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PUBLIC VERSION

COMMERCE COMMISSION

REVISED DRAFT DETERMINATION

Note: This is a revised draft determination issued for the purpose of advancing the Commerce Commission's decision on this matter. It follows on from and revises an initial draft determination of the matter, dated 23 February 2005. The conclusions reached in this revised draft determination are preliminary and take into account the information provided to the Commission to date.

PROPOSED REVOCATION OF, AND GRANTING OF A FURTHER AUTHORISATION IN SUBSTITION FOR, AN AUTHORISATION OF ARRANGEMENTS TO JOINTLY MARKET AND SELL POHOKURA GAS

Revised draft determination pursuant to the Commerce Act 1986 (the "Act") in the matter of the Commission's proposed revocation of, and granting of a further authorisation in substitution for, an authorisation of arrangements whereby OMV New Zealand Limited ("OMV"); Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited ("Shell"); and Todd (Petroleum Mining Company) Limited ("Todd") would jointly market and sell gas produced from the Pohokura natural gas field.

The Commission:	P R Rebstock (Chair) D R Bates QC S W Stevens
Second Draft Determination	On 1 September 2003, in its Decision 505, the Commission determined, pursuant to s 61(1)(a) of the Act, to grant an authorisation, subject to a number of conditions, for OMV, Shell, Todd and any person who becomes a party to the Pohokura Joint Venture, to enter into arrangements to jointly market and sell gas produced from the Pohokura natural gas field. On 23 February 2005, the Commission determined, on the basis of the information provided to it at that time, that it would be likely to revoke that authorisation pursuant to s 65 of the Act. After receiving submissions on that initial draft determination, the Commission now proposes, pursuant to s 65 of the Act, to revoke the authorisation and grant a further authorisation in substitution for it.
Date:	13 October 2005

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EXECUTIVE SUMMARY[1]

Introduction

On 1 September 2003, the Commerce Commission authorised, under sections 58 and 61(1)(a) of the Commerce Act, an arrangement between Shell, OMV and Todd, the three members of the Pohokura Joint Venture. Under the arrangement the three companies would jointly (rather than separately) market and sell gas produced from the Pohokura field.

In April 2004, the members of the Pohokura Joint Venture advised the Commission that because they had been unable to agree on issues associated with the joint marketing and sale of Pohokura gas, they intended to market and sell the gas separately. Subsequently, each of the parties announced that they had separately entered into contracts for the sale of Pohokura gas.

The Commission decided to consider whether or not it should revoke its authorisation of the joint marketing and sale arrangement. Section 65 of the Commerce Act sets out the circumstances in which the Commission may alter, revoke, or substitute authorisations. If the Commission is satisfied that the 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, the Commission may amend or revoke the authorisation or substitute a new authorisation to replace the original.

On 23 February 2005, the Commission issued a draft determination under which the Commission proposed to revoke the authorisation granted in Decision 505, pursuant to s 65(1) of the Act.

Written submissions on the draft determination were received from OMV, Shell, Todd and Genesis Energy. The Commission after taking account of those submissions now proposes to revoke the authorisation granted in Decision 505 but to issue a substitute authorisation. Because of this change the Commission has issued this revised draft determination to provide interested parties with the opportunity to make further submissions, particularly on the proposed substitute authorisation.

The Commission's Reasons for Authorising Joint Sale and Marketing

In their Application for authorisation of the joint marketing and sale arrangement, dated 20 December 2002, the Pohokura Joint Venture stated at paragraph 16:

> …..the practical problems the Pohokura JV parties would face in separately marketing gas would be difficult if not impossible to overcome. Substantial welfare losses will occur if joint marketing is not authorised. Absent joint marketing, a substantial delay in the development of the field is expected, at a time of scarcity of resource. In addition, separate marketing would result in significant extra transaction and production costs, and sub-optimal field depletion. This would impact significantly on the value of the field, and that effect would have the potential of significantly reducing exploration incentives in New Zealand.

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

and

> In attempting to separately sell gas produced jointly, pursuant to contracts negotiated individually, the Pohokura JV parties would face a number of insurmountable problems.

In submissions in support of its Application for authorisation, the Pohokura Joint Venture said that separate marketing would, at best, result in a three year delay in production from the field. This was due to the additional time it would take before the individual parties could achieve the final investment decision (FID) from their boards of directors. Having regard to these and other submissions from interested parties, the Commission concluded in Decision 505 that separate marketing would delay production by one year.

The Commission decided that joint marketing and sale of the gas would result in a lessening of competition in the gas production market, with fewer competitors and higher gas prices. This would lead to detriments from a lessening in allocative, productive and dynamic efficiencies.

On the other hand, the Commission considered that there would be potential benefits that would arise from joint marketing. The majority of those benefits would arise from the earlier development by one year of the Pohokura field (with benefits in the order of $47.8m to $81.9m arising). There were also other more minor benefits.

After weighing the detriments and benefits, the Commission decided that there would be a net benefit to the public from joint marketing under the arrangement and that it would authorise the joint marketing and sale arrangement. However, as it noted in Decision 505, without the early production which joint marketing and sale was considered to bring, the arrangement would not have been authorised, notwithstanding the other benefits accepted by the Commission.

In the event, the Pohokura Joint Venture chose to adopt a separate marketing and sale approach in mid-April 2004, and reached the FID in June 2004. The Commission considers that separate marketing and sale has not led to a delay in the FID or in the date of production of gas from the field.

Jurisdiction to Reconsider the Authorisation

False or misleading in a material particular

Section 65(1)(a) of the Commerce Act empowers the Commission to reconsider an authorisation if it was granted on information that was ‘false or misleading in a material particular. The Commission considers that “false or misleading” in this context means untrue or misleading in fact and does not necessarily import any element of deliberate falsehood or intent to mislead.

The information concerning likely delays involved predictions as to a future state of affairs in an area of accepted uncertainty. Arguably, such information is not “false or misleading” in the sense required by paragraph 65(1)(a) if the predictions were based on an objective foundation, notwithstanding that they have subsequently proved false. The Commission considers that there existed some objective basis for the one year delay forecast. The Commission does not consider, however, that it is necessary in this proceeding to determine whether the information at issue is properly regarded as “false or misleading” in terms of

section 65(1)(a) because if it was not, due to the existence at the time it was made of an objective foundation for that prediction, then the Commission considers that a "material change of circumstances" must have subsequently occurred and section 65(1)(b) will apply.

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

Material change in circumstances

As discussed, the Commission considers that the effect of paragraphs 65(1)(a) and 65(1)(b) of the Commerce Act, read together, is that there is a continuum between a "change of circumstances" and "false or misleading" conduct, and not a gap between those concepts. If the information was wrong and not objectively justifiable at the time the authorisation was made, then it was "false or misleading", but the "change of circumstances" provision does not apply because the circumstances, considered objectively, have not changed. If, however, the information was objectively justified at the time the authorisation was made but subsequently proves to be incorrect, objectively viewed, then a change of circumstances must be considered to have occurred.

At the time the Commission was considering the authorisation, the evidence indicated that early production could not be achieved by separate marketing and sale of gas. Consequently, a change in circumstances is evidenced by the fact that the parties have moved to separate marketing. 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 the FID, 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 the FID.

The Australian case *Re Media Council*[2] 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.

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.

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.

Conclusion on Jurisdiction

On the information currently available to it, the Commission considers that:

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[2] *Re Media Council; Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593.

- either the authorisation in Decision 505 was granted on information that was "false or misleading in a material particular"; or

- "there has been a material change of circumstances since the authorisation was granted".

As a result, the Commission's preliminary conclusion is that it has jurisdiction to reconsider the authorisation granted in Decision 505.

Exercise of Discretion to Reconsider the Authorisation

On the basis of submissions received on the initial draft determination and also on Australian jurisprudence on the point, the Commission considers that when it decides that it has jurisdiction under s 65 of the Act, it should carry out a 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 but have altered in a minor way, particularly as to the benefits and detriments of the authorised arrangement, the Commission should 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.

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. 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:

- 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, as in this case, 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. This is the type of analysis that the Commission has carried out in reaching this revised draft determination.

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 in benefits or detriments.

Analysis of Benefits and Detriments

The Commission, from the information it has to date, accepts that there may be considerable practical difficulties associated with selling small quantities of gas when flows of that gas cannot be predicted in a reliable way. It seems plausible that there would be a substantial additional complexity if the Joint Venture parties were obliged to sell that gas separately. Any of the individual parties would be less likely to provide meaningful assurances to buyers about likely supply than the parties jointly.

For this reason the Commission is prepared to consider a substitute authorisation for joint marketing of what it has called "ad hoc" gas from the Pohokura field. Ad hoc gas would include any commissioning gas, peaking gas and gas produced during the final stages of the life of the field when output and deliverability cannot be guaranteed. The Commission seeks advice on how ad hoc gas can be defined with more precision.

To analyse competitive effects of, and public benefits and detriments arising from, an arrangement, the Commission compares the factual with the counterfactual. In this case the counterfactual is the continuation of the situation under Decision 505 whereby all gas from the Pohokura field would be able to be sold jointly without that joint marketing breaching the Commerce Act. The Commission has assumed in its analysis that the Pohokura joint venture parties in the counterfactual will choose to sell all gas beyond 2012 jointly. The factual is the situation which would result should the Commission determine that Decision 505 be revoked and replaced by an authorisation which would permit only the joint marketing of ad hoc gas. The Commission has assumed that the gas which will be sold separately in the factual and jointly in the counterfactual will be no more than 50% of the total current reserves. It is important to note that:

- the commencement date for production from Pohokura would be the same in both the factual and the counterfactual; and

- quantities of gas produced from Pohokura are determined largely by investments already made and by contracts already entered into. Consequently they would be similar in the factual and counterfactual.

The Commission has used the national gas production (and first point of sale) market in its analysis. Moreover, only future benefits and detriments are taken into account. The analysis does not take account of the claims of the parties that while the original authorisation was not necessary for the marketing and sale of the initial tranches of gas from Pohokura, it facilitated the early development of the field. Whether or not those claims can be justified, the earliest production date has now been determined and, therefore, for the purpose of this analysis the benefit has been considered to fall in the past, rather than in the future.

The benefits from the factual arise because a greater proportion of the gas from the Pohokura field will be sold separately in the factual compared with in the counterfactual and that this is likely to produce more competitive outcomes. The Commission has concluded that the environment will be more competitive in the factual with separate marketing post-2012 than in the counterfactual with, potentially, joint marketing post-2012.

Notwithstanding that the broad production parameters are likely to be similar in the factual and counterfactual there remains some incentive on the parties, in a joint marketing scenario, to take advantage of any market power associated with such joint marketing to limit output

below efficient levels. The Commission has concluded at this time that, by avoiding this potential for sub-optimal levels of production in the future, the factual would enhance allocative efficiency and thereby produce moderate benefits to the public.

Moreover, the Commission considers that the greater competitive pressures in the factual would be likely to lead to lower costs in the factual than in the counterfactual. These lower costs are likely to outweigh any additional marketing costs associated with separate marketing post 2012. The Commission has attributed a small public benefit to the enhanced productive efficiency resulting from an overall cost reduction in the factual.

Of further 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 joint venture partners, while the demand side is also limited to a small number of major players. Competition is an important pre-condition of a dynamic market, and this in turn requires market depth with industry participants acting independently of each other. The Commission considers that separate marketing of the post 2012 tranches of gas from Pohokura, would be likely to produce a more competitive market than joint marketing. In turn this more competitive outcome is likely to lead to enhanced dynamic efficiency. The Commission considers that it is particularly important to have a dynamic market to ensure an efficient adjustment to a post-Maui environment.

Therefore, the Commission when comparing the factual and counterfactual has characterised the allocative efficiency benefits from the factual as being moderate, the productive efficiency benefits as being small and the dynamic efficiency benefits as being potentially significant. On the other hand, the Commission considers that the detriments from the factual, as opposed to the counterfactual, are not significant.

On balance the Commission considers that the benefits of revocation and substitution of a new authorisation are likely to outweigh the detriments.

Preliminary Conclusions

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

- the authorisation in Decision 505 was either granted on information that was false or misleading or there has occurred a material change in circumstances subsequent to the date of the authorisation granted in Decision 505;

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

- given submissions received, the appropriate course of action is to consider a revocation and substitute authorisation, rather than an amendment to the extant authorisation;

- as in this case, substitution of the existing authorisation by a fresh authorisation is being considered, the Commission must compare benefits and detriments in the future with the existing authorisation continuing in force, with benefits and detriments in the future with a substitute authorisation in force;

- given that analysis, the Commission considers net public benefits will arise from the grant of a substitute authorisation; and

- the substitute authorisation should permit the joint sale and marketing only of ad hoc gas (as tentatively defined in this draft determination).

Draft Determination

If the Commission's preliminary conclusions are confirmed after its consideration of submissions on this draft determination, the Commission proposes, pursuant to s 65(1) of the Act, to revoke the authorisation granted in Decision 505 and grant a further authorisation in substitution for it.

At this stage the Commission proposes to grant a further authorisation in the following or similar terms.

> Pursuant to s 61(1)(a) of the Act, the Commission grants authorisation for OMV, Shell, Todd and any person who becomes a party to the Pohokura joint venture to enter into arrangements to jointly market and sell only:
>
> - gas produced during the initial commissioning of the Pohokura field and its production equipment. Initial commissioning ends when any gas is supplied under any of the existing gas supply arrangements which Shell, OMV and Todd have individually entered into and which exist at the time when this determination comes into effect;
>
> - gas produced from time to time in quantities greater than the maximum rated output of the Pohokura gas production station as it is at any time; and
>
> - gas produced from the Pohokura field after an independent assessment has determined that the proven and probable (as that term is understood in the New Zealand petroleum exploration industry) economic reserves of gas have fallen below 25 petajoules.

Next Steps

The Commission is now seeking written submissions from interested parties in respect of the preliminary conclusions it has reached in this revised draft determination. The deadline for written submissions to be received by the Commission is 14 November 2005.

Interested parties may advise the Commission by 14 November 2005 as to whether they consider it necessary for the Commission to hold a conference to discuss the issues raised by this revised draft determination. At present, the Commission does not consider a conference is necessary, but it will consider submissions/requests on the point and finally decide whether to hold a conference. Interested parties will be notified of the Commission's decision on this matter and will be provided with details, if a conference is to be held.

INTRODUCTION

1. On 20 December 2002, Preussag Energie Gmbh ("Preussag"), Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited ("Shell"); and Todd (Petroleum Mining Company) Limited ("Todd"), applied to the Commerce Commission ("the Commission") under s 58(2) of the Commerce Act 1986 ("the Act") for authorisation to enter into arrangements to jointly market and sell gas produced from the Pohokura field ("the Arrangement"). On 14 May 2003, the Commission was notified that OMV New Zealand Limited ("OMV") had purchased Preussag's participating interest in the Pohokura Joint Venture.

2. OMV, Shell and Todd are the parties to a Joint Venture Operating Agreement dated 15 July 1999 relating to Petroleum Mining Permit number 38154 issued by the Minister of Energy on 8 October 2004. PMP 38154 applies to an area of seabed immediately off the coastline north east of New Plymouth. Petroleum reserves which exist in the concession are known as the Pohokura natural gas field ("the Pohokura field"). The Pohokura field is owned in the following proportions:

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

3. In this draft determination, these parties, when acting together under the Joint Venture Operating Agreement, are referred to as the Pohokura Joint Venture.

4. Although the Pohokura Joint Venture considered that neither s 27 nor s 30 of the Act applied to the Arrangement, they recognised that opinions to the contrary were possible and wished to ensure that their acts of joint marketing, joint negotiation with purchasers, and entering jointly into contracts for the sale of natural gas from the field were immune from challenge under the Act. They, therefore, applied for authorisation of the Arrangement.

5. On 1 September 2003 the Commission determined, in Decision 505, to authorise the Arrangement, subject to certain conditions. The full text of the determination is provided at paragraph 20 of this draft determination.

6. On 13 April 2004, the Pohokura Joint Venture advised the Commission that they had been unable to reach agreement on critical issues associated with the joint marketing and sale of Pohokura gas. As a result, they had decided that it would be necessary to market and sell the gas separately so that sufficient contracts would be in place to ensure each party was able to make a final investment decision in time for Pohokura gas to be produced at full production capability, by mid-2006.

7. 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.

8. The Commission decided to consider whether s 65(1) of the Act applied and if so whether it should revoke its authorisation of the Arrangement. On 23 February 2005, the Commission released its draft determination of the matter.

9. The Commission received written submissions on its draft determination from Shell, OMV, Todd and Genesis Energy Ltd[3]. After taking account of the submissions, the Commission has decided to modify the approach, taken in the draft determination, to the analysis of issues arising under section 65 of the Act. As a result of its revised approach, the Commission now proposes to revoke the existing authorisation and to grant a further authorisation in substitution for it, on the basis of a forward-looking benefit/detriment analysis.

10. The draft determination released on 23 February 2005 did not address the proposal to grant a substitute authorisation or the supporting benefits and detriments analysis. In their submissions, the interested parties specifically requested that they be consulted again if the Commission intended to consider making such a substitute authorisation.

11. In this case the Commission considers it appropriate that the interested parties be given a further opportunity to make submissions to the Commission on its approach to the analysis of issues under section 65 of the Act and on the likely outcome of that analysis.

12. The Commission has, therefore, issued this revised draft determination and is now seeking written submissions from interested parties in respect of the preliminary conclusions it has reached in this revised draft determination. The deadline for written submissions to be received by the Commission is 14 November 2005.

13. Interested parties may advise the Commission by 14 November 2005 as to whether they consider it necessary for the Commission to hold a conference to discuss the issues raised by this revised draft determination. At present the Commission does not consider a conference is necessary, but will consider submissions and finally decide whether to hold a conference. Interested parties will be notified of the Commission's decision whether to hold a conference and will be provided with details, if a conference is to be held.

THE PARTIES

OMV

14. The OMV group is an Austrian-based energy company, historically with government roots, but now with diversified ownership. The OMV Group's core business is exploring for, and producing, oil and natural gas.

15. OMV's interests in New Zealand include:

- 10% ownership of the Maui field;
- 69% ownership of the Maari oil field; and
- joint interests in a number of petroleum exploration permits with other exploration companies, including Shell and Todd.

[3] The submissions received by the Commission are summarised beginning at paragraph 62.

Shell

16. Shell is part of the Royal Dutch Shell Group of Companies. The Shell Group companies are involved in activities relating to oil and natural gas, chemicals, electricity generation, and renewable resources in more than 135 countries.

17. The primary activities of Shell in New Zealand include:

- the exploration for, and production of oil and gas, including significant shareholdings in the Maui, Kapuni and Pohokura natural gas fields;
- the operation of Shell brand service stations;
- the production and distribution of marine and aviation fuels, lubricants, petrochemicals and detergents; and
- various equity investments including the New Zealand Refining Company and 50% of the shares in Shell Todd Oil Services Limited ("STOS"), the operator of the Maui, Kapuni and Pohokura fields.

Todd

18. Todd is part of the Todd family's group of companies. Todd Energy is a diversified energy business whose activities include:

- the exploration for, and production of oil and gas. It has significant shareholdings in the Maui, Kapuni, Pohokura, Mangahewa and McKee natural gas fields and in several exploration joint ventures holding petroleum exploration permits;
- 50% of the shares in STOS;
- natural gas retailing through it subsidiary Nova Gas Ltd ("Nova");
- electricity generation;
- electricity retailing through its subsidiaries Bay of Plenty Electricity Ltd and King Country Energy Ltd;
- coal mining; and
- LPG wholesaling.

19. Todd has a strategic agreement concerning exploration activities with Shell.

THE AUTHORISED ARRANGEMENT

The Determination in Decision 505

20. In Decision 505, the Commission authorised joint marketing and sale of gas from the Pohokura field:

> Pursuant to s 61(1)(a) of the Act, the Commission grants authorisation for:
>
> - OMV New Zealand Limited;
> - Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited;
> - Todd (Petroleum Mining Company) Limited; and
> - any person who becomes a party to the Pohokura joint venture,
>
> to enter into arrangements to jointly market and sell gas produced from the Pohokura field.

The authorisation is subject to the following conditions:

1) The Arrangement, as it applies to the carrying out of additional joint marketing and sale of gas for the period after 30 June 2006, is authorised only if the Pohokura field and its associated off-shore, and on-shore, gas production equipment is fully operational before 30 June 2006.

   For the purposes of Condition One:

   - the Arrangement to jointly market and sell gas includes the following:
     - the Pohokura Joint Venture discussing and agreeing on all relevant terms and conditions, including price, quantity, rate, specification and liability of the joint sale of gas from the Pohokura field; and
     - the Pohokura Joint Venture negotiating and entering into contracts for the sale of Pohokura gas jointly;
   - fully operational means that the Pohokura field and its associated off-shore, and on-shore, gas production equipment is installed, commissioned and is capable of producing at least 60 petajoules of gas per annum; and
   - the date of 30 June 2006 may be extended by the Commission on application by the Applicants for the period of any delay which the Commission considers was caused by events beyond the Applicants' reasonable control.

   For the avoidance of doubt, the Arrangement to jointly market and sell gas from the Pohokura field is authorised until 30 June 2006. The marketing and sale of gas by way of contracts agreed before 30 June 2006 but which extend beyond that date, remains authorised notwithstanding that the Pohokura field and its associated off-shore, and on-shore, equipment is not fully operational before 30 June 2006.

2) Any assignment by the Applicants or any other party acquiring an interest in the Pohokura JV of any part of their rights or interests in the Pohokura field, must be made conditional on the purchaser(s) obtaining from the Commission a clearance pursuant to section 66, or an authorisation pursuant to section 67 of the Commerce Act 1986.

3) The Applicants or any other party acquiring an interest in the Pohokura Joint Venture must not enter into any contract for the sale of gas from the Pohokura field which contains terms or conditions which limit or restrict the resale of the gas to third parties.

The Commission's Reasons for Granting the Authorisation

The Factual and Counterfactual

21. For the purposes of Decision 505, the factual, with the Arrangement authorised and in place, involves the Pohokura Joint Venture jointly marketing and selling gas from the Pohokura field. The first production of gas from the field would occur during February 2006 and the full production capability of the field would be reached by the end of the second quarter of 2006.

22. The counterfactual, in the absence of the Arrangement, would have the following characteristics:

- the Pohokura Joint Venture would negotiate and agree on the development profile and gas output of the field;

- OMV, Shell and Todd would then separately sell a proportion of the gas output of the Pohokura field, corresponding to their individual equity ownerships of the field;

- OMV, Shell and Todd would negotiate and agree on measures to address the contractual implications of separate marketing; and

- production from the Pohokura field would be delayed by one year relative to the factual, as a result of the time needed to cement such measures in place.

The Relevant Market

23. The relevant market for consideration of the competition effects of the Arrangement was the national natural gas production (and first point of sale) market;

Lessening of Competition in the Factual

24. The characteristics of joint marketing in the factual in comparison to the counterfactual were taken to be:

- a lesser number of competitors in the market;

- higher prices and an enhanced potential for price discrimination;

- a more limited range of terms and conditions being offered to gas purchasers by the joint venture; and

- a slowed or inhibited development of a more efficient and competitive wholesale gas market in the future.

25. The Commission concluded that joint marketing in the factual, with authorisation of the Arrangement, would result in a lessening of competition in comparison to separate marketing in the counterfactual without authorisation of the Arrangement.

Detriments

26. The Commission considered that the following additional detriments would arise in the factual, in comparison to the counterfactual:

- a significant, but moderate detriment from a lessening in allocative efficiency;

- a small detriment from a lessening in productive efficiency; and

- a more significant detriment from a loss of dynamic efficiency.

Benefits

27. The Commission considered in Decision 505 that there would be potential benefits that would arise in the factual but not in the counterfactual as a result of:

- earlier development of the Pohokura field (with benefits in the order of $47.8m to $81.9m arising);

- limited lower production and transaction costs; and

- possibly some improvement in operational efficiency; limited savings in field facilities, appraisal and design costs; and an increase in incentives for oil companies to explore for gas in New Zealand.

Weighing the Detriments and Benefits

28. After weighing the detriments and benefits, the Commission decided in Decision 505 that it appeared that there would be a net benefit to the public from joint marketing under the Arrangement. However, the Commission decided that for it to be satisfied about this net effect it was necessary to impose conditions stated in paragraph 20 to lock in the benefits.

The Commission's Determination

29. In summary, in Decision No. 505 the Commission stated that joint marketing would:

- restrict the number of competitors in the market;
- result in higher prices and enhance the potential for price discrimination;
- result in a more limited range of terms and conditions being offered to gas purchasers; and
- slow or inhibit the rate at which a more efficient and competitive market may evolve in the future.

30. On the other hand, the Commission accepted that in the counterfactual there would also be a high level of co-ordination between the parties on such matters as field development and determining output parameters.

31. Overall, the Commission concluded that the Arrangement, if authorised, would lessen competition in the gas production and first point of sale market, and that this would lead to detriments from a lessening in allocative, productive and dynamic efficiencies.

32. The Commission considered that benefits to the public could arise from joint marketing in the form of lower production and transaction costs and, possibly, some improvements in operational efficiency, a saving in field facilities, appraisal and design costs, and an increase in the exploration incentive.

The Critical Factor in the Commission's Reasoning

33. The benefit which was critical to the Commission's decision to grant the authorisation was that arising from the early development of the Pohokura field. After considering numerous submissions on the matter, the Commission concluded that with separate, rather than joint, marketing full production capacity of the Pohokura field would be delayed by one year from mid-2006 to mid- 2007.

34. The Commission noted in paragraph 516 of the Decision that, on the balance of probabilities, the benefits from the arrangement excluding the benefit from early production, were likely to be less than the detriments from the loss of competition. To ensure that joint marketing achieved early production, the Commission imposed a

condition which stated that joint marketing, as it applies to the carrying out of additional joint marketing of sale of gas for the period after 30 June 2006, is authorised only if the Pohokura field and its associated off-shore and on-shore, gas production equipment is fully operational before 30 June 2006. Gas marketing and sales of gas prior to that date were not affected by this condition.

35. As a result of these considerations, the Commission authorised joint marketing and sale of Pohokura gas, subject to conditions.

36. In reaching its decision, the Commission took account of submissions by the Pohokura Joint Venture. Discussed below are the statements and claims about such early production and marketing, made by the Pohokura Joint Venture to the Commission, in their Application for authorisation, during the Commission's investigation of the matter and at the Commission's conference.

The Parties' Submissions during the Original Authorisation Process

37. In their Application for authorisation of the joint marketing and sale arrangement, dated 20 December 2002, the Pohokura Joint Venture stated at paragraph 16:

> The immaturity of the New Zealand gas market means that the practical problems the Pohokura JV parties would face in separately marketing gas would be difficult if not impossible to overcome. Substantial welfare losses will occur if joint marketing is not authorised. Absent joint marketing, a substantial delay in the development of the field is expected, at a time of scarcity of resource. In addition, separate marketing would result in significant extra transaction and production costs, and sub-optimal field depletion. This would impact significantly on the value of the field, and that effect would have the potential of significantly reducing exploration incentives in New Zealand.

38. The difficulties of separate marketing were discussed at paragraph 26 of the Application.

> In attempting to separately sell gas produced jointly, pursuant to contracts negotiated individually, the Pohokura JV parties would face a number of insurmountable problems. Contracts negotiated without co-ordination will consequently contain different extraction rates, quantity, term, etc. The practical problems faced by the Pohokura JV parties include determining how they would:
>
> - apportion the costs of appraisal, development and operation;
> - apportion facilities access;
> - appropriately allocate risk, in particular reserves risk;
> - apportion uplift rights;
> - apportion field deliverability;
> - apportion all products recovered; and
> - appropriately adjust overlift and underlift.

39. Paragraph 45 of the Application states:

> The Pohokura JV parties do not consider that separate marketing is feasible in the foreseeable future or for the expected life of Pohokura. Accordingly, no development is a counterfactual in the event that authorisation is not granted.

40. The Pohokura Joint Venture further stated in their Application that if the Commission did not accept such a "no development" counterfactual, there were two other theoretical options. One of these was adopted by the Commission as the most likely counterfactual[4] (which was subsequently accepted by the Pohokura Joint Venture). This was given the title "scenario 1". Scenario 1 was described in Decision No. 505 as follows:

> "Scenario 1" is where the parties separately sell their proportion of gas after agreeing on parameters for the development of the field. This included an optimal depletion path which may be described in terms of maximum daily, average daily and annual quantities. Within these constraints each Pohokura JV party is able to separately sell its proportionate share of gas to the buyer(s) on the basis of independently negotiated terms and conditions, including price.

41. The Pohokura Joint Venture argued in their Application for authorisation that in a "Scenario 1" type situation, even if an optimistic view were taken, the development of the field would be delayed by three years beyond the time required for development under the factual with the joint marketing arrangement in place, and the welfare losses from separate marketing would be very large.

42. Subsequent to their submission on the draft determination, the Pohokura Joint Venture provided additional information claiming that the production and marketing delay which would result, if separate marketing was forced on them, would in fact be six years, although they stated that three years was the appropriate, albeit conservative, timeframe to use for the purpose of the analysis.[5]

43. The Commission's reasons for Decision 505 set out the timetable provided by the Pohokura Joint Venture in which they estimated times for joint and separate marketing:

> The Applicants' joint marketing scenario estimated there would be 43 individual tasks to be completed taking 483 days under the following timetable:
>
> - authorisation approved on 8 August 2003;
> - Phase 1 – gas marketing completed in 483 days on 21 March 2004;
> - Phase 2 – bank approvals and project financing completed in parallel with Phase 1 by 21 March 2004; and
> - earliest FID to be made on 21 March 2004.
>
> In contrast, the Applicants' Scenario 1 separate marketing timetable estimated there would be 138 individual tasks to be completed taking approximately 2200 days under the following timetable:
>
> - appeal of joint marketing decision would take 730 days to 8 August 2005 with no other work taking place during this period;
> - Phase 1 – preparation for selling gas completed in 120 days;
> - Phase 2 – seeking bank approval / project financing completed in 50 days;
> - Phase 3 – joint venture agreements completed in 838 days;
> - Phase 4 – gas marketing completed in 479 days;
> - Phase 5 – renegotiation of JV joint agreements based on gas marketing outcomes completed in 260 days;
> - Phase 6 – project redesign completed in 390 days; and

[4] See, for instance, Dr Berry for the Pohokura Joint Venture, Conference transcript of 1 July 2003, p7.
[5] Pohokura Joint Ventures' Reply, Conference transcript, 3 July 2003, p393.

- earliest FID to be made on 24 August 2010.

44. In Decision No. 505 the Commission concluded that joint marketing and sale, as opposed to separate marketing and sale, would result in a lessening of competition. Further, it concluded that this would result in a loss of allocative, productive and dynamic efficiencies. These effects would result in a detrimental impact on gas users and the economy as a whole.

45. The Pohokura Joint Venture submitted that there were a wide range of public benefits which they claimed would be likely to arise from joint marketing and sale. The Commission considered them all and concluded that benefit to the public would arise from lower production and transaction costs and possibly from more operationally efficient depletion of the field, a savings in facilities and in appraisal and design costs and an increase in the incentive to explore for additional gas. However, the largest benefit arose from the early production from the field (by one year). The Commission assessed the value of this benefit as being in the order of $47.8m to $81.9m.

46. The Commission concluded that, on the balance of probabilities, the detriments from the loss of competition outweighed the benefits, excluding the benefit from early production. To put it another way, without the early production, which joint marketing and sale was considered to bring, the Arrangement would not have been authorised, notwithstanding the other benefits accepted by the Commission.

47. The Joint Venture submitted that the date that production commences critically depended on the date of the final investment decision, that being the date which determines when the physical construction and development of the field can commence. The Pohokura Joint Venture informed the Commission that the final investment date would be significantly delayed if they were required to market and sell Pohokura gas separately. The construction and development steps after the final investment decision were expected to take about the same time, irrespective of whether the gas is to be marketed and sold jointly or separately.

48. As discussed above, the Pohokura Joint Venture submitted that with joint marketing and sale, the final investment decision date would be 21 March 2004 and the field would be in full operation by 30 June 2006, whereas under separate marketing and sale the final investment decision date would be 24 October 2010. The Commission concluded that the likely delay with separate marketing and sale would be one year.

49. In the event, the Pohokura Joint Venture chose to adopt a separate marketing and sale approach in mid-April 2004, and reached the final investment decision at the end of June 2004. The Commission has concluded from this that the separate marketing and sale approach has not led to a delay in the final investment decision. The delay between 21 March 2004 (the original final investment decision target date) and the end of June 2004 may be attributable to the seven and a half months[6] spent by the Pohokura Joint Venture attempting (and failing) to reach an agreement amongst themselves on joint marketing and sale arrangements.

[6] 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.

Separate Marketing Developments Post-Authorisation

50. On 13 April 2004, OMV and Shell advised the Commission that the Pohokura Joint Venture had been unable to reach agreement on critical issues associated with the joint marketing of Pohokura gas. They advised they decided that 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.

51. In May 2004, Shell announced in two separate media releases:

> …the contracted sales of foundation volumes of its 48% share of Pohokura gas.
>
> …the sale of parcels of gas to Contact Energy, Ltd, Genesis Power Ltd, and Multi Gas (NZ) Ltd, was one of the key milestones to be achieved to further confirm that the Pohokura project is firmly on track to produce gas from mid 2006.
>
> Shell's Pohokura entitlement is now largely contracted until 2012 with some of the contracts extending even further out into the future.
>
> …it had sold two further parcel[s]….to NGC Holdings Ltd. ….With this further sale of Pohokura gas to NGC, Shell….. has now essentially concluded our marketing campaign targeting foundation customers in the lead up to the investment decision for the Pohokura development stated for mid-2004,…

52. Also in May, Contact Energy Ltd announced in a press release:

> In early April, OMV … offered an initial tranche of gas from the Pohokura field to prospective buyers. The volume of gas offered was up to OMV's… share of production from the … field for a period of five years commencing from the field's first production date. This is expected to be around 30 June 2006.
>
> Under the terms of the arrangements …..Contact will purchase the entire initial tranche of gas from OMV.
>
> The volume of gas covered by the arrangement is broadly equivalent to the fuel requirement of our Otahuhu B power station….

53. In May 2004, Genesis Energy announced in a media statement:

> Genesis has entered into agreements with Todd Energy to purchase gas from the ……Pohokura oil and gas fields.
>
> It has ….purchased Todd Energy's entitlements from Pohokura, with delivery starting 1 January 2006 through to the end of December 2011

54. On 30 June, 2004 Shell announced in a media release:

> Shell New Zealand has formally given the green light to the development of the Pohokura gas field, when it signed off the Final Investment Decision (FID) today.
>
> Shell New Zealand Exploration and Production Commercial Manager Ajit Bansal said taking FID signalled the formal start of the development of the Pohokura field.

> It is now all systems go for Pohokura. With the taking of FID today the Joint Venture has instructed the operator, Shell Todd Oil Services to lodge a Mining Permit with Crown Minerals.

55. In their statements quoted in paragraphs 37 to 39 above, the Pohokura Joint Venture said that separate marketing and sale of gas either had practical problems that "would be difficult if not impossible to overcome" or is not "feasible in the foreseeable future or for the expected life of Pohokura". Within nine months of the Commission's authorisation of joint marketing and sale of gas from the Pohokura field each of Shell, OMV and Todd acted contrary to these statements. Presumably, in that short length of time, the "difficult or impossible practical problems" have been overcome and it has become "feasible" to separately market and sell Pohokura gas. Moreover, again contradicting the Pohokura Joint Venture's statements to the Commission during its consideration of the authorisation application (one of which is quoted in paragraph 43 above), separate marketing has not resulted in a delay to the date of the final investment decision or to the development and production timetable for Pohokura gas.

56. The Pohokura Joint Venture have stated that they may still need to revert to the joint marketing and sale of Pohokura gas:

- if gas balancing arrangements cannot be negotiated and the companies need to revert to some form of joint sale to fulfil the existing gas sale agreements;
- for the marketing and sale of commissioning gas, peaking gas and for those subsequent tranches of gas, particularly as deliverability becomes less certain at the end of the life of the field;
- if separate marketing results in significant unutilised capacities or other inefficiencies; and
- when further investment becomes necessary to recover residual gas.[7]

57. Whether or not this is correct, these matters were not at the heart of the Commission's decision to authorise joint marketing and sale. The Commission authorised joint marketing and sale, despite its detrimental impact on competition, principally because it was persuaded (by information which has since proved to be incorrect) that joint marketing and sale was necessary in order to realise the benefits associated with early gas production from the Pohokura field. Parties have submitted that the continued retention of the authorisation may provide the Pohokura Joint Venture with a useful back-up if separate marketing and sale proves difficult. However, it would also mean that if joint marketing and sale was chosen at some time in the future (if the authorisation remained in place), gas consumers would face detriments from the loss of competition.

58. It is possible that the Pohokura Joint Venture parties have now found benefits from joint marketing and sale which are different from those submitted to the Commission during the course of its consideration of the original Application for authorisation. Equally, it is possible that there are different detriments. However, the material relevant change is that the nexus between joint marketing and sale and early production no longer exists. Without that the public benefit analysis alters

[7] In their letter to the Commission of 18 October 2004.

substantially in a way which was discussed by the Commission when it gave the authorisation. The Commission in Decision No.505 indicated that without that nexus, the authorisation would not have been given.

THE COMMISSION'S INITIAL DRAFT DETERMINATION

59. The Commission released its initial draft determination on 23 February 2005. The Commission's preliminary conclusions in the initial draft determination, on the basis of the information available to it at the time, were that:

- Either the authorisation granted in Decision 505 was granted on the basis of information that was false or misleading in a material particular or, alternatively, there had been a material change in circumstances since the authorisation was granted;
- as a result, the Commission had jurisdiction to consider whether to revoke, amend, or grant a further authorisation in substitution for Decision 505;
- the Commission should, after considering whether to revoke, amend or grant a further authorisation in substitution for the authorisation under Decision 505, exercise its discretion to revoke the authorisation; and
- the Commission ought not to amend, or grant a further authorisation in substitution for, Decision 505.

60. The Commission stated that:

> If the Commission's preliminary conclusions are confirmed after its consideration of submissions on this draft determination, the Commission proposes to revoke the authorisation granted in Decision 505, pursuant to s 65(1) of the Act.

61. The commission received submissions on its initial Draft Determination from each of the individual members of the Pohokura Joint Venture. These are summarised below. A further submission was also received from Genesis Energy Ltd.

Submissions by Todd

Summary

62. Todd submitted, in summary, that:

- The Commission does not have jurisdiction to revoke the authorisation because no false or misleading statements have been made and there have been no material change in circumstances.
- It would be inappropriate for the Commission to exercise its discretionary powers because joint arrangements may still be necessary, it would create a risk of delay in production, no analysis has been undertaken on whether an amended authorisation is appropriate.

- The Commission has not followed the procedural steps prescribed in s 65(2), in particular it has not considered whether there should be an amended or substituted authorisation.

False or Misleading

- It is wrong to assume that because a representation as to future events turns out to be wrong, there has been a false or misleading statement.

- Statements are not false or misleading if they are based upon sound background knowledge, the maker of the statement intends to make good the forecast, and they are not made recklessly.

Final Investment Decision

- The Commission infers that the Pohokura Joint Venture's position that the Final Investment Decision (FID) could only be achieved in 2004 if joint marketing was authorised. The Commission overstated the importance of the FID.

- The Pohokura Joint Venture had advised the Commission that the FID was an estimate only. The claim by the Pohokura Joint Venture that joint marketing was critical to achieving the FID was based on an industry-wide assessment.

Early Production

- The statement that early production will occur in any event is premature.

- Todd never stated that joint marketing was necessary to achieve early production by June 2006 – just that it would delay development by three to seven years.

- The view on the extent of the delay was based on sound industry knowledge. Therefore, it could not have been false or misleading in the relevant sense.

Material Change of Circumstances

- The fact that there has not yet been a material change in circumstances is not, of itself, a change in market circumstance.

- The inability to agree joint selling terms reflects a disparity of commercial interests within the Pohokura Joint Venture.

- Joint marketing is still the best option for commissioning gas, for peaking gas and for subsequent tranches particularly as deliverability becomes less certain.

- The Pohokura Joint Venture may also need to revert to joint marketing if gas balancing agreements cannot be negotiated, or if separate marketing leads to inefficiencies, or in respect of residual gas. Therefore, absence of an ability to jointly market might still cause a delay.

- The only significant change since the authorisation is the 50% plus increase in liquids prices. This has increased the incentive to develop the field quickly.

- The standard authorisation test would still show that benefits outweigh detriments.

Exercise of Discretion

- Even if there was jurisdiction it would be inappropriate for the Commission to exercise its discretion because it cannot be assumed that separate marketing will result in the planned dates for production from the field being met, and revocation may create a risk of additional delay.

- The Commission is in error in asserting that there are no grounds requiring it to consider an amended or substituted authorisation.

- If the Commission revoked the authorisation and it became clear that separate marketing could not work, presumably the Commission would expect the Pohokura Joint Venture to reapply for the restoration of revoked rights to jointly market. It would cause the duplication of significant costs in the authorisation process and it is likely that it would not occur until 2006, increasing the risk of delays in development of the field.

- If the Commission concludes that it has jurisdiction under s 65(1)(a) it must assess the impact of the changes in question on detriments and benefits before it can exercise its discretionary powers. This assessment is merely a matter of adjusting the previous analysis to account for changes in facts.

- The Commission must consider the prospect of an amended or substituted authorisation before it can exercise its power of revocation.

- The 'straight conduct test' as discussed in *Re Media Council* does not apply here because the parties have not moved away from the authorised conduct, the Pohokura Joint Venture has every intention to engage in the authorised conduct, there remains the likelihood of joint marketing, and some separate marketing is not inconsistent with joint marketing.

- The assessment will require a new factual and counterfactual. Detriments will need a significant reassessment. Also new public benefit assessments.

- The Commission is incorrect to conclude that there are insufficient grounds for an amended or substitute authorisation. It has failed to give sufficient weight to the likelihood that there will continue to be the need for joint marketing, the basic facts and reasoning in Decision 505 remain, it has failed to consider the changed counterfactual or the changed benefits and detriments.

Process Issues

- The Commission has failed to reassess the standard authorisation test and it has not discharged its responsibility to give parties a reasonable opportunity to make submissions.

- If the Commission wishes to proceed then the appropriate way forward will be for it to invite the Pohokura Joint Venture parties to make detailed submissions on the authorisation test, issue a revised draft determination and provide an opportunity for further written submissions.

Submissions by Shell

63. Shell submitted, in summary, that:

- Information provided was not misleading – what has happened is merely that the counterfactual as described two years previously has not come to pass. That will be a common situation with Commission authorisations (and clearances), but it is unrealistic to say in those cases that the Commission has made its decision on the basis of false or misleading information.

- Shell could not have reasonably anticipated the degree of misalignment of the commercial interests of the Pohokura joint venturers such that joint selling could not be negotiated amongst them. Therefore, the Application represented an accurate and honest appraisal of the likely counterfactual at the time.

- The existence of the authorisation was a factor in Shell's decision to commit to a FID, as it provided the comfort of an alternative option should the Pohokura Joint Venture be unable to agree on the contractual mechanisms necessary for separate selling.

- The benefits of early production are no longer fundamental to the Commission's analysis because early production will occur regardless of whether the gas is marketed jointly or separately.

- Shell requests that before any revocation occurs, the Commission should carry out cost/benefit analyses with and without the revocation, which would reveal significant risk with the revocation as compared to minimal detriment without the revocation.

- Shell does not request that the Commission amend the existing authorisation, rather that it should re-examine the matter of revocation in one year's time when the commercial dynamics have had time to play out. Shell suggests there is no downside to exercising such caution.

- The parties may have to revert to joint selling and without an authorisation that would lead to lengthy delays while another authorisation was sought. That would not be in the public interest.

Submissions by OMV

Background

64. OMV submitted, in summary, that:

- It was OMV's honestly held view at the time of the authorisation that the only way to achieve early production from Pohokura was to jointly market the gas.

- The necessary agreement on the field development plan and the FID would probably not have been achieved without the authorisation of joint selling.

- Although OMV has gone to the market separately, this does not mean that separate marketing is possible and/or will be achieved by June 2006. It may still be necessary to revert to joint marketing.

- A legally binding gas balancing agreement still has to be negotiated, and this will not be straightforward. When it is negotiated, it may need Commerce Act authorisation.

Application of Section 65

- At the time of the authorisation OMV honestly held the view that joint marketing was the only practical way of achieving early production from Pohokura.

- OMV does not agree that the Commission was provided with information which was false or misleading, and does not agree that the requirements of s 65(1)(a) are satisfied.

- OMV and the other Pohokura Joint Venture parties spent a considerable amount of time and effort attempting to negotiate joint marketing arrangements.

- OMV finally concluded that the prospects of resolving internal differences were non-existent, and it accepted the future risk associated with negotiating a future gas balancing agreement.

- There is still considerable doubt as to how the situation will play out. If a gas balancing agreement cannot be agreed, OMV may still need to fall back on a joint marketing alternative.

- It is premature to speculate that the nexus between joint marketing and early production has been severed.

- If the Commission determines to revoke the Authorisation, OMV requests that the Commission consider further submissions to amend the Authorisation to permit joint marketing in specific circumstances, such as if a gas balancing agreement cannot be concluded in time to allow early production.

GROUNDS FOR RECONSIDERATION OF AN AUTHORISATION

65. 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.

66. 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) are fulfilled. 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 amend or revoke.

67. 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. [8] 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

68. 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.[9]

69. Paragraphs (a) and (b) of subs 65(1) should be construed as complementary, so that interpretation of what is 'false or misleading' influences interpretation of what is a relevant 'change of circumstances'. Accordingly, there should be no 'gap' or *lacuna* between the two grounds.

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[8] "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.

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

False or Misleading?

70. 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'.

71. 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.

72. 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,[10] with FID 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.[11]

73. 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 not believe the forecasts or predictions or was recklessly indifferent concerning them" before it can be held that the representation was false or misleading.[12]

74. 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.[13] Such an implied statement as to present or past fact may be false or misleading.[14] 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 also enable them to achieve early production. If this was the case, then their statement could be considered false or misleading.

75. The Commission does not have before it any evidence that suggests the joint venture parties were aware that separate marketing would or might be feasible, at the time they made relevant representations to the Commission.

76. 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

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[10] Decision No. 505, paras 292, 320 (increased from three years, as per their application).
[11] Decision No. 505 para 338.
[12] *Commerce Commission v Chalmers* (1990) 3 TCLR 522, 523.
[13] *Thompson v Mastertouch TV Service Pty Ltd (No 2)* (1977) 15 ALR 487.
[14] *Commerce Commission v Telecom Corporation of New Zealand Ltd* (1990) 4 TCLR 1.

interpretation of those words in the context of Fair Trading Act s 9, the difference in statutory context is material.

77. 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.

78. 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 caused little or no delay in achieving the FID, 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.

79. 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 submission on the initial draft determination, 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 there existed some objective basis for the one year forecast. The Commission does not consider, however, that it is necessary in this proceeding to determine whether the information at issue is properly regarded as "false or misleading" in terms of section 65(1)(a) because if it was not, due to the existence at the time it was made of an objective foundation for that prediction, then the Commission considers that a "material change of circumstances" must have subsequently occurred.

In a Material Particular?

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

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

82. 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.

83. 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.

84. 'Material' means that the particular must be relevant and of moment and significance in relation to the purpose for which it was provided.[15] It will be relevant if it may, will or must be taken into account.

85. The information as to the infeasibility of achieving the FID by March 2004 in the absence of joint marketing and sale of gas was a 'material particular' because the FID 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.

86. In Decision 505 the 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.[16] 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.[17] 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 arranging supply contracts individually as opposed to collectively would be more time consuming and would lead to higher costs.[18] In the absence of authorisation, the time taken to enter into the contracts would be significant and, as a result, would delay the FID.

87. 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 FID would be made by 1 April 2004. Once the FID 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.[19] In the absence of joint marketing the FID would not be made until 24 August 2010.[20]

88. 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 FID 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

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[15] *Minister of Immigration, Local Government and Ethnic Affairs v Dela Cruz* (1992) 110 ALR 367.
[16] 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.
[17] *Decision No. 505* at para 298.
[18] *Decision No. 505* at para 181.
[19] *Decision No. 505* at para 291.
[20] *Decision No. 505* at para 319.

earlier than the proposed FID 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 FID 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.

89. 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.

Change of Circumstances?

90. 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". OMV does not, however, regard the change as 'material'.

91. 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'."

92. 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.

93. 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.

94. The Commission considers that the effect of paragraphs 65(1)(a) and 65(1)(b) of the Commerce Act, read together, is that there is a continuum between a "change of circumstances" and "false or misleading" conduct, and not a gap between those concepts. If the information was wrong and not objectively justifiable at the time the authorisation was made, then it was "false or misleading" but the "change of circumstances" provision does not apply because the circumstances, considered objectively, have not changed. If, however, the information was objectively justified at the time the authorisation was made but subsequently proves to be incorrect,

objectively viewed, then a change of circumstances must be considered to have occurred.

95. At the time the Commission was considering the authorisation, the evidence indicated that early production could not be achieved by separate marketing and sale of gas. Consequently, a change in circumstances is evidenced by the fact that the parties have moved to separate marketing. 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 the FID, 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 the FID.

Change in Circumstances that is "Material"?

96. 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.

97. Shell denies that relevant conditions have materially altered.

98. 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".

99. The Australian case *Re Media Council*[21] 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.

100. 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.[22]

101. 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.

Conclusion on Jurisdiction

102. On the information currently available to it, the Commission considers that:

- either the authorisation in Decision 505 was granted on information that was "false or misleading in a material particular"; or

[21] *Re Media Council; Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593.
[22] *Re Media Council of Australia & Ors* (1996) ATPR 41-497, 42-241.

- "there has been a material change of circumstances since the authorisation was granted".

103. As a result, the Commission's preliminary conclusion is that it has jurisdiction to reconsider the authorisation granted in Decision 505.

Does the Commission have jurisdiction to reconsider the authorisation granted in Decision 505?

EXERCISE OF THE COMMISSION'S DISCRETION

Discretion of the Commission

104. 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.

105. 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.

106. Section 91 of the Trade Practices Act formerly 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.

107. 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.[23]

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

108. 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.

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

110. 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 should be regarded as similar to a 'minor variation' to an authorisation under the Trade Practices Act. Hence, the distinction between 'amending' and 'revoking and substituting' under the Commerce Act would seem to be similar to the distinction between a 'minor variation' and 'revoking and substituting' under the Trade Practices Act.

111. 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.[24] 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.

112. 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.

113. 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.

114. 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

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

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

115. Todd submitted that:

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

116. 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)'.

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

118. The Trade Practices Act contains similar provisions to s 65 of the Commerce Act. Australian courts and the ACCC have therefore considered how the decision making body should exercise its discretion once jurisdiction has been established. While the relevant provisions are not identically 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.

119. 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.

120. In *Re Media Council of Australia & Ors,*[25] 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

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

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'.

121. 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?
> (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.[26]

122. 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 authorisations applications, to have regard to relevant benefits and detriments when considering how to exercise its discretion under s 65.

123. 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 should 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.

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

124. 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. 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:

- 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, as in this case, 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. This is the method of analysis of the balance of benefits and detriments carried out below.

125. 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 in benefits or detriments.

Conclusion on the Exercise of Discretion

126. 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. It has determined how to exercise its discretion in accordance with the methodology described above.

127. Further, the Commission has noted the submissions of the participants in the Pohokura Joint Venture that, absent any authorisation, practical difficulties will arise in respect of the marketing and sale of:

- gas produced during the process of commissioning the Pohokura field production equipment;

- peak gas flows produced from Pohokura field, above normal maximum production limits; and

- tranches of gas produced near to the end of the life of the Pohokura field when deliverability becomes less certain.

128. In the analysis below, these categories of gas produced from the Pohokura field are grouped together under the term "ad hoc" gas.

129. As part of this revised draft determination, the Commission analyses whether to revoke the authorisation granted in Decision 505 and, as well, whether to grant a further authorisation in substitution for it. The Commission's purpose in considering the substitute authorisation is to alleviate the practical marketing and sale difficulties raised by submitters.

130. The Commission does not consider that such a change can be categorised as the authorisation remaining in force fundamentally unchanged but amended to reflect changes that may be required to ensure the benefits of the conduct are in future realised.

131. 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.

The Commission is willing to consider exempting the Joint Venture parties from the requirement that they separately sell ad hoc gas – that is limited amounts of gas which fall within the description of commissioning gas, peaking gas and gas produced towards the end of the life of the field.
What are the practical and cost difficulties associated with selling ad hoc gas separately?
How best can ad hoc gas be defined to ensure that any exemption from the separate marketing requirement is appropriately limited?
What is the approximate quantity of gas which falls within this definition?

ANALYSIS OF BENEFITS AND DETRIMENTS OF A SUBSTITUTE AUTHORISATION

The Gas sector

132. Natural gas accounted for 23.9% of New Zealand's total energy supply in 2003 (compared with 30.4% in 2002). In the year to September 2004 it was gas was used by different sectors in the following proportions:

Electricity generation	40.5%
Methanol production	26.3%
Ammonia/Urea production	4.8%
Industrial & Commercial	23.6%
Residential	4.7%
Transport	0.1%

133. 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 next year), although none is close to the size of the Maui field.

134. 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 its depletion date. Total production for the year ended September 2004 was 156 PJ, of which 99 PJ came from the Maui field.

135. On the demand side, gas used for electricity generation has declined from 116 PJ in 2001 to 64 PJ in 2004, while that used by the petrochemical sector (principally in the production of methanol) has declined from 91 PJ in 2001 to 48 PJ in 2004.

The Factual and the Counterfactual

136. For the purpose of its analysis of competitive effects of an arrangement, and of the public benefits and detriments of that arrangement, the Commission compares the factual with the counterfactual.

137. The counterfactual is the continuation of the situation under Decision 505 whereby all gas from the Pohokura field would be able to be sold jointly without that joint marketing breaching the Commerce Act.

138. In this instance the factual is the situation which would result should the Commission determine that Decision 505 be revoked and replaced by an authorisation which would permit only the joint marketing of ad hoc gas. Important features of the counterfactual are:

- the commencement date for production from Pohokura would be the same in both the factual and the counterfactual; and

- quantities of gas produced from Pohokura are determined largely by investments already made and by contracts already entered into. Consequently, they would be the same in both the factual and counterfactual.

Market Definition

139. The purpose of defining a market is to provide a framework within which the competition implications 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.

140. 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.

141. The relevant principles relating to market definition are set out in *Telecom v Commerce Commission (1991*[27]*)* ("the AMPS A case") and in the Commission's Mergers and Acquisition Guidelines.

142. 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").

143. 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

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

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 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.

144. While market circumstances have changed in some respect 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.

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

Are the counterfactual and market definition used in this Draft Determination appropriate for the analysis of the matter before the Commission?

Competition

146. 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 MED'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%**

147. 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[28] 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 by the field owners – 50% by Shell and 50% by Todd; and

- most 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 in proportion to their equity interests in the field.

148. Apart from the gas fields in the above table, other fields which are producing gas or which are considered to be promising include the:

[28] "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.

- Kaimiro and Ngatoro fields are owned by Greymouth Petroleum and produces between 1 and 3 PJ per annum:

- Radnor field near Stratford is described by its owners Bridge Petroleum as a promising field perhaps capable of producing [8 PJ] per annum. Bridge Petroleum also owns the small Surrey field; and

- Cardiff field owned by Austral Pacific has been the subject of some promising reports.

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

150. 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, but the Commission has no reason to move away from this "best estimate".

Weighing Benefits and Detriments

Introduction

151. The following analysis assesses the public benefits and detriments of an authorisation, permitting joint marketing and sale only of ad hoc gas, which might be granted in substitute to that in Decision 505.

152. As discussed, the Commission is prepared to consider a substitute authorisation for joint marketing of ad hoc gas from the Pohokura field. Ad hoc gas includes commissioning gas, peaking gas and gas produced during the final stages of the life of the field when output and deliverability cannot be guaranteed. For the avoidance of doubt, future tranches of gas whose deliverability is sufficiently certain to enable sale by fixed quantity/ term gas supply agreements, are not included in the term ad hoc gas. However, the Commission seeks advice from submitters as to how ad hoc gas can be defined with more precision.

153. Only future benefits and detriments are taken into account. The analysis does not take account of the claims of the parties that while the original authorisation was not necessary for the marketing and sale of the initial tranches of gas from Pohokura, it facilitated the early development of the field. Whether or not those claims can be justified, the timing of the field development has now been determined and will not be affected by the Commission's decision in this case.

Assumptions Used in the Analysis

154. The assumptions used in this analysis include:

- the factual is an authorisation granted in substitute for that in Decision 505 under which all future Pohokura gas, other than ad hoc gas, will be sold separately;

- the counterfactual is the status quo, with the extant authorisation remaining in force;

- the Pohokura field will commence production in 2006 irrespective of whether the factual or counterfactual is adopted;

- most gas from the field from the date production commences until 2012 has been either committed to meeting gas sale agreements entered into separately or, in the case of commissioning gas and peaking gas, will be sold jointly in both the factual and counterfactual;

- the Pohokura joint venture parties in the counterfactual will choose to sell all gas produced after 2012 jointly. This is the conservative approach from the Commission's perspective. It is possible that the parties would choose to sell future tranches separately (in the manner in which they have chosen to sell the initial tranche) even of the current authorisation for separate marketing remained in existence;

- the gas which will be 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; 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.

Benefits

155. 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 there are a number of special features which have to be borne in mind when assessing benefits and detriments.

- It is anticipated that a greater proportion of the gas from the Pohokura field will be sold separately in the factual compared with in the counterfactual and that this is likely to produce more competitive outcomes.

- 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 when, or if, alternative gas fields are discovered and come into production 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 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 would tend to limit output (and thereby 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 the incentive on the parties to optimise the production of liquids from the field.

- As discussed above the method of selling in the factual and counterfactual differs only after 2012 (when there is separate selling in the factual and joint selling in the counterfactual). Consequently many of the benefits associated with this difference occur in the future and will need to be discounted to be expressed in 2005 dollar values.

156. The benefits the Commission has attributed to switching from the counterfactual to the factual are considered below under the descriptions of allocative, productive and dynamic efficiencies.

Allocative Efficiency

157. 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'.

158. 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 gas which will be sold separately in the factual and (potentially) jointly in the counterfactual is likely to be no more than half the output of the field, and that gas will not be produced after 2012.

159. Nevertheless the Commission considers there remains a possibility 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 in the joint marketing scenario to take advantage of any market power associated with joint marketing to limit output below efficient levels.

160. The Commission has concluded at this time that, by avoiding this potential for sub-optimal levels of production in the future, the factual would enhance allocative efficiency and thereby produce moderate benefits to the public.

Productive Efficiency

161. Productive efficiency relates to the resources used in producing a particular output. An improvement in productive efficiency is achieved by a firm lowering its costs (that is, by using fewer or less valuable resources) when producing that output. In general, competition provides the strongest incentive on a firm to reduce costs.

162. In Decision 505 the Commission noted that joint marketing would result in some reduction in marketing costs. However, marketing costs were considered likely to comprise only a small proportion of total costs incurred in getting the gas to the market.

163. In respect of the matter currently before it, the Commission considers that the greater competitive pressures in the factual would be likely to lead to lower costs in the factual than in the counterfactual. These lower costs are likely to outweigh any additional marketing costs associated with separate marketing post 2012.

164. The Commission has attributed a small public benefit to the overall cost reduction in the factual.

Dynamic Efficiency

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

166. 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.

167. This continues to be the case. Thus new or improved production technology is equally likely to be adopted in the factual and counterfactual.

168. 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.

169. 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 the present 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.

170. 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 an efficient and competitive market.

171. 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."

172. 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.

173. The GPS and the GIC will clearly play an important role in the 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 pre-condition of a dynamic market, and this in turn requires market depth with industry participants acting independently of each other. If key gas fields, such as Pohokura, Maui and Kapuni were under common joint venture ownership and if the gas from those fields was marketed jointly, the major parties would tend to act co-operatively rather than competitively.

174. Notwithstanding the existing authorisation of joint marketing, it might be overstating things to characterise the current relationship between Shell and OMV on the one hand and Todd on the other as mutually supportive and co-operative. Despite that, the Commission considers that separate marketing would be likely to produce a more competitive market than joint marketing. In turn, this more competitive outcome is likely to lead to enhanced dynamic efficiency.

175. Given the importance the Commission places on the need for a dynamic gas market in New Zealand, it considers that the benefit to the public from a more dynamic market in the factual is potentially significant.

Detriments

176. If the Commission revoked the authorisation contained in Decision 505 and substituted an authorisation that permitted the joint marketing of only ad hoc gas, many of the benefits claimed for joint marketing during the consideration of the earlier application could not be achieved.

177. The principal benefits claimed at that time 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.

178. The claims relating to early production from the field are not relevant in this case. As noted above the factual and counterfactual assume the same date for first production.

179. 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 is not counted as a detriment.

180. The appraisal and design costs have already been incurred and are unaffected by whether the factual or counterfactual applies.

181. The cost of putting in place a gas balancing agreement is common to both the factual and the counterfactual in this case.

182. 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. For instance it was considered that joint marketing may assist the parties to better meet the requirements of individual customers on such matters as off-take terms, swing, risk, and so on. In this instance, as most of the output until 2012 has already been sold, and as the factual applies for the joint marketing of ad hoc gas including that gas produced in the final stages of the life of the field, it is considered that the factual would have very little detrimental impact on these benefits.

183. In Decision 505 the Commission attributed a benefit to lower transaction costs from joint marketing. For instance it reached the view that joint marketing would enhance information flows and coordination and lessen the areas for dispute between the parties. 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 factual in this case has the potential to make this situation any worse seems doubtful.

Balance of the Benefits and Detriments

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

185. The Commission considers that the detriments from the factual, as opposed to the counterfactual, are not significant

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

What material factors affecting the benefits and detriments of the substitute authorisation have not been taken into account in the analysis in this Draft Determination?

CONCLUSIONS LEADING TO A REVISED DRAFT DETERMINATION

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

- the authorisation in Decision 505 was either granted on information that was false or misleading or there has occurred a material change in circumstances subsequent to the date of the authorisation granted in Decision 505;
- 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;
- given submissions received, the appropriate course of action is to consider a revocation and substitute authorisation, rather than an amendment to the extant authorisation;
- as in this case, substitution of the existing authorisation by a fresh authorisation is being considered, the Commission must compare benefits and detriments in the future with the existing authorisation continuing in force, with benefits and detriments in the future with a substitute authorisation in force;

- given that analysis, the Commission considers net public benefits will arise from the grant of a substitute authorisation; and

- the substitute authorisation should permit the joint sale and marketing only of ad hoc gas (as tentatively defined in this draft determination).

REVISED DRAFT DETERMINATION

188. If the Commission's preliminary conclusions are confirmed after its consideration of submissions on this draft determination, the Commission proposes, pursuant to s 65(1) of the Act, to revoke the authorisation granted in Decision 505 and grant a further authorisation in substitution for it.

What matters not covered by this Draft Determination should be taken into account by the Commission before it makes its final determination

189. At this stage the Commission proposes to grant a further authorisation in the following or similar terms.

> Pursuant to s 61(1)(a) of the Act, the Commission grants authorisation for OMV, Shell, Todd and any person who becomes a party to the Pohokura joint venture to enter into arrangements to jointly market and sell only:
>
> - gas produced during the initial commissioning of the Pohokura field and its production equipment. Initial commissioning ends when any gas is supplied under any of the existing gas supply arrangements which Shell, OMV and Todd have individually entered into and which exist at the time when this determination comes into effect;
>
> - gas produced from time to time in quantities greater than the maximum rated output of the Pohokura gas production station as it is at any time; and
>
> - gas produced from the Pohokura field after an independent assessment has determined that the proven and probable (as that term is understood in the New Zealand petroleum exploration industry) economic reserves of gas have fallen below 25 petajoules.