

9 June 2003

CONTACT ENERGY LIMITED: SUBMISSION TO THE COMMERCE COMMISSION

**DRAFT DETERMINATION ON THE APPLICATION BY THE POHOKURA JOINT VENTURE PARTIES FOR
AUTHORISATION OF JOINT MARKETING ACTIVITIES**

1. INTRODUCTION

- 1.1 Contact Energy Limited welcomes the opportunity to provide a submission on the Commerce Commission's draft determination on the application by the Pohokura Joint Venture parties' ("JV parties") application for authorisation of joint marketing activities. This submission complements Contact's initial submission to the Commission in March 2003.
- 1.2 Section 2 of this submission contains an executive summary. Section 3 discusses key issues arising from the draft determination. Section 4 contains responses to the specific questions asked by the Commission in its draft determination.

Confidentiality
- 1.3 Contact seeks confidentiality for specific information in the submission included in square brackets and shaded. A copy of this submission with the confidential information deleted is provided to assist the Commission.
- 1.4 Contact requests that the Commission make a confidentiality order under section 100 of the Commerce Act 1986 in respect of this information.
- 1.5 Contact also requests that, on the expiry of any confidentiality order that the Commission makes, the information continues to be withheld under section 9 of the Official Information Act 1982. Contact requests that it be notified by any request made under that Act for the information, and be consulted as to whether the information remains commercially sensitive at the time that the request is made.
- 1.6 These requests for confidentiality are made because the information is commercially sensitive and disclosure would be likely to unreasonably prejudice the commercial position of Contact.

2. EXECUTIVE SUMMARY

- 2.1 Contact does not consider that joint marketing of gas from Pohokura should be authorised.
- 2.2 Contact does not agree that separate marketing would necessarily result in delay. In any case, the avoidance of delay is not a benefit sufficient to outweigh the significant detriments that will result from joint marketing.
- 2.3 The conditions proposed by the Commission will not ensure that delay does not occur, and will be difficult to sensibly enforce.

2.4 However, if the Commission decides to confirm its draft determination and authorise the joint marketing of Pohokura gas subject to conditions, only the following conditions will secure the benefits, or avoid the detriments, identified by the Commission:

- the authorisation should be limited to the sale of gas by the JV parties sufficient to commence the initial field development;
- the authorisation should cover only gas marketed and subject to binding contracts (which should include a “first gas” date) signed no later than 1 December 2003; and
- the ability of the JV parties to impose restrictive conditions on the sale of the gas (for example, high “take” obligations for purchasers coupled with flexible obligations on the JV parties to deliver, and on-sale restrictions) should be limited.

3. KEY ISSUES

3.1 This section focuses on four key issues arising out of the draft determination. They are:

- the different commercial objectives of the JV parties;
- incentives for future producers of gas in New Zealand;
- the conditions proposed by the Commission; and
- the importance of the Pohokura field to New Zealand.

Objectives of the JV parties

3.2 In paragraphs 175 and 179 of the draft determination, the Commission records the views of producers of gas from Australian fields where separate marketing arrangements have recently been entered into regarding why separate marketing was possible in those cases. Specifically, Woodside and AWE indicated the importance of having a high degree of commercial integrity between the parties, a willingness to commence the development project, and co-operation between the relevant joint venture parties.




3.3 This is a crucial consideration in the present scenario. Each of the JV parties has different objectives regarding production from Pohokura.

[REDACTED]

3.4 [REDACTED]

3.5 [REDACTED]

3.6 Contact is concerned that these conflicting incentives are in reality a major reason why the JV parties have been reluctant to develop separate marketing arrangements, despite the assurances given to the Commission in 2000 in the context of the FCE/Shell transaction.

- 3.7 The Commission should be cautious about accepting arguments to the effect that concluding appropriate separate marketing arrangements will be unduly time-consuming, particularly given the significant detriments identified by the Commission as flowing from joint marketing.
- 3.8 In the Commission's 12 May 2003 report ("12 May report") relating to its investigation into the sale of 10% of OMV's interest to Todd, the Commission states that "there is clearly an incentive for both Shell and Todd to develop the Pohokura field" (paragraph 77), and that OMV's incentive should be to develop Pohokura as soon as possible (paragraph 60).
- 3.9 It seems to Contact that these observations should apply regardless of the marketing arrangements. That is to say, the JV parties should have the incentive to bring gas to the market without delay whether they jointly or separately market the gas.
- 3.10 [

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Incentives for future producers

- 3.11 It is crucial for the development of gas markets in New Zealand that the Commission sends a clear message that joint marketing is not going to be the norm in the future.
- 3.12 Only then will producers be incentivised to make arrangements to allow for separate marketing of gas from fields they own or have interests in.
- 3.13 If joint marketing of Pohokura gas is authorised it will send the message that, despite clear provisions for separate marketing in the particular joint venture arrangements, the relevant parties will be able to jointly market their gas if they manage to convince the Commission that separate marketing arrangements are too difficult to conclude within a particular timeframe.

Conditions

- 3.14 As stated above, Contact's position is that the Commission should decline to authorise joint marketing of gas.
- 3.15 However, if the Commission does propose to authorise joint marketing, Contact is concerned that the conditions proposed by the Commission do not address the detriments identified. Nor are the proposed conditions workable or effective from a legal perspective because their breach will not lead to the possibility of sensible enforcement.
- 3.16 Accordingly, it is not appropriate for the Commission to authorise the application on the basis of the conditions proposed in the draft determination.
- 3.17 The only basis on which an authorisation should be granted is with conditions that limit its scope to a particular amount of gas, and require that the gas may only be marketed jointly if it is subject to a tender process leading to binding production contracts shortly after the tender process. These possible conditions are discussed further in section 4 of this submission.
- 3.18 This would allow the JV parties to have the certainty they state they require through joint marketing while creating a strong incentive to have gas flowing from Pohokura at an early stage without requiring the Commission to intervene again.

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- 3.19 This is because, once commitments to supply have been entered into, there will no longer be an incentive on any of the JV parties to delay production, as delay would effectively reduce the JV parties' returns on their gas.
- 3.20 Under the conditions proposed by Contact, all parties would have the right incentives to extract gas as quickly as possible and the authorisation would be no more extensive than necessary to ensure that a reasonable amount of gas is available within a reasonable time, in accordance with the Government's stated objectives in the relevant GPSs.

National importance of Pohokura

- 3.21 The timely development of Pohokura gas supply is of crucial national importance to ensure an adequate electricity supply to around 2012.
- 3.22 It is particularly important that some, if not all, gas from Pohokura is separately marketed because sales of gas from the Pohokura field are likely to dominate the gas market for at least 10 years.

4. RESPONSES TO COMMERCE COMMISSION QUESTIONS

- 4.1 This section contains Contact's responses to questions posed by the Commission in the draft determination.

Question 1: The Commission seeks comment on the likely impact of the analysis of the Application in the event that Methanex either continues production, mothballs, or closes its three plants.

- 4.2 In Contact's original submission to the Commission on the application, Contact stated that it does not believe that the scenario suggested by CRA in its base case (i.e. that Methanex will operate at approximately 100% of capacity until 2006, and from 2006 will remain at 50 to 100% of capacity depending on gas prices) is likely.
- 4.3 This has been confirmed by recent announcements by Methanex indicating that it is considering exiting the market.
- 4.4 Accordingly, in the absence of a major new discovery, it is unlikely (irrespective of whether gas is jointly or separately marketed) that Methanex will remain a major user of gas after 2005. Methanex's continued participation in the market could in fact trigger further gas shortages, resulting in higher gas prices, a switch to more expensive fuels for electricity generation, and higher electricity prices to consumers.
- 4.5 In any case, Contact does not envisage a scenario, with or without Methanex, where the JV parties will be unable to sell all the gas produced from Pohokura.

Question 2: The Commission seeks comment on the possible impact of the two GPSs and in particular what effect they may have on issues being addressed in the Draft Determination

- 4.6 Contact supports the Commission's approach to the two GPSs. It is well established law that the Commission must not ignore a policy statement, but must give it genuine attention and thought, and such weight that it considers appropriate.

Gas industry GPS

- 4.7 The gas industry GPS informs the context in which the Commission must make its determination but does not alter any of the analysis required in respect of an application for authorisation. This is, to a great extent, because of the general, outcome-focussed, nature of the gas industry GPS, which allows argument as to the details of how to achieve the relevant outcome.
- 4.8 For example, in paragraph 5 of the gas industry GPS it is stated that the Government is seeking “specific outcomes” that will ensure that gas resources are used efficiently, and market barriers to gas exploration and field development are minimised.
- 4.9 The JV parties have argued that market barriers to gas exploration and field development will in fact be increased if joint marketing is not authorised. Contact disagrees that this is the case.
- 4.10 Contact also considers gas resources will be used more efficiently if the JV parties are required to separately market their gas – the JV parties will be less able to manipulate production schedules of Pohokura and other fields owned by them.
- 4.11 It is important to remember that decisions to invest in electricity generation assets are based on projected revenues and the cost of inputs that will be used in producing electricity. Accordingly, if joint marketing is permitted, investment decisions will also be affected.

Pohokura GPS

- 4.12 Contact agrees that the timely development of Pohokura is a crucial matter. The development of Pohokura can occur in a timely manner under separate marketing. Joint marketing, if authorised by the Commission, is only likely to be consistent with timely development if the conditions suggested by Contact (discussed later in this submission) are imposed.

Question 3: The Commission seeks comment on the developments in Australia and other jurisdictions and asks, in the New Zealand context, how much relevance these developments have for this Application

- 4.13 In its initial submission, Contact urged the Commission to keep in mind the particular facts of the Australian cases. Contact therefore supports the Commission’s conclusion in paragraph 291 of the draft determination that there are significant differences between the two cases primarily relied on by the Applicants (North West Shelf Project and Mereenie) and the current case to which the application relates.
- 4.14 It is relevant to the present application that the ACCC said that, when it had to consider applications relating to joint marketing of gas on prior occasions, a crucial issue was whether separate marketing is feasible. If the separate marketing of gas was not feasible, then the ACCC considered whether allowing joint marketing was a better outcome than no development.¹
- 4.15 It is clear that, in the present situation, separate marketing is feasible. It cannot be suggested by the applicants that the development of the Pohokura field would not proceed without authorisation.
- 4.16 It is also relevant that, in relation to the most recent Australian developments (separate marketing of gas from both the Geographe/Thylacine and Yolla fields), the producers of those fields have emphasised the importance of relationships between the joint venture parties.

¹ Draft determination, paragraph 184.

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- 4.17 If the parties to a producer joint venture are non-co-operative, or a party to the relevant joint venture is “*playing commercial games and playing off their commercial position*” against other joint venture parties, this may add to delay (if any) that may result from separate marketing.
- 4.18 The Commission should be cautious about concluding that separate marketing would not be “feasible” simply because of possible commercial game-playing within the relevant joint venture. Granting an authorisation on that basis runs the risk of encouraging such game-playing.

Question 4: The Commission seeks comment on its current view that the joint venture exception applies to the proposal

- 4.19 For the purposes of this application only, Contact accepts that the exemption in section 31(2)(a) is likely to apply and accordingly that there is no deemed lessening of competition.
- 4.20 However, as the effect of joint marketing on competition will be significant as compared with the separate marketing counterfactual, the fact that section 31(2)(a) applies is ultimately of no consequence to the Commission’s analysis.

Question 5: The Commission seeks comment on its definition of the market as the national natural gas market

- 4.21 Contact agrees that the appropriate functional dimension of the market encompasses transactions between producers of gas and their first point of sale customers.
- 4.22 Contact agrees that it is no longer appropriate to adopt different market definitions for the pre-2009 and post-2009 time periods.
- 4.23 Accordingly, Contact supports the Commission’s conclusion in paragraph 238 that the market relevant to the consideration of this Application is the national natural gas production (and first point of sale) market (the “gas market”).

Question 6: The Commission seeks comment on its conclusion that separate marketing is feasible and that the Pohokura field would be developed even if the authorization were not granted

- 4.24 Contact agrees with the Commission’s conclusion (in paragraph 301) that separate marketing is feasible. The JV parties themselves have in fact conceded that separate marketing is feasible.
- 4.25 From a commercial perspective, it is unrealistic to suggest that the JV parties would walk away from their already significant investment in Pohokura. OMV recently purchased its interest in Pohokura, and Todd is soon to increase its interest in the joint venture, even though separate marketing is a distinct possibility.
- 4.26 If joint marketing is not authorised, the JV parties will have sufficient commercial incentives to conclude arrangements necessary to support separate marketing arrangements quickly. The relationship between the JV parties is relevant in terms of how easy it will be to put in place provisions for separate marketing, but Contact does not think it in any way likely that the JV parties will not ultimately produce gas from Pohokura. The Commission’s 12 May report supports this analysis (paragraphs 59-61 and 75-79).
- 4.27 If separate marketing proceeded according to the Commission’s view of the counterfactual, with each joint venturer able to sell its proportion of gas in line with its equity interest, and within an agreed gas output profile,

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the arrangements between the JV parties should not be significantly more complicated than under joint marketing.

- 4.28 Under joint marketing, purchasers of gas are likely to require balancing mechanisms to manage their risks, so that the burden of arranging balancing mechanisms may simply be shifted from producers to purchasers.
- 4.29 In addition, the Commission should bear in mind that the Crown has a role in the development of gas fields such as Pohokura. The Crown's ability to grant a production permit to a third party allows the Crown to put pressure on the JV parties to put separate marketing arrangements in place in a timely manner.

Question 7: The Commission seeks comment on the characteristics of its counterfactual

- 4.30 Contact generally supports the counterfactual suggested by the Commission in paragraph 319 of the draft determination, although Contact disagrees that a delay in bringing gas to the market needs to occur if joint marketing is not authorised and separate marketing is instead necessary.

Question 8: The Commission seeks comment on the likely length of delay under the counterfactual

- 4.31 In light of the JV parties' assertions in 2000 that separate marketing is contemplated, and intended, it is odd that no progress has been made since that time to conclude the necessary arrangements.
- 4.32 It is important for the Commission to bear in mind the comments made by Woodside and AWE (paragraphs 175 and 179 of the draft determination respectively) that commercial integrity in the relationship between the parties, a willingness to get a project up and running, and co-operation between joint venture parties, are crucial issues in developing separate marketing arrangements.
- 4.33 If the JV parties in this instance are committed to bringing gas to market, then there should not be any significant difference between the joint marketing and separate marketing scenarios in terms of the time taken to do so.
- 4.34 It is realistic to expect the first tranche of gas from Pohokura to be offered on to the market by the end of 2003. Once agreements are concluded for the purchase of that gas, the producers are incentivised to get gas production underway (although Contact acknowledges that this may not be until 2006), and to negotiate further gas agreements.

Question 9: The Commission seeks comment on whether the current level of competition would preclude or limit the Pohokura JV parties from using any market power to engage in anti-competitive behaviour

- 4.35 The majority of gas from existing producing fields is already committed. There is no other gas currently being offered on the market for delivery from 2006. By that time Maui will be close to depletion if not totally depleted (based on the recent redetermination). There are no other fields of any scale capable of producing sufficient quantities to satisfy demand from 2006.
- 4.36 Even if the Pohokura and Kupe fields are developed, gas from them is unlikely to satisfy demand, even in the absence of Methanex and other petrochemical demand. As discussed elsewhere in this submission, the presence of Methanex will only exacerbate the supply shortfall.
- 4.37 As discussed in Contact's initial submission, one or more of the JV parties control 4 of the 5 largest gas-producing fields and the majority of uncommitted gas reserves. The new discoveries noted by the

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Commission in paragraph 145 of the draft determination are uncertain, both as to their size and their possible production profiles. Accordingly, such new discoveries cannot be assumed to have any effect on constraining other producers in the market at present.

- 4.38 Contact expects that it would take up to 10 years from discovery to bring a significant new gas resource to market.
- 4.39 In summary, the existing level of competition in the gas market is in no sense sufficient to constrain the behaviour of the JV parties, and, in particular, will not constrain the JV parties from taking advantage of their market power.

Question 10: The Commission seeks comment on the extent to which joint marketing would enhance the potential for the Pohokura JV parties to engage in price discrimination and the impact this may have on competition in the gas market or any other market

4.40 [REDACTED]

4.41 [REDACTED]

4.42 [REDACTED]

- 4.43 In a joint marketing scenario, the JV parties could more effectively target parties it identifies as being willing to pay more for gas. They would be able to extract the maximum value from these purchasers before offering any surplus gas to purchasers who would only offer lower prices (for example, petrochemical producers).
- 4.44 Under a separate marketing scenario, all sellers would similarly target the purchasers willing to pay the highest price, but competition between the sellers would be more likely to lead to downward pressure on prices to a level just greater than the price that the next level of purchasers would be willing to pay.
- 4.45 If the JV parties are able to impose on-sale restrictions, purchasers will not be able to arbitrage any price discrimination. Contact therefore recommends that, if the Commission does grant an authorisation, conditions should prohibit on-sale restrictions in gas contracts covered by the authorisation.

Question 11: The Commission seeks comment on the extent to which the range of terms and conditions of sale would be limited by the Arrangement

- 4.46 As discussed in Contact's initial submission, recent offerings have been highly unsatisfactory because of the terms offered. Joint marketing would enable the JV parties to impose any terms they wish.
- 4.47 Contact is concerned that the JV parties under joint marketing could impose high "take" obligations on buyers with minimal flexibility and high prices, and prohibit, or significantly restrict, the ability of buyers to on-sell gas. They could also pass reserve risk to buyers who are not well placed party to manage that risk efficiently.



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- 4.48 Conversely, Contact expects that the JV parties, in a joint marketing scenario, would impose few obligations on themselves in terms of producing gas within particular timeframes.
- 4.49 Accordingly, Contact supports the Commission’s conclusion in paragraph 393 of the draft determination that the choice of terms and conditions offered to potential purchasers of gas is likely to be greater under separate marketing, and that a reduction in this choice amounts to a lessening of competition.

Question 12: The Commission seeks comment on whether the authorisation of the Arrangement may inhibit the development of a more competitive gas market in the future

- 4.50 Contact supports the Commission’s conclusion in paragraph 399 of the draft determination.
- 4.51 It is unlikely that, in the absence of separate marketing by the JV parties, the gas market will not develop greater depth in the near future – Table 1 in the draft determination illustrates the significant concentration of the production sector. Even if a significant new discovery was made by an independent third party or parties, it may be years before that gas reaches the market.

Question 13: The Commission seeks comment on its conclusion that the Arrangement would lessen competition in the market, particularly beyond the short term

- 4.52 Contact agrees that the arrangement is likely to lessen competition in the market, particularly beyond the short term.
- 4.53 []
- 4.54 []

Question 14: The Commission seeks comment on the extent to which the Arrangement would impact on allocative efficiency

- 4.55 Any withholding of supply of gas from the Pohokura field (by delaying entering into supply contracts), as referred to earlier in this submission, will lead to significant allocative efficiency losses.
- 4.56 Even though gas supply may be the same under both joint marketing and separate marketing, prices and other conditions of supply will be different. This will impact on the price of electricity (and therefore quantities demanded) by downstream markets (for example, electricity generators) giving rise to allocative efficiency losses.

Question 15: The Commission seeks comment on the extent to which the Arrangement would impact on the productive efficiency of the industry

- 4.57 In paragraph 412 of the draft determination, the Commission states “a firm increases productive efficiency when it reduces costs”. Productive efficiency is also increased if a firm does not allow costs to increase at a rate faster than they should.
- 4.58 Paragraph 413 of the draft determination correctly records that productive inefficiency may occur when a satisfactory level of profit is assured, even when the firm is less than efficient.
- 4.59 However, paragraphs 430 to 432 seem to be inconsistent with this statement. In terms of productive efficiency, it is irrelevant that production costs are much more significant than marketing costs and that production would be undertaken jointly under both the joint marketing and separate marketing scenarios. As paragraph 413 correctly records, the potential for productive inefficiency is concerned with whether a satisfactory level of profit is assured.
- 4.60 The reduction in competition in marketing the gas enables profitability to be maintained or even enhanced when the JV parties are less than efficient.
- 4.61 Accordingly, there is scope for productive inefficiency in respect of production (including both initial capital development costs and on-going operational costs) and marketing if joint marketing is authorised.
- 4.62 In the absence of competition between the JV parties in marketing Pohokura gas, it is also possible that productive inefficiencies may occur with respect to the production and sale of the other gas. The cost of these inefficiencies is likely to be passed on to purchasers.

Question 16: The Commission seeks comment on the extent to which the Arrangement would impact on the dynamic efficiency of the industry in the short-term and also beyond the short-term

- 4.63 The Commission states in paragraph 433 that, given that the production function would be undertaken jointly under both the arrangement and the counterfactual, there may be little difference between the arrangement and the counterfactual in terms of the incentive to adopt the most efficient new technology.
- 4.64 Contact does not agree with this. The incentive to adopt new technology is a function of pressure on profitability. If joint marketing reduces pressure on profitability levels (as Contact believes it will), then the incentive for dynamic efficiency is also reduced.
- 4.65 The long-term nature of gas sales arrangements, and the deficit in available supplies, limit the incentive on producers to offer improved terms and therefore the scope for dynamic efficiency. Only a market that continually offers a number of competitive options results in dynamic efficiency.

Question 17: The Commission seeks comment on means by which the loss of dynamic efficiency may be quantified and the outcome of such any quantification

- 4.66 Dynamic efficiency losses could be measured by a review of past quantification by the Commission in other decisions.

Question 18: The Commission seeks comment on the extent of overseas ownership of the Pohokura JV parties and of acquirers of gas

- 4.67 The Commission is correct in stating that, at present, the level of overseas ownership of the producers and purchasers are similar, although if Methanex exits the market the level of New Zealand ownership of purchasers will increase.
- 4.68 An important point to remember, however, is that the public of New Zealand purchases electricity and gas from entities such as Contact and Genesis.
- 4.69 As discussed elsewhere in this submission, the lack of competition between the JV parties under joint marketing will mean that electricity generators, like Contact and Genesis, will pay more for their gas if both price and non-price terms of supply are taken into account. The higher prices are likely to be passed to New Zealand consumers.
- 4.70 Therefore, the net effect of wealth transfers associated with higher gas prices will be gains for largely foreign owned gas producers at the expense of New Zealand consumers.
- 4.71 This implies a net national economic detriment.

Question 19: The Commission seeks comment on the extent to which any price discrimination by the Pohokura JV may lead to income transfers from gas consumers to the Pohokura JV and the extent to which this would cause economic detriment

- 4.72 As discussed above, the Commission is correct in its analysis that price discrimination by the JV parties will likely lead to income transfers from purchasers to acquirers. The key issue, in this instance, is the detriment to the public, caused by the flow-on effect of such transfers.

Question 20: The Commission seeks comment on the conclusion that the detriments attributable to the on-going joint marketing of gas from the Pohokura field would be significant, particularly beyond the short-term

- 4.73 The detriments attributable to the on-going joint marketing of gas from the Pohokura field will be significant.
- 4.74 Contracts for gas from the Pohokura field will likely be long-term. Accordingly, any detriments, particularly efficiency detriments occurring as a result of joint marketing activities, will be carried through for the term of the relevant contract(s).

Question 21: The Commission seeks comment on the value that should be placed on benefits to the public arising from early production of condensate from the Pohokura field

- 4.75 Contact does not agree that joint marketing will result in earlier production of condensate.
- 4.76 Even if earlier production occurred under joint marketing than under separate marketing, this would, aside from some royalty and tax payments to the Crown, largely result in financial benefits to the JV participants.
- 4.77 However, as discussed above, the participants are largely overseas entities, so from the national economic perspective these financial benefits should be discounted accordingly.

Question 22: The Commission seeks comment on the value that should be placed on benefits to the public arising from early production of LPG from the Pohokura field

- 4.78 Contact does not agree that joint marketing will result in earlier production of LPG.
- 4.79 Even if earlier production occurred under joint marketing than it would under separate marketing, this would result in financial benefits to the JV parties who are largely overseas entities and therefore should be discounted accordingly.

Question 23: The Commission seeks comment on all aspects of the demand assumptions adopted by the Commission

- 4.80 Contact does not have any comment on the assumptions adopted by the Commission.

Question 24: The Commission seeks comment on the limitations of using a linear demand curve giving the 'lumpy' nature of gas consumption

- 4.81 Contact has no comment on this question.

Question 25: The Commission seeks comment on all aspects of the supply assumption adopted by the Commission including the appropriateness of \$8 of a ceiling price

- 4.82 Contact has no comment on this question.

Question 26: The Commission seeks comment on likely gas production through until 2020. The Commission seeks comment on what might be a reasonable range of production to use when undertaking its analysis in particular the plausibility of MED's assessment and of the assumption of 175 PJ per annum gas production from 2010 onwards

- 4.83 Contact thinks that the Commission may have significantly overstated the availability of gas in the shorter term (say to 2012).
- 4.84 There is no justification for the inclusion of significant quantities of Maui non-contract gas in future supply. Those quantities were not identified in the recent Maui determination. There is significant risk that Maui reserves will be less than the volumes shown under the Maui contract.
- 4.85 It is also optimistic to include reserves from new fields. MED has recently reduced its forecast from 80PJ/year without explanation. If significant new discoveries are made it is likely they will occur in a lumpy fashion and be unable to deliver the constant annual quantities forecast by MED.
- 4.86 In the longer term (beyond 2012), if significant gas reserves are not discovered, gas users will either reduce their gas-fuelled energy requirements or switch to higher priced energy suppliers such as LNG or fuel oil. Commitment to those options may limit the development opportunities available for natural gas over the long term, but will not be possible to any significant extent in the shorter term.

Question 27: The Commission seeks comment on all aspects of the assessment of the benefit to the public arising from the avoidance of a delay in production of gas, condensate, and LPG from the Pohokura field

- 4.87 As discussed above, Contact does not consider that the production of gas, condensate, or LPG will occur earlier under joint marketing.
- 4.88 On the basis of the significant delay forecast by the Commission, however, any delay in the first gas being available from Pohokura beyond 2006 may have significant consequences for the gas market. These consequences are likely to be particularly acute in the industrial and generation sectors.
- 4.89 It is not possible, in a practical sense, to put realistic alternatives to gas-fired generation in place by 2006. Accordingly, a delay in the production of gas from Pohokura much beyond 2006 is likely to cause some disruption in the electricity sector, particularly if hydro lake levels are low.

Question 28: The Commission seeks comment on the value that should be placed on benefits to the public arising from lower production and transaction costs enhanced exploration incentives and from reduction in adverse effects on the environment

- 4.90 The price of Pohokura gas will be set by the market and not on a cost basis. Any benefits gained by lower production and transaction costs and enhanced exploration incentives will benefit only the JV parties.
- 4.91 Adverse environmental effects stem from the increased use of coal. These effects are attributed to the delay in the development of Pohokura caused by separate marketing. As stated elsewhere in this submission, Contact does not believe the delay can be attributed to separate marketing.

Question 29: The Commission seeks comment on its assessment of the weight that should be given to public benefits and detriments that would arise from the Arrangement

- 4.92 Contact remains unconvinced that the timing of development/production from the Pohokura field will be any different under joint marketing or separate marketing.
- 4.93 Accordingly, the benefits suggested as flowing from “*the avoidance of delay*”, in Contact’s view, are negligible. On the other hand, the detriments flowing from authorising joint marketing (particularly without conditions) would be significant.
- 4.94 In paragraph 504 of the draft determination, the Commission correctly identifies the very high level of uncertainty existing in gas markets at present. The Commission should be reluctant to authorise joint marketing where such uncertainty exists as to the benefits that may occur as a result of allowing joint marketing.

Question 30: The Commission seeks comment as to the appropriateness of these possible conditions or any other conditions

- 4.95 Contact is strongly of the view that the possible conditions suggested by the Commission will not reduce the detriments, or increase the benefits, such that joint marketing should be authorised.
- 4.96 The conditions proposed by the Commission are insufficient to ensure that the benefit of avoiding delay is achieved.

Limited period of authorisation

- 4.97 It is likely that most purchasers will want gas contracts to run for more than five years. This is particularly so if the purchaser is contemplating new investment in generation capacity. In addition, it is likely that some of the JV parties would desire relatively lengthy contracts to ensure the “bankability” of the project. The Commission’s reasoning in respect of a “cornerstone purchaser” in decisions 408 and 411 are relevant here.
- 4.98 Accordingly, it will be unacceptable to at least some purchasers and some JV parties that their contractual arrangements will lose the protection of an authorisation after 5 years.

Requirement for Pohokura to be developed by a certain time

- 4.99 Contact agrees with the Commission’s assessment in paragraph 504 that joint marketing will not ensure that gas from Pohokura will be brought onto the market earlier than in a separate marketing context. In fact, as discussed above, Contact considers that it is possible for gas to be produced either under a joint marketing scenario or a separate marketing scenario within a similar timeframe.
- 4.100 However, Contact doubts whether the proposed condition requiring first gas to be produced by February 2006 will realistically ensure delay is avoided.
- 4.101 If, by February 2006, first gas has not been produced, this will mean that the condition has been breached and the JV parties will lose the benefit of the protection offered by an authorisation. This would leave the JV parties vulnerable to a challenge under the Commerce Act in relation to contracts it has already entered into.
- 4.102 In addition, there is a serious question as to whether a condition of this nature, by itself, is capable of enforcement. It is unclear from the draft determination whether the Commission has considered how it would enforce this condition.
- 4.103 However, detriments such as reduced efficiency and higher prices will have been locked in because contracts will have been entered into. The benefits of early production will not have occurred. It is also highly likely that purchasers and end-consumers will bear the consequences of the breach of the condition.
- 4.104 If the Commission is minded to authorise joint marketing by the JV parties, the authorisation should only cover gas marketed and subject to binding contracts signed no later than 1 December 2003.
- 4.105 This contract does not give rise to enforcement problems – a contract entered into by the JV parties jointly will be subject to the authorisation if signed before 1 December 2003, and not subject to the authorisation if signed later.

Assignment of authorisation to successors

- 4.106 Contact is not convinced that limiting the authorisation to the existing parties to the Application will increase the benefits, or decrease the detriments to such an extent that the authorisation should be granted.

Ring-fenced marketing

- 4.107 In reality, all projects of the magnitude of the Pohokura development will be considered by the senior management and the boards of the relevant JV parties. In this context, the senior management and board are bound to consider all investments of their company. Accordingly, the proposed ring-fencing condition is unlikely to be effective or enforceable.

Alternative conditions

4.108 If the Commission is, subsequent to receiving additional submissions and the conference, still minded to grant an authorisation, Contact considers that the following conditions are more likely to address the detriments that arise from joint marketing:

- *authorisation to cover limited quantity of gas* – the authorisation should only cover the sale of gas by the JV parties sufficient to commence an initial development of the field. This allows the JV parties to cover their costs in producing first gas, but then requires them to separately market any subsequent gas;
- *first gas sales by 1 December 2003* – the authorisation should only cover gas marketed and subject to binding contracts signed no later than 1 December 2003. The contracts should also include a “first gas” date to keep the pressure on the JV parties to deliver gas. Once such contracts are concluded the JV parties will have a significant incentive to produce the gas as soon as possible so that they can be paid as soon as possible for their gas;
- *obligations to supply* – in Contact’s initial submission, Contact highlighted the unsatisfactory nature of recent offerings. One particularly unsatisfactory aspect has been the lack of obligations on producers to supply. It is appropriate, therefore, to limit the ability of the JV parties to impose high “take” obligations on purchasers but minimal supply obligations on themselves. The JV parties should only be relieved of their obligation to supply gas for normal maintenance requirements and under standard force majeure;
- *no on-sale conditions* – the authorisation of the Application will severely limit competition in the production sector. If purchasers are unable to, or are restricted in their ability to, on-sell gas purchased from producers, the wholesale level of the market will be similarly constrained. In addition, on-sale restrictions would eliminate the ability of purchasers to arbitrage away different prices arising from price discrimination. It is appropriate, therefore, that an authorisation be subject to the condition that the JV parties are unable to impose on-sale restrictions on purchasers under contracts covered by the authorisation.

5. CONCLUSION

5.1 Contact does not agree that separate marketing will result in a delay of the development of Pohokura. On this basis, Contact does not consider the benefits of joint marketing (if any) would outweigh the significant detriments. Accordingly joint marketing should not be authorised.

5.2 However, if the Commission is minded to authorised joint marketing subject to conditions, the only conditions that will secure the benefits identified by the Commission are the following:

- the authorisation should be limited to the sale of gas by the JV parties sufficient to commence the initial field development;
- the authorisation should cover only gas marketed and subject to binding contracts signed (which should include a “first gas” date) no later than 1 December 2003; and

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- the ability of the JV parties to impose restrictive conditions on the sale of the gas (for example, high “take obligations” coupled with flexible obligations to deliver and on-sale restrictions) should be limited.

If you would like to discuss this submission, please contact:

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