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PUBLIC VERSION

COMMERCE COMMISSION

DETERMINATION

DECISION 581

Determination in the matter of the proposed revocation of the authorisation of joint marketing and sales of Pohokura gas by:

OMV NEW ZEALAND LIMITED, SHELL EXPLORATION NEW ZEALAND LIMITED, SHELL (PETROLEUM MINING) COMPANY LIMITED, AND TODD (PETROLEUM MINING COMPANY) LIMITED,

The Commission:	P R Rebstock (Chair) D R Bates QC S W Stevens
Determination	On 1 September 2003, in Decision 505, the Commission granted authorisation, pursuant to sections 58 and 61(1)(a) of the Commerce Act 1986, to OMV New Zealand Limited, Shell Exploration New Zealand Limited, Shell (Petroleum Mining) Company Limited, and Todd (Petroleum Mining Company) Limited, to jointly market and sell gas produced from the Pohokura natural gas field. The Commission determines, pursuant to section 65 of the Commerce Act 1986, to revoke the authorisation granted in Decision 505. The Commission further determines, pursuant to section 65, to neither amend, nor grant a further authorisation in substitution for, the authorisation granted in Decision 505.
Date:	2 June 2006

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EXECUTIVE SUMMARY[1]

Introduction

On 1 September 2003, the Commerce Commission authorised an arrangement between Shell, OMV and Todd, the three members of the Pohokura Joint Venture, whereby they would jointly (rather than separately) market and sell gas produced from the Pohokura field. The authorisation was granted because the Commission considered that the public benefits of joint marketing and sale would be greater than the competitive detriments arising from the arrangement. The crucial public benefit argued for by Shell, OMV and Todd, which allowed the Commission to authorise the arrangement, was that production from the Pohokura field would occur one year earlier under a joint marketing and sale regime than under individual marketing and sale.

In April 2004, the members of the Pohokura Joint Venture advised the Commission that they had been unable to agree on issues associated with joint marketing and sale and that they intended to market and sell the gas separately. Shortly after, each of the parties announced that they had separately entered into contracts for the sale of Pohokura gas. The original date for full production from the Pohokura field was not altered by the changed marketing regime.

The Commission decided to consider whether or not it should revoke its authorisation of the joint marketing and sale arrangement. Under section 65 of the Commerce Act, if the Commission is satisfied that an authorisation was granted on information that was false or misleading in a material particular, or that there has been a material change in circumstances since the authorisation was granted, or a condition upon which the authorisation was granted has not been complied with, that the Commission may amend or revoke the authorisation or substitute a new authorisation to replace the original.

On 13 October 2005, the Commission issued a revised draft determination. Its preliminary conclusions were that the Commission would revoke the authorisation granted in Decision 505 but grant a substitute authorisation for the joint marketing and sale only of gas produced during commissioning, gas produced at the end of the life of the field and gas produced in quantities at greater than normal production rates (together, "ad hoc gas").

Written submissions on the revised draft determination led the Commission to revise its preliminary view that it should grant a substitute authorisation of the joint marketing and sale only of ad hoc gas. After a request from the Commission, Shell, OMV and Todd provided further submissions on the Commission's revised view as to the appropriateness of a substitute authorisation of ad hoc gas.

Jurisdiction to Reconsider the Authorisation

For the purposes of establishing jurisdiction under s 65(1), the Commission has considered, firstly, whether there has been a material change of circumstances since the authorisation was granted and secondly, whether the authorisation was granted on information that was false or misleading in a material particular.

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[1] The Executive Summary is provided for the assistance of readers of the Commission's determination. It does not purport to completely encompass all the details in the determination. Readers are referred to the body of the determination for a complete picture of the issues.

Material change of circumstances

At the time the Commission was considering the authorisation application, the evidence indicated that early production could not be achieved by separate marketing and sale of gas. If, at the time the authorisation was granted, it was true that separate (rather than joint) marketing and sale of gas from the Pohokura field would have significantly delayed production from the field, then it appears there must have been a 'change of circumstances' in the market because separate marketing has occurred and that has not led to a significant delay in production from the field.

Further, as the change in circumstances in the present case relates directly to the need for joint marketing and sale of gas, which was proposed as crucial to achieving the benefits of early production, in the Commission's view it must be considered to be a material change of circumstances.

False or misleading in a material particular

In Decision 505, the Commission formed the view, on the basis of representations made by the parties and information provided by other market participants, that joint marketing and sale of gas would be required in order to achieve early production from the field. In April 2004, OMV, Shell and Todd chose not to jointly market and embarked instead on separately marketing and selling gas.

The information in question involved predictions as to a future state of affairs in an area of accepted uncertainty. An argument was raised that such information is not "false or misleading" in the sense required by section 65(1)(a) if the predictions were based on an objective foundation, notwithstanding that they have subsequently proved false. In its submissions, Todd argued that statements could not be false or misleading if they are based upon sound knowledge (i.e. they are statements which a reasonable person with the relevant expertise would make). The Commission considers that in this case there existed an objective basis for the one year forecast. Given this objective foundation at the time, which now no longer exists, a "material change of circumstances" must have occurred. However, the Commission considers that if it is wrong, and there was not an objective foundation for the information at issue at the time, the information can be properly regarded as "false or misleading" in terms of section 65(1)(a).

Conclusion on jurisdiction

The Commission concludes that it has jurisdiction under s 65(1)(b); and in the alternative s 65(1)(a), to reconsider the authorisation granted in Decision 505.

Exercise of Discretion to Reconsider the Authorisation

Once the Commission has established that it has jurisdiction under s 65(1), it must consider whether it should:

- revoke the authorisation;
- amend the authorisation;
- revoke the authorisation and grant a further authorisation in substitution for it; or
- allow the original authorisation to remain in effect, without amendment.

Should a Further Authorisation in Substitution be Granted

In its Revised Draft Determination the Commission considered whether it should revoke the existing authorisation and substitute a new authorisation that would allow for the joint marketing and sale of peaking gas, commissioning gas and gas at the end of the life of the field.

Submissions received on the Commission's proposal to grant a substitute authorisation raised a number of complex issues. The Commission now considers that should an authorisation be required for the joint sale and marketing of peaking gas, commissioning gas and gas at the end of the life of the field this would be more appropriately dealt with by consideration of a new application for authorisation. A new application would allow parties the opportunity to frame the most appropriate authorisation, and allow issues arising from the application to be fully tested in the manner envisaged by the authorisation provisions set out in the Act.

The Commission concludes that, in these circumstances, it is not appropriate for it to consider whether to grant a substitute authorisation.

Should the Commission Revoke the Existing Authorisation

Factual and Counterfactual

The factual in this instance is the likely outcome with the revocation of Decision 505. The counterfactual is the continuation of the authorisation, whereby gas from the field would be able to be jointly marketed and sold without breaching the Commerce Act.

The Market

The market used by the Commission in the analysis of the possible revocation is the national natural gas production (and first point of sale) market.

Competition

The Pohokura field holds around 39% of total New Zealand gas reserves. Fields in which at least one of Shell, OMV and Todd has a substantial interest account for around 77% of reserves.

Much of the gas in the production fields is committed to meeting existing supply contracts. In addition the great majority of the anticipated output of the Pohokura field (which has yet to commence production) until 2012 is committed to meeting supply contracts already entered into separately by Shell, OMV and Todd.

Weighing Benefits and Detriments

In assessing the benefits and detriments of revocation the following facts and assumptions have been used:

- in the factual the authorisation would be revoked;
- in the counterfactual the extant authorisation would remain in force;
- the field will commence production in 2006 in both the factual and counterfactual;

- most gas to be produced up to 2012, which represents about 50% of the likely total amount of gas in the Pohokura field, has already been marketed and sold separately;
- gas produced after 2012 will be marketed and sold jointly in the counterfactual, but will be predominantly sold separately in the factual; and
- the pattern of production in the factual and counterfactual will be similar.

Benefits

In considering benefits and detriments the Commission has had regard to the following factors:

- as more gas will be sold separately in the factual compared with the counterfactual, the factual will produce a more competitive outcome;
- it is difficult to predict with confidence the extent to which the factual will be more competitive as this depends in part of future gas field discoveries;
- output from the field will be reasonably similar in the factual and counterfactual; and
- as the different method of selling in the two scenarios only occurs post 2012, the benefits and detriments associated with each will need to be discounted to be expressed in 2006 dollars.

Allocative Efficiency

Notwithstanding broadly similar production patterns in the factual and in the counterfactual, the Commission considers that there would be more efficient production levels in the factual and that, therefore, revocation would produce moderate public benefits through enhancement of allocative efficiency.

Productive Efficiency

The Commission considers that the greater competitive pressure in the factual lead to slightly greater levels of productive efficiencies over that likely in the counterfactual.

Dynamic Efficiency

The Commission considers that separate marketing and the concomitant greater level of competition is likely to facilitate a more dynamic gas market.

Detriments

The Commission considers that as first production date is likely to be the same in the factual and the counterfactual, revocation would not produce any detriment or benefit in respect of early production.

In addition the Commission notes that the cost of putting in place a gas balancing agreement will be likely to be the same in the factual and the counterfactual.

The Commission acknowledges that revocation may result in the loss of some flexibility, but attributes only a minor amount of detriment to this.

Balance of Benefits and Detriments.

The Commission considers that the allocative efficiency benefits from revocation are moderate, the productive efficiency benefits are small and the dynamic efficiency benefits are potentially significant.

On the other hand, the Commission considers that the detriments from revocation are insignificant.

On balance, the Commission considers that the benefits of revocation are likely to outweigh detriments.

Other Matters to Which the Commission has had Regard

In reaching its determination, the Commission also considers that:

- when there has been a material change in the circumstances since the granting of authorisation, as in this case, the correct answer in the new circumstances is most likely to be arrived at if the Commission's normal authorisation processes are followed. That means the best course of action is to revoke the extant authorisation, it then being open to the parties to reapply for authorisation if they consider that remains appropriate in the new circumstances; and

- the Commission noted in Decision 505 that without the, now absent, nexus between joint marketing and sale of Pohokura gas and early production from the field, it would not have authorised the joint marketing and sale. There is now no persuasive evidence of a net public benefit if the authorisation remains in place. In the Commission's view an authorisation of anti-competitive behaviour without demonstrable net public benefit should not continue to exist.

Conclusions Leading to the Determination

The Commission's conclusions are that:

- a material change in circumstances has occurred subsequent to the date of the authorisation granted in Decision 505. However, if that is incorrect, and if circumstances now are not materially different from those at the time of Decision 505, then the authorisation must have been granted on information that was false or misleading in a material particular;

- as a result, the Commission has jurisdiction to consider whether to revoke, amend, or grant a further authorisation in substitution for the authorisation granted in Decision 505;

- after taking account of submissions received, the appropriate course of action is to consider revoking the authorisation granted in Decision 505, rather than either amending the authorisation or revoking the authorisation and granting of a further authorisation in substitution for it;

- the Commission must compare benefits and detriments in the future with the existing authorisation continuing in force, with benefits and detriments in the future without any authorisation of joint market and sale of Pohokura gas in force;

- given that analysis, the Commission considers net public benefits will arise from the revocation of the authorisation granted in Decision 505; and

- the Commission should revoke that authorisation.

Determination

The Commission now determines, pursuant to section 65 of the Commerce Act 1986, to revoke the authorisation granted in Decision 505. The Commission further determines, pursuant to section 65, to neither amend, nor grant a further authorisation in substitution for, the authorisation granted in Decision 505.

INTRODUCTION

1. In Decision 505, the Commerce Commission (the Commission) determined to authorise arrangements between OMV New Zealand Limited (OMV); Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited (Shell); and Todd (Petroleum Mining Company) Limited (Todd). These parties were authorised under s 58(2) of the Commerce Act 1986 (or the Act) to enter into arrangements to jointly market and sell gas produced from the Pohokura natural gas field (or Pohokura field).

2. The Pohokura field is owned and operated as a joint venture by the parties to the authorised arrangements in the following proportions.

   - OMV 26%
   - Shell 48%
   - Todd 26%

3. The OMV group is an Austrian-based company whose core business is exploring for, and producing, oil and natural gas. OMV also owns 10% of the Maui field. The relevant activities of Shell in New Zealand are the exploration for, and production of oil and gas, which include significant shareholdings in the Maui and Kapuni natural gas fields. Todd Energy is a diversified energy business whose activities include the exploration for, and production of oil and gas. Along with its Pohokura ownership, it has significant shareholdings in the Maui and Kapuni fields and owns the Mangahewa and McKee fields. It is also a natural gas retailer through its subsidiary, Nova Gas Ltd.

4. The Commission authorised the joint marketing and sale arrangements because it considered that the public benefits outweighed the detriments arising from a loss of competition in gas markets. The determinative factor was that the field would begin production one year earlier than it would in the absence of authorisation. Without such a benefit, the Commission would not have authorised the joint marketing and sale arrangements.

5. In April 2004, the members of the Pohokura Joint Venture advised the Commission that, because they had been unable to reach agreement on critical issues associated with the joint marketing and sale of Pohokura gas, they intended to market and sell the gas separately. They also advised that the change from joint to separate marketing and sale would not delay the mid-2006 planned production date.

6. During May 2004, the Commission noted press releases informing the public that OMV, Shell and Todd had individually, rather than jointly, marketed and sold tranches of gas from the Pohokura field to various purchasers.

7. The Commission noted that the nexus between joint selling and early production, from which the most important public benefit arose, appeared no longer to exist. Therefore, it decided to consider whether s 65(1) of the Act applied and, if so, whether it should revoke its authorisation of the relevant arrangements. On 23 February 2005, the Commission released a draft determination of the matter, in which its preliminary

conclusion was that it would be likely to revoke the authorisation granted in Decision 505.

8. The Commission took account of the submissions it received in respect of its first draft determination and decided to revise the approach it had taken. On 13 October 2005 it issued a revised draft determination in which, on the basis of a forward-looking benefit and detriment analysis, its preliminary conclusion was that it would revoke the existing authorisation and grant a further authorisation in substitution for it. The Commission's preliminary view was that the further substitute authorisation should include the joint sale and marketing only of commissioning gas, peaking gas and end of field gas.

9. The Commission received submissions on the revised draft determination. The content of the submissions led the Commission to reconsider its preliminary conclusions in the revised draft determination, to grant a further authorisation in substitution. The Commission decided that further consultation should be carried out with the Pohokura joint venture partners, to allow the Commission to consider their views on that proposed revised conclusion. On 28 February 2006, the Commission wrote to the three joint venture partners seeking further submissions. It has received responses from each of the Pohokura joint venture partners and has taken those into account in reaching this determination.

10. No interested party submitted that the Commission should hold a conference on the matter. The Commission itself did not consider that a conference was necessary and no conference was held prior to the release of this determination.

THE GAS SECTOR

11. Natural gas accounted for 21.0% of New Zealand's total primary energy supply in 2004 (compared with 30.1% in 2002). In the year to September 2005, gas was consumed by different sectors in the following proportions:

- electricity generation 49.2%;
- methanol production 15.9%;
- ammonia-urea production 4.4%;
- industrial and commercial 26.0%;
- residential 4.4%; and
- transport 0.1%.

12. Gas became a significant contributor to the energy sector with the development of the Kapuni gas field in 1970, and output greatly increased with development of the much larger Maui field in 1979. Other commercial gas fields have been discovered in the past 30 years, including Pohokura which is due to commence production this year. None of these other fields have close to the original quantity of gas in the Maui field.

13. Gas production reached its peak in 2001 when 242 PJ was produced, of which 191 PJ came from the Maui field. Since that time, production has declined as the Maui field has approached depletion. Total production for 2004 was 156 PJ, of which 103 PJ came from the Maui field.

14. On the demand side, gas used for electricity generation has declined from 116 PJ in 2001 to 63 PJ in 2005, while that used by the petrochemical sector (principally in the production of methanol) has declined from 91 PJ in 2001 to 45 PJ in 2005.

THE ANALYSIS IN DECISION 505

15. In Decision 505, the Commission authorised the three Pohokura joint venture partners to enter into arrangements to jointly market and sell gas produced from the field. The authorisation was subject to three conditions which are not relevant to this determination.

16. The Decision 505 factual anticipated the Pohokura joint venture partners jointly marketing and selling gas from the Pohokura field and full production capability being reached by 30 June 2006.

17. The Decision 505 counterfactual, absent the arrangements, anticipated that OMV, Shell and Todd would separately sell proportions of the output of the field corresponding to the equity ownerships of each. OMV, Shell and Todd would have agreed on measures to address the contractual implications of separate marketing, in particular, a gas balancing agreement. Production from the Pohokura field would have been delayed by one year, relative to the factual, as a result of the time needed to agree the relevant contracts.

18. The relevant market was considered to be the national natural gas production (and first point of sale) market. The Commission concluded that joint marketing in the factual, with authorisation of the arrangements, would result in a lessening of competition and detriments in comparison to separate marketing in the counterfactual, absent such authorisation. The detriments would arise from a loss of allocative, productive and dynamic efficiencies. Fewer competitors in the market in the factual, vis a vis the counterfactual would lead to: higher prices and an enhanced potential for price discrimination; a more limited range of terms and conditions being available to gas purchasers; and a slowed or inhibited development of a wholesale gas market. These effects would result in a detrimental impact on gas users and the economy as a whole.

19. On the other hand, the Commission also considered that there would be potential benefits that would arise in the factual but not in the counterfactual arising from:

- earlier development of the Pohokura field;
- lower construction, production and transaction costs;
- an improvement in operational efficiency; and
- an increase in incentives for oil companies to explore for gas in New Zealand.

After weighing the detriments and benefits, the Commission decided that there would be a net benefit to the public from joint marketing under the relevant arrangements.

20. In reaching its conclusion in Decision 505, the Commission took account of submissions and statements by OMV, Shell and Todd that absent joint marketing, a delay in the development of the field of either three or six years was expected. The Joint Venture explained that the date that production would commence critically depended on the date of the final investment decision and that date would be significantly delayed beyond the planned date of 21 March 2004 if they were required to market and sell Pohokura gas separately. They also stated that construction and development steps after the final investment decision take about the same time, irrespective of whether the gas is to be marketed and sold jointly or separately.

21. The Commission concluded in Decision 505 that separate marketing would delay the arrival of full production by one year. Crucial to the Commission's decision to grant authorisation was the public benefit that would arise from that early development of the Pohokura field. Indeed, the Commission emphasised in Decision 505 that the benefits from the arrangement, *excluding* the benefit arising from production one year early, were likely to be less than the detriments from the loss of competition and without those particular benefits authorisation would not have been granted.

POST-AUTHORISATION DEVELOPMENTS

22. In the event, the Pohokura joint venture partners decided not adopt a joint marketing and sale approach. On 13 April 2004, OMV and Shell advised the Commission that the Pohokura joint venture partners had been unable to reach agreement on critical issues associated with the joint marketing of Pohokura gas. They advised that they decided it would be necessary to market and sell the gas separately so that sufficient contracts were in place to ensure each party was able to make a final investment decision in time for Pohokura gas to come on stream by mid-2006.

23. The parties reached a final investment decision on 30 June 2004. The separate marketing and sale approach did not apparently lead to a delay in the final investment decision or a delay to full production from the field. Instead, any delays were likely to be attributable to the seven and a half months[2] that the Pohokura joint venture partners spent attempting (and failing) to reach agreement on joint marketing and sale arrangements.

24. The Commission authorised joint marketing and sale, despite its detrimental impact on competition, principally because it was persuaded that joint marketing and sale was necessary in order to realise the public benefits associated with early gas production from the Pohokura field. Once the matters described above became apparent, the Commission came to the preliminary view that, in the new circumstances, if joint marketing and sale was reverted to by the parties at some time in the future (if the authorisation remained in place), gas consumers would face net detriments from the loss of competition at that time.

[2] That is, the seven and a half month period between 1 September 2003, the date of the authorisation. and mid April 2004, the date the Pohokura Joint Venture decided to proceed with separate marketing.

25. The Commission considered that while it was possible that the Pohokura joint venture parties had found public benefits from joint marketing and sale other than those submitted to the Commission in the original application for authorisation, or that there were new or different detriments, the nexus between joint marketing and sale and early production no longer existed. Without that connection, the public benefit analysis altered substantially to the extent that without it authorisation would not have been granted.

26. As a result of these factors, the Commission decided to consider, under section 65 of the Act, whether the authorisation granted in Decision 505 should be revoked or varied.

THE COMMISSION'S REVISED DRAFT DETERMINATION

27. As discussed, after taking account of submissions on its first draft determination, the Commission decided to issue a second, revised draft determination. The preliminary conclusions in the revised draft determination were that:

- the authorisation in Decision 505 was either granted either on information that was false or misleading in a material particular, or there had been a material change in circumstances subsequent to the Commission granting the authorisation;
- as a result, the Commission had jurisdiction to consider whether to revoke, amend, or grant a further authorisation in substitution for the authorisation granted in Decision 505;
- given submissions received, the appropriate course of action was to consider a revocation and substitute authorisation, rather than an amendment to the Decision 505 authorisation; and
- the Commission considered net public benefits would have arisen from the grant of a substitute authorisation of the joint sale and marketing only of ad hoc gas;

28. After taking account of submissions received on the revised draft determination, the Commission has decided that the granting of a further authorisation in substitution is not the appropriate course of action. This is discussed further below.

GROUNDS FOR RECONSIDERATION OF AN AUTHORISATION

29. The circumstances in which the Commission may alter, revoke, or substitute authorisations made under s 58 are set out in s 65 of the Commerce Act, which provides:

> 65 Commission may vary or revoke authorisations
>
> (1) Subject to subsection (2) of this section, if at any time after the Commission has granted an authorisation under section 58 of this Act the Commission is satisfied that—
>
> (a) The authorisation was granted on information that was false or misleading in a material particular; or
>
> (b) There has been a material change of circumstances since the authorisation was granted; or

> (c) A condition upon which the authorisation was granted has not been complied with—
>
> the Commission may revoke or amend the authorisation or revoke the authorisation and grant a further authorisation in substitution for it.
>
> (2) The Commission shall not revoke or amend an authorisation or revoke an authorisation and substitute a further authorisation pursuant to subsection (1) of this section unless the person to whom the authorisation was granted and any other person who in the opinion of the Commission is likely to have an interest in the matter is given a reasonable opportunity to make submissions to the Commission and the Commission has regard to those submissions.

30. Under s 65 the Commission has the jurisdiction to revoke the authorisation, amend the authorisation, or substitute a new authorisation if it is satisfied that any of the matters set out in s 65(1)(a)-(c) have occurred. The Commission is not obliged to amend, revoke or substitute a new authorisation. It may elect to do nothing, notwithstanding that it has jurisdiction to intervene.

31. The issue of possible revocation of the authorisation was discussed briefly at the Commission's conference on the application, by counsel for the Pohokura Joint Venture, Dr Mark Berry. [3] The Commission is of the view that the scenario outlined by Dr Berry as to when s 65 of the Act could be used to revoke an authorisation, currently exists: it transpires that separate marketing is feasible, achievable and is happening.

JURISDICTION UNDER SECTION 65

Introduction

32. In its initial draft determination, the Commission set out its preliminary view that either:

- The information provided at the time of the original application for authorisation was false or misleading in a material particular so far as it indicated the final investment decision could only be achieved by 2004 with joint marketing and sale; or
- A material change in circumstances since authorisation has had the effect that joint marketing has not been necessary to achieve the final investment decision by 2004.[4]

33. For the purposes of establishing jurisdiction under s 65(1), the Commission has first considered whether it is satisfied there has been a material change of circumstances since the authorisation was granted. Should jurisdiction arise under s 65(1)(b), it will not be necessary to consider whether jurisdiction could be established under s 65(1)(a) or (c).

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[3] "Section 65 has this ability to reopen matters where there is a material change in the market at a later point in time. But to follow that through logically thinking about the competition concerns the Commission has, a revocation would only seem to be on the table potentially if the market moved to such a position that separate marketing was going to be happening. So in other words the market would have had to have moved to such a point of maturity that separate marketing was feasible and achievable." Transcript of Commerce Commission Conference on Pohokura, Applicant's Reply, p400.

[4] Commerce Commission "Draft Determination: Proposed Revocation of Authorisation of Arrangements to Jointly Market and Sell Pohokura Gas" (Public Version, 23 February 2005) page 6.

Change of Circumstances?

34. In its submission, OMV states that it "…accepts that there has been a change in circumstances, as the dynamics of the New Zealand gas market have changed since the Authorisation, due in part to the successful conclusion of the Maui Strawman negotiations[5]". OMV does not, however, regard the change as 'material'.

35. OMV acknowledged in its submission that "…there has been a change in circumstances, which it would characterise as 'a final investment decision was made in June 2004 on the basis of going to market separately'."

36. Todd submitted that:

> a change of circumstances for the purposes of s 65 means a change in market circumstances since the grant of the authorisation and was intended to apply to factors which are exogenous of the contractual arrangements which have been authorised
>
> … that (i) more has become known about the Maui reserves, and arrangements have been entered into in relation to those reserves; and (ii) a higher value now attaches to the Pohokura liquids do not amount to a change of circumstances.
>
> … The only significant change since the authorisation is the 50 percent increase in the price of liquids but this has not changed the view that separate marketing is a significant barrier to the maximisation of gas and liquids volume over the life of the field.
>
> … An authorisation is not prescriptive and the fact that there has not yet been joint marketing is not of itself a change in market circumstances.

37. In its submission, Shell argued that the underlying facts have not changed. There was always a volatile commercial dynamic between the joint venture parties and this is "the root cause of the failure of the parties to commence a joint selling process." This argument is supported by Todd to the extent that it argues that changes to the proposed contracting approach between the joint venture parties do not constitute a material change in circumstances.

Change in Circumstances that is "Material"?

38. Todd submitted that even if changes in the contractual arrangements proposed by the Pohokura Joint Venture are changes of circumstances, there is no material change of circumstances for the purposes of s 65, as the arrangements for marketing and sale of gas still result in public benefits which outweigh any detriments.

39. Shell denies that relevant conditions have materially altered.

40. OMV "…accepts that there has been a change in circumstances…" due in part to the successful conclusion of the Strawman negotiations, but argues "…this in itself is not a sufficiently 'material' change to support the step of revoking the Authorisation".

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[5] Maui Strawman was the term used for the negotiations between gas industry parties and the Government on the allocation of the final amounts of gas in the Maui field.

41. The Australian case *Re Media Council*[6] suggests that the process of determining whether or not there has been a material change in circumstances must commence with examination of the circumstances as they existed at the time the authorisation was granted. Next, consideration must be given to the circumstances as they exist at the time revocation is being considered.

42. Regarding the materiality of the change in circumstances, *Re Media Council* suggests that:

> A material change in circumstance includes a change in circumstances which has a significant impact upon the benefits to the public or upon the detriment, including anticompetitive detriment, arising out of the conduct or the provision in question.[7]

43. As the change in circumstances in the present case relates directly to the need for joint marketing and sale of gas, which was proposed as crucial to achieving the benefits of early production, the Commission consider that, on the basis of the *Re Media Council* analysis, it must be considered to be a material change of circumstances.

False or Misleading?

44. While the Commission considers it can establish jurisdiction under s 65(1)(b), for completeness it has gone on to consider whether s 65(1)(a) also applies. Section 65(1)(a) of the Commerce Act empowers the Commission to reconsider the authorisation if it was granted on information that was 'false or misleading in a material particular'. All of the parties to the Pohokura Joint Venture submitted that the information provided at the time of the authorisation was neither false nor misleading.

45. In Decision 505, the Commission formed the view, on the basis of representations made by the parties and information provided by other market participants, that joint marketing and sale of gas would be required in order to achieve early production from the field. In the Applicants' submission, the absence of joint marketing and sale of gas would mean that development of the field would be delayed for six years,[8] with final investment decision forecast for 21 March 2004 under joint marketing and 24 August 2010 under separate marketing. The Commission considered that the appropriate counterfactual entailed separate marketing of gas and that "production of the Pohokura field will be delayed by one year from the February 2006 commencement date, to February 2007 for first gas, and the end of June 2007 for full production capability.[9]"

46. In its submission on the initial draft determination, Todd relied on *Commerce Commission v Chalmers,* where the District Court held, interpreting the Fair Trading Act, that:

> In the absence of New Zealand authority the Commission should be slow to infer that because the representation as to future events has turned out to be wrong it must therefore, and for that reason alone, have been false and misleading. … it has to be proved that the representor "did

[6] *Re Media Council; Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593.
[7] *Re Media Council of Australia & Ors* (1996) ATPR 41-497, 42-241.
[8] Decision No. 505, paras 292, 320 (increased from three years, as per their application).
[9] Decision No. 505 para 338.

> not believe the forecasts or predictions or was recklessly indifferent concerning them" before it can be held that the representation was false or misleading.[10]

47. Todd characterised its statement that joint marketing is required to meet the final investment date as a representation as to a future event. Nevertheless, a statement relating to the future may contain an implied statement as to present or past fact.[11] Such an implied statement as to present or past fact may be false or misleading.[12] It might be that, at the time the joint venture parties represented to the Commission that early production could not be achieved in the absence of joint marketing, the joint venture parties knew that alternative methods of sale and gas balancing were feasible and would not cause a delay to production of one year.[13] If this was the case, then their statement could be considered false or misleading.

48. The expression "false or misleading" has not been judicially considered in the context of Commerce Act s 65. Although some guidance can be derived from judicial interpretation of those words in the context of Fair Trading Act s 9, the difference in statutory context is material.

49. The Commission considers that "false or misleading" in the context of s 65 means untrue or misleading in fact and does not necessarily import any element of deliberate falsehood or intent to mislead.

50. In the present setting, the question is whether the information provided to the Commission at the time of the authorisation (which suggested that unless joint marketing was approved there would be significant delay in the field being brought into full production) can be characterised as false or misleading in light of the fact that separate marketing has subsequently occurred and has resulted in little or no delay in achieving the final investment decision, which is a principal milestone towards production. The information on which the prediction was based came from the Pohokura Joint Venture parties, from market participants, and from the Commission's independent expert.

51. The information in question involved predictions as to a future state of affairs in an area of accepted uncertainty. An argument was raised that such information is not "false or misleading" in the sense required by section 65(1)(a) if the predictions were based on an objective foundation, notwithstanding that they have subsequently proved false. In its submissions, Todd argued that statements could not be false or misleading if they are based upon sound knowledge (i.e. they are statements which a reasonable person with the relevant expertise would make). The Commission considers that in this case there existed an objective basis for the one year forecast. Given this objective foundation at the time, which now no longer exists, a "material change of circumstances" must have occurred. The Commission considers, however, that if it is wrong, and there was not an objective foundation for the information at issue at the time, the information can be properly regarded as "false or misleading" in terms of section 65(1)(a).

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[10] *Commerce Commission v Chalmers* (1990) 3 TCLR 522, 523.
[11] *Thompson v Mastertouch TV Service Pty Ltd (No 2)* (1977) 15 ALR 487.
[12] *Commerce Commission v Telecom Corporation of New Zealand Ltd* (1990) 4 TCLR 1.
[13] Which the Commission had adopted in its counterfactual in Decision 505.

In a Material Particular?

52. Section 65(1)(a) requires that, for jurisdiction to arise, the information must be "false or misleading *in a material particular*".

53. Todd submitted that, in summary, any representation as to the final investment decision being achieved earlier under joint marketing and sale was not material, because materiality attaches to early production and the final investment decision is but one of a number of decision points leading to the commencement of production.

54. Todd noted that there is limited guidance on what constitutes a 'material particular' and relied on the observation in *Gault on Commercial Law* that "[a] material particular of a business activity is any element of the business which is essential or of importance". Todd further stated:

> The Final Investment Decision is but one of a number of decision points leading up to production. In the context of the proposed separate delivery of gas, the materiality of this decision point must be viewed in light of its relationship to the achievement of first production and the efficient exploitation of the field. Many decisions have yet to be made before there will be separate delivery. … the relevant welfare assessments do not follow from any comparison between Final Investment Decision dates under separate and joint marketing.

55. In their submissions, Shell and OMV stated that the information was not false or misleading and did not address whether it was false or misleading in a material particular.

56. 'Material' means that the particular must be relevant and of moment and significance in relation to the purpose for which it was provided.[14] It will be relevant if it may, will or must be taken into account.

57. The information as to the infeasibility of achieving the final investment decision by March 2004 in the absence of joint marketing and sale of gas was a 'material particular' because the final investment decision was regarded as crucial to the date of commencement of operation of the field and the early commencement of operation of the field was regarded as giving rise to the benefits that were decisive in the authorisation being granted.

58. In Decision 505 the projected delay between early gas production under joint marketing relative to the date of production under separate marketing was clearly material. At the conference Todd indicated that the investment decision would be made in either event, but the key issue before the Commission was *when* it would be made.[15] The Commission considered information provided by the Applicant, in particular the Applicants' claimed that, due to the uncertainty and magnitude of the sunk investment required to develop Pohokura, long term contracts would need to be in place before investment approval could be given.[16] Mr Agostini, an expert called on behalf of the Pohokura Joint Venture, indicated that separate marketing would not appear to be a suitable regime for the Pohokura Joint Venture because in New Zealand

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[14] *Minister of Immigration, Local Government and Ethnic Affairs v Dela Cruz* (1992) 110 ALR 367.
[15] Commerce Commission, *Decision No. 505: OMV New Zealand Limited; Shell Exploration New Zealand Limited; Shell (Petroleum Mining) Company Limited; Todd (Petroleum Mining Company Limited,* 1 September 2003, para 285.
[16] *Decision No. 505* at para 298.

arranging supply contracts individually as opposed to collectively would be more time consuming and would lead to higher costs.[17] In the absence of authorisation, the time taken to enter into the contracts would be significant and, as a result, would delay the final investment decision.

59. This was confirmed by the project schedules submitted by the Pohokura Joint Venture. Two schedules were provided to the Commission. One set out target dates in the development of the field in the absence of joint marketing, the other set out target dates where joint marketing was authorised. Where joint marketing was authorised, the schedule indicated that the final investment decision would be made by 1 April 2004. Once the final investment decision had been made, construction would start straight away. Construction activities were expected to take approximately two years, with first gas scheduled for the beginning of 2006 and full production capability scheduled for the second quarter of 2006.[18] In the absence of joint marketing the final investment decision would not be made until 24 August 2010.[19]

60. In April 2004 OMV, Shell and Todd chose not to jointly market and sell gas and embarked instead on separate marketing and sale. They achieved the final investment decision by the end of June 2004, three months later than the target indicated in the production schedule submitted to the Commission under the joint marketing scenario and significantly earlier than the proposed final investment decision date in the schedule for separate marketing. The three month delay between the target date of 1 April 2004 and the actual date of the final investment decision may be attributable to difficulties encountered by the parties to the joint venture in reaching agreement on critical issues associated with the joint marketing and sale of Pohokura gas.

61. If the information was false or misleading, it would be so "in a material particular" as the facts in issue are relevant and of moment and significance in relation to the grounds on which authorisation was sought.

Conclusion on Jurisdiction

62. On the information currently available to it, the Commission is satisfied that "there has been a material change of circumstances since the authorisation was granted". If that conclusion is incorrect, and circumstances at the present time are not materially different from those obtaining at the time that Decision 505 was made, then the Commission considers the authorisation must have been granted on information that was false or misleading in a material particular. In either event, the Commission has jurisdiction under s 65(1) to revoke or amend the authorisation or grant another in substitution for it.

63. The Commission's conclusion is that it has jurisdiction to reconsider the authorisation granted in Decision 505.

[17] *Decision No. 505* at para 181.
[18] *Decision No. 505* at para 291.
[19] *Decision No. 505* at para 319.

EXERCISE OF THE COMMISSION'S DISCRETION

Discretion of the Commission

64. Once the Commission has found that it has jurisdiction under s 65 of the Act it must consider whether it should:

- revoke the authorisation;
- amend the authorisation;
- revoke the authorisation and grant a further authorisation in substitution for it; or
- allow the original authorisation to remain in effect, without amendment.

65. Unlike the Trade Practices Act, the Commerce Act provides no direction on how the Commission should exercise its discretion and choose among each of the four options open to the Commission.

66. Section 91 of the Trade Practices Act was similar to s 65 of the Commerce Act, until the Trade Practices Act was amended in 1998 by the Gas Pipelines Access (Commonwealth) Act. That amendment resulted in s 91 being replaced by:

- s 91A: Minor variations of authorisations;
- s 91B: Revocation of an authorisation; and
- s 91C: Revocation of an authorisation and substitution of a replacement.

67. Previously, the Australian Competition and Consumer Commission (ACCC) had no power to make a minor variation to an authorisation but could revoke one altogether or revoke it and grant a new authorisation. Following the 1998 amendments, the ACCC can make a 'minor variation' to an authorisation under s 91A only where it receives an application from the person to whom the authorisation was granted. The ACCC must be satisfied that the variation is "minor," and that the variation would not be likely to result in a reduction in the extent to which the benefit to the public of the authorisation outweighs any detriment. Miller's commentary states:

> A "minor variation" is a single variation that does not involve a material change in the effect of the authorisation: s 87D.[20]

68. Miller notes that the section's utility may be limited because the ACCC is explicitly required to form the view that the variation would not result in a lessening of public benefits.

69. Sections 91B and 91C both require the ACCC to complete a public benefits and detriments analysis before revoking an authorisation or revoking and substituting a new authorisation. Section 91C allows parties having an authorisation already in place to seek a substitute authorisation, where circumstances have changed and a new

[20] Miller, R, *Miller's Annotated Trade Practices Act*, 22nd ed, LBC Information Services, Sydney, 2001, p719.

formulation of the authorisation is required. The process for doing so is very similar to that for granting an initial authorisation.

70. The distinction drawn between a 'minor variation' and 'substitution' under the Trade Practices Act depends on the degree of change to the authorisation that is required. The Commission considers that that the distinction between 'amending' and 'revoking and substituting' under the Commerce Act also depends on the degree of change to the authorisation that is required. An 'amendment' to an authorisation under the Commerce Act might be more significant than a 'minor variation' to an authorisation under the Trade Practices Act, as a 'minor variation' may be made on application by the authorised party and is defined by reference to 'a single variation that does not involve a material change in the effect of the authorisation'.

71. The Commerce Commission's Decision No. 238 described an amendment to an authorisation as being appropriate when all the basic elements of the facts and reasoning on which the determination was based are still in place, but some material detail or details should be altered.[21] Amendment of the existing authorisation is appropriate where it becomes apparent that the conduct has changed in a minor way or the benefits or detriments (or both) associated with the conduct in question differ in a minor way from those on which the authorisation was based, so that the authorisation should remain in force fundamentally unchanged but amended to reflect changes that may be required to ensure the benefits of the conduct are in future realised.

72. Revocation is appropriate where it becomes apparent that the benefits of the conduct in question do not outweigh the detriments associated with the lessening in competition.

73. Revoking and substituting a new authorisation is appropriate when the benefits or detriments associated with an authorisation have fundamentally altered, so that a 'fresh authorisation' is justified. An amendment would be appropriate where it is proposed to alter the existing authorisation but not to the extent that it would become, in effect, a new authorisation. The existing authorisation would remain fundamentally unchanged, if it were 'amended'. Revocation and substitution of a fresh authorisation would be appropriate where it becomes apparent that the conduct has changed or the benefits or detriments (or both) associated with the conduct in question differ significantly from those on which the authorisation was based, so that a new consideration of the matter is warranted.

74. The Commission considers that it might be appropriate to leave the existing authorisation in force in a case in which, despite information being false or misleading, there is no material change in circumstances and the benefits or detriments are the same as those that were considered at the time the authorisation was granted.

The Commission's Approach to the Exercise of its Discretion

75. Todd submitted that:

- the Commission cannot propose revocation without first undertaking proper analysis of whether an amended or substitute authorisation is appropriate; and

[21] Commerce Commission, *Decision No. 238: Revocation of Decision 221*, 13 September 1989, p5.

- revocation would be likely to delay production because arrangements for the joint sale of gas are likely still to be necessary, either for first tranche gas or other (as yet unsold) gas, and the Pohokura Joint Venture would have to re-apply to the Commission for a new authorisation.

76. Shell did not request amendment or substitution of the authorisation but asks that the Commission '…give due and proper consideration as to whether or not it is appropriate to revoke the existing authorisation' and proposes it is necessary for the Commission to make a 'thorough consideration of the costs and benefits' by comparing 'the factual (where the authorisation is revoked) with the counterfactual (where the authorisation remains on foot)'.

77. OMV requested the opportunity to make further submissions to amend the authorisation, if the Commission determines it should be revoked or amended.

78. The Trade Practices Act contains similar provisions to s 65 of the Commerce Act. Australian courts and the ACCC have considered how the decision making body should exercise its discretion once jurisdiction has been established. While the relevant provisions are differently worded, the Commission notes that Australian precedent is generally regarded as persuasive by the New Zealand courts, and considers that New Zealand courts might apply a similar approach.

79. The Trade Practices Act ss 91A, 91B and 91C all require the ACCC to conduct analyses to ensure that the benefits of the change continue to outweigh the detriments. Prior to amendment in 1998, the Trade Practices Act did not specifically link the discretion to revoke, or revoke and substitute a new authorisation, to the benefit/detriment analysis now required. The Courts nevertheless implied that analysis into the exercise of the discretion.

80. In *Re Media Council of Australia & Ors,*[22] Lockhart J set out the appropriate test to be applied when considering whether to revoke an authorisation. The case suggests that once the decision maker is satisfied that one of the three qualifying criteria has been met, then the decision maker has to determine, in the exercise of the discretion, whether or not such change of circumstances was of a kind, or of such magnitude or significance to warrant revoking the authorisation previously granted. The determination of public benefit and detriment is relevant to both determining whether there has been a material change of circumstances and, if so, whether such change warrants revocation of the authorisation. Lockhart J went on to say that, in the course of determining relevant public benefit and detriment, the decision maker should compare the position which would or would be likely to exist in the future, on the one hand if the authorisation were to continue, and on the other if it were absent. This has been called the 'future with and without test'.

81. These tests were affirmed in *Re AGL Cooper Basin Natural Gas Supply Arrangements*, when the Federal Court considered the decision of the ACCC to revoke an authorisation and grant a further authorisation in substitution for it. The Federal Court asked three questions:

(1) Has there been a material change of circumstances since the authorisation was granted?
(2) If so, should the authorisation be revoked?

[22] *Re Media Council of Australia & Ors* (1996) ATPR 41-497, 42-225.

> (3) If so, should there be granted a further authorisation in substitution for the authorisation so revoked?
>
> In answering the first question, there are two tests that may be applied, as discussed in *Media Council (No 4)* at 42,261:
>
> - Is the current conduct that is undertaken by the parties the conduct that was originally authorised; or is the original authorisation a dead letter?
> - Has there been such a change of circumstances since the date of the original authorisation as will likely have significant impact on the balance of public benefit and detriment?
>
> … To answer the second question, the Tribunal asks: what difference would revocation make to the future benefit and detriment to the public interest – the "future with and without test".
>
> To answer the third question, we employ the Tribunal's standard authorisation methodology, which also requires the application of the "future-with-and-without test" to establish the likely balance of benefit and detriment that would arise from the substitute conduct that it is proposed to authorise.[23]

82. Sections 91A, 91B and 91C of the Trade Practices Act are more prescriptive than s 65 of the Commerce Act. While a public benefit/detriment analysis is not explicitly required under s 65 of the Commerce Act, the Commission considers it relevant, and consistent with Commission practice in considering authorisation applications, to have regard to relevant benefits and detriments when considering how to exercise its discretion under s 65.

83. The Commission concludes that when it decides that it has jurisdiction under s 65(1) of the Act, it should carry out a 'now versus then' comparison of the circumstances surrounding the authorisation at both the present time and at the time it was granted, as follows:

- if, despite false or misleading information, the circumstances now are the same as they were at the time of the authorisation, the Commission should leave the existing authorisation in place. In the Commission's view, this will seldom occur when false or misleading information has been relied on and never where there has been a material change in circumstances; and

- if, despite false or misleading information, circumstances are fundamentally unchanged and have altered in only a minor way, particularly as to the benefits and detriments of the authorised arrangement, the Commission may amend the authorisation, for example, by changing a condition on which it was granted, in order to ensure that the anticipated net benefits will in fact be achieved.

84. Alternatively, if circumstances have changed, particularly as to the benefits and detriments associated with the authorised arrangement, then the Commission should consider whether or not to revoke the existing authorisation or revoke it and substitute a new authorisation. Depending on the circumstances of the particular case, amendment of the authorisation might be the appropriate course. In making this decision, the Commission must carry out the appropriate counterfactual analysis. That is, it must compare the future benefits and detriments both 'with and without' the authorisation, as follows:

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[23] *Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593, 44,209.

- if mere revocation is being considered, the Commission should compare benefits and detriments in the future with the extant authorisation continuing in force, against benefits and detriments in the future with no authorisation in force; but

- if, substitution of the extant authorisation by a fresh authorisation is being considered, the Commission should compare benefits and detriments in the future with the extant authorisation continuing in force, with benefits and detriments in the future with a substitute new authorisation in force.

85. The Commission must be satisfied that the proposed amendment or substitution is necessary to ensure that the public benefits claimed for the conduct are in fact realised. This means that an amendment or a substitute authorisation should be tailored to meet the change in circumstances or change in benefits or detriments.

Conclusion on the Exercise of Discretion

86. The Commission has concluded that it has jurisdiction to consider whether to revoke, amend or grant a further authorisation in substitution for that granted in Decision 505.

87. The Commission has considered and rejected Shell's view that it defer any decision on revocation until 'commercial dynamics have a chance to play out'. Most of the gas which will be produced from the field up to 2012 has been sold and this gas will not be affected by the proposed substitute authorisation. Nevertheless other gas (such as gas produced after 2012) could be transacted at any time and the Commission considers that the joint selling of this gas would lessen competition and should not be protected by Decision 505. Consequently, it would be inappropriate to delay further a decision on the matter now before the Commission.

SHOULD A FURTHER AUTHORISATION IN SUBSTITUTION BE GRANTED

88. The preliminary conclusion to authorise the joint sale and marketing of ad hoc gas arose as a result of submissions received by the Commission on its initial draft determination. Ad hoc gas was defined as any or all of:

- gas produced during the initial commissioning of the Pohokura field and its production equipment (also termed “commissioning gas”);

- gas produced from time to time in quantities greater than the maximum rated output of the Pohokura gas production station (also termed “peaking gas”); and

- and gas produced from the Pohokura field towards the end of its life when rates of gas production were falling (also termed “end of field gas”).

89. The Commission received submissions opposing the preliminary view expressed in its revised draft determination that a further authorisation of joint marketing and sale of ad hoc gas should be granted.

90. The Commission now considers that this would be best dealt with in the context of a new application for authorisation allowing the opportunity for the parties to frame the

appropriate authorisation and for the potential competition issues to be fully tested in the manner envisaged by the authorisation provisions set out in the Act.

91. The Commission, therefore, concludes that it will not exercise the power under s 65 to grant a further authorisation in substitution for that granted in Decision 505. The Commission will consider an application for a new authorisation if and when the parties make one.

ANALYSIS OF BENEFITS AND DETRIMENTS OF REVOKING THE AUTHORISATION GRANTED IN DECISION 505

92. In considering whether to exercise its discretion under s 65 of the Act the Commission has regard to the public benefits and detriments of revocation.

The Factual and the Counterfactual

93. For the purpose of this exercise, the Commission has compared the factual scenario with the counterfactual scenario.

94. The counterfactual is the continuation of the authorisation granted in Decision 505 whereby gas from the Pohokura field may be jointly marketed and sold without being at risk of breaching the Commerce Act.

95. The factual is the likely outcome with Decision 505 revoked. Any gas from the field which is jointly marketed and sold may be at risk of breaching Part II of the Act.

Market Definition

96. The purpose of defining a market is to provide a framework within which the implications for competition and the concomitant implications for public benefits and detriments of the arrangements can be analysed. The relevant markets are those in which competition may be affected by the arrangement being considered, and in which the application of Part V of the Act can be examined.

97. Section 3(1A) of the Act provides that:

> .. the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

98. The relevant principles relating to market definition are set out in *Telecom v Commerce Commission (1991*[24]*)* ("the AMPS A case") and in the Commission's Mergers and Acquisition Guidelines.

99. In Decision 505 the Commission defined the relevant market as being that for the national natural gas production (and first point of sale) market ('the gas market').

100. The parties in the gas sector have submitted at various times, most recently in the context of the Commission's Inquiry into whether gas pipeline services should be controlled, that other energy forms are sufficiently substitutable for gas to place them within the one product market for the purpose of competition analysis. The

[24] *Telecom Corporation on New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473.

Commission in its Inquiry report (and in earlier decisions on energy sector matters) has concluded that while there is a degree of competition between different energy forms, that competition is not sufficiently strong to justify using a single energy market.

101. While market circumstances have changed since that time, these changes have not been such as to affect the appropriateness of that market definition used in Decision 505 for assessing the impact of collective or separate selling of Pohokura gas.

102. Accordingly, the Commission has used the national natural gas production (and first point of sale) market in its analysis below.

Competition

103. A key element to competition in the gas production and first point of sale market is ownership of gas fields, the output of those fields, and their reserves. The following table has been compiled by the Commission and is based, in part, on information in the Ministry of Economic Development's July 2005 Energy Data File and also on estimates made by the Commission. It is intended to be indicative only.

Table - Estimated Gas Reserves at December 2004 and Production in 2004

Field	Owner	Reserves (PJ)	%	Production 2004 (PJ)	%
Maui – Legacy Gas	Shell 84% OMV 10% Todd 6%	146	8	106	66
Maui – ROFR Gas	Shell 84% OMV 10% Todd 6%	200	10	-	-
Kaimiro/ Ngatoro	Greymouth Petroleum	8	1	1	1
Kapuni	Shell 50% Todd 50%	258	14	25	16
McKee	Todd 100%	77	4	8	5
Mangahewa	Todd 100%	47	2	7	4
Rimu	Swift 100%	74	4	4	2
TAWN	Swift 100%	43	2	10	6
Pohokura (Producing from 2006)	Shell 48% OMV 31% Todd 16%	750	39	-	-
Kupe (Producing from 2007)	Origin 50%, Genesis 31%, NZOG 19%	309	16	-	-
Total		**1912 PJ**	**100%**	**161 PJ**	**100%**

104. Much of the gas in the above fields is committed to meeting existing supply contracts. For instance:

- Maui legacy gas is committed to the Crown which in turn has contracts to supply that gas to NGC, Contact Energy and Methanex. These transactions are made at contract prices which are considered to be substantially below current market

prices for gas;

- the sellers of Maui ROFR[25] gas (Shell, OMV and Todd) may sell that gas at market prices but must first offer the gas to NGC, Contact Energy and Methanex;

- half the output of the Kapuni field is committed to NGC. The remaining half is sold separately by the field owners – Shell and Todd; and

- the great majority of the output of the Pohokura field until around 2012 is committed to meeting supply contracts already entered into separately by Shell, OMV and Todd.

105. New entry into the petroleum exploration is subject to a licensing regime, but this regime is not considered a significant barrier to new exploration.

106. It is noted from the above table that current gas fields in which at leat one of Shell, OMV and Todd has a substantial interest account for around 77% of the country's known gas reserves.

107. In the projections used in Decision 505 the Commission suggested that new fields might produce 35 PJ per annum from 2008 until 2013 and 60 PJ per annum thereafter. This type of assessment is always very speculative, especially in the later years, but the Commission has received no additional information to justify a move away from these "best estimates".

Weighing Benefits and Detriments

Introduction

108. The following analysis assesses, in general terms, the net public benefits of revocation of Decision 505. The Commission notes that it has not had the benefit of having these assessments tested by industry participants and others as would occur in an authorisation application case. However, the analysis has the benefit of information obtained and tested during the consideration of the original authorisation in 2003. The Commission has also had regard to the submissions of Shell, Todd and OMV in this instance.

109. Only benefits and detriments arising from a revocation are taken into account in this analysis. The analysis does not incorporate any benefit or detriment for the timing of first production from the development of the field. The Commission considers that timing is not materially affected by whether gas is sold jointly or separately, or by the Commission's decision in this instance.

110. In assessing benefits and detriments the Commission notes that the factual scenario (i.e. the situation with revocation) may still see some gas sold jointly if such sales do not lessen competition. It has been suggested that sales of commissioning gas, peaking gas and gas at the end of the life of the field may fall into this category, although the Commission has not reached a firm conclusion about this. However the

[25] "Right of first refusal" gas is that gas remaining in the Maui field which may be sold at market, rather than Maui contract, price, in terms of the "Strawman" agreement.

Commission considers that the joint sale of sale of a large proportion of the gas in the Pohokura field would be prohibited in the factual.

Summary of Major Assumptions Used in the Analysis

111. The facts and assumptions used in this analysis include:

- the Pohokura field will commence production in 2006 irrespective of whether the factual or counterfactual is adopted;
- most gas to be produced from the field up to 2012 has been either committed to meeting gas sale agreements entered into separately or will be marketed and sold jointly in both the factual and counterfactual;
- the Pohokura joint venture partners will, in the counterfactual, choose to market and sell all gas produced after 2012 jointly. This is the conservative approach from the Commission's perspective. The Commission recognises that the parties may choose to market and sell some future tranches of gas separately (that is, they may continue to sell in the manner in which they have chosen to sell the initial tranche) even if the current authorisation remains extant. However of relevance to the Commission is that in the counterfactual they would be free to sell all gas jointly;
- the gas which will be marketed and sold separately in the factual and jointly in the counterfactual will be no more than 50% of the total current reserves in the Pohokura field – the remaining gas in the field is already committed to the contracts separately entered into by the parties; and
- the pattern of production from the field in the factual is likely to be similar to that in the counterfactual – the key determinants being the design of the production facilities and the incentive to optimise the value of the liquids produced from the field, and these would be unaffected by revocation.

Benefits

112. The principles used by the Commission in evaluating benefits and detriments are set out in *Guidelines to the Analysis of Public Benefits and Detriments* and in various Commission determinations including in Decision 505 (paragraphs 397-409). In the current case the following factors are relevant to the assessment of benefits and detriments:

- as more gas will be sold separately in the factual compared with the counterfactual, the factual will produce a more competitive outcome;
- the extent to which the market will be more competitive in the factual is difficult to assess with any precision. It depends in part on how much 'independent' gas from alternative fields is available by the time the next tranche of Pohokura gas is placed on the market. It is possible that competition concerns arising from the joint marketing of Pohokura gas would be significantly lessened if Pohokura gas (and other gas under the control of the Pohokura JV parties) represented only a small proportion of total gas available to the market;

- while in general it can be concluded that a firm (or a joint venture) with market power may seek to limit output (and thereby increase prices and reduce consumer welfare), in this instance the level of output from Pohokura is likely to be reasonably similar in the factual and counterfactual. Output will be strongly influenced by the design of the production facilities (which has already been determined) and by the incentive on the parties to optimise the production of liquids from the field; and

- the method of selling in the factual and counterfactual differs only after 2012 (after which it is assumed that the gas will be sold predominantly separately in the factual and jointly in the counterfactual). Consequently many of the benefits associated with this difference occur well into the future and will need to be discounted to be expressed in 2006 dollar values;

113. The benefits the Commission has attributed to revocation are considered below under the headings of allocative, productive and dynamic efficiencies.

Allocative Efficiency

114. Allocative efficiency relates to the extent to which production levels match the quantity that is most beneficial to society.

115. In Decision 505 the Commission stated that joint marketing would result in a loss of allocative efficiency. This loss was described by the Commission as being 'moderate but significant'.

116. The factual background to Decision 505 was, of course, different from that which the Commission must now take into account. In the present scenario the amount of gas which may be sold separately in the factual and jointly in the counterfactual is likely to be no more than half the output of the field, and that gas will not be produced until post 2012.

117. The Commission considers that joint marketing in the counterfactual would impact adversely on allocative efficiency. Notwithstanding that the broad production parameters are likely to be similar in the factual and counterfactual (as discussed above) there remains some incentive on the parties to take advantage of any market power associated with joint marketing to limit output to less than efficient levels.

118. The Commission has concluded that revocation would be likely to see more efficient levels of production than the counterfactual, and that this will produce moderate benefits to the public.

Productive Efficiency

119. Productive efficiency is a measure of resources used to produce a particular output. An improvement in productive efficiency can be achieved by a firm reducing its costs (that is, by using fewer or less valuable resources) to produce the same output. Competition generally provides a strong incentive on firms to enhance productive efficiency.

120. It is possible that productive efficiencies can also be achieved by competitors sharing functions. For instance in Decision 505 the Commission noted that with joint

marketing the cost of marketing gas would be shared by the joint venture partners and that this would reduce the cost to be borne by each. This productive efficiency was considered likely to be small because marketing represents only a very small proportion of the total costs incurred by producers.

121. In the current case the Commission has considered the likely productive efficiency gain from separate marketing (arising from competitive pressure to be efficient) and that from joint marketing (arising from a sharing of marketing costs with joint marketing). It has concluded that overall revocation and an attendant greater amount of separate marketing would be slightly more productively efficient than the counterfactual.

122. The Commission has attributed a small public benefit to this matter.

Dynamic Efficiency

123. Dynamic efficiency is concerned with the speed with which an industry adopts new and superior technology and produces sought after new products. Competition is generally considered to act as a stimulus to dynamic efficiency, and market power and regulation as retardants.

124. In Decision 505 the Commission noted that the production function at Pohokura would not be affected by which form of selling was chosen as joint decision making on production matters would be a feature of both scenarios. This continues to be the case. Thus new or improved production technology is equally likely to be adopted in the factual and counterfactual.

125. Of much greater significance to this case is the way the gas sector is likely to develop in the future. The production side is currently highly concentrated with the most significant parties by far being Shell, OMV and Todd – the Pohokura JV partners - while the demand side is also limited to a small number of major players.

126. The Commission in Decision 505 noted that the then Government Policy Statement (GPS) stated that future production of gas from an increased number of smaller gas fields will require more sophisticated pro-competitive arrangements, and that gas industry participants, in conjunction with consumers, should develop arrangements which, inter alia, promote enhanced competition where possible and, where it is not, seek outcomes that mirror as far as possible those that would apply in competitive markets. The Commission in that Decision considered that a lack of depth to the gas market reflected in the limited number of participants on both the supply and demand sides would inhibit the development of a more competitive, and therefore a more dynamic marketplace.

127. The Commission stated in Decision 505 that the potential for the Pohokura field to ameliorate the lack of depth problem would be lost if gas from the Pohokura field was sold jointly rather than separately. Therefore there was a risk that joint marketing of gas from the Pohokura field would slow the development of a more dynamic market.

128. Since that time the Government in October 2004 released a new GPS on gas governance which among other matters stated that the Government's overall policy objective for the gas industry is:

> "To ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable, and environmentally sustainable manner."

129. Further the Gas Industry Company Ltd (GIC) has been formed. The GIC is an industry owned entity established under the Gas Act 1992. As the industry body it is the co-regulator of the gas industry working with both the Government and the gas industry to develop outcomes that meet the Government's policy objectives as stated in the GPS on gas governance. Its principal objective is to ensure that gas is delivered to existing and new customers in a safe, efficient and reliable manner.

130. The GPS and the GIC will clearly play an important role in the future development of the gas industry. The Commission considers that meeting the GIC and GPS objectives would be facilitated by a dynamic market. As discussed in Decision 505, competition is an important element for of a dynamic market, and this in turn requires market depth with industry participants acting independently of each other.

131. The Commission places considerable value on the facilitation of a more dynamic gas market in New Zealand. Because revocation is likely to produce a more competitive outcome, it is likely to assist in this regard

Detriments

132. The Commission has considered whether the benefits claimed for joint marketing would be lost with the revocation of Decision 505.

133. The principal benefits claimed for joint marketing were early production from the field, lower production and transaction costs, lower facility costs, lower appraisal and design costs, optimal pool depletion, avoidance of the need to put a balancing agreement in place, increased exploration incentive and positive impact on the environment.

134. The claims relating to early production from the field are not relevant to the current analysis. As noted above the factual and counterfactual assume the same date for first production.

135. The claims relating to lower facility costs, extra appraisal or design costs, increased exploration incentives and positive impact on the environment were given limited or no weight in Decision 505. Accordingly the inability to gain some or all of these 'benefits' in the factual in this case has been given limited or no weight in this consideration of the revocation of that Decision.

136. The appraisal and design costs have already been incurred and are therefore unaffected by whether gas is sold jointly or separately in the future.

137. As contracts have already been entered into for separate selling of some gas, the cost of putting in place a gas balancing agreement will be common to both the factual and the counterfactual. A gas balancing agreement is required for either scenario.

138. The Commission in Decision 505 attributed a small amount of public benefit to the greater flexibility which sellers might have if they sold jointly rather than separately. It considered that joint marketing may assist the parties to meet the requirements of individual customers on such matters as off-take terms, swing, risk, and so on.

However, as most of the output until 2012 has now been sold it is considered that these benefits would not be materially affected by the revocation of Decision 505.

139. The Commission reiterates that if circumstances post 2012 require joint marketing and sales of Pohokura gas, an application for authorisation could be made to the Commission at that time.

140. In Decision 505 the Commission attributed a small benefit to lower transaction costs from joint marketing. It reached the view that joint marketing would enhance information flows and coordination and lessen the areas for dispute between the parties and that therefore joint marketing could lessen the potential for litigation. In retrospect this view seems perhaps excessively optimistic. Notwithstanding the Commission's authorisation of joint marketing in Decision 505, there have to date been frequent disputes between the joint venture parties. Whether the revocation of Decision 505 has the potential to make this situation any worse seems doubtful.

Balance of the Benefits and Detriments

141. As discussed above, the Commission, when comparing the factual and counterfactual, has characterised the allocative efficiency benefits from revocation of Decision 505 as being moderate, the productive efficiency benefits as being small and the dynamic efficiency benefits as being potentially significant.

142. The Commission considers that the detriments from revocation are not significant.

143. On balance it is considered that the benefits of revocation of the authorisation are likely to outweigh the detriments.

OTHER MATTERS TO WHICH THE COMMISSION HAS HAD REGARD

144. In reaching its determination, the Commission also considers that:

- when there has been a material change in the circumstances since the granting of authorisation, as in this case, the correct answer in the new circumstances is most likely to be arrived at if the Commission's normal authorisation processes are followed. That means the best course of action is to revoke the extant authorisation, it then being open to the parties to reapply for authorisation if they consider that remains appropriate in the new circumstances; and

- the Commission noted in Decision 505 that without the, now absent, nexus between joint marketing and sale of Pohokura gas and early production from the field, it would not have authorised the joint marketing and sale. There is now no persuasive evidence of a net public benefit if the authorisation remains in place. In the Commission's view an authorisation of anti-competitive behaviour without demonstrable net public benefit should not continue to exist.

CONCLUSIONS LEADING TO THE DETERMINATION

145. The Commission's conclusions, on the information available to it at this time, are that:

- a material change in circumstances has occurred subsequent to the date of the authorisation granted in Decision 505. However, if that is not correct and if circumstances now are not materially different from those at the time of Decision 505, then the authorisation must have been granted on information that was false or misleading in a material particular;

- as a result, the Commission has jurisdiction to consider whether to revoke, amend, or grant a further authorisation in substitution for the authorisation granted in Decision 505;

- after taking account of submissions received, the appropriate course of action is to consider revoking the authorisation granted in Decision 505, rather than either amending the authorisation or revoking the authorisation and granting a further authorisation in substitution for it;

- the Commission must compare benefits and detriments in the future with the existing authorisation continuing in force, with benefits and detriments in the future without any authorisation of joint marketing and sale of Pohokura gas in force;

- given that analysis, the Commission considers net public benefits will arise from the revocation of the authorisation granted in Decision 505; and

- the Commission should revoke that authorisation.

DETERMINATION

146. The Commission now determines, pursuant to section 65 of the Commerce Act 1986, to revoke the authorisation granted in Decision 505. The Commission further determines, pursuant to section 65, to neither amend, nor grant a further authorisation in substitution for, the authorisation granted in Decision 505.