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# Statement of Preliminary Issues

# OMV New Zealand Limited and Shell Investments NZ Limited

**3 July 2018**

## Introduction

1. On 15 June 2018, the Commerce Commission (the Commission) registered an application (the Application) from OMV New Zealand Limited (OMV) to acquire Royal Dutch Shell's gas and liquids portfolio in New Zealand. OMV specifically seeks clearance to acquire from Shell Investments NZ Limited 100% of the shares in each of Shell Exploration NZ Limited, Energy Infrastructure Limited, Shell Taranaki Limited and Shell New Zealand (2011) Limited (together Shell).[1]

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

3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **24 July 2018**.

## The parties

5. OMV New Zealand is a wholly owned subsidiary of Austrian company OMV Aktiengesellschaft. OMV's business includes the exploration, production, marketing and sale of oil and natural gas. In New Zealand, OMV has interests in the Maui and Pohokura gas fields, the Maari oil field, limited onshore infrastructure assets (eg, tanks and pipelines) associated with the transportation and storage of gas and liquids, and offshore exploration permits.

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

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[1] A Public version of the application will be available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/1128.

[2] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

## Our framework

7. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[3] As required by the Commerce Act 1986, we assess acquisitions using the substantial lessening of competition test.

8. We compare the extent of competition in each relevant market both with and without the acquisition. This allows us to assess the degree by which the proposed acquisition might lessen competition.[4] If the lessening of competition is likely to be substantial, we will not give clearance to the proposed acquisition. When making that assessment, we consider, among other matters:

   8.1 constraint from existing rivals – the extent to which current rivals compete and the degree they would expand their sales if prices increased;

   8.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

   8.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

## Market definition

9. We define markets in the way that we consider best isolates the key competition issues that arise from the acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.

10. OMV submits that the New Zealand markets potentially affected by the acquisition are:[5]

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

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

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

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

11. We will test whether these market definitions are appropriate. In particular, we will consider whether the functional dimension of natural gas and LPG markets are markets for production and wholesale supply (as OMV submits, consistent recent

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3 Commerce Commission, *Mergers and acquisitions guidelines* (July 2013). Available on our website at www.comcom.govt.nz.

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

5 The Application at [103].

High Court and Court of Appeal decisions) or whether production is in a separate market to wholesale supply (as the Commission has found in past decisions).

## Without the acquisition

12. We will consider the likely state of competition if the acquisition proceeds and compare it with the likely state of competition if it does not. We will consider whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for the assets.

## Preliminary issues

13. We will investigate whether the proposed acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral or coordinated effects, or vertical effects, might result from the proposed acquisition. The questions that we will be focusing on are:

    13.1 unilateral effects: would OMV be able to profitably raise prices to its customers or reduce quality by itself;

    13.2 coordinated effects: would the proposed acquisition change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable; and

    13.3 vertical effects: would the proposed acquisition increase OMV's ability and/or incentive to foreclose rivals.

### Unilateral effects: would OMV be able to profitably raise prices by itself?

14. Where two suppliers compete in the same market, a merger of the two would remove a competitor that would otherwise act as a competitive constraint, potentially allowing the merged entity to unilaterally raise prices or lessen quality.[6]

15. OMV and Shell overlap in the production of natural gas and LPG. We will focus on whether the loss of competition between OMV and Shell in these product areas would enable OMV to raise prices.

16. OMV submits that the proposed acquisition would not have the effect of substantially lessening competition because:[7]

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

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

[6] For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or worsen an element of service (ie, it could increase quality-adjusted prices).

[7] The Application at [37].

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

16.2.2 large wholesalers of natural gas and LPG; and

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

17. To assess whether the proposed acquisition may enable OMV to raise prices in the areas of overlap, we will assess:

17.1 how closely OMV and Shell compete against one another;

17.2 the degree of constraint that rival producers of natural gas and LPG would provide on OMV;

17.3 the extent to which wholesalers that source their natural gas and LPG from gas producers impose a constraint on gas producers;

17.4 if the acquisition would be likely to result in price increases, whether entry or expansion would be likely, timely, and sufficient in extent to defeat those increases; and

17.5 whether customers have special characteristics that would enable them to resist a price increase by OMV.

**Coordinated effects: would the proposed acquisition make coordination more likely?**

18. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.

19. OMV submits that that the proposed acquisition would not substantially lessen competition due to coordinated effects because market conditions exist which render coordination unlikely. These conditions include:[8]

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

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

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[8] The Application at at [319].

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

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

20. Our focus will be on the prospect for coordinated effects in the markets relating to the supply of natural gas and LPG. We will assess whether the relevant markets are vulnerable to coordination, and whether the acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

**Vertical effects: would the acquisition increase OMV's ability and/or incentive to foreclose?**

21. A vertical merger is a merger between firms operating at different levels of a supply chain (for example, a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by raising the costs of rivals, refusing to supply downstream rivals, or by changing the conditions of entry to make it harder to enter or expand.

22. OMV submits that the proposed acquisition would not substantially lessen competition due to vertical effects because:[9]

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

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

23. As part of our assessment of the vertical effects of the acquisition, we will assess whether the acquisition might increase OMV's ability and/or incentive to foreclose rivals. We will, in particular, consider:

23.1 whether agreements relating to the operation of the Maui and Pohokura fields and onshore infrastructure assets mean that OMV would have the ability to foreclose rivals, through having control over an important input;

23.2 whether OMV would have the incentive to foreclose rivals in the relevant markets, through earning additional profit from the strategy; and

23.3 whether the competition lost from any foreclosed rivals would be sufficient to have the likely effect of substantially lessening competition in any relevant market(s).

[9] The Application at at [23] and 12-13.

## Next steps in our investigation

24. The Commission is currently scheduled to make a decision on whether or not to give clearance to the acquisition by **10 August 2018.** However, this date may change as our investigation progresses.[10] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

25. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

### Making a submission

26. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "OMV/Shell" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **24 July 2018**.

27. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

28. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA (eg, in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information).

[10] The Commission maintains a clearance register on our website where we update any changes to our deadlines and provide relevant documents: http://www.comcom.govt.nz/clearances-register/.