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Rachel Owens
Investigator
Commerce Commission *[sent by email: rachel.owens@comcom.govt.nz]*

Dear Ms Owens

Submission on Draft Determination on Pohokura Gas Marketing Application

Methanex is in general agreement with the analysis and conclusions reached by the Commission in its draft determination. The Commission has concluded that the joint marketing of Pohokura gas will lead to a substantial lessening of competition in the gas market. Approval of the joint marketing arrangement therefore requires that the compensating public benefits outweigh the competitive detriments.

The competitive detriments of joint marketing from Pohokura are substantial:

- Higher than otherwise prices;
- Ability to price discriminate;
- Ability to dictate contract terms;
- Inhibit development of liquidity in gas market;

Whilst the Commission has concluded that the public benefits outweigh the competitive detriments, the analysis and conclusions drawn from the analysis are not clear cut.

In Methanex' view the public benefit is restricted to the potential for an earlier on-stream date. In all other respects the effect of joint marketing over separate marketing is negative or in some cases at best neutral.

In the current context of the gas market, the timely development of Pohokura is of paramount importance. Methanex agrees that an earlier than otherwise on-stream date for Pohokura is a significant public benefit.

Methanex considers that the only factors that may delay the start date is the negotiation of the gas balancing and product allocation agreements. Methanex accepts that the JV will want these agreements finalised prior to committing to gas sales arrangements. Additional time is likely to be required to negotiate these agreements, although estimating the additional time required is highly subjective.

Given that the earlier on-stream date is the key factor in the Commission authorising joint marketing, the Commission has attached certain conditions in an attempt to lock in this benefit. Methanex comments on these as follows:

Limited Period of Authorisation

The Commission has suggested that authorisation of joint marketing be limited to a period of 5 years. Methanex assumes that this is intended to provide for a period of 5 years from February 2006 in which the JV can sell the gas under joint contracts. Methanex agrees that the period in which the JV can jointly sell gas must be limited in duration. The time period should be based on the minimum necessary to provide the JV a return on the development costs of Pohokura. This time period should be no longer than 5 years.

Providing the JV with the ability to jointly sell gas for a longer period would simply provide a longer period in which the JV can exert the anti-competitive advantages provided by joint marketing. These are as listed above. The public benefit that gets the Commission "over the line" in authorising joint marketing is the earlier than otherwise development. There is no need to allow long term joint sales to secure this public benefit.

Pohokura has huge potential as a catalyst to a more competitive and liquid gas market. To capture this benefit all gas sales should be on a separate selling basis beyond the approved time period.

Requirement for Pohokura to be Developed by Certain Time

Methanex is not convinced of the practicality of the condition expressed in paragraph 514 (1) of the Commission's draft determination, but can see some merit in the condition expressed in 514 (2).

The imposition of a defined start date may be difficult to achieve in practise. There would be various events outside the control of the JV that would have to be allowed for. It is not stated what the consequences of failing to meet the start date would be. The termination of the gas contracts it had negotiated would be disastrous for both the JV and the gas buyers.

Locking in the end date of the 5 year period in which the JV can sell the gas under joint contracts would be workable and would provide the JV with extra incentive to meet the start date.

Assignment of Authorisation to Successors

The restriction of the authorisation to the existing parties is possibly unnecessary. The current parties to the JV are already the dominant players in the market. In addition, if there are any future dealings that seek to align interests between projects then the Commission will presumably have the opportunity to rule on those dealings at the time. Imposing a restriction on this authorisation may in itself cause future delays if there is a change in ownership (of little consequence) and new authorisation is required, thereby potentially delaying development.

Ring-Fenced Marketing

It is not clear what the ring fencing would achieve and how it would take effect.

Comments on specific questions raised by the Commission

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

A decision as to whether Methanex continues production, mothballs or closes its plants, is not independent of gas availability. Methanex is keen to remain in New Zealand and if the gas is available at an economic price then Methanex would continue production to the extent it can access the gas. Methanex has three plants and can operate at almost any rate between 20 PJ and 90 PJ per annum. Given the range of supply scenarios assumed in the Commission's analysis (Table 12 and paragraph 480) it would seem reasonable to assume that demand will exceed supply in any given year. The level of supply in any year should therefore be capable of being fully sold, although this may not be the case if the JV require a price in excess of Methanex' (or others) ability to pay.

Questions 18 & 19 – The Commission seeks comment on the extent of overseas ownership of the Pohokura JV and of acquirers of gas. 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.

Whilst Contact and NGC may have majority overseas ownership, it is probable that these companies would pass through higher prices to their New Zealand customer base.

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.

The extra negotiation costs claimed by the JV are highly unlikely to eventuate. There will be one off costs associated with the development of gas balancing and product allocation agreements. The ongoing costs will be associated with a minimal level of activity in administering the gas balancing and product allocation arrangements. There may be an increase in gas sales contracts negotiating costs but these are also likely to be minimal. Under the joint marketing model the individual JV parties will all be directly involved in meetings with customers and drafting and reviewing contract terms.

Under the Commission's counterfactual, there is no reason why separate marketing would result in increased facilities costs. Under separate marketing the parties will agree on a production profile and the facilities required to achieve this. The profile will be determined by a mix of market requirements and field optimisation. This is no different to a joint marketing model and the JV parties are already aware of the likely market demand requirements.

Again under the Commission's counterfactual, there is no reason why separate marketing would result in increased appraisal and design costs. Under this model the JV will jointly agree the development sizing and concept. Any subsurface risks would equally apply under a joint or separate marketing model.

Methanex concurs with the views of the Commission with regard to exploration incentives and the reduction in adverse effects on the environment.

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.

Methanex considers that the public benefits arising from the Arrangement in the form of lower transaction costs, lower appraisal and design costs, lower development costs and more efficient decisions on optimal depletion rates are minimal at best.

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

Comments on the conditions are provided above.

Yours sincerely

Phil Watson
Commercial Manager, NZ