



## COMMERCE COMMISSION

### **Decision No. 411**

Determination pursuant to the Commerce Act 1986 in the matter of the application for clearance of a business acquisition involving:

**SHELL OVERSEAS HOLDINGS LIMITED**

**and**

**FLETCHER CHALLENGE ENERGY**

**The Commission:**

M J Belgrave  
M N Berry  
P R Rebstock

**Summary of Application:**

Shell Overseas Holdings Limited has sought clearance to acquire 100% of the shares of Fletcher Challenge Limited associated with Fletcher Challenge Energy and 100% of the shares in the holding company for Fletcher Challenge Energy, Energy International Holdings Limited.

**Determination:**

Pursuant to section 66(3)a of the Commerce Act 1986, the Commission determines to give a clearance for the proposed acquisition.

**Date of Determination:**

17 November 2000

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SQUARE BRACKETS**

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## THE PROPOSAL

1. Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Shell Overseas Holdings Limited (Shell) gave notice to the Commission dated 20 October 2000, seeking clearance for it, or its interconnected body corporate to acquire:
  - 100% of the shares of Fletcher Challenge Limited (FCL) associated with Fletcher Challenge Energy (FCE); and
  - 100% of the shares in the holding company for FCE, Energy International Holdings Limited (formerly Zurich Holdings (No. 7) Limited).
  
2. The current notice refers to a notice given by Shell Exploration Company B V under section 66(1) of the Act dated 16 August 2000 (the previous application). The applicant notes that the arguments made in and the information provided under the previous application, should be treated as having been filed in support of this application. The acquisition proposed under the previous application was essentially the same as under the current application, but the divestment undertakings included as part of the application have changed. On 12 October 2000, the Commission made a determination declining to give a clearance for the proposed acquisition as detailed in the previous application. The reasons for the determination are contained in Decision 408.

## Undertakings

3. The notice includes the following:

“SOH undertakes to the New Zealand Commerce Commission that, if the FCE Acquisition proceeds:

- in the event that any or all of certain assets specified in paragraph 5 below (the “Divestment Assets”) are associated with or appropriated to any of the shares purchased by SOH as part of the FCE Acquisition, SOH will divest all its legal and equitable interests and rights in any such Divestment Assets within [ ] to a third party that is not associated with or an interconnected body corporate of SOH;
- in the case of the proposed divestment of a 10% equity interest in the Maui field:

➤ [ ]

] and

➤ the person to whom such divestment is made shall have the benefit of a Deed Poll executed by SOH, being a Deed Poll in the form attached as a schedule to the Undertaking;

- the divestment of any of the Divestment Assets to a third party shall be an unreserved divestment of all of the legal and equitable interests and rights, held by or on behalf of Shell Exploration, in the Divestment Assets.

The Divestment Assets are:

- all of FCE's direct and indirect equity interests and any other involvement in the Kupe field (including, but not limited to, any interests in the petroleum mining licences associated with Kupe, and any interest in the Kupe Joint Venture Operating Agreement dated 14 October 1982);
- all of FCE's direct and indirect equity interests and any other involvement in Kapuni Gas Contracts Limited;
- all of FCE's direct and indirect equity interests and any other involvement in Fletcher Challenge Gas Investments Limited;
- all of FCE's direct and indirect equity interests in the Tariki, Ahuroa, Waihapa and Ngaere fields (including, but not limited to, any interests in the petroleum mining licences associated with these fields) and, for the avoidance of doubt, such divestment shall include the pipeline which runs from the TAWN fields to Contact's New Plymouth power station;
- all of FCE's direct and indirect equity interests in the Ngatoro field (including, but not limited to, any interest in the petroleum mining licence associated with that field) except all potential reservoirs deeper than the currently producing Miocene age Mt Messenger sands (such exclusion to include, but not be limited to, the Eocene aged Kapuni Group sands) and, for the avoidance of doubt, such divestment shall include the pipeline which runs between the Kaimiro field and the Ngatoro field;
- all of FCE's direct and indirect equity interests in the McKee field (including, but not limited to, any interest in the petroleum mining licence associated with that field) and, for the avoidance of doubt, such divestment shall include the pipeline which runs from the McKee field to Methanex;
- interests comprising in aggregate a 10% equity interest in the Maui field (including, but not limited to, the petroleum mining licence associated with that field, together with a 10% interest in Maui Development Limited);
- interests comprising in aggregate a 3.6667% equity interest in the Pohokura field and in the petroleum exploration permit associated with that field, (thereby reducing SOH's equity interest to 48% post-merger), together with an equivalent participating interest in the joint venture;
- all of FCE's direct and indirect equity interests in the Kaimiro field except all potential reservoirs deeper than the currently producing Miocene age Mt Messenger sands (such exclusion to include, but not be limited to, the Eocene aged Kapuni Group sands); and
- all of FCE's direct and indirect equity interests in the Mangahewa field, as such field is described in the petroleum mining permit for which FCE has applied (including any interests in that petroleum mining permit) except all potential reservoirs deeper than the reserves contained in the MA-72 Kapuni Group reservoir.

SOH further undertakes, pursuant to section 69A of the Act, forthwith on (or before) settlement of the FCE Acquisition to divest to Rubicon Limited (being a company to be formed) all the legal and equitable interests of FCE in all of the shares in, or all of the assets employed in connection with the retail business of Challenge Petroleum Limited (*Challenge!*) including, for the avoidance of doubt, but not limited to:

- all business systems necessary for the operation of *Challenge!*;
- the assets, liabilities and operations of the Timaru terminal and the New Plymouth terminal; and

- a perpetual licence for Rubicon Limited and its successors to continue to use the trademark *Challenge!* in all its current forms.

SOH acknowledges that the Undertaking forms part of any clearance given in relation to the FCE Acquisition, and creates binding and legal obligations on SOH in relation to the Act.”

4. The Deed Poll referred to in the divestment undertaking was executed by Shell on 17 November 2000. Under the Deed Poll, Shell undertakes that it will not vote in favour of a decision on any matter relating to the Maui joint venture unless the decision is also supported by Todd or the purchaser of the 10% equity interest being divested by Shell. This means that either Todd or the 10% divestee must vote in favour of a decision for that decision to be binding on the joint venture.
5. Section 69A states:
 

Commission may accept undertakings –

  - (1) In giving a clearance or granting an authorisation under section 66 or section 67 of this Act, the Commission may accept a written undertaking given by or on behalf of the person who gave notice under section 66(1) or section 67(1) of this Act as the case may be, to dispose of assets or shares specified in the undertaking.
  - (2) The Commission shall not accept an undertaking in relation to the giving of a clearance or the granting of an authorisation under section 66 or section 67 of the Act, other than an undertaking given under subsection (1) of this section.
  - (3) An undertaking given to the Commission under subsection (1) of this section is deemed to form part of the clearance given or the authorisation granted in relation to the acquisition to which the undertaking relates.
6. The Commission is satisfied that the Undertaking has been given by or on behalf of the applicant in this case, and that it relates to the disposal of assets or shares. Accordingly the Commission is able to accept the Undertaking in accordance with section 69A(1). The Undertaking forms part of the application considered below.

### **Method of Implementation**

7. The precise form of the transactions agreed by Shell, Apache Corporation and FCL to implement the acquisition is set out in the application.
8. Rubicon Limited, a company yet to be formed, which will be unrelated to Shell, will purchase the assets relating to the *Challenge!* service station network.

## THE PARTIES

9. Shell is part of the Royal Dutch/Shell Group of Companies. It ultimately has two parent companies:
  - Royal Dutch Petroleum Company, based in the Netherlands; and
  - The Shell Transport and Trading Company plc, based in the United Kingdom.
10. These two companies between them hold, directly or indirectly, all interests in the companies which comprise the Royal Dutch/Shell Group of Companies (the Shell Group). Shell Group companies are involved in activities relating to oil and natural gas, chemicals, electricity generation, and renewable resources in more than 135 countries.
11. The application spells out the following activities the Shell Group is engaged in internationally:
 

*Exploration and Production (or "E&P"):* searching for oil and gas fields by means of seismic surveys and exploration wells, developing economically viable fields by drilling wells and building the infrastructure of pipelines and treatment facilities necessary for delivering hydrocarbons to market;

*Oil Products:* refining and processing crude oil and other feedstocks into transportation fuels, lubricants, heating and fuel oils, LPG and bitumen, and distributing and marketing these products to customers;

*Chemicals:* processing hydrocarbon feedstocks into base chemical products, petrochemical building blocks and polyolefins, and marketing them globally;

*Downstream Gas and Power:* marketing and trading natural gas, wholesaling and retailing of natural gas and electricity to industrial and domestic customers, developing and operating independent electric power plants;

*Renewables:* manufacturing and marketing solar energy systems, implementing rural electrification projects in developing countries, sustainably growing and marketing wood, converting wood fuel into marketable energy, developing wind energy projects.
12. Within New Zealand, the Shell Group is currently active in all the above areas. The primary activities of Shell NZ include:
  - the exploration for, and production of, oil and gas, including holding significant shareholdings in the Maui and Kapuni fields;
  - the operation of *Shell* brand petrol stations, with more than 350 retail locations nation-wide;

- investments in renewable resources, most notably a joint venture with Carter Holt Harvey in Mangakahia Forest in Northland;
  - the production and distribution of chemicals, including petrochemicals and detergents;
  - the production and distribution of commercial products, including marine and aviation fuels, and lubricants; and
  - equity investments in NZRC (17.1%), Fulton Hogan Limited (37.6%), Loyalty New Zealand Limited (25%) and the New Zealand Burger King franchise (50%).
13. Shell NZ owns 50% of the shares in Shell Todd Oil Services Limited (STOS). The remaining 50% of the shares are owned by Todd Energy Limited (Todd).
14. Shell and Todd are parties to an agreement made in 1955 (the 1955 JV) under which they agreed to carry out, as a joint venture, prospecting and mining for petroleum in an area including Taranaki, the surrounding areas and offshore from those areas, and production of any petroleum that may be discovered. Part of this agreement proposed the setting up of a servicing company “to do the prospecting and mining on behalf of the joint venture”. The agreement provides that Shell is responsible for the staffing of the servicing company and for providing technical advice to the company.
15. This servicing company is now known as STOS and is the operator of the Maui field, and its onshore production facilities, and of the Kapuni field and production facilities.

## **FCE**

16. FCE is a division of FCL and is separately listed on the New Zealand Stock Exchange.
17. The application lists the activities of FCE in New Zealand as:
- exploration for, and the production and marketing of, oil, LPG and natural gas;
  - operatorship of the McKee, TAWN, Kaimiro, Pohokura and Mangahewa fields;
  - a 14.2% interest in NZRC, which operates the refinery at Marsden Point;
  - wholesale, retail and marketing of petroleum products, motor spirits and convenience products through the *Challenge!* service stations.
18. FCE’s activities overseas include:
- exploration for, and production, transmission and marketing of, oil and gas in Canada and Brunei;
  - exploratory drilling ventures in Argentina;
  - petroleum storage and wholesaling in Brisbane;



- a 50% interest in the 120 MW gas fired Cogeneration Project, located at the Worsley Alumina plant in South Western Australia;
- an 11% interest in the Capstone Turbine Corporation, a Los Angeles based “Micro-Turbine” manufacturer which has recently listed on NASDAQ; and
- a 15% interest in Petroz NL, an Australian oil and gas exploration and production company with interests in Australia, the Timor Gap Zone of Co-operation, Indonesia and Italy.

## **PROCEDURES**

19. The application was registered by the Commission on 20 October 2000. Section 66(3) of the Commerce Act requires that the Commission, within 10 working days after the date of registration of the application, or such longer period agreed by the Commission and the applicant, gives, or declines to give, a clearance for the acquisition. The tenth working day after the registration of the application was 6 November 2000. The Commission and Shell agreed to an extension of the period, with the Commission’s determination being required by 17 November 2000.
20. Shell advised the Commission that it did not seek a confidentiality order for the fact of the application, but that it did require confidentiality for some specific information contained in the application. The Commission, in accordance with section 100 of the Commerce Act, made a confidentiality order on 24 October 2000 prohibiting the publication or communication of that information until 20 working days from the Commission’s determination of the application. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.
21. The Commission’s determination is based on an investigation conducted by its staff and the information subsequently provided by staff to the Commission.
22. The majority of the investigation work was carried out in respect of the previous application and is relevant to the current application. As indicated above, the essential difference between the previous application and the current application is that in the latter case the proposed acquisition is subject to additional undertakings by Shell.

## **INVESTIGATION**

23. In the course of their investigation of the acquisition proposed by Shell in the previous application, Commission staff had discussions with and sought the views and comments of a number of parties, as detailed in Decision 408.
24. Staff sought the views and comments of a number of industry participants in relation to the current application. These included Contact Energy Limited (Contact), Todd

Energy Limited (Todd), Methanex Limited (Methanex), Natural Gas Corporation (NGC), Rockgas Limited (Rockgas), Swift Energy New Zealand Limited (Swift) and FCE.

## **BACKGROUND TO THE NEW ZEALAND GAS INDUSTRY**

25. In Decision 408, the Commission provided background information on the New Zealand gas industry and the major production fields.

## **MARKET DEFINITION**

### **Introduction**

26. The Commission's approach to market definition in general is discussed in paragraphs 26 to 37 of Decision 408.

### **Gas**

#### *Product Market*

27. For the reasons set out in paragraphs 38 to 42 of Decision 408, the Commission concludes that there is a discrete product market for natural gas.

#### *Functional Markets - Production and Wholesaling*

28. In its earlier decision the Commission concluded that it was appropriate to undertake its competition analysis in separate production and wholesaling functional markets. Principally this was because it considered that the use of separate markets best facilitated its assessment of market power in this case. The Commission was mindful of the comments of the High Court in the AMPS A case<sup>1</sup> which stated, in part,

“If we ask what functional divisions are appropriate in any market definition exercise the answer, plainly enough, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers.”

29. The applicant has argued in its submission in support of the current application that producers are clearly a substitute in demand for wholesale customers in the event that the wholesalers seek to increase price. Thus the industry should be analysed in the context of the conjoined market.
30. The Commission accepts that there are occasions when producers and wholesalers compete for the same customers. There are other occasions when they do not. Producers generally enter supply commitments with those who require a substantial quantities of gas over a long term. Electricity generators and the petrochemical industry are examples of gas users who would normally look to producers for long-

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<sup>1</sup> *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473

term supply contracts. It is only on rare occasions (such as recently when wholesalers, such as NGC and Contact, were faced with Maui take-or-pay deficits and the forthcoming depletion of the Maui field) when they are able to onsell gas to other major users. On the other hand, producers do not usually have the resources and infrastructure necessary to market profitably to retailers and industrial and commercial customers who typically make up the customer base of wholesalers.

31. The Commission is of the view that there is not such a degree of substitutability on the demand side that producers and wholesalers should necessarily be placed within the one market. On the supply side, the characteristics of producers and wholesalers are, of course, quite different.
32. In any event, the Commission does not consider that the conclusions which are drawn from its overall analysis are dependent on its definition of functional markets. It considers that it is able to give full weight to the constraint that wholesalers are able to place on producers without incorporating them within the one functional market as suggested by the applicant.

#### *Time Dimension*

33. The Commission considers that it is appropriate to include a time element in the market definition if a market is likely to exhibit different characteristics in different periods. It considers that the gas production market has these characteristics.
34. The predominant influence in the market for much of the past two decades has been the Maui field, which is by far New Zealand's largest production field. It currently accounts for around 80% of all gas produced. It is anticipated that the field will be depleted around 2009. The loss of Maui gas at that time may substantially change the nature of the gas production market. This is discussed further in paragraphs 50 to 54 in Decision 408.
35. For the purpose of its competition analysis, the Commission considers that it is appropriate to adopt two gas production markets, one being the current gas production market and the other being the post-2009 gas production market.

#### **LPG**

36. FCE currently has a substantial ownership interest in the Maui Mining Companies (MMCs) joint venture which owns the LPG production facility at Oaonui. It also owns the production facility at Waihapa. Shell has an ownership interest in the MMCs, in Liquigas which is a wholesaler of LPG, and in the Kapuni Mining Companies (KMCs) which have contractual rights to LPG from the Kapuni field.
37. In its assessment of the previous application, the Commission adopted the LPG production market as being the appropriate market to assess the competitive implications of that proposal. The Commission considers that this market definition remains the appropriate one in which to consider the competitive implications of the current proposal on LPG production.

## **Other Activities**

38. As noted in Decision 408, FCE and Shell have an interest in the production of oil and condensate, the refining of oil, and the retailing of petrol. Principally because of the divestments offered by Shell as part of the proposal, the Commission concluded that no competition concerns would arise from the acquisition in respect of those activities. That remains the situation with the current application.
39. Accordingly these activities are not considered further in the competition analysis below.

## **Conclusion on Market Definition**

40. The Commission concludes that the relevant markets for the analysis of the proposed acquisition are:
- the current gas production market;
  - the post-2009 gas production market; and
  - the LPG production market.
41. In each case the market is national in scope.

## **COMPETITION ANALYSIS**

### **Introduction and the Dominance Test**

42. The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would result, or would be likely to result, in an acquisition or strengthening of dominance.
43. Section 47(1) of the Commerce Act prohibits certain business acquisitions:
- “No person shall acquire assets of a business or shares if, as a result of the acquisition, -
- (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
  - (b) That person’s or another person’s dominant position in a market would be, or would be likely to be, strengthened.”
44. Section 3(9) of the Commerce Act states:
- “For the purposes of sections 47 and 48 of this Act, a person has ... a dominant position in a market if that person as a supplier ... of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is ... in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-

- (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
- (b) The extent to which that person is ... constrained by the conduct of competitors or potential competitors in that market:
- (c) The extent to which that person is ... constrained by the conduct of suppliers or acquirers of goods or services in that market.”

45. In paragraphs 81 to 88 of Decision 408, the Commission discussed the meaning of a dominant position.

## **BACKGROUND TO THE GAS MARKETS**

### **Production Fields**

46. The New Zealand gas industry consists of production, high pressure transmission pipelines, low pressure local distribution networks and wholesale and retail gas sales.
47. Currently, gas is entirely produced in the Taranaki region, where eight fields produce oil and gas (including condensate and naphtha). New Zealand’s production of natural gas is dominated by the Maui field which is currently producing around 80% of total production. The next largest producer is Kapuni with around 11%. Other production fields include McKee, Kaimiro, Ngatoro and Tariki/Ahuroa/Waihapa/Ngaere (usually referred to collectively as the “TAWN” fields).
48. In addition to the production fields there are a number of other fields which the owners anticipate, with varying degrees of confidence, contain gas in commercial quantities. These include Mangahewa, Kupe, Pohokura, Rimu and Kauhauroa.
49. The three major users of gas in New Zealand are electricity generation, petrochemical manufacture and retail sale. Electricity generation including co-generation accounts for around 41%, petrochemicals (principally methanol) also accounts for around 41% and the remaining 18% is reticulated throughout the North Island to major users, gas distributors, other industrial users and to the commercial and residential sectors.

### Current Gas Production

50. Gas production for the 1999 calendar year is shown in the following table prepared from information in the Ministry of Economic Development's Energy Data File July 2000:

**Table 1: Gas Production**

Field	Current Field Owners <sup>2</sup>	1999 Gas Production	
		PJ	%
Maui	FCE 68.75%	175	80
	Shell 25%		
	Todd 6.25% <sup>3</sup>		
Kapuni	Shell 50%	24	11
	Todd 50%		
TAWN	FCE 96.73%	9	4
	Bligh 3.27%		
McKee	FCE 100%	8	3
Kaimiro	FCE 100%	1	1
Ngatoro	FCE 60%	1	1
	NZOG 35%		
	NEL 5%		
<b>Total</b>		<b>218</b>	<b>100</b>

51. As indicated in this table, Shell and FCE have a substantial ownership interest in all current gas production fields.
52. The Commission has prepared the following table of approximate "proven and probable" (2P) gas reserves from information contained in the Energy Data File July 2000, and from information provided by the field owners.

<sup>2</sup> As discussed above, Shell has undertaken to divest the merged entity's interest in the TAWN, McKee, Kaimiro and Ngatoro fields, and a 10% interest in the Maui field.

<sup>3</sup> Todd also manages a 6.25% interest in the field on behalf of Taranaki Offshore Petroleum Co Inc, a Delaware company controlled by Shell offshore. For the purpose of the analysis of the current application this interest is counted as being a Shell interest rather than a Todd interest.

**Table 2: Gas Reserves**

<b>Field</b>	<b>Reserves (PJ)</b>
Kaimiro	9
Kapuni	346
Kupe	236
Maui	1373
McKee	61
Mangahewa	112
Ngatoro	8
Pohokura	1,050
Tariki/Ahuroa/ Waihapa/Ngaere	103
<b>Total</b>	<b>3,298</b>

53. The principal production fields are considered separately below.

#### **The Maui Field<sup>4</sup>**

54. The Maui field is currently owned 68.75% by FCE, 25% by Shell and 6.25% by Todd.
55. The field is situated off shore Taranaki and is by far the largest production field in New Zealand. As at 1 January 2000 (after 21 years' production) the field contained 61% of New Zealand's estimated oil reserves and 60% of New Zealand's gross gas reserves (excluding the undeveloped Pohokura field). It was discovered in 1969 when the gas market was very small, and the Crown concluded that it was the only entity capable of finding a use for such a large quantity of gas. The Crown purchased a 50% share in the field and entered a 30 year take-or-pay gas purchase contract with the mining companies. This contract, known as the White Paper, in effect dedicated all of the then estimated recoverable reserves to the Crown. The first Maui gas came ashore in 1979. Initially the Crown had expected to use most of the gas in meeting anticipated growth in electricity demand and had planned to construct four new major power stations. However the electricity market did not develop as quickly as forecast and less than half the thermal generating capacity was built. In the early years this lack of demand resulted in the Crown building up large quantities of gas under its take-or-pay obligation, which it had paid for but not taken.
56. In 1981 and 1982, the Crown entered into agreements to establish a petrochemical industry centred on Taranaki, in part to utilise its gas take-or-pay obligations. The industry included an ammonia-urea plant at Kapuni, a chemical methanol plant at Waitara Valley and a synthetic gasoline plant at Motonui – the latter two involving the Crown as joint venture partners. All plants had passed into private hands by 1990.
57. In 1990 the Crown negotiated, or renegotiated, contracts with downstream users with the principal aim of reducing the Crown's petroleum industry exposure. This was

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<sup>4</sup> Information in this section is drawn largely from a paper given to the 2000 New Zealand Petroleum Conference by David Taylor of the Treasury.

achieved by transferring the bulk of the Crown's rights and obligations under the Maui Contract to the actual users via a back-to-backing framework. The counterparties were New Zealand Liquid Fuels Investment Ltd (for use at the synfuels plant), Petralgas, NGC and Electricorp (now Methanex, NGC and Contact Energy.)<sup>5</sup>

58. The 1990 contracts were negotiated concurrently in an attempt to ensure that they jointly matched most of the rights and obligations included in the Crown's contract with Maui Development Ltd (MDL), a company made up of the joint venture partners. The new contracts approximately sum to the Crown's take-or-pay obligation, match rights to gas with actual gas available from the field prior to 2009, and rights to delivery with those available, and so on.
59. At the New Zealand Petroleum Conference on 19-22 March 2000, David Taylor, Manager of the Energy/SOEs section of the Asset and Liability Management Branch of the Treasury, stated:

“The Crown has no current plans to exit the contracts. If Seller {ie the MMCs} and Users {ie NGC, Contact and Methanex} were to put a proposal to the Crown, some of the issues the Crown would have to consider (general policy considerations aside) are:

- the extent to which the Crown would obtain full consideration for the value it holds via the contracts;
- whether the proposal left the Crown with any residual liabilities or contractual connections; and
- whether the negotiation process could be conducted at moderate cost and without being unduly resource consuming.

It remains to be seen whether Users and Seller will identify sufficient mutual benefits and determine to pursue a goal of Crown exit in the months ahead.”

### **The Kapuni Field**

60. The Kapuni field is ultimately owned 50% by Shell and 50% by Todd.
61. The Kapuni field is located onshore in Taranaki and was the first of the significant gas discoveries when it was found in 1959. The mining licence is held by a joint venture between the KMCs (which since the withdrawal of BP, comprises Shell and Todd, each with a 50% interest). The field is rich in condensate, but the gas in the field has a high carbon dioxide content and must be treated before it can be used for the reticulated market. Commercial gas was first produced from the field in 1970. Again the Government of the day had a substantial say in the use to which the gas was put – principally at that time in the reticulated market. Subsequently Kapuni gas has been utilised mainly in the petrochemical industry as Maui gas has replaced it for reticulation.
62. The Kapuni gas was originally contracted to Kapuni Gas Contracts Ltd (KGCL) for the life of the field. However, as a result of the High Court judgment in 1997, the KMCs now have a right to half the output of the field. The application notes that any gas supplied to KGCL as part of its entitlement is sold at [

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<sup>5</sup> With ownership changes NZLFI and Petralgas contracts are now with Methanex. With the split of ECNZ, the ECNZ contract was surrendered and the Crown entered into a new contract with Contact Energy.



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63. The judgment limited the use to which KMC's entitlement could be put. It states:

“The plaintiffs {the KMCs} will be able to sell their half into the wholesale or retail market. We note and enforce the undertaking incorporated in counsel's final submission not to sell gas to the Petrochemicals nor for electricity generation, other than for co-generation projects.”

64. At projected levels of production the field is expected to last until [ ].

### **The TAWN Fields**

65. The TAWN fields are 96.73% owned by FCE and 3.27% by Bligh.

66. The TAWN fields comprise the Tariki, Ahuroa, Waihapa and Ngaere fields. They are onshore fields located in reasonable proximity of each other in eastern Taranaki and were discovered by Petrocorp between 1985 and 1993. The fields produce both gas and condensate.

67. Tariki and Ahuroa have around 103 PJ of reserves remaining, while Waihapa and Ngaere are now largely depleted.

68. All gas from TAWN is currently sold to Contact under a contract [ ] At the present rate of production the contract quantity will be met in [ ]

69. The TAWN fields are expected to be depleted in [ ]. FCE's present interest in the fields is included in Shell's divestment undertaking.

### **The McKee Field**

70. The McKee field is 100% owned by FCE.

71. The McKee field perhaps has greatest value as an oil field but is also a small but significant source of gas. It is an onshore field located inland from Stratford. It was discovered in 1982 by Petrocorp. The field is expected to be depleted by around [ ].

72. All McKee gas is currently sold to Methanex under a generic gas contract which expires at the end of this year. [ ]

73. The McKee field is included in Shell's divestment undertaking.

### **The Kaimiro Field**

74. The Kaimiro field is wholly owned by FCE.

75. The Kaimiro field produces a small amount of gas and condensate. It was discovered in 1988 and is located in north Taranaki. At present levels of production (around 1 PJ per annum), it is expected to continue to produce gas until around [ ].
76. The gas from Kaimiro is not currently contractually committed to any party.
77. The Kaimiro field is included in Shell's divestment undertaking.

### **The Ngatoro Field**

78. The Ngatoro field is owned 60% by FCE, 35% by New Zealand Oil and Gas (NZOG) and 5% by Ngatoro Energy Ltd (NEL).
79. The Ngatoro field was discovered in 1991 by NZOG. The field has principally been developed to extract the condensate, and the associated gas was flared until 1998. The Ngatoro gas is piped to Kaimiro for processing. [ ] FCE has rights to 100% of Ngatoro gas. It sells that gas along with Kaimiro gas to Methanex.
80. FCE's interest in the Ngatoro field has been included in Shell's divestment undertaking.

### **The Mangahewa Field**

81. The Mangahewa field is wholly owned by FCE.
82. Mangahewa is an onshore field located around 20 km east of New Plymouth. It was discovered in 1996 by FCE. FCE's latest assessment of 2P reserves is 111.5 PJ. A small amount of gas was taken from the field in 1997 and 1998 from test wells and this was sold to Methanex.
83. FCE has informed the Commission that it has begun development of Mangahewa in the current financial year with an onstream date of [ ]. FCE has applied for a petroleum mining permit to undertake production from the field. [ ]
84. The production capacity of the field is expected to be [ ] PJ per annum. However the Commission understands that [ ] PJ per annum, and that the field could be depleted around [ ].
85. The Mangahewa field is included in Shell's divestment undertaking.

## THE CURRENT GAS PRODUCTION MARKET

### Introduction

86. For the reasons set out in Decision 408, the Commission was not satisfied that the proposed acquisition which was the subject of the previous application would not result, or would not be likely to result, in the acquisition or strengthening of dominance in the current gas production market.
87. Shell has argued that some of the Commission's conclusions used in reaching that decision were incorrect. In addition, Shell has undertaken to divest the merged entity's interest in several gas fields. These are its total interests in:
- McKee;
  - TAWN;
  - Ngatoro;
  - Kaimiro; and
  - Mangahewa fields.
88. In addition, Shell has undertaken to divest:
- a 10% interest in the Maui field; and
  - a 3.6667% interest in the Pohokura field.
89. The divestments offered in respect of the previous application are also included in the current application. These include the merged entity's interest in:
- the Kupe field.
90. In its analysis of the current application the Commission has taken account of Shell's arguments and the effects of the additional divestments.
91. The Commission has used in its analysis a similar framework to that used in its previous analysis. It has considered those factors which may limit or prevent the merged company from exercising "a high degree of market control" (in the words of the Port Nelson decision<sup>6</sup>). It has done this by considering:
- the constraint from competitors;
  - the constraint from potential competitors;
  - the constraint from new entry;
  - the constraint from acquirers of gas – current supply contracts;
  - the constraint from acquirers of gas – ability to on-sell gas; and
  - the constraint from acquirers - ability to switch to alternative fuel forms.

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<sup>6</sup> *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC).

## Constraint from Competitors

92. In its analysis below, the Commission has considered the potential for competition to Shell from gas fields in which Shell does not have an ownership interest (including those which it has undertaken to divest) and from Shell's post acquisition joint venture partners in Maui, Kapuni and Pohokura.

### *Competition from Independently Owned Fields:*

#### *The McKee Field*

93. The McKee field had 61 PJ of 2P reserves at 30 June 2000 and the field is currently producing around 8 PJ of gas per annum, which is being supplied to Methanex. The contract under which this gas is provided [ ]
94. Notwithstanding the termination of the current supply contract, the Commission considers that it is likely that gas from McKee will continue to be supplied to Methanex in the immediate future. The Methanex plant is close to McKee, there is a dedicated pipeline from the field to the Methanex plant and, if the gas goes to Methanex, it does not have to be treated to meet the specification requirements necessary for the gas transmission pipelines.
95. Nevertheless the new owner of McKee will have discretion over the price and destination over the gas from McKee. The field has the potential until 2006 to provide [ ] PJ per annum of gas in competition to Shell, and smaller quantities thereafter until the field is depleted in [ ].

#### *The TAWN Fields*

96. The TAWN fields are estimated to have had 2P reserves at 30 June 2000 of 103 PJ. TAWN gas is being used to supply Contact at the rate of [ ] PJ per annum under a generic gas contract. There remains an additional [ ] PJ to be supplied under the contract. In terms of the contract, Contact [ ].
97. The Commission believes that it is likely that the contract will be assigned to the new owner of the field. The infrastructure associated with the field meets the requirements of supply to the New Plymouth and Stratford power plants.
98. The applicant has argued that an additional [ ] PJ per annum could be produced from TAWN at the discretion of the new owner. However the commitments to Contact and uncertainty about the ultimate size of the field could mean that this gas is available on an interruptible basis only.

*The Ngatoro Field*

99. FCE has estimated that the Ngatoro field had reserves of 8.2 PJ and produces slightly less than 1 PJ per annum. FCE has rights to 100% of Ngatoro gas up to [ ].
100. The Commission considers that gas production from the field is unlikely to be economic as a stand-alone venture. Currently it is processed at the neighbouring Kaimiro field, and is mixed with Kaimiro gas to meet pipeline specifications. FCE currently has rights to all Ngatoro gas which it sells, together with Kaimiro gas, to Methanex.

*The Kaimiro Field*

101. The Kaimiro field has reserves of around 9 PJ and gas from the field is being produced at the rate of around 1 PJ per annum and the gas is currently being sold with Ngatoro gas to Methanex.

**Overall Conclusion on Competition from Divested Gas Fields**

102. The Commission considers that the TAWN, McKee, Ngatoro and Kaimiro fields between them will provide an important level of competition to Shell post-acquisition. Between them they produce around 19 PJ per annum. As an indication of the significance of this quantity, it represents around 48% of the total amount of gas used last year by other than the electricity and petrochemical sectors.

**Competition from Other Production Fields***Todd*

103. Todd is a joint venture partner with Shell in the Kapuni field and with Shell and FCE in the Maui field. The Commission has considered whether Todd would be likely to provide a competitive constraint on Shell given these and other interests in common.
104. The Commission considers that Todd's ownership interest in Maui is not likely to give it access to gas with which it can compete with Shell. The gas from the Maui field is currently committed to the Crown which, in turn, has back-to-back long-term contracts with NGC, Contact and Methanex. If the reserves contained in the Maui field prove greater than is necessary to meet the contractual obligations with the Crown, the MMCs joint venture can offer that surplus gas to the market. However, it may be several years before the MMCs would be sufficiently confident about these extra reserves (if they exist) to do this without putting them at risk of being unable to satisfy their current obligations.
105. Todd's interest in the Kapuni field comes through its joint venture (with Shell) in the KMCs which owns 100% of the field. Until 1997 the output of the field was

contractually committed to KGCL for the life of the field. The effect of the 1997 Court decision is to commit the gas from the Kapuni gas field equally between KGCL and the KMCs from 1 April 1997. [

]

106. In 1999, [ ] PJ was produced from the field. Of that, around [ ] PJ was supplied to KGCL for on-sale to Methanex and NGC, [ ] PJ went to KMCs for on-sale to Kiwi Dairy, Taranaki By-Products and other smaller customers, and around [ ] PJ was reinjected into the field.
107. Notwithstanding that current sales of KMCs' share of Kapuni gas are made by the KMCs jointly, both Shell and Todd can sell their share of Kapuni gas in their own right. [

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108. In its previous decision, the Commission concluded that, on balance, Todd from its position in the KMCs, was not likely to place an effective competitive constraint on Shell, post-acquisition.
109. This conclusion has been contested by Shell and Todd.
110. In its letter to the Commission dated 8 November 2000, Chapman Tripp for Shell stated:

“Todd remains a vigorous competitor at all levels of the market in which it operates;

The effect of the 55JV is to constrain Shell by entrenching Todd as a “contrary force” in Shell’s exploration and production activities in Taranaki; and

Todd’s conduct in respect of various disputes with various members of the industry – including Shell – is consistent with that of an independent head in the market.

There are no ownership links between Shell and Todd, no overlapping directorates, no rights of one company to appoint directors of another, and no other formal links between the two companies other than those arising in the context of the 55JV. That arrangement is a quite normal joint venture arrangement and does not bind the two companies other than for the express purposes of the joint venture. Certainly, it in no way limits the ability to compete with, or act independently of, each other in downstream markets (that is, anything other than exploration in the Taranaki region).”

111. In oral submissions to the Commission, Todd was adamant that it is an effective competitor of Shell.
112. Having considered these submissions and other information the Commission concludes that Shell and Todd are not one head in the market. However the Commission considers that the 1955 JV does have an impact on the intensity of the competition between Shell and Todd.

113. Todd does compete with Shell in some areas, and it has taken positions on joint venture matters which are at odds with those of Shell. Nevertheless the Commission considers that on critical matters they will be likely to work together. The success of the joint ventures will depend on there being a constructive working relationship between the joint venture partners. Neither Todd nor Shell would lightly take action which would affect the other if that was to lead to a breakdown of a constructive working relationship between the two.
114. To some extent, the incentive on Todd and Shell to maintain a healthy relationship with each other also applies to partners in most joint ventures. Each partner in a joint venture may avoid actions against other partners if they could put the success of the joint venture at risk. However it is the scope and scale of the relationships between Shell and Todd which makes it unusual. The mutual dependence on each other in these circumstances, particularly Todd on Shell, may mean that Todd is less of a competitive force on Shell than would otherwise be the case.
115. The Commission considers that Todd may place some competitive constraint on Shell, but in its analysis it has not relied on it to be a fully effective competitor post-acquisition.

### **Constraint from New Entry**

#### *The Mangahewa Field*

116. The Mangahewa field has been included in Shell's divestment undertaking.
117. At present the gas in the field is uncommitted [
- ]
118. The Commission considers that a new owner of the field is unlikely to want to extract the gas over this period. FCE has stated that [
- ]
119. The Commission considers that the divestment of the Mangahewa field, and the likely level of production from that field, will result in an important constraint being placed on Shell post-merger.

#### *The Rimu Field*

120. For the reasons set out in paras 141 to 143 of Decision 408, the Commission does not consider that it can place a significant amount of weight on Rimu as a competitive source of gas in the current production market. Nevertheless it recognises that the owner of the field, Swift, has announced<sup>7</sup> plans to build a processing plant in South Taranaki so it can bring up to four Rimu oil wells into commercial production by the

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<sup>7</sup> See The Dominion of 17 November 2000.

middle of next year, and that up to \$25 million could be spent on the project in the next year or two.

121. It is possible that if the project is successful, it could result in around [ ] PJ of gas being produced in the early stages, and additional amounts subsequently.

#### *The Maui Field*

122. It is widely regarded as possible that the Maui field could produce additional gas beyond what is necessary to meet the contractual commitments with the Crown. If that gas falls within the area covered by the existing petroleum mining permit for Maui, the MMCs would have the right to that gas. The divestment of a 10% interest in the field by Shell, together with the execution of the Deed Poll, mean that Shell will face some degree of constraint on the production and marketing of this gas.

#### **Constraint from Acquirers of Gas – Current Supply Contracts**

123. The extent to which current gas supply contracts would constrain Shell post-acquisition was discussed in paras 146 to 163 of Decision 408.
124. The Commission notes that the Maui contract places an effective constraint on the MMCs for most of the life of the field (until say 2007 at least), and the Kapuni contract with KGCL places an effective constraint on the KMCs for half the gas from the field for the life of the field.
125. The Commission considers that these contracts would ensure that Shell post-acquisition would not have discretionary power over the gas supplied under these contracts. This gas amounted to 187 PJ out of total gas production in 1999 of 218 PJ.

#### **Constraint from Kapuni High Court Decision**

126. The Commission notes that the Kapuni judgment prevents Shell and Todd from selling their share of Kapuni gas for electricity generation (except for co-generation) and for the production of petrochemicals. While there may be ways that Shell could ameliorate this constraint (possibly by selling to intermediaries), nevertheless it weakens the position of Shell and Todd as sellers of this gas. [

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#### **Constraint from Acquirers Ability to On-sell Gas**

127. The Commission discussed the constraint arising from the ability of acquirers of gas to onsell that gas in paras 164 to 192 of Decision 408.



128. For the reasons set out in that Decision, the Commission considers that some constraint exists but that it is not sufficient in itself to prevent dominance.

### **Constraint from Acquirers – Ability to Switch to Alternative Fuel Forms**

129. For the reasons set out in paras 193 to 199 of Decision 408, the Commission does not consider that this constraint is material to the consideration of dominance in the current gas production market.

### **Conclusion on Dominance in Current Gas Production Market**

130. The Commission considers that post-acquisition Shell would be largely constrained from exercising market power in respect of that gas supplied under the Maui contract with the Crown and under the Kapuni contract with KGCL. Further Shell would face some limited competitive constraint from Todd, and from the ability of firms with gas supply contracts to on-sell that gas. Further constraint may arise from the Rimu field should it commence production within the next two years as has been suggested.
131. The Commission considers that the important competitive constraint would arise from those gas fields which Shell has undertaken to divest. These are the McKee, TAWN, Ngatoro, Kaimiro and Mangahewa fields. McKee, TAWN, Ngatoro and Kaimiro are currently producing 19 PJ per annum and Mangahewa is likely to be producing in excess of 10 PJ by 2002 [ ].
132. Having regard to all these matters, the Commission concludes that the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the current gas production market.

## THE POST-2009 GAS PRODUCTION MARKET

### Introduction

133. As discussed in the market definition section above, the Commission believes that the supply side of the gas production market can be expected to alter substantially as the Maui field and others approach their depletion date. Accordingly the Commission has defined a discrete market in which to analyse the likely competitive situation at that time and the effect of the acquisition.
134. In the analysis below, the Commission has considered the likely level of competition from those current gas production fields which are anticipated still to be producing gas in 2010. It has also assessed possible entry into the market by 2010. In addition it has considered the impact of other possible constraints on Shell post-2009.

### Output From Current Gas Production Fields in 2010

135. Of the current gas production fields only Kapuni is expected to be producing significant quantities of gas in 2010. However there is now some optimism that with current projected production rates and levels of reserves, both TAWN and McKee will be producing some gas at that time. As a result of its undertaking, Shell would divest its interest in these two fields.

#### *Kapuni Production*

136. The applicant has revised the future Kapuni production forecasts from its earlier application. The field contains [ ] PJ of recoverable reserves and will continue to produce until [ ]. Shell's assessment of likely production in 2010 is [ ] PJ.
137. As a result of the 1997 Court decision, the half of the output of the Kapuni field which does not go to KGCL goes to Shell and Todd. However the Court decision prevents Shell and Todd from selling that gas to the petrochemical industry or for electricity generation, other than for co-generation projects.

#### *TAWN Production*

138. Information provided by FCE shows that the projected depletion date of the TAWN field is [ ], and projected production in 2010 is around [ ] PJ. That gas is uncontracted at this time.

#### *McKee Production*

139. Information provided by FCE shows that the projected depletion date of the McKee field is [ ] and projected production in 2010 is [ ] PJ per annum. That gas is uncontracted at this time.

## Output from Current Undeveloped Fields in 2010

140. The Commission considers that there are five discovered but undeveloped fields which have the potential to produce gas in 2010 and beyond. These are the Pohokura, Mangahewa, Kupe, Rimu and Kauhauroa fields. They are considered separately below.

### *Pohokura*

141. The Pohokura field was discovered in March 2000 by FCE and is approximately 5 km off-shore and very close to Motonui, the location of Methanex's plant. The field is currently owned by FCE 33.3%, Shell 18.3%, Todd 15% and Preussag Energie GmbH 33.3%. Preussag is part of the large German-based Preussag AG group which also has mineral and industrial divisions.
142. As part of the current application, Shell has undertaken to divest a 3.6667% interest in the Pohokura field, thus reducing Shell's interest in Pohokura post-acquisition to 48%.
143. The field is in its early appraisal stage – 2 wells have been drilled to date - but FCE is sufficiently confident of its size to state that it will be New Zealand's third largest field after Maui and Kapuni. The field is a simple structure in shallow water depths, with close proximity to shore and infrastructure. The field also has a high liquids yield.
144. FCE's latest assessment of 2P reserves of gas in Pohokura is 1,050 PJ. It is possible that the field could produce at the rate of 60 – 90 PJ per annum, with the field having a life of at least 12 years from development. It is unlikely production from the field will occur before late 2004.

### *Mangahewa*

145. In terms of the application, Shell will divest the merged entity's interest in the Mangahewa field.
146. As discussed above Mangahewa has 111.5 PJ of reserves at present. It is considered likely to commence production in 2001 or 2002. FCE has informed the Commission that it is installing processing capacity of around [ ] and it has plans to produce at an annual rate of [ ] PJ per annum. FCE notes that with a modest amount of additional expenditure the Mangahewa processing capacity can be increased to around [ ] PJ per annum.
147. FCE has also stated:

[

]

*Kupe*

148. Shell has undertaken to divest the merged entity's interest in the Kupe field.
149. The potential of the Kupe field to provide gas to the post-2009 market was discussed in paras 216 to 227 of Decision 408. The Commission considered that Kupe has the potential to be an important production field post-2009. It is one of the few undeveloped fields which has proven reserves, and while it may require a significant increase in gas prices for the field to be viable, this is possible based on potential supply and demand scenarios. The Commission considered that Kupe was a likely producer of 25 PJ of gas in 2010.
150. This remains the Commission's view.

*Rimu*

151. In its previous decision the Commission stated that it is possible that the field will be developed and will be producing around 10 PJ per annum if the field produces around the size suggested by the applicant (in excess of 100 PJ). However the Commission noted that this level of output was not certain.
152. The Commission has subsequently had further discussions with Swift about the prospects of the field. It considers that there have been no new developments which would cause it to change its previous assessment. A production rate of 10 PJ is possible by 2010, although if the field is developed as is currently being indicated by the field owner, the rate may be [ ] PJ in the early years after the field commences production, which could be 2001.

*Kauhauroa*

153. As noted in Decision 408, doubts remain about the potential of the Kauhauroa field, particularly if there are no new fields discovered in the region which can share infrastructure costs. The Commission considers that it is possible, but not probable, that Kauhauroa could produce 10 PJ per annum in 2010.
154. Kauhauroa is owned by Westech Energy New Zealand Ltd and Orion New Zealand Ltd.

**Summary of Gas Production from Fields in 2010**

155. An assessment of likely and possible gas production in 2010 is shown in the following table:

**Table 3: Potential Gas Production in 2010**

	<b>Fields with a Shell Interest PJ</b>	<b>Fields without a Shell Interest PJ</b>
<b>Likely:</b>		
Kapuni (Shell 50%)	[ ]	
Pohokura (Shell 48%)	60-90	
TAWN		[ ]
McKee		[ ]
Mangahewa		[ ]
Kupe		25
<b>Possible:</b>		
Rimu		10
Kauhauroa		10

156. As discussed below, the competitive significance of the gas from the individual fields varies considerably.

### **The Competitive Significance of Gas from the Major Fields**

157. The above table shows that Shell post-merger will have an important equity interest in two major production fields, Kapuni and Pohokura. However the bare output figures relating to those fields do not give an accurate guide to Shell's potential market strength. This is considered further below.

#### *Kapuni Gas*

158. Of Kapuni gas production (projected to be [ ] PJ per annum in 2010), half is committed under a supply contract to KGCL for the life of the field. The supply and price of that gas is fixed under the contract and Shell would not have the potential to exercise any market power in relation to that gas.
159. As discussed in the section on the current gas production market, Todd has a right to take its share of gas from the field.
160. The Kapuni gas over which Shell may exercise some discretion over supply and price is a quarter of the likely output, or [ ] PJ per annum. However its discretion is not unlimited. It remains bound by the provision of the Kapuni High Court decision which prevents it from selling that gas for electricity generation or to the petrochemical industry.

#### *Pohokura Gas*

161. Shell has argued that the divestment of a 3.6667% interest in Pohokura means that Shell, with a 48% interest, is not able to exert a substantial degree of influence over the field. The Commission considers that the divestment represents an important shift in the legal control over the field that Shell could exercise post-acquisition. The difference in actual control may be less given that consensus decision making is the



be that some customers who cannot take gas on an interruptible load basis would be deterred from entering into contracts for that gas.

### *Kupe Gas*

169. The cost of extracting Kupe gas from the field, and treating that gas, means that it may require a price of \$3.50/GJ for the development of the field to be viable. The Commission considers that such a price is possible in projected supply and demand scenarios. The Commission also notes that prospective buyers of the Kupe field have suggested that with new technology production costs are likely to be less than previously forecast and that it will be viable to develop the field within the current decade.

### **New Discoveries**

170. The potential for new discoveries of gas fields to impact on the post-2009 gas production market was discussed in paras 247 to 291 of Decision 408. The Commission considered that sustainable new entry is likely to occur within the time frame relevant to the Commission's consideration of the post-2009 gas production market. However the Commission could not be confident of the extent of new entry and that it would be sufficient to ensure that the merged entity would not be in a dominant position in the market.
171. The Commission has not received any new information which has caused it to change its view on the likely competitive significance of new discoveries.
172. One of the elements which has changed from the earlier application in this respect is the divestment of 10% of Maui. As discussed above, there is some suggestion that the Maui field, over which the MMCs have rights, could contain gas more gas than currently projected. This would give the MMCs additional gas which could be accessed after 2009. The 10% divestment means that Shell's ability to exercise control over that gas is less than would be the case without the divestment.

### **Constraint from Todd's Ability to take Gas from Pohokura**

173. The Pohokura JV Agreement permits the JV partners to take gas in kind. For the reasons discussed in paras 233 to 236 of Decision 408, the Commission in relation to the earlier application did not consider that it should give substantial weight to the potential for this provision to place an important constraint on Shell post-acquisition.
174. Todd has provided evidence to the Commission that it has informed the Pohokura Offtake Committee that it expects to take, at least in part, its equity entitlement to Pohokura product. (Todd has a 15% interest in Pohokura.) The gas it takes, if it is significant, could provide competition to the JV/Shell. It is not clear at this stage how significant it will be, or whether it will be limited to the requirements of Todd's downstream companies. The Commission is of the view that Todd would not be likely to take sufficient gas to place more than a minor competitive constraint on the behaviour of Shell.

175. Nevertheless the Commission acknowledges Todd's intentions and recognises that Shell's divestment of 3.6667% of Pohokura would increase the likelihood of joint venture partners taking some equity gas.

### **Conclusion on Competitive Constraints**

176. The Commission considers that Kupe and, to a lesser extent Rimu and Kauhauroa are likely to provide some gas in competition to Shell in the post-2009 market. Further the Commission considers that it is likely that new gas production fields will be discovered and developed by parties independent of Shell, although the quantum of gas likely to be in these fields cannot be assessed with any certainty at this stage.
177. The Commission considers that an important competitive constraint on Shell will come from those fields which are included in the additional divestment undertakings Shell has included in the current application. These include Kupe, TAWN, McKee and Mangahewa.

### **Impact of Divestment of Pohokura Shares**

178. As noted above, Shell has undertaken to divest a 3.6667% equity interest in the Pohokura field. This divestment would reduce Shell's post-acquisition interest to 48%.
179. The Commission considers that this divestment has the potential to lessen Shell's effective control and influence over Pohokura in two respects. First, if the joint venture partner Preussag exercises its pre-emptive rights over the shares being divested, it will have the right to veto decisions of the field's Operating Committee on ordinary operating matters. Second the divestment lessens the potential of Shell to pursue its own plan for field development (in the absence of unanimity by the joint venture partners) by undertaking a "sole risk" development.
180. The Commission concludes that the divestment of 3.6667% equity interest would lessen Shell's control over the Pohokura field by a small but measurable amount.

### **Conclusion on Dominance in the Post-2009 Market**

181. The Commission has considered all the competitive and other constraints which would be likely to apply to Shell in the post-2009 gas market.
182. Some constraint is likely to arise from new gas fields, but the scale of these fields is very uncertain at this time, and the Commission has not relied on them for its conclusion on dominance.
183. The Commission has given some weight to competition arising from the Kupe field, and to a lesser extent from the Rimu and Kauhauroa fields. It also recognises that, in respect of Kapuni gas, Shell is constrained by contractual obligations in respect of gas taken by KGCL and by the restriction arising from the Court decision.



184. The Commission considers that the divestment undertaking associated with the latest application significantly increases the competition which would be faced by Shell and the constraints on its activity. The relevant divestments include the McKee, TAWN and Mangahewa gas fields and the divestment of 3.6667% of Pohokura and 10% of Maui.
185. Having regard to all these matters, the Commission concludes that the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the post-2009 gas production market.

## THE MARKET FOR THE PRODUCTION OF LPG

### Introduction

186. The Commission concluded in Decision 408 that it was not satisfied that the proposed acquisition would not result, or would not be likely to result, in Shell acquiring or strengthening a dominant position in the market for the production of LPG.
187. The proposed divestments affecting this market are:
- all of FCE's equity interests in the TAWN fields (including, but not limited to, any interests in the petroleum mining licences associated with these fields); and
  - interests comprising in aggregate a 10% equity interest in the Maui field (including, but not limited to, the petroleum mining licence associated with that field, together with a 10% interest in Maui Development Limited).
188. The discussion below focuses on the changes which would be effected by these divestments and whether these changes would address the Commission's concerns so that it is able to be satisfied that the acquisition would not be likely to result in the acquiring or strengthening of dominance in the market for the production of LPG. Background material on the LPG sector is contained in Decision 408.
189. The current application, with the proposed divestments, would result in Shell increasing its interest in the Maui field from the current level of 25%. At present, FCE has a majority interest in the Maui joint venture, with a 68.75% share. Hence the share of the merged entity before divestment of a 10% interest would be 93.75%. The question for the Commission is whether Shell taking its interest in the Maui joint venture from 25% to 83.75% would result in the acquiring or strengthening of a dominant position in the LPG production market.

### Assessing the Competitive Implications of the Proposed Acquisition

#### *Market concentration*

190. In Decision 408, the Commission concluded that the effect of the proposed acquisition was to remove FCE as an independent supplier of LPG from the TAWN field. The undertaking to divest the TAWN field allows the production from this field to be sold in competition with the merged entity.

**Table 4: Commission’s Estimates of Annual LPG Production**

	<b>Producer</b>	<b>LPG production (tonnes pa)</b>	<b>LPG production (%)</b>
Maui	FCE/Shell/Todd	[ ]	[ ]
TAWN	FCE/Bligh	[ ]	[ ]
Kapuni	NGC	[ ]	[ ]
		[ ]	<b>100%</b>

191. Following the divestment of the TAWN field, the MMCs would produce [ ] of New Zealand’s current LPG production and [ ] of LPG which is sold on the New Zealand market. As noted in Decision 408, about 75,000 tonnes or half of the LPG produced from the Maui field each year is exported. The owner of the TAWN field would produce [ ] of LPG sold on the domestic market and, from the Kapuni field, NGC would produce [ ].
192. Taking into account the changes since the first application, the constraints which would be placed on the merged entity from current competition, potential entry and from buyers of LPG are considered below.

#### **Constraints from existing competitors**

##### *TAWN*

193. Production from the TAWN field would compete with that of the merged entity. As noted above, production from this field comprises around [ ] of LPG sold on the domestic market. FCE advised that a contract has been signed giving Rockgas the right to the TAWN LPG until [ ]. Rockgas is a major wholesaler and retailer of LPG which competes with Shell in downstream markets.

##### *NGC*

194. The Commission expressed the view in Decision 408 that NGC was restricted in its ability to constrain the merged entity for the following reasons:
- a significant proportion of NGC’s production is contractually committed to Shell and Todd for the life of the Kapuni field; and
  - NGC cannot increase its LPG output without an increase in supply of gas from Kapuni, and this is subject to an increase in gas sales made by the KMCs.
195. In its letter of 6 November, Chapman Tripp, for Shell, advised the Commission that the corollary of any successful challenge of the Liquigas contract would be that NGC would obtain a contractual right to terminate its contract with the KMCs. On the termination of this contract, NGC would no longer be obliged to supply LPG to Shell and Todd. The letter states in part:

“In this regard, clause 4.11 of a Deed dated 23 December 1985 between NGC and the KMCs inserts a clause 25B into the NGC/KMCs LPG contract, which provides that:

...the Purchasers shall pay {NGC} for Commercial Propane purchased by them pursuant to this Agreement at a price equal to 98.5% of the price for General Product (as that term is defined in the Maui LPG Purchase Agreement)... In the event that the {Liquigas contract} shall terminate the Purchasers and {NGC} all meet to agree a price for Commercial Propane... In the event that the Purchasers and {NGC} have not agreed such a price within three calendar months... either party may terminate the Agreement thereafter by giving one month’s notice to the other.”

196. NGC has confirmed that this would be the effect of the deed.
197. The Commission expressed the view in Decision 408 that it could not be confident that the contract between Liquigas and the MMCs was sufficiently robust to withstand a challenge. The result of a successful challenge to the contract would be to relieve NGC of its commitments to supply LPG to Shell and Todd.
198. In Decision 408, when considering the effectiveness of NGC as a competitor in the LPG production market, the Commission took into account NGC’s contractual commitment to sell a significant proportion of its production to Shell and Todd. In the absence of these contractual commitments, NGC’s production of around [ ] tonnes would provide vigorous competition to Shell.
199. NGC has stated in its annual report for the year ended 30 June 2000:
- “NGC continues to actively develop the LPG market and to increase its market share ...”
200. The Commission considers that, without its contractual commitments, NGC would have the ability to provide a real constraint on Shell.

#### *Todd*

201. Todd’s LPG wholesaling business utilises its entitlement to up to [ ] tonnes of LPG from NGC at Kapuni. Notwithstanding the Commission’s view that Todd and Shell’s involvement in the Maui joint venture and resultant joint marketing of LPG from the Maui field provides an incentive for Todd and Shell to work together, the Commission recognises that there is a strong incentive for Todd to retain its access to Kapuni LPG from NGC.
202. Accordingly there is an incentive for Todd to favour retaining the Liquigas contract.

#### *Conclusion on constraints from existing competitors*

203. Based on the analysis above, the Commission considers that LPG production from TAWN and NGC’s production from Kapuni would be able to provide an effective constraint on the merged entity.

#### **Potential Competition**

204. In Decision 408, the Commission considered the nature and extent of the constraint on the merged entity from potential new entrants. The Commission concluded that

Swift, the owner of the petroleum exploration permit which includes the Rimu field, was the only potential entrant likely to have access to the necessary natural gas with a suitable liquids content to produce LPG. The Commission was satisfied that Swift was a likely entrant into the LPG production market, but was not satisfied as to the extent of Swift's entry within the relevant time frame. Hence the Commission was not satisfied that Swift would be an effective constraint on Shell post acquisition in the LPG production market.

205. In the current application, Shell submitted that "regard must be had to the likely production to come from fields that are not yet in production, but will be within the timeframe relevant to the Commission's consideration." In the Commission's view, however, the situation is unchanged since the first application. Swift has not completed its appraisal programme and has not issued an estimate of the reserves in the field.

### **Constraint from Potential Imports**

206. The Commission, in Decision 408, did not consider that imports of LPG would act as an effective constraint on Shell post-acquisition. Shell has commented in relation to the current application as follows:

"The fact that the domestic price is currently much lower than the market price is not necessarily permanent. Wholesalers would import propane if the world price fell below the domestic price, which it could do in a low world oil price scenario."

207. The Commission understands that imports of LPG have not occurred, that freight would be a major component of the price, and that imports of LPG would require investment in storage facilities. The Commission remains of the view that imports would not be an effective constraint on Shell post acquisition.

### **Constraint from Buyers or Suppliers**

208. The Commission considered in Decision 408 whether the contract entered into in 1981 between Liquigas and the MMCs for the sale of Maui LPG would give Liquigas sufficient countervailing power to constrain Shell's activities in LPG production post acquisition.

209. The Commission commented at paras 376 and 377 as follows:

"The Commission's view is that the agreements were entered into in an environment which was very different from that which now exists. For example, the regulatory environment has changed with the enactment of the Commerce Act 1986. As noted by industry participants, the role of Liquigas in the market has changed in recent years. Liquigas is no longer the sole supplier of LPG to the New Zealand wholesale market, Liquigas does not acquire any of the LPG from the Kapuni field as was originally envisaged and the provision preventing the MMCs from selling LPG into the New Zealand market in competition with Liquigas has been waived.

The applicant advised that the pricing policy schedule was revoked by the directors of Liquigas in 1994. The Commission understands that the price was set in 1986 and has remained unchanged since that time. In the Commission's view, a long term contract without any mechanism for price adjustments cannot be considered robust."

210. The Commission considered that the countervailing power of Liquigas over the MMCs arising from the contract was not an effective constraint. Shell's increased interest in the Maui joint venture would give it the power to decide unilaterally on a challenge to the validity of the contract which, if successful, would give it the ability to raise prices to Liquigas. Shell retained a right of veto in relation to major decisions by Liquigas, including decisions on changes to the Maui Liquigas contract. The Commission's view was that the contract did not give Liquigas sufficient countervailing power to constrain Shell from exercising market power, post acquisition.
211. As noted above, it would appear that Todd has an incentive to vote against a challenge to the contract. In any decision to challenge the contract Shell would also take into account the resulting loss of its entitlement to LPG from Kapuni.
212. Chapman Tripp, for the applicant commented in its letter of 6 November:
- “Successful challenge of the Liquigas contract would also increase NGC's market share, further limiting the MMCs' ability to raise domestic prices.”
213. Chapman Tripp has argued that any incentive for the merged entity (or Todd) to challenge the Liquigas contract would be significantly diminished by the likely consequences in terms of putting Shell's and Todd's supply of Kapuni LPG from Kapuni at risk. This argument would appear to be valid but the Commission's concern, as expressed in Decision 408, was that the acquisition would give Shell the ability to decide unilaterally to challenge the contract.
214. Shell has undertaken to divest shares comprising in aggregate a 10% equity interest in the Maui field (including, but not limited to, any interest in the petroleum mining licence associated with that field, together with a 10% interest in Maui Development Limited).
215. Shell submitted that this would have significant consequences for the LPG production market because:
- any residual market power vesting in the merged entity (due to the vulnerability of the Liquigas Contract to challenge by the merged entity), will be diluted by a factor of 10%; and
  - it will provide its purchaser with an entitlement to appoint a director to the Board of Maui Development Limited.
216. The Commission considers that the proposed divestment of 10% of Maui has a small impact on the commercial or legal position of the merged entity.
217. The Commission notes, however, that Shell has executed a Deed Poll to the effect that Shell would require the affirmative vote of another party (namely Todd or the purchaser of the 10% interest to be divested by Shell) in order to effect a binding decision of the Maui joint venture. This is contingent upon the implementation of the acquisition.

218. In Decision 408, the Commission concluded that “compared with the current position, where FCE must obtain the agreement of either Shell or Todd to challenge the contract, the acquisition would give Shell the ability to decide unilaterally what action to take in relation to the contract”. The divestment and the Deed Poll remove Shell’s ability to do so.
219. The Commission’s view is that Shell’s increased holding in the Maui joint venture does not give it a greater ability to challenge the validity of the contract than FCE currently has. In addition the Commission notes that the link between the termination of the Maui/Liquigas contract and the termination of the NGC contract with Shell and Todd would appear to lessen the incentive for Shell and Todd to challenge the validity of the contract. The Commission was not advised of this link during its consideration of the previous application. This link, together with the divestments, make an important difference to the Commission’s conclusion on dominance in the LPG production market.

### **Conclusion on Dominance in the Market for the Production of LPG**

220. In Decision 408, the Commission was of the view that the merged entity would not be constrained by actual or potential competitors or by Liquigas as an acquirer of LPG. Shell’s undertaking to divest the TAWN field creates a significant competitor with its own processing facilities. While the Commission remains of the view that there are doubts as to the robustness of the Liquigas contract, the fact that Shell and Todd’s entitlements to LPG from NGC are dependent on the contract continuing allows the Commission to give more weight to the constraint arising from the contract. The Commission has also taken into account in reaching this conclusion Shell’s divestment of 10% of Maui and the execution of a Deed Poll maintaining the requirement that the agreement of two of the MMCs is required to effect a binding decision of the joint venture.
221. In the event that the Liquigas contract terminates, NGC would have the ability to use all of its production to compete with the merged entity and would be an effective competitor.
222. Having regard to the factors outlined above, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in Shell acquiring or strengthening a dominant position in the market for the production of LPG.

### **OVERALL CONCLUSION**

223. The Commission has considered the impact of the proposed acquisition in the following relevant national markets:
- the current gas production market;
  - the post-2009 gas production market; and

- the LPG production market.
224. Having regard to the matters set out in section 3(9) of the Commerce Act, and all other relevant factors, the Commission concludes that it is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in each of the relevant markets.



**DETERMINATION ON NOTICE OF CLEARANCE**

Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give a clearance to Shell Overseas Holdings Limited to acquire 100% of the shares of Fletcher Challenge Limited associated with its Energy Division and 100% of the shares in Energy International Holdings Limited.

Dated this 17th day of November 2000

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M J Belgrave  
Chair