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Determination

OMV New Zealand Limited and Shell Companies [2018] NZCC 13

The Commission:	Sue Begg Dr Stephen Gale Anna Rawlings
Summary of application:	An application from OMV New Zealand Limited to acquire 100% of the shares in each of Shell Exploration NZ Limited, Energy Infrastructure Limited, Shell Taranaki Limited and Shell New Zealand (2011) Limited (together the Shell Companies).
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to the proposed acquisition.
Date of determination:	9 August 2018

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

CONTENTS

The proposed acquisition

1. On 15 June 2018 the Commerce Commission registered an application (the application) under section 66(1) of the Commerce Act 1986 (the Act) from OMV New Zealand Limited (OMV) to acquire 100% of the shares in each of Shell Exploration NZ Limited, Energy Infrastructure Limited, Shell Taranaki Limited and Shell New Zealand (2011) Limited (together the Shell Companies). Shell Investments NZ Limited is the current owner and vendor of all of the shares in the Shell Companies, and is ultimately owned by Royal Dutch Shell (Shell).

2. OMV and Shell are both involved in the exploration, production, marketing and sale of natural gas, LPG and liquids in New Zealand.

3. The acquisition would see OMV acquire Shell's stake in the Maui and Pohokura fields (plus associated production, pipeline and tank assets) and Shell exit the market.

Our decision

4. The Commission gives clearance to the proposed acquisition as it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

5. Our approach to analysing the competition effects of the acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[1]

6. In making our decision, we have had regard to an economic policy statement that the Government sent the Commission on 17 April 2003 in respect of this industry and the Pohokura gas field in particular.[2]

The substantial lessening of competition test

7. As required by the Act, we assess mergers and acquisitions using the substantial lessening of competition test.

8. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[3]

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2013).

[2] Statement of to the Commerce Commission of the Economic Policy of the Government: Government Policy Statement of the Importance of the Pohokura Gas Field for Energy Security issued pursuant to section 26 of the Act (17 April 2003). Section 26 of the Act requires the Commission to have regard to such economic policy statements made from time to time by the Minister of Commerce.

[3] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

9. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),[4] or reduce non-price factors such as quality or service below competitive levels.

When a lessening of competition is substantial

10. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[5] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[6]

11. As set out in our guidelines, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[7]

12. A lessening of competition or an increase in market power may manifest itself in a number of ways, including higher prices or reduced services.[8]

13. While we commonly assess competition effects over the short term (up to two years), the relevant timeframe for assessment depends on the circumstances. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.[9]

When a substantial lessening of competition is likely

14. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur.[10]

The clearance test

15. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[11] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

The parties

OMV

16. OMV New Zealand is a wholly owned subsidiary of Austrian company OMV Aktiengesellschaft. OMV's business includes the exploration, production, marketing and sale of oil and natural gas. In New Zealand, OMV has interests in the Maui and

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4 Or below competitive levels in a merger between buyers.
5 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].
6 Ibid at [129].
7 *Mergers and Acquisitions Guidelines* above n1 at [2.23].
8 Ibid at [2.21].
9 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [131].
10 Ibid at [111].
11 Section 66(3)(a).

Pohokura gas fields, the Maari oil field, limited onshore infrastructure assets (eg, tanks and pipelines) associated with the transportation and storage of gas and liquids, and offshore exploration permits.

Shell

17. Shell is a multi-national British-Dutch oil and gas company. In New Zealand, Shell has interests in the Maui and Pohokura gas fields as well as a number of onshore infrastructure assets. Together, these assets comprise the gas and liquids portfolio that OMV proposes to acquire. The primary activities of Shell in New Zealand are the production and sale of oil, natural gas and LPG.

Industry background

18. The gas industry consists of several functional levels, ranging from exploration and production of gas to the domestic use of gas by end consumers. The functional levels relevant to this acquisition relate to the exploration, production and first point of sale of gas in New Zealand. OMV and Shell are two of the major participants in this sector. With the acquisition, OMV would acquire Shell's stake in the Maui and Pohokura joint ventures (plus associated production, pipeline and tank assets). These fields are currently the top two fields in New Zealand by production volume.

19. Other significant natural gas producers are:

    19.1 Todd Energy, the other partner to OMV and Shell in the Maui and Pohokura joint ventures, and sole owner and operator of the Kapuni, McKee and Mangahewa gas fields;

    19.2 Greymouth Petroleum, which is sole owner and operator of the Turangi, Kowhai, Ngatoro and Radnor gas fields; and

    19.3 Beach Energy, Genesis Energy and New Zealand Oil & Gas Limited (NZOG), which together own the Kupe gas field.

20. There are four types of users of natural gas:

    20.1 petrochemical customers, which account for 50% of total demand;

    20.2 electricity generator customers, which account for around 25% of demand;

    20.3 industrial and commercial customers, which account for around 20% of demand; and

    20.4 residential customers, which account for less than 5% of demand.

21. Gas producers sell natural gas directly to petrochemical customers and electricity generators but not directly to residential customers. Some gas producers also sell natural gas directly to industrial and commercial customers, but others sell to this type of customer through gas wholesalers.

22. Gas wholesalers buy gas from producers and on-sell it to large customers and gas retailers. Some customers buy gas for their own use and also to wholesale and retail to other parties.

23. A significant portion of the natural gas sold in New Zealand is supplied under long term supply contracts. A very small portion of sales (approximately 1%) are made on a spot basis, either bilaterally or through a market trading platform (emsTradepoint).

24. On 12 April 2018, the New Zealand Government announced that it would grant no new offshore oil and gas exploration permits.

Market definition

25. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.

26. We define markets in the way that best isolates the key competition issues that arise from a merger.[12] In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

Applicant's view of the relevant markets

27. OMV submitted that the New Zealand markets potentially affected by the acquisition are:[13]

    27.1 a national market for the production and wholesale supply of natural gas;

    27.2 a national market for the production and wholesale supply of LPG;

    27.3 a regional Taranaki market for the storage of liquids; and

    27.4 "point to point" markets in Taranaki for the transportation of liquids via pipelines to/from the Omata and Paritutu storage tanks.

Our view of the relevant markets

Natural gas and LPG markets

28. We consider that the relevant natural gas and LPG markets for the purposes of assessing the competitive effects of the proposed acquisition are the:

    28.1 national market for the production and first point of sale of natural gas (natural gas market); and

[12] *Mergers and Acquisitions Guidelines* above n1 at [3.10-3.12].
[13] The Application at [103].

28.2 national market for the production and first point of sale of LPG (LPG market).

29. These markets are consistent with past decisions of the Commission. They exclude the functional dimension of the wholesale supply of natural gas and LPG. This is because the evidence indicates that the wholesale supply of each of natural gas and LPG is unlikely to be a sufficiently close competitive constraint on prices for customers who purchase natural gas or LPG at the production and first point of supply level (eg, petrochemical and electricity generator customers in the case of natural gas). That is, these customers would be unlikely to switch to wholesale supply if the price for natural gas or LPG at the production and first point of sale increased by a small but significant amount.[14] This is because wholesale prices are significantly higher and/or the volume of supply available from wholesale suppliers is insufficiently large for these customers.

30. The overlap between OMV and Shell is only at the production and first point of sale level of the supply chain, as they do not operate at the wholesale level. Evidence gathered during our investigation indicates that OMV and Shell (and other non-vertically integrated gas producers) compete very little with wholesalers in the supply of natural gas and LPG, and consider their main competitors are other gas producers.[15]

31. Additionally, evidence indicates that pure wholesalers (eg, Vector) generally only compete with other wholesalers in the supply of natural gas and LPG. This includes other pure wholesalers, as well as vertically integrated gas producers with their own wholesale and retail arms (eg, Genesis Energy, Todd Energy and Greymouth Petroleum).[16]

32. We note that these markets differ from those adopted by the New Zealand Courts when considering this industry. The Courts have defined wholesale supply as being in

[14] The exception to this would be those industrial and commercial customers for whom supply terms from production and first point of sale are sufficiently similar to those from wholesale suppliers so as to make these two sources of supply sufficiently close substitutes. This indicates that there may be separate relevant customer markets. However, given that the conclusions of our competitive affects assessment is the same across the different customer types the Commission has not considered it necessary to further delineate markets according by customer groups in this case.

[15] Evidence [ ], shows that it sees only other natural gas producers as competitors for term contracts with large customers, and that it only competes with wholesalers for spot sales (which are a very small proportion of sales in the market by volume). [ ] This is consistent with [ ].

[16] We note that vertically integrated gas producers compete with both gas producers and pure wholesalers to supply different segments of the market. Vertically integrated gas producers compete with other gas producers (including OMV and Shell) for term contracts to supply large customers, but compete with other vertically integrated gas producers and wholesalers to supply smaller industrial and commercial customers. See, for example, Commerce Commission interview with Genesis Energy (20 July 2018) and Commerce Commission interview with Vector (31 July 2018).

the same market as production and first point of sale.[17] Market definition is a heavily fact dependant exercise, and the evidence before the Commission may differ from that considered by the Courts. On the evidence we obtained during our investigation, we consider that it is appropriate to exclude wholesale supply from the relevant natural gas and LPG markets for the purposes of assessing the competitive effects of the proposed acquisition. We also note that adopting the wider market definition used by the Courts would make competition issues less likely with the proposed acquisition.

Markets relating to liquids

33. In addition to the natural gas and LPG markets defined above, we consider that markets relating to liquids (eg, oil and condensate) are also relevant for assessing the vertical effects of the proposed acquisition. The specific liquids markets that are relevant are:

    33.1 a regional Taranaki market for the storage of liquids;

    33.2 "point to point" markets in Taranaki for the transportation of liquids via pipelines to/from the Omata and Paritutu storage tanks; and

    33.3 markets for the sale of liquids.

With and without scenarios

34. To assess whether a merger is likely to substantially lessen competition in a market, we compare the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[18]

With the acquisition

35. The acquisition would see OMV acquiring Shell's stake in the Maui and Pohokura fields (plus associated production, pipeline and tank assets) and Shell exiting the market.

36. The specific assets that OMV would acquire are:

    36.1 a 48% participating interest in the joint venture relating to the Pohokura gas field, increasing OMV's stake in this joint venture to 74%;

    36.2 an 83.75% participating interest in the joint venture relating to the Maui gas field (being the part of the Maui mining permit down to 12,000 feet subsea), increasing OMV's stake in this joint venture to 93.75%;

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17 Todd Pohokura Limited v Shell Exploration NZ Limited, High Court Wellington, CIV 2006-485-1600 (13 July 2010) and Todd Pohokura Limited v Shell Exploration NZ Limited and OMV New Zealand Limited [2015] NZCA 71.

18 *Mergers and Acquisitions Guidelines* above n1 at [2.29].

36.3 a 77.50% interest in the joint venture relating to the part of the Maui mining permit below 12,000 feet subsea (Maui deep), increasing OMV's stake in this joint venture to 87.5%;

36.4 a 100% interest in three tanks at the Omata Tank Farm;

36.5 an 83.75% interest in one tank (T3500) at the Omata Tank Farm;

36.6 an 83.75% interest in two of the five tanks at the Paritutu Tank Farm;

36.7 an 83.75% interest in the Maui Production Station to Paritutu Tank Farm liquids pipeline;

36.8 a [ ]% interest in the EPJV Pipelines (being the 032 gas export pipeline from the Pohokura Production Station to the Maui gas pipeline, and the 040 liquids export pipeline for the export of gas and condensate from the Pohokura Production Station to the Omata Tank Farm), giving OMV sole ownership of these pipelines;

36.9 a 100% interest in the Omata Tank Farm (connecting with the Paritutu Tank Farm) to Port Taranaki export liquids Pipeline;

36.10 a 50% interest in the loading arm situated at the Port of Taranaki; and

36.11 the upstream oil services business of Shell Taranaki.

Without the acquisition

37. OMV submitted that if it did not acquire the Shell Companies, the counterfactual would involve the acquisition of the Shell Companies by another purchaser who participated in the competitive tender process and reached a late stage of that process.[19] OMV also submitted that, in the absence of a suitable purchaser for the Shell Companies, Shell could possibly continue to operate its interests in the Pohokura and Maui joint ventures.[20]

38. Shell wishes to exit the relevant markets, as (after a global review of its assets) Shell has identified better investment opportunities outside of New Zealand. [ ][21] [22]

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19 The Application at [104].

20 Ibid at [106.4].

21 E-mail from Chapman Tripp (on behalf of Shell) to the Commerce Commission (18 June 2018) and Commerce Commission interview with Shell (5 July 2018).

22 [ ]

39. Shell advised that, [ ].[23] We note Shell's documents that recommend sale to OMV note that [ ].[24] [ ]

40. We consider that the likely counterfactual is the equivalent of the status quo, where Shell would either remain as an independent competitor and would continue to compete in the relevant markets or sell to an independent third party.

How the acquisition could substantially lessen competition

41. We have considered three possible ways in which the proposed acquisition would be likely to have the effect of substantially lessening competition:

    41.1 first, the acquisition could give rise to unilateral effects by allowing OMV to profitably raise prices to its customers or reduce quality by itself in the natural gas and LPG markets;

    41.2 second, the acquisition could increase the potential for OMV and remaining competitors to coordinate their behaviour and collectively exercise market power such that prices increase in the natural gas market; and

    41.3 third, the acquisition could give rise to vertical effects by increasing OMV's ability and/or incentive to foreclose rivals. On this point, we have specifically considered the potential for vertical effects in:

        41.3.1 the natural gas market by prejudicing Todd Energy's position within the Maui and Pohokura fields; and

        41.3.2 the markets for the transportation and storage of liquids as a result of OMV foreclosing access by its competitors to onshore infrastructure assets (eg, tanks and pipelines), which may affect competition in markets for the sale of liquids and indirectly affect competing gas producers' ability to produce and sell their gas.[25]

42. Because investment decisions are made in the relevant markets over long time horizons, the focus of our analysis has been on whether competition is likely to be impacted in the medium to long term.

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[23] Commerce Commission interview with Shell (5 July 2018).

[24] [ ], provided under the cover of an email from Chapman Tripp (on behalf of Shell) to the Commerce Commission (18 June 2018).

[25] As we discuss later, if foreclosure of access to tanks and pipelines means that a competitor is unable to sell liquids from a field this could affect total production from that field and could indirectly affect competing gas producers' ability to produce and sell their gas.

Competition analysis – unilateral effects

43. A merger can substantially lessen competition if it increases the potential for the merged entity to be able to unilaterally raise prices. Where two suppliers compete in the same market and the constraint from other competitors is limited, a merger could remove a competitor that would otherwise provide a competitive constraint, allowing the merged entity to raise prices. A merger could also reduce competition if the target was a potential or emerging competitor. In such a case, a merger could result in higher prices compared to the scenario without the merger.[26]

44. OMV submitted that the proposed acquisition would not have the effect of substantially lessening competition because:[27]

    44.1 the market shares of OMV and Shell in natural gas and LPG are in decline as the Maui field nears the end of its life and the Pohokura field comes off plateau; and

    44.2 OMV would continue to face constraint post-acquisition from:

        44.2.1 other market participants involved in the production of natural gas and LPG who hold a large proportion of reserves and face limited barriers to expanding production in the short term;

        44.2.2 large wholesalers of natural gas and LPG; and

        44.2.3 supply contracts that limit its ability to increase prices in the short term and the ability of customers to switch suppliers, further constraining prices in the longer term.

45. We detail our unilateral effects analysis for each of the LPG and natural gas markets separately below. For the reasons given, we are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to unilateral effects in either market.

LPG

46. We are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the LPG market. The aggregation in LPG with the acquisition would be minimal and OMV would continue to face constraint post-acquisition from other producers of LPG (the Kapuni and Kupe fields), which are the market leaders. This is confirmed in Table 1 and Figure 1.

47. Table 1 sets out LPG market shares based on actual sales in 2017 by volume.[28]

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[26] *Mergers and Acquisitions Guidelines* above n1 at [3.62-3.63].
[27] The Application at [37].
[28] For OMV, Shell and Todd, Table 1 includes their shares of Maui joint sales of LPG.

Table 1: LPG market shares (2017)

Gas producer	Sales (kT)	Market share (%)
OMV	[ ]	[ ]
Shell	[ ]	[ ]
Merged entity	**[ ]**	**[ ]**
Todd	[ ]	[ ]
Beach	[ ]	[ ]
Genesis	[ ]	[ ]
Westside	[ ]	[ ]
NZOG	[ ]	[ ]
Total	**[ ]**	**100**

48. Figure 1 depicts historic actual and forecast future market shares for LPG.[29]

Figure 1: LPG market shares over time

[ ]

49. With the acquisition, no existing competition between OMV and Shell in the supply of LPG is lost. This is because any interest that OMV and Shell currently have in the supply of LPG is limited to the Maui field, where production is jointly sold (ie, OMV and Shell do not compete to sell that output).

50. [

]

Natural gas

51. We are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the natural gas market due to unilateral effects. In summary, this is because:

    51.1 only limited competition between OMV and Shell would be lost; and

    51.2 OMV would face constraint post-acquisition from other gas producers which, with investment, are capable of expanding production.

Market shares

52. Table 2 sets out natural gas market shares based on actual sales in 2017 by volume.[30]

[29] For simplicity, Figure 1 shows sales of LPG from Kupe by Beach, Genesis and NZOG consolidated.
[30] For OMV, Shell and Todd, Table 2 includes their shares of Maui joint sales of natural gas.

Table 2: Natural gas market shares (2017)

Gas producer	Sales (PJ)	Market share (%)
OMV	[ ]	[ ]
Shell	[ ]	[ ]
Merged entity	**[ ]**	**[ ]**
Todd	[ ]	[ ]
Greymouth	[ ]	[ ]
Beach	[ ]	[ ]
Genesis	[ ]	[ ]
TAG Oil	[ ]	[ ]
Westside	[ ]	[ ]
NZOG	[ ]	[ ]
Total	**[ ]**	**100**

53. Table 2 shows that, based on 2017 sales figures, OMV's share of the natural gas market would increase from [ ]% to almost [ ]% with the acquisition, with remaining competitors making up the other [ ]% of the market. However, we have also examined likely future market shares, taking into account data on natural gas reserves and contingent resources released by the Ministry of Business Innovation and Employment,[31] as well as production forecasts provided directly to us by gas producers.

54. Figure 2 depicts historic actual and forecast future market shares for natural gas.[32]

Figure 2: Natural gas market shares over time

[ ]

55. Table 2 and Figure 2 show that in 2017, while OMV and Shell combined accounted for almost [ ]% of the sales of natural gas, their share of sales has declined in the last five years, while Todd Energy's and Greymouth Petroleum's shares of sales have increased.

56. All of the natural gas supplied by OMV and Shell is produced at the Pohokura and Maui fields. Historically, output from Pohokura and Maui has accounted for a large proportion of the supply of natural gas. While OMV would be the largest producer and supplier of natural gas on completion of the acquisition, its overall market share is likely to be lower over time. This is because:

56.1 OMV is forecasting that, [ ], annual production and sales of natural gas from Pohokura and Maui will decline by [ ]% (the merged entity's share of this decline equating to [ ]PJ) between now and 2022.[33] [34] In the longer term,

[31] http://www.mbie.govt.nz/info-services/sectors-industries/energy/energy-data-modelling/publications/petroleum-reserves-data.

[32] For simplicity, Figure 2 shows sales of natural gas from Kupe by Beach, Genesis and NZOG consolidated.

[33] E-mail from Simpson Grierson (on behalf of OMV) to the Commerce Commission (6 August 2018).

this decline is likely to continue as the Maui field is nearing the end of its life and Pohokura is approaching the end of its peak production; and

56.2 as discussed further below, there is a likelihood of other major natural gas producers (in particular, Todd Energy and Greymouth Petroleum) expanding production in the future and continuing to increase their market share.

57. Data provided by the other major natural gas producers indicates that, with investment, they have the ability to materially expand production and/or extend the production life of gas fields. In addition, if prices were to increase post-acquisition, other gas producers would have the incentive to undertake this investment and expand. This potential investment and forecast increase in production is factored into Figure 2.

57.1 Todd Energy is forecasting to increase annual production and sales of natural gas by [ ]% (by [ ]PJ) between now and 2022, [ ].[35]

57.2 Greymouth is forecasting to increase annual production and sales of natural gas by [ ]% (by [ ]PJ) between now and 2022, [ ].[36]

58. Data provided by Todd and Greymouth supports arguments made by OMV that, with investment, they could expand and constrain OMV post-acquisition. In addition, we note that the Kupe joint venture partners are also considering investing in order to extend plateau production at that field for a number of years.[37]

59. We note that the above forecasts of gas production are relatively certain for the next two to three years, but less certain for 2021 and 2022. In the next two to three years, gas producers are committed to supply the majority of this volume to customers and have made investment decisions that will enable them to produce that volume. The actual amount of gas that will be produced by each supplier in 2021 and 2022 is dependent on investment decisions that are yet to be made, as well as the customer contracts that suppliers secure. As we note below, any post-acquisition price

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34 [ ] We note that, without any investment to extend the production life of the Pohokura and Maui fields, the decline in the merged entity's share would be greater.

35 Email from Todd Energy to the Commerce Commission (17 July 2018) and Commerce Commission interview with Todd Energy (1 August 2018).

36 Email from Greymouth Petroleum to the Commerce Commission (27 July 2018) and Commerce Commission interview with Greymouth Petroleum (3 August 2018).

37 Commerce Commission interview with Genesis Energy (20 July 2018).

increases by OMV would be likely to increase the incentive for competitors to invest in capacity expansions, which would act to constrain OMV.

60. In terms of the timeframe of any expansion, Greymouth has advised that, [ ].[38] This suggests that OMV's competitors [ ] in response to any post-acquisition price increase by OMV.

Competition between gas producers

61. In assessing whether a merger would be likely to have the effect of substantially lessening competition, we assess the state of existing competition in the relevant markets and also whether, if prices increase and/or quality decreases, existing competitors would expand their sales, or new competitors would enter and effectively compete with the merged entity.

62. Evidence from gas producers and customers interviewed is that the natural gas market is currently competitive, and that prices have fallen in recent years.[39] While OMV and Shell are two of the major gas producers, evidence indicates that they are not close competitors or a key source of competition in the natural gas market, and that this is unlikely to change in the next few years given the volumes that each has is tied up in long-term supply contracts.

63. Table 3 provides a breakdown of OMV's and Shell's natural gas sales in 2017 by volume.

Table 3: OMV and Shell natural gas sales (2017, PJ)

Gas producer	Maui share	Pohokura	Total sales
OMV	[ ]	[ ]	[ ]
Shell	[ ]	[ ]	[ ]
Merged entity	**[ ]**	**[ ]**	**[ ]**
% of parties' combined total	[ ]%	[ ]%	100%

64. OMV and Shell do not compete to supply natural gas from Maui. This is because all production from the Maui field is jointly sold (ie, OMV and Shell do not compete to sell the output). As such, there would be no loss of competition between OMV and Shell in the supply of natural gas from Maui due to the acquisition. Table 3 shows that Maui accounted for [ ]% of OMV's and Shell's combined sales of natural gas in 2017.

65. The only volumes for which OMV and Shell potentially compete against each other are in respect of natural gas produced from the Pohokura field. However, the evidence we found indicates that limited competition between OMV and Shell in the supply of natural gas from Pohokura would be lost with the acquisition.

38 Commerce Commission interview with Greymouth Petroleum (3 August 2018).

39 See for example, [ ].

66. Recently, OMV and Shell have directly competed only for spot sales (which account for approximately only 1% of total sales of natural gas by volume). For the bulk of the volume they supply, OMV and Shell negotiate contracts bilaterally with large customers, as opposed to competing for tenders.

67. Moreover, customers have generally been unable to use either gas producer as a credible outside option when negotiating with the other, since rarely have both had sufficient production available at the same time to supply the same large contract. This is because both OMV and Shell:

67.1 commit most of their production to long-term contracts; and

67.2 do not tend to have contracts terminating at similar dates.

68. Accordingly, we found no evidence of customers switching significant volume between OMV and Shell in recent years.

69. OMV and Shell are not a key source of competition in the natural gas market. This is to some extent because they supply only the very largest customers and do not compete to supply industrial and commercial customers. It is also due to the fact that they have more volume tied up in long-term supply contracts than some other gas producers.

70. Table 4 summarises the volume that the major gas producers have contracted for the next few years. When compared to the total volumes in Table 2, it shows that OMV and Shell have a large proportion of their volumes committed to customers in term contracts that do not come up for renewal for at least three years. However, this is not the case for all gas producers.

Table 4: Contracted natural gas volumes (PJ)

Gas producer	Total volume	Contracted volume
OMV	OMV share of Pohokura [ ]; post-acquisition [ ]	[ ]
Shell	Shell share of Pohokura [ ], plus Maui joint sales [ ]	[ ]
Todd	[ ]	[ ]
Greymouth	[ ]	[ ]
Genesis (all of Kupe)	[ ]	[ ]

71. We consider that, with the acquisition, only limited existing competition would be lost between OMV and Shell in the supply of natural gas.

72. We also assessed whether the acquisition could result in a loss of potential increased competition between OMV and Shell, should more of their customer contracts ever come up for renewal simultaneously in the future. However, we see little prospect of this in the medium term, since both OMV and Shell already have most of their available production committed for the next few years, with the end-dates of their main contracts being staggered. In addition, competition is likely to occur between other major gas producers in the next few years, with a number of their customer contracts coming up for renewal.

73. This view was supported by customers. Customers in this market are sophisticated buyers who typically exercise bargaining power via negotiations over long-term supply contracts. Feedback from customers was that they do not see their bargaining power diminishing as a result of the acquisition, as they would continue to have the same ability to switch volumes between natural gas producers.[40]

74. This view was also held by Methanex, which has a relatively unique position in the market as the single largest customer, accounting for nearly half of all natural gas produced. Because of its relative size the bargaining position of Methanex may differ to some extent from other customers.[41] Despite this, Methanex is similarly unconcerned as it does not consider that the proposed acquisition would materially alter its bargaining position.[42]

75. More generally, we note that the production of natural gas involves relatively high fixed costs and relatively low marginal costs, which tends to increase the incentive for suppliers to produce and sell all of their available capacity rather than withhold supply from the market.

76. Further, other competitors would likely expand to replace any competition between OMV and Shell that would be lost. As already noted, with investment, other gas producers have the ability and incentive to materially expand production and/or extend the production life of their gas fields.

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[40] Some customers are protected to some extent by rights to buy natural gas from some [ ].

[41] [ ]

[42] Methanex considers that it has reasonably good buyer power because the volume it demands is an attractive proposition to natural gas producers in terms of base load and does not see this changing with the acquisition (it considers that there will still be sufficient competition). Commerce Commission interview with Methanex (20 July 2018) and Submission from Methanex to the Commerce Commission (27 July 2018).

77. The evidence indicates that the extent to which other gas producers will invest to expand depends on a number of factors, including [ ].[43] Any significant post-acquisition price increases by OMV would be likely to incentivise competitors to undertake investment to produce more natural gas, which would act to constrain OMV.

78. Given our conclusions above on the constraint that OMV would face post-acquisition from other gas producers, we have not needed to reach a view on the extent to OMV would face constraint from gas wholesalers (from outside from the market), the ability of certain customers to exert substantial influence on negotiations, and/or the entry of new gas producers or new gas fields.

Competition analysis – coordinated effects

79. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that quality reduces and/or prices increase across the market.

80. Unlike a substantial lessening of competition, which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way. Such behaviour need not be unlawful, and includes tacit collusion such as accommodating price responses or parallel conduct.

81. OMV submitted that the proposed acquisition would not cause coordinated effects in the natural gas market. In OMV's view, the market is characterised by the following conditions which would render coordination unlikely with or without the acquisition:[44]

  81.1 the presence of existing rivals with the ability to expand to take market share away from rivals who engage in coordination;

  81.2 the majority of gas being supplied subject to long term contracts at different time periods based on different price drivers;

  81.3 a lack of transparency on the pricing for contracted gas sales, meaning that there is no mechanism for market participants to achieve or monitor any coordination; and

  81.4 customers being price conscious and having a high degree of countervailing power.

82. For the reasons below, we are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the natural gas market due to coordinated effects.

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43 [ ]

44 The Application at [319].

83. In carrying out our assessment, we apply the two stage framework set out in our guidelines:[45]

83.1 we first asked whether the natural gas market has features which make it vulnerable to coordination;[46] and

83.2 we then asked whether the acquisition is likely to change conditions in the natural gas market so that coordination is more likely, more complete, or more sustainable.

Is the market vulnerable to coordination?

84. A range of market features are commonly accepted as making a market more vulnerable to coordination. These are features that make it more likely that firms would be able to successfully coordinate their behaviour to increase their profits. Not all need be present for a market to be vulnerable to coordination. Nor does the existence of some or all of these features inevitably mean that firms would engage in coordinated behaviour.[47]

85. The natural gas market appears to display some features that may make coordination more likely:

85.1 natural gas is a homogeneous product;

85.2 there are relatively few producers and no obvious maverick;

85.3 producers are interrelated by joint ventures; and

85.4 producers interact with each other often through the joint ventures.

86. However, other features of the natural gas market may make coordination more difficult to achieve:

86.1 producers are not similar – they vary in size and cost structure;[48]

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45 *Mergers and Acquisitions Guidelines* above n1 at [3.86].

46 Our focus here is on whether the natural gas market is vulnerable to anticompetitive coordination arising in future, with and without the acquisition. The market already features some coordination in the form of joint marketing at Maui. It has been argued that features of the natural gas market can make this type of coordination necessary, and so to some extent inevitable (ie, that the costs and risks of exploring for gas are sometimes high enough that gas producers would not incur them without being spared from competing with each other over any resulting output). The Commission has considered such arguments in relevant past decisions, such as OMV New Zealand Limited, Shell Exploration New Zealand Limited, Shell (Petroleum Mining) Company Limited and Todd (Petroleum Mining Company) Limited(Commerce Commission Decision 505, 1 September 2003). These arguments are not relevant here, since no new fields are presently being developed.

47 *Mergers and Acquisitions Guidelines* above n1 at [3.89-3.90].

48 Different gas producers have different business models and cost structures. OMV and Shell are involved in gas exploration and production only, operating offshore fields, of which Maui has very large and possibly imminent decommissioning liabilities. Todd Energy and Greymouth Petroleum are involved in gas exploration and production, as well as the wholesale and retailing of gas, the gas fields they operate have different cost profiles to OMV's and Shell's (due to being onshore and lacking imminent

86.2 demand is not stable – it is in fact volatile, with large customers in particular taking variable volumes year-by-year;[49] and

86.3 prices and volumes are not transparent – a large proportion of supply contracts are negotiated bilaterally, resulting in confidential contracts with bespoke terms (including price- and volume-variation clauses).[50]

87. Due to this particular arrangement of features, we consider that the natural gas market is not highly vulnerable to coordination. Since most supply is by contracts with negotiated prices and medium-to-long durations, gas producers seeking to coordinate may find it easier to allocate customers between them (whether tacitly or expressly) to remove effective competition from price negotiations.[51] However, key features of the natural gas market are likely to make it difficult for any gas producers trying to establish or maintain such an allocation:

87.1 the differences in gas producers' cost structures are fairly large, which would tend to undermine agreement on how to split the market (ie, on how many customers to allocate to each gas producer);

87.2 the volatility of demand would also discourage agreements to allocate customers, and would encourage cheating. That is, gas producers may not agree on specific customer allocations, or may cheat on them, because a given customer's demand could easily turn out lower than expected, with the incentive to cheat being sharpened because producers need to cover high fixed costs; and

87.3 the opacity of most contracts would encourage cheating on customer allocations.

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decommissioning liabilities), and their downstream arms add particular costs. Beach Energy operates the smallest major field (Kupe), but is otherwise less present in New Zealand than the other producers are, while Genesis (a major shareholder in Kupe) is also an electricity generator, wholesaler and retailer. The remaining gas producers (eg, WestSide and TAG Oil) are tiny.

49 For example, demand from petrochemical customers has fluctuated between 20PJ and 100PJ a year during the last decade, while demand from electricity generation customers has fluctuated between 60PJ and 100PJ a year. Gas Industry Company Limited "The New Zealand Gas Story" (6th Edition, December 2017) at Figure 10.

50 See the discussion of unilateral effects, above.

51 Gas producers would be less likely to try to coordinate on price points, which are rarely set. Producers would be unlikely to try to drive up all prices by restricting output in concert in part because they typically have high fixed costs. For example, [ ]. Gas producers would also be unlikely to try to drive up all prices by concertedly foregoing or delaying investments in new production because there is significant demand for natural gas. [ ]

Would the acquisition make coordination more likely, complete, or sustainable?

88. Where a merger materially enhances the prospects for any form of coordination between businesses, the result is likely to be a substantial lessening of competition. This could happen if the proposed acquisition is likely to change conditions in the natural gas market so that coordination is more likely, more complete, or more sustainable.[52]

89. We do not consider that the proposed acquisition would be likely to change the conditions in the natural gas market so that coordination is more likely, more complete or more sustainable. This is because:

    89.1 it would not remove any of the features that make coordination difficult to achieve, described at paragraphs 86-87 above; and

    89.2 as noted above, customers of natural gas producers are large, sophisticated buyers who negotiate long-term contract negotiations and so are well placed to disrupt (ie, encourage cheating on) any attempted market allocation.

90. In particular, the acquisition is unlikely to materially enhance the prospect of coordination between OMV and Todd Energy – which would (in terms of market shares) be the two most parallel gas producers post-acquisition – outside of Maui, since their cost structures would remain quite different. Additionally, other parties such as Greymouth Petroleum would remain to disrupt any coordination.

Competition analysis – vertical effects

91. A merger can result in a substantial lessening of competition due to vertical effects where it gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.[53] This could occur by the merged entity raising the costs of rivals, refusing to supply downstream rivals, or by changing the conditions of entry to make it harder to enter or expand.

92. OMV submitted that the proposed acquisition would not substantially lessen competition due to vertical effects because:[54]

    92.1 the acquisition would not prejudice Todd Energy's position within the Maui and Pohokura fields; and

    92.2 the acquisition would not foreclose access by Todd Energy and other parties to onshore infrastructure assets (eg, tanks and pipelines).

93. For the reasons below, we are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to vertical effects.

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52 *Mergers and Acquisitions Guidelines* above n1 at [3.86.2].
53 Ibid at [5.2].
54 The Application at [23] and 12-13.

Maui and Pohokura joint ventures

94. We have considered the potential for vertical effects to arise from the acquisition in the natural gas market by prejudicing Todd Energy's position within the Maui and Pohokura fields.

95. Decisions around major development at both Maui and Pohokura currently require [ ] and this will continue to be the case post-acquisition. We have considered how the acquisition could change how operational decisions are made. From a competition perspective, a concern could arise if the acquisition were to materially increase OMV's ability to make unilateral decisions (without input from Todd Energy) about the operation of the Maui and Pohokura joint ventures, in particular in terms of the amount of natural gas produced by the fields each year.

96. Because all Maui production is jointly sold, any impact on Maui decision making is unlikely to harm competition in the natural gas market.[55] However, if post-acquisition, OMV was able to materially reduce or vary from year to year the volume of natural gas that Todd Energy is able to sell from the Pohokura field, this could reduce the effectiveness of Todd as a competitor and lessen competition in the natural gas market.

97. Regardless of whether OMV might, post-acquisition, have the ability to make unilateral decisions (without input from Todd Energy), we do not consider that the proposed acquisition would be likely to result in vertical effects in the natural gas market. This is because:

    97.1 Todd Energy has the ability (with investment) to increase its natural gas production at Kapuni, McKee and Mangahewa. This would reduce the effect of any potential foreclosure of natural gas production at Pohokura.[56] As Table 5 below shows, output from Kapuni, McKee and Mangahewa accounted for [ ]% of Todd's natural gas sales in 2017. As noted earlier, Todd Energy is forecasting to increase production and sales of natural gas at these fields by [ ]% (by [ ]PJ) between now and 2022; and

Table 5: Todd Energy natural gas sales (2017)

Field	**Sales (PJ)**	**% of total**
Maui share	[ ]	[ ]
Pohokura	[ ]	[ ]
Other fields	[ ]	[ ]
Total	**[ ]**	**100**

55 [ ] Commerce Commission interview with Todd Energy (1 August 2018).

56 The volume of natural gas able to be produced by Todd Energy's other gas fields may also mean that there is little to no ability on the part of OMV to foreclose Todd post-acquisition (because it would face competition from other gas fields).

97.2 we consider it unlikely that OMV would be incentivised to curtail production at Pohokura in order to deprive Todd Energy of volume, as this would also result in OMV depriving itself of volume. As noted in Table 4 earlier, OMV has committed (via customer contracts) to supply a large volume of natural gas (and its post-acquisition volumes) to [ ] large customers, creating a floor below which it cannot reduce production for a number of years. Reducing output from Pohokura to deprive Todd Energy of volume would likely compromise OMV's ability to meet these contractual obligations.

Onshore infrastructure assets

98. We have considered the potential for vertical effects to arise from the acquisition as a result of OMV foreclosing access by its competitors to onshore infrastructure assets (eg, tanks and pipelines) used the transportation and storage of liquids, which may affect competition in markets for the sale of liquids and could also indirectly affect competing gas producers' ability to produce and sell their gas.

99. We canvassed the views of a range of industry participants and none raised material concerns about the acquisition foreclosing access to the onshore infrastructure assets and affecting competition in markets for the sale of liquids. Industry participants interviewed were generally comfortable with the access arrangements in place for such assets and considered that this access would continue post-acquisition, noting that alternatives were available in some cases.

99.1 TAG Oil advised that it has no issues with access to the Omata tank farm for oil and considered that nothing would change with the acquisition. An external party (Hale and Toomey) manages capacity allocation and there is a user group that oversees access arrangements.[57]

99.2 NZOG advised that it had no issues with access to tanks for liquids, as it has its own tank at Port Taranaki. It also has no issues with access to pipelines as there are open access arrangements. It noted that oil and condensate can be trucked to port rather than go via pipeline, and there are also some independently owned pipelines (eg, Liquigas for the export of LPG).[58]

99.3 [ ] stated when interviewed that current commercial arrangements will ensure access to infrastructure in the future.[59]

100. [ ] stated that the onshore infrastructure assets being acquired by OMV are critical to the export of liquids from the Taranaki gas fields.[60]
[

57 Commerce Commission interview with TAG Oil (19 July 2018).
58 Commerce Commission interview with NZOG (19 July 2018).
59 [ ]
60 [ ]

][61]

101. We do not consider that OMV would be incentivised to worsen the access terms for onshore infrastructure assets used for the transportation and storage of liquids to its rivals (including denying access).

101.1 The onshore infrastructure assets (outside those within the Maui and Pohokura joint ventures) being acquired relate to liquids (eg, oil and condensate) as opposed to natural gas. This means that any foreclosure of access to these assets would only directly affect competition in markets for the sale of liquids, not the natural gas market.

101.2 Because a gas producer needs to be able to sell its liquids from a field in order to keep producing natural gas, foreclosure to these assets could indirectly affect competing gas producers' ability to produce and sell their gas. However, we consider that OMV is unlikely to seek to enhance its market power in the natural gas market by worsening rivals' terms of access to these assets because doing so would affect [ ].

102. In discussing access to onshore infrastructure assets, [ ] and TAG Oil raised a separate issue of the proposed acquisition substantially lessening competition in the sale of liquids (for export) by removing OMV and Shell as independent alternative suppliers. [ ][62] However, we do not consider that the acquisition changes anything in terms of the sale of liquids. While OMV and Shell may have once competed to export liquids, Shell no longer exports liquids from New Zealand. In addition, we do not consider that there are significant barriers to another party competing in the sale of liquids. We note that TAG Oil stated that Todd Energy was another supply option, and that Todd had exported liquids in the past.[63]

61 [ ]

62 Commerce Commission interview with TAG Oil (19 July 2018) and [ ].

63 Commerce Commission interview with TAG Oil (19 July 2018).

Determination on notice of clearance

103. We are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

104. Pursuant to section 66(3)(a) of the Act, the Commerce Commission determines to give clearance to OMV New Zealand Limited to acquire 100% of the shares in each of Shell Exploration NZ Limited, Energy Infrastructure Limited, Shell Taranaki Limited and Shell New Zealand (2011) Limited.

Dated this 9th day of August 2018

Sue Begg
Deputy Chair