) (4) 385 2945, Facsimile (64) (4) 382 9717, Email meug@xtra.co.nz

We agree with the applicant that the appropriate market is the national gas market upstream of the retail market, ie exploration and wholesaling. However we consider the future gas market needs to be split between the near term (to December 2004) and the longer term:

- Prior to December 2004 the gas industry will be in transition between supply being dominated by the Maui contract and a more competitive market. This is termed the "transition phase"; and
- After December 2004 the gas industry will have better structures to promote competition. This is termed the "post December 2004 market."

The structures to promote competition are set out in the Government Policy Statement for the Gas Industry. In particular they include non-discriminatory access to the Maui pipeline and development of balancing and reconciliation protocols to allow gas trading. The Government Policy Statement states, "the Government expects that efficient industry arrangements will be in place by December 2004."

Counterfactual

In the transition phase the applicant argues that separate marketing is not feasible. MEUG does not agree. If the Pohokura JV partners had no other gas field interests then they would be incentivised to conclude separate marketing and selling arrangements to realise revenues and therefore a return on their exploration investment to date. The problem is that parties in the JV do not have that same incentive.

In the post December 2004 market we would expect separate marketing would be possible. Indeed if it were not possible we would expect continuing changes in structures and Government Policy Statements to ensure it became possible.

One aspect of the counterfactual that needs to be considered is the possibility of an authorisation with conditions to mitigate the detrimental effects of market power within the JV. The applicant has not considered this possibility, but it may be a pragmatic way to manage the problem of unwinding the market power issues and allowing the timely development of the field.

Public detriments and benefits

Assuming separate marketing and selling is possible in the transition phase, then:

- The applicants' case that in an environment where new market structures would have to be designed and implemented first does add weight to their argument that there would be detrimental delays and high transaction costs;
- However the market power of the JV will also be high and their ability to dictate timing and quantities of Pohokura gas to be released to the market would create public detriments (ie they would shorten supply compared to a longer-term competitive outcome and therefore create a deadweight loss).

A detriment that must also be considered is the effect of an authorised joint venture that has currency beyond the transition phase and into the post December 2004 market. In this case the post December 2004 market may have detriments compared to the case where the Pohokura partners competed to sell their separate field entitlements. For example if we already had structures to facilitate wholesale gas market competition, then the public detriments from authorising dominance of some of the JV partners in controlling the output, timing and price of Pohokura would be significant compared to declining authorisation and requiring separate marketing and selling. If that is the outcome we want post December 2004, then we need to consider carefully relinquishing that option by authorising the applicants' proposal for the expected lifetime of the field to 2020.

If the arrangement is authorised, we have significant concerns should the Commission also accede to the applicants wish to extend the authorisation to respective successors and permitted

assigns of the field owners (refer paragraph 8 of the application). If authorisation extended to cover this possibility, then a party who would increase their market dominance by acquiring a shareholding of the JV would be immune from doing so. To ensure this does not occur, we recommend this requested extension of any authorisation be declined.

Concluding comments

In our view:

- The reliance on Australian based precedents is inappropriate because we have a market with dominance issues and the mistakes in the Australian market structure need not be repeated in New Zealand;
- The applicant has not defined the market appropriately. Instead a difference between the "transition phase" and "post December 2004 market" needs to be considered;
- The above two changes of first, considering what a "competitive" market structure in New Zealand might be and second, the change in the market definition, will increase the public detriments relative to public benefits compared to that suggested by the applicant; and
- The Commission should in any event decline the request to grandfather any authorisation for future changes in ownership within the JV.

Nothing in this submission is confidential.

Yours sincerely

Ralph Matthes
Executive Director