



COMMERCE COMMISSION

Decision No. 506

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

**TODD (PETROLEUM MINING COMPANY) LIMITED
and**

OMV NEW ZEALAND LIMITED

The Commission: **Paula Rebstock (Chair)**
 Donal Curtin
 Denese Bates

Summary of Application: The acquisition by Todd (Petroleum Mining Company Limited ("Todd")) of an increased participating interest in the Pohokura Gas field from OMV NZ ("OMV").

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

Date of Determination: 22 September 2003

**CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE
BRACKETS**

CONTENTS

| | |
|---|----|
| CONTENTS | 1 |
| EXECUTIVE SUMMARY | 2 |
| THE PROPOSAL | 3 |
| THE PROCEDURES | 3 |
| TRANSACTION BACKGROUND | 3 |
| THE PARTIES | 4 |
| <i>OMV</i> | 4 |
| <i>Todd</i> | 5 |
| <i>OTHER RELEVANT PARTIES</i> | 5 |
| <i>Shell</i> | 5 |
| <i>Preussag</i> | 6 |
| INDUSTRY BACKGROUND | 6 |
| <i>STRUCTURE</i> | 6 |
| <i>OWNERSHIP OF AND PRODUCTION FROM NATURAL GAS FIELDS IN NEW ZEALAND</i> | 6 |
| <i>The Pohokura Field</i> | 8 |
| MARKET DEFINITION | 8 |
| IDENTIFYING RELEVANT MARKETS | 9 |
| PRODUCT MARKET | 9 |
| FUNCTIONAL MARKET | 10 |
| TIME DIMENSION | 11 |
| CONCLUSION ON RELEVANT MARKET | 11 |
| Factual | 11 |
| Counterfactual | 12 |
| CONCLUSION ON COUNTERFACTUAL | 12 |
| Introduction | 12 |
| <i>MARKET CONCENTRATION</i> | 13 |
| <i>EXISTING COMPETITION</i> | 13 |
| <i>SCOPE FOR THE EXERCISE OF COORDINATED MARKET POWER</i> | 14 |
| Overall Conclusion | 14 |
| Appendix 1 | 17 |

EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act was received on 19 September 2003. The notice sought Clearance for the acquisition by Todd Energy ("Todd") of an increased participating interest in the Pohokura Gas field from OMV New Zealand ("OMV"). Todd is purchasing a 9.86195% share of OMV's participating interest in Pohokura.

Market Definition

2. In keeping with the conclusions reached on market definition in Decision 505, the market definition that will be used for the purposes of this clearance is the national natural gas production (and first point of sale) market.

Counterfactual

3. The Commission considers the appropriate counterfactual is Preussag selling a 35% interest to OMV and OMV maintaining a 35% interest in Pohokura. As OMV does not currently possess a significant interest in any other gas fields in New Zealand this scenario does not raise any competition concerns.

Competition Analysis

Existing Competition

4. The acquisition does not alter the JV structure sufficiently to create a substantial lessening of competition.

Coordinated Market Power

5. While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.

Overall Conclusion

6. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the national natural gas production (and first point of sale) market.

THE PROPOSAL

7. A notice pursuant to section 66(1) of the Commerce Act was received on 19 September 2003. The notice sought Clearance for the acquisition by Todd Energy (“Todd”) of an increased participating interest in the Pohokura Gas field from OMV New Zealand (“OMV”). Todd is purchasing a 9.86195% share of OMV’s participating interest in Pohokura.

THE PROCEDURES

8. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. A decision on the application was required by 3 October 2003.
9. In its application, Todd sought confidentiality for information that was previously submitted in the course of the Commission’s s47 investigation and as noted in a letter from Todd on 12 June 2003.
10. The Commission reviewed this information for confidentiality before publishing a public copy of the s47 investigation report. The provisions of the Official Information Act 1982 currently apply to the material the Commission deemed confidential.
11. The Commission’s determination is based on a s47 investigation conducted by staff in May 2003.
12. The Commission’s approach is based on principles set out in the Commission’s Practice Note 4.¹

TRANSACTION BACKGROUND

13. Commission staff learned of Todd’s intention to increase its participating interest in the Pohokura JV while working on the Pohokura Gas Marketing Authorisation in April of 2003. Staff were concerned that the acquisition might breach Commission guidelines on safe harbours and might result in a substantial lessening of competition.
14. The Commission conducted a s47 investigation in May 2003. The investigation was concluded with a decision to take no further action in regards to the transaction. The Commission’s decision was based on four factors:
 - Post acquisition, Todd’s increased participating interest allows it to vote in concert with Shell to pass operating decisions. While this does increase the ability of Todd to delay development, the acquisition does not affect Shell’s incentive to delay or develop the Pohokura field. Shell, through its veto right, can delay development with or without Todd’s support in both the counterfactual and post acquisition scenarios.

¹ Commerce Commission, *Practice Note 4: The Commission’s Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

As the likelihood and ability of Shell to delay development is not substantially affected by Todd's acquisition there is not a substantial lessening of competition as a result of the acquisition.

- It does not appear from the uncommitted gas figures, sunk cost investment in the field and the likelihood of securing a cornerstone purchaser for the Pohokura field that there is a compelling financial incentive for the two firms to cooperate to delay production of Pohokura.
- The major parties potentially affected by the acquisition have not raised any serious concerns over the transaction.
- While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.

15. On 15 September 2003, OMV wrote to the Commission explaining that OMV intended to complete the transaction on the understanding that Decision 505 on the Pohokura JV did not affect completing the transaction in any way. In clarifying OMV's letter with them it became clear that their concern lay in the conditions contained in Decision 505. In this decision, authorisation was granted based on a number of conditions, including:

“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.”²

16. In considering OMV's letter, the Commission found that this condition of the authorisation clearly applied to any changes in the ownership of the Pohokura JV and that the actual assignment of shares between Todd and OMV had not occurred. Given this situation, the Commission determined that Todd should submit a clearance application as a requirement of the second condition in Decision 505.

17. Due to the recently completed s47 investigation into this acquisition, the Commission agreed with Todd that a clearance application would be processed within one to two working days.

18. Accordingly, Todd submitted a clearance application on the 19th of September 2003.

THE PARTIES

OMV

19. 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, with refineries in Austria and in Germany.

20. OMV's New Zealand interests include:

- a 10% ownership of the Maui field;

² Decision 505, Paragraph 586

- a 69% interest in the Maari field (which does not contain natural gas); and
- a joint interest in a number of exploration blocks with exploration companies, including Shell and Todd.

Todd

21. Todd is part of the Todd family's group of companies. Its parent, Todd Energy Ltd 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/oil/condensate fields and in several exploration joint ventures holding PEPs;
- natural gas retailing through its subsidiary Nova Gas Ltd ("Nova")³;
- electricity generation;
- electricity retailing through its subsidiaries Bay of Plenty Electricity Ltd and King Country Energy Ltd;
- coal mining; and
- LPG wholesaling.

22. As discussed above, Todd has a strategic agreement with Shell and is a joint owner of STOS, the oil field operator.

Other relevant parties

Shell

23. Shell is part of the Royal Dutch/Shell Group of Companies. It ultimately has two parent companies:

- Royal Dutch Petroleum Company, based in the Netherlands; and
- the 'Shell' Transport and Trading Company plc, based in the United Kingdom.

24. These two companies between them hold, directly or indirectly, all interests in the companies which comprise the Royal Dutch/Shell Group of Companies ("the Shell Group"). 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.

25. The primary activities of Shell in New Zealand have included:

- 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 petrol stations;
- the production and distribution of marine and aviation fuels, lubricants, petrochemicals and detergents; and
- various equity investments, the most relevant of which is in the New Zealand Refining Company ("the NZRC").

³ Todd previously also retailed gas and electricity through Fresh Start Limited, which was sold to Genesis on 1 June 2003.

26. Shell owns 50% of the shares in Shell Todd Oil Services Limited (“STOS”), the operator of the Maui, Kapuni and Pohokura fields. The remaining 50% of the shares are owned by Todd.

Preussag

27. Preussag Energie GmbH is one of Germany’s largest oil and natural gas producers. Its head office is in Lingen, Germany. Its activities extend to Europe, the North Sea, North Africa, Central Asia, the Middle East, South America, the Philippines and New Zealand.
28. Preussag entered New Zealand in 1994 in a study and bidding arrangement with Fletcher Challenge Energy, BHP, and Ampolex. The joint venture secured four offshore permits in 1995. The original joint venture re-formed over the years. In February 2000 the then joint venture partners, Fletcher Challenge Energy, Shell, Todd and Preussag Energie, discovered the offshore Pohokura gas/condensate field.

INDUSTRY BACKGROUND

Structure

29. The New Zealand gas industry has largely been privatised over the past 20 years. Natural gas is a crucial source of energy, supplying approximately 29% of New Zealand’s total primary energy use.
30. The industry structure is made up of several gas fields owned by several producing companies, several wholesalers, two pipeline transmission companies, and several distributors and/or retailers.
31. Production of gas has been dominated by the Maui field, since first gas flowed from the field in 1979. The Maui producers do not sell directly to the wholesale market but to the Crown, at a price locked in under a long-term contract. The Crown on-sells the gas to downstream purchasers (NGC, Contact and Methanex) at prices that are low relative to competing supplies. The terms of the Maui gas contract are set out in the Maui White Paper that was published in 1973.

Ownership of and Production from Natural Gas Fields in New Zealand

32. Currently, gas is entirely produced in the Taranaki region, where eleven fields produce oil and gas (including condensate and naphtha). The ownership of natural gas fields for which petroleum mining licences have been issued, together with the natural gas production of each, is shown below in Table 1.

Table 1
Ownership of, and Production From, Natural Gas Fields for Year Ended September 2002*

| Name of field | Ownership (%) | Gross Natural Gas Production (PJ) | Gross Gas Produced (%) |
|----------------------|--|--|-------------------------------|
| Maui | Shell subsidiaries: 83.75 Todd subsidiaries: 6.25 OMV 10.00 | 179.10 | 75 |
| Kapuni | Shell subsidiaries 50.00 Todd subsidiaries 50.00 | 27.46 | 11.5 |
| TAWN | Swift 100.00 | 13.13 | 5.5 |
| Mangahewa | Todd 100.00 | 10.03 | 4.2 |
| McKee | Todd 100.00 | 6.45 | 2.7 |
| Ngatoro | Greymouth Petroleum 29.785 Swift 29.785 Petroleum Resources Ltd 20.43 Australian and New Zealand Petroleum Ltd 15.00 Ngatoro Energy 5.00 | 1.67 | 0.7 |
| Kaimiro*** | Greymouth Petroleum 100.00 | .48 | 0.2 |
| Rimu | Swift 100.00 | .48 | 0.2 |
| Kupe | Genesis subsidiaries 70.00 NZOG 19.00 The Crown 11.00 | No production | |
| Total | | 238.8 | 100 |

* The Ministry of Economic Development Energy Data File, January 2003.

**A subsidiary of Indo-Pacific Ltd

*** Kaimiro figure includes Moturoa field for October 2001

The Pohokura Field

33. The Pohokura condensate and gas field lies in the offshore exploration block PEP 38459. It is approximately 16km long by 5km wide extending offshore in a north-west direction, from close to the Methanex Motonui site near Waitara in North Taranaki.
34. The field was discovered in February 2000 by the joint venture comprising, at that time, of Fletcher Challenge Energy (“FCE”), Preussag, Shell and Todd. The field was successfully appraised in May 2000 and a 3D seismic survey was conducted over the entire field late in 2000.
35. The field contains gas and associated liquids. The Pohokura JV parties intend to recover the liquids jointly, but sell those products separately. This is a common approach to the sale of such products around the world.
36. Initially the field was estimated to hold reserves at a level of 1000 petajoules (“PJ”), making it by far the largest known undeveloped gas resource in New Zealand. While the reserves in the field have not yet been determined precisely, based on current estimates provided by the Applicants, the Commission has made an assumption for the purposes of this Determination that an approximate figure for recoverable gas reserves may be 750 PJ. If the price of gas was \$4/GJ, which the Commission believes is a conservative figure, the reserves value would be in the order of \$3 billion. In addition, the Commission understands that the condensate and LPG in the field would have a value of around \$[]].
37. Development costs for the Pohokura field could be up to \$[], depending on the number of platforms decided on and the size of the associated production station.

MARKET DEFINITION

38. The Act defines a **market** as:

... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

39. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the ‘*ssnip* test’). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.
40. The Commission defines relevant markets in terms of four characteristics or dimensions:
- the goods or services supplied and purchased (the product dimension);
 - the level in the production or distribution chain (the functional level);
 - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
 - the temporal dimension of the market, if relevant (the timeframe).

Identifying Relevant Markets

41. To identify the markets relevant to the acquisition, it is necessary to consider the business activities undertaken by the Applicants.
42. The relevant market can vary depending on the matter at issue. As stated in the AMPs A case:

The boundaries {of the market} should be drawn by reference to the conduct at issue, the terms of the relevant section or section, and the policy of the statute. Some judgment is required, bearing in mind that “market” is an instrumental concept designed to clarify the sources and potential effects of market power that may be possessed by an enterprise.

43. The activity directly affected by the acquisition is the first sale of gas produced from the Pohokura field.
44. The Pohokura JV does not cover the marketing of other products likely to be produced from the Pohokura field. Accordingly it is not necessary for the purpose of assessing competition effects to define markets which incorporate condensate and LPG. (While the early production of condensate and LPG affects the public benefit analysis, the market in which these products fall is not directly relevant to that exercise.)

Product Market

45. In the past, when the Commission has considered business acquisitions in the energy sector it has received submissions suggesting that natural gas, electricity and other energy forms are substitutable and that each falls within an ‘energy’ product market. This has not been the approach adopted by the Commission to date. The Commission stated in Decision 270⁴:

None of the evidence presented to the Commission points to a clear cut answer to the market definition problem. However, all of the evidence is consistent with the conclusion that natural gas and other fuels, especially electricity and to a lesser extent coal, are indeed substitutes for each other, both technically and commercially – but they are at best imperfect substitutes, and cannot be regarded as being in the same market.⁵

46. This approach is consistent with decisions of the courts. In the High Court judgment in *Power New Zealand v Mercury*⁶, subsequently upheld in February 1997 by the Court of Appeal, the Court said:

It is common ground that gas is not in close competition with electricity. We see no reason to question this approach.⁷

47. In the Kapuni litigation⁸ the High Court heard a substantial amount of economic evidence on market definition. It said:

⁴ Decision 270, Natural Gas Corporation of New Zealand Limited and Enerco New Zealand Limited, 22 November 1993.

⁵ *ibid*, paragraph 129.

⁶ *Power New Zealand Ltd v Mercury Energy Ltd* (1996) 1 NZLR 686.

⁷ *ibid*, p.704.

⁸ *Shell (Petroleum Mining) Company Limited and Another v Kapuni Gas Contracts Limited and Another* (1997) 7 TCLR 463.

We accept that {light fuel oil, coal and electricity} are substitutable {for natural gas} in certain favourable circumstances, but always at the edges and seldom in response to a SSNIP.⁹

48. In subsequent decisions¹⁰ the Commission in each case considered it appropriate to adopt discrete product markets for electricity and natural gas. The Commission recognised that while inter-fuel competition provided some constraint on each energy form, it did not consider the constraint sufficiently strong to include electricity and natural gas in the same market.
49. For the Pohokura Gas Authorisation the JV partners accepted that the relevant product market in assessing the Pohokura JV was natural gas. The Commission is not aware of any new information which would persuade it that its past practice of placing natural gas in a discrete product market is now inappropriate.

Functional Market

50. In Decision 408¹¹ the Commission accepted the appropriateness of separate functional markets for the:

- production (and first sale) of natural gas; and
- wholesaling of natural gas.

51. In this instance the Commission adopts this functional distinction for reasons similar to those stated in Decision 408.

52. The production (and first point of sale) market encompasses transactions between the producers of gas and their first point of sale customers. Such customers potentially include:

- resellers, such as NGC, Contact and Genesis;
- the individual Applicants themselves who may have retail arms or contractual obligations to supply gas;
- electricity generators such as Contact and Genesis;
- petrochemical manufacturers such as Ballance and Methanex; and
- large industrial consumers.

53. On the other hand, the wholesale market encompasses transactions between parties such as those described above and large end users such as large industrials or retailers.

54. The Commission considers that the functional market of principal relevance in this instance is that for gas production (and first point of sale). Submissions received during the Pohokura Authorisation indicate that the JV parties accept this position.

⁹ *ibid*, p.527.

¹⁰ Including Decision 330, NGC/Powerco, Decision 333 Contact/Enerco, Decision 340 TransAlta/Contact, Decision 345 UnitedNetworks/TransAlta, Decision 380 UnitedNetworks/Orion, Decision 408 Shell/Fletcher Challenge Energy.

¹¹ Decision 408.

Time Dimension

55. In Decisions 408 and 411 the Commission concluded that it was appropriate to include a time dimension in the gas market definition. It adopted a discrete market for gas production up to 2009 and another market for gas production beyond 2009.
56. In reaching this position, the Commission took into account the dominant nature of the Maui gas field and the expectation at that time (that is, in 2000) that Maui would continue to account for a substantial proportion of total gas produced until 2009, when it would be significantly depleted. The Commission concluded that the characteristics of the gas market would change markedly around 2009 and that an assessment of the competitive nature of the gas market into the future would be assisted by considering separately the period up to 2009 and the period after 2009.
57. In submissions received from the Applicants during the Commission's work on the Pohokura Determination (Decision 505), the Applicants stated that such an approach is no longer appropriate. They suggested that there is no longer an indicative point of a sharp change in the competitive situation and that the depletion of Maui is now well anticipated.
58. The Commission recognises that the depletion of Maui is now likely to occur earlier than had previously been indicated and it appears that this has already been factored into the market. Thus the depletion of Maui, when it occurs, is unlikely to result in a stark change in the nature of the market.
59. However, it is reasonable to assume that there will be important changes over time in both the supply and demand side as new fields are discovered and developed and large gas users arrive or depart. It is not possible to predict these changes with any precision but each of these changes could have an important effect on the market.
60. In relation to the current Application and recognising the conclusions reached in Decision 505, the Commission has decided that it is not appropriate to adopt discrete markets for different time periods.

Conclusion on Relevant Market

61. In keeping with the conclusions reached on market definition in Decision 505, the market definition that will be used for the purposes of this clearance is the national natural gas production (and first point of sale) market.

FACTUAL

62. The Commission uses a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question (the factual), and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.
63. In the factual scenario Todd, OMV and Shell with their respective post acquisition participating interests will operate the Pohokura JV under the conditions set out in the Pohokura Determination (Decision 505) with altered interests of Todd [], Shell [] and OMV [].

COUNTERFACTUAL

64. According to Todd the alternative scenarios to Todd purchasing a 9.8% interest from OMV are:
- OMV divests to Shell increasing Shell's interest in Pohokura from 48% to 58%.
 - OMV divests to a third party, which requires the third party to purchase a [] stake in Pohokura in order to acquire a voting presence in the JV.
65. Shell increasing its stake from 48% to 58% does not alter the voting dynamic in the JV. Both Shell and Todd had pre-emptive rights to purchase Preussag's stake. However, Shell would not be permitted to increase its participating interest because of its requirement to reduce its interest in Pohokura to below 50% as a result of Decision 411.
66. A fourth entrant into the JV must secure an interest of [] or more to become a voting member in the JV. A new member of the JV holding less than [] would have no ability to protect its interests. The present proposal has OMV selling just fewer than 10% of its interest in the JV to Todd. The sale of this amount gives OMV voting parity with Todd and makes it possible for OMV and Shell to take action on operating decisions without support from Todd.
67. It appears unlikely OMV would be willing to sell more of its interest to a fourth entrant, which would increase the difficulty of the JV reaching unanimity on development decisions. A more likely scenario is OMV maintaining ownership of the full 35% participating interest it purchases from Preussag.

Conclusion on Counterfactual

68. An outside party purchasing a stake in Pohokura of less than [] is unlikely due to the voting requirements of the JV. OMV's decision to sell Todd a less than 10% interest reflects OMV's intent to establish voting parity with Todd. The Commission considers the appropriate counterfactual is Preussag selling a 35% interest to OMV and OMV maintaining a 35% interest in Pohokura. As OMV does not currently possess a significant interest in any other gas fields in New Zealand this scenario does not raise any competition concerns.

INTRODUCTION

69. As stated above, the Commission recently completed a s47 investigation into the proposed acquisition which found the transaction did not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.
70. In order to assess this clearance application, the Commission has reviewed the findings of the s 47 investigation. The Commission has specifically considered whether there had been any material change in circumstances since the time of that investigation that would alter the analysis and subsequent finding in that investigation.
71. The Commission has concluded that there are no material changes in circumstances and that therefore the findings in the s47 investigation still stand.
72. The Commission also considers the fact that recent decisions and announcements by Shell with regard to their views on the Pohokura Authorisation and intentions for exploration in

New Zealand, further strengthens the Commission's findings with relation to the competition impact of the Todd/ OMV transaction.

73. The conclusions reached in the s 47 investigation are reproduced below and the full analysis can be found in Appendix 1.

Market Concentration

74. The Todd purchase of a 9.8% stake in the Pohokura field from OMV will result in Todd's total market share increasing from [] to []. Table 2 below illustrates estimated market shares for participants in the market in 2006 when the Pohokura field is scheduled to come on line.

Table 2: Estimated Market shares in 2006¹²

| 2006 | Shell | Todd | Preussag | OMV | Swift | Bligh | Greymth | Marabella | Total take per annum | Gas deposits as % of total market |
|---------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|----------------------|-----------------------------------|
| Maui | [] | [] | | [] | | | | | [] | [] |
| Kapuni | [] | [] | | | | | | | [] | [] |
| Mangahewa | | [] | | | | | | | [] | [] |
| McKee | | [] | | | | | | | [] | [] |
| TAWN | | | | | [] | [] | | | [] | [] |
| Kaimiro | | | | | | | [] | | [] | [] |
| Pohokura | [] | [] | | [] | | | | | [] | [] |
| Rimu | | | | | [] | | | [] | [] | [] |
| Total | [] | [] | [] | [] | [] | [] | [] | [] | [] | |
| Market share Percentages | | | | | | | | | | |
| | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] |

75. The Commission's Practice Note 4 states competition is unlikely to be lessened "where the three-firm concentration ratio (with individual firm's market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%." The three firm concentration ratio post Todd's acquisition is []. While the addition of the 9.8% stake in the Pohokura gas field increases Todd's market share by only 2.5%, the acquisition puts Todd with a [] market share outside the Commission's safe harbours.

Existing Competition

76. Todd's increased participating interest will allow Todd and Shell to pass an operating decision on the length of time required to resubmit a development for unanimous approval. This change increases the ability of Todd to act in concert with Shell to potentially delay development. However, Shell has the ability in both the counterfactual and post acquisition to delay development by exercising its veto right on operating decisions. As Shell's incentives to delay or not to delay are not related to Todd's acquisition and Shell has the ability to act without Todd's support, the acquisition does not alter the JV structure sufficiently to create a substantial lessening of competition.

¹² Figures sourced from Shell and Todd estimates.

77. This finding is supported by the lack of concern exhibited by market participants over the acquisition. In addition, the financial incentives provided by the sunk cost investment and the establishment of a contractual arrangement with a cornerstone purchaser and the conditions imposed by Decision 505 make it likely all three JV parties will develop the Pohokura field as soon as possible.

Scope for the Exercise of Coordinated Market Power

78. Todd's acquisition does not increase the incentives on Shell to delay development of Pohokura. As Shell retains the ability to delay development both pre and post acquisition with or without Todd's support, the change in the voting structure does not substantially increase the chance of Pohokura being delayed.
79. Shell's ability to exercise its veto right on operating decisions both pre and post acquisition and the lack of an apparent financial incentive to delay Pohokura development suggest the acquisition will not result in a substantial lessening of competition.
80. While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.
81. In addition the Commission's conclusion in Decision 505 to authorise joint marketing of the Pohokura field and the conditions imposed will facilitate development of the field.

The Commission concludes, on the balance of probabilities, that the Arrangement has the potential to advance production from the Pohokura field by one year. If this potential became a reality, it would provide an important benefit to the public. The Pohokura GPS also recognises the importance of early production. The Commission has quantified the benefit from early production as being in the order of \$47.8m to \$81.9m. In addition the Commission considers that limited additional benefit to the public would arise from lower production and transaction costs and possibly more operationally efficient depletion of the field, a savings in facilities and in appraisal and design costs (limited), and an increase in the exploration incentive.¹³

Overall Conclusion

82. The Commission has considered the probable nature and extent of competition that would exist in the market for the national natural gas production (and first point of sale) market.
83. The Commission considers that the appropriate counterfactual is Preussag selling a 35% interest to OMV and OMV maintaining a 35% interest in Pohokura.
84. The Commission has considered the nature and extent of the contemplated lessening. In the supply of national natural gas production (and first point of sale) market, the proposed acquisition would result in the Todd obtaining a market share which falls outside the Commission's safe harbour guidelines.
85. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the acquisition from:
- the JV voting structure; and

¹³ Decision 505, paragraph 514

- conditions imposed on the JV parties by Decision 505.
86. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the national natural gas production (and first point of sale) market.

87. DETERMINATION ON NOTICE OF CLEARANCE

88. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of OMV NZ Ltd's 9.8615% participating interest by Todd (Petroleum Mining Company) Limited.

Dated this 22nd day of September 2003

Paula Rebstock

Acting Chair

Appendix 1**Memorandum**

To: John Belgrave, Paula Rebstock, Donal Curtin,
Denese Bates, Peter JM Taylor

Cc: Geoff Thorn, Fritha Mackay

From: Seth Campbell 1.2/J5788

Date: 12 May 2003 288756-1

Classification: Restricted

Subject: Todd/ Pohokura Investigation Report

Restricted information in this document is contained in brackets

INTRODUCTION

2. Todd Energy Limited (“Todd”) currently holds a 16.1379% interest in the Pohokura gas field. The other parties with ownership stakes are the Shell Company Limited (“Shell”), with 48.0003% and Preussag Energie GmbH (“Preussag”) with 35.8618%.
3. Preussag has agreed to sell its total interest in the Pohokura JV to OMV New Zealand Ltd (“OMV”). OMV in turn has agreed to sell a portion of this interest, 9.86195%, to Todd.
4. The resulting market shares are: Shell 48%, Todd 26% and OMV 26%. The increase in Todd’s participating interest will mean that either Shell and Todd, or Shell and OMV, will be able to satisfy the [] voting thresholds required for operating decision taken by the Operating Committee.
5. The parties involved are expected to finalise the acquisition before the end of May 2003.

INJUNCTION INVESTIGATION CONCLUSION

6. I recommend no further action be taken in regard to the acquisition by Todd of a further 9.861% participating interest in the Pohokura JV for the following reasons:
 - Post acquisition, Todd’s increased participating interest allows it to vote in concert with Shell to pass operating decisions. While this does increase the ability of Todd to delay development, the acquisition does not affect Shell’s incentive to delay or develop the Pohokura field. Shell, through its veto right, can delay development with or without Todd’s support in both the counterfactual and post acquisition scenarios.

As the likelihood and ability of Shell to delay development is not substantially affected by Todd’s acquisition it does not appear there is a substantial lessening of competition as a result of the acquisition.

- It does not appear from the uncommitted gas figures, sunk cost investment in the field and the likelihood of securing a cornerstone purchaser for the Pohokura field that there is a compelling financial incentive for the two firms to cooperate to delay production of Pohokura.
- The major parties potentially affected by the acquisition have not raised any serious concerns over the transaction.
- While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.

INJUNCTION

7. Commission staff learned of Todd's intention to increase its participating interest in the Pohokura JV while working on the Pohokura Gas Marketing Authorisation. Staff were concerned that the acquisition might breach Commission guidelines on safe harbours and may increase the likelihood of collusion between Shell and Todd.

8. [

]

9. [

]

10. Commission staff met with Todd on 4 April 2003. At the meeting Todd agreed to submit an undertaking to the Commission to provide seven working days notice before the transaction is completed. OMV indicated the transaction was unlikely to occur before the end of April.

11. Todd submitted the undertaking on 9 April 2003.

INDUSTRY BACKGROUND

12. All of New Zealand's gas and oil production so far has been from the Taranaki Basin, the country's most explored and commercially successful hydrocarbon area. However, the basin is only moderately explored compared with basins world-wide, and there is considerable scope for further commercial discoveries as demonstrated by recent exploration successes. The rest of New Zealand is severely under-explored, and most sedimentary basins have the potential for commercial hydrocarbon discoveries.

Pohokura Gas Field

13. The Pohokura field was discovered in March 2000 by Fletcher Challenge Energy (“FCE”) and is approximately 5 km off-shore and very close to Motonui, the location of Methanex’s plant. The field is currently owned under a JV agreement by Shell, Todd and Preussag. Post acquisition the three owners will be Shell, Todd and OMV.
14. Industry participants are sufficiently confident of its size to state that it will be New Zealand’s second largest field after Maui. The field is a simple structure in shallow water depths, with close proximity to shore and infrastructure. The field also has a high liquids yield.
15. In the Pohokura Gas Authorisation Draft, the Commission stated: “While the reserves in the field have not yet been determined precisely, based on current estimates provided by the Applicants, the Commission has made an assumption for the purposes of this draft determination that an approximate figure for recoverable gas reserves may be 750PJ. If the price of gas was \$4/GJ, which the Commission believes is a conservative figure, the reserves value would be in the order of \$3 billion. In addition, the Commission understands that the condensate and LPG in the field would have a value of around \$[].”¹⁴ It is unlikely production from the field will occur before 2006.

Committed and Uncommitted Gas

16. Large portions of the recoverable gas in New Zealand gas fields are contractually committed to filling long term contracts with gas users. In addition to committed gas there is also a supply of uncommitted gas. This is gas that is not currently assigned under a long term contract to a customer.
17. In Decisions 408 and 411 the Commission determined that current uncommitted gas is an important element to the gas production market. It is this gas which potential new gas users must compete for, and it therefore provides much of the markets competitive dynamic.
18. Those seeking to acquire existing uncommitted gas from a producer currently have the option of negotiating only with Todd or Shell (and their joint venture interests) as they are the only firms holding uncommitted gas supplies in New Zealand. It should be noted that estimates of the amount of uncommitted gas are highly speculative and prone to revision.

EXISTING PARTICIPANTS

Shell

19. Shell is part of the Royal Dutch/Shell Group of Companies. It ultimately has two parent companies:
 - Royal Dutch Petroleum Company, based in the Netherlands; and
 - The “Shell” Transport and Trading Company plc, based in the United Kingdom.

¹⁴ Pohokura Draft Determination p38.

20. These two companies between them hold, directly or indirectly, all interests in the companies which comprise the Royal Dutch/Shell Group of Companies (the “Shell Group”). 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.
21. 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 petrol stations;
 - the production and distribution of marine and aviation fuels, lubricants, petrochemicals and detergents; and
 - various equity investments, the most relevant of which is in the NZRC.
22. Shell owns 50% of the shares in Shell Todd Oil Services Limited (“STOS”) the operator of the Maui, Kapuni and Pohokura fields. The remaining 50% of the shares are owned by Todd Energy Limited (Todd).
23. Shell and Todd were parties to an agreement made in 1955 under which they agreed to carry out, as a joint venture, prospecting and mining for petroleum in an area including Taranaki, the surrounding areas and offshore from those areas, and production of any petroleum that may be discovered. The agreement included the establishment of STOS.
24. This agreement was replaced with the Area of Mutual Interest Agreement (“AMIA”) on 1 March 2002. The new agreement covers exploration and development activity in the same region. [

]

This was not possible under the 1955 agreement.

Preussag

25. Preussag Energie GmbH is one of Germany’s largest oil and natural gas producers. Its head office is in Lingen, Germany. Its activities extend to Europe, the North Sea, North Africa, Central Asia, the Middle East, South America, the Philippines and New Zealand.
26. Preussag entered New Zealand in 1994 in a study and bidding arrangement with Fletcher Challenge Energy, BHP, and Ampolex. The joint venture secured four offshore permits in 1995. The original joint venture re-formed over the years. In February 2000 the then joint venture partners, Fletcher Challenge Energy, Shell, Todd and Preussag Energie, discovered the offshore Pohokura gas/condensate field.

Todd

27. Todd is part of the Todd Family’s Group of Companies. Its parent, Todd Energy Ltd 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/oil/condensate fields and in several exploration joint ventures holding PEPs;
 - natural gas retailing through its subsidiaries Nova and Fresh Start Limited (“Fresh Start”);
 - electricity generation;

- electricity retailing through its subsidiaries Bay of Plenty Electricity Ltd, King Country Energy Ltd and Fresh Start;
- coal mining; and
- LPG wholesaling.

28. As discussed above Todd has a strategic agreement with Shell and is a joint owner of STOS, the oil field operator.

OMV Group

29. OMV group is an Austrian-based energy company, historically with government roots, but now with diversified ownership. OMV's core business is exploring for and producing oil and natural gas, with refineries in Austria and in Germany.

Pohokura Joint Venture

30. The Pohokura Joint Venture is currently composed of Todd, Shell and Preussag. Post acquisition the parties holding a participating interest will be Todd, Shell and OMV. The increase in Todd's participating interest in Pohokura alters the voting dynamic in the JV's Operating Committee. Currently, development decisions require unanimous approval from all members of the JV. This will not change post acquisition.

31. In order to pass a measure on an operating decision the JV Operating Committee requires a vote by two members having a combined []% share in the JV. Pre acquisition Shell and Todd together held a 64% interest. Todd and Shell voting together could not pass an operating decision without the support of Preussag. Preussag, effectively, had a veto right on operating decisions. Shell with its 48% interest also held a veto right as Preussag and Todd could not pass an operating decision without Shell's support. Post acquisition Shell maintains this veto right in operating decisions.

Table 1: Todd's ownership stake in Pohokura pre and post acquisition

| Pre acquisition | | | | Post acquisition | | | |
|-----------------|-------------|---------------|-----------------|------------------|-------------|---------------|-----------------|
| | Pohokura JV | | Combined entity | | Pohokura JV | | Combined entity |
| Shell | 24 | 48.0% | 48.0% | Shell | 24 | 48.0% | 48.0% |
| Todd | 8.05 | 16.1% | 16.1% | Todd | 13 | 26.0% | 26.0% |
| Preussag | 17.95 | 35.9% | | OMV | 13 | 26.0% | |
| total | 50 | 100.0% | 64.1% | total | 50 | 100.0% | 74.0% |

32. Post acquisition Shell and Todd will be able to pass an operating decision without support from OMV. OMV and Shell will also be able to act in concert to pass an operating decision without the support of Todd.

33. The Pohokura Operating Committee functions: "To provide for the overall supervision and direction of Joint Operations, there is established an Operating Committee composed of representatives of each Party holding a participating interest of [] or more shall appoint one representative and one alternate representative to serve on the operating committee."¹⁵ The Powers and Duties of the Operating Committee are as follows:

¹⁵ Article 5.1 Joint Venture Operating Agreement, Sept 2002.

- “The consideration and the determination of all matters relating to general policies, procedures and methods of operation under this Agreement including the Safety, Health and Environmental Policy;”
- “The consideration, modification and approval or rejection of all proposed Exploration, Appraisal, Development and Production Work Programmes and Budgets, Development Plans and AFEs authorisation for expenditure (including the amount of detail provided therein) prepared and submitted to it pursuant to the provisions of this Agreement;”
- “The determination of the timing, location objective and depth of all wells drilled as part of the Joint Operations and any change in the use or status of a well; and”
- “The consideration and, if so required, the determination of any other matter relating to the Joint Operations which may be referred to it by the Operator or a Party (other than a dispute between the Parties or any of them, or between a Party which is otherwise designated under this Agreement for referent to it).”
- “The determination of whether or not to proceed with Development Operations in respect of any Discovery and the manner in which such development shall be carried out.”

34. John Bay, an expert in the New Zealand gas industry, outlined what operating decisions involve:

- “Article 5.2 gives a very clear picture of what operating decisions are made by the Operating Committee. It is often easier to think about the structure of the joint venture as you would of any company. The Operating Committee has essentially the same authorities and obligations as a Board of Directors. In short, they are charged with making every decision to do with running the operations and managing the joint venture. This includes virtually every significant strategic decision from additional exploration, drilling wells, performing remedial work, installing and/or upgrading equipment, staffing issues, production testing, marketing decisions (gas, liquids & LPG), approval of contractors and contracts, etc. As with companies, the Operating Committee’s key authority lies essentially in the approval of work programmes and budgets throughout the life of the project.”¹⁶

35. [

]

36. According to the Pohokura JV agreement, a development plan must include the following:

¹⁶ John Bay’s response to questions from Commission staff, 6 May 2003.

- Details of the proposed work to be undertaken, Operator’s intended staffing plan for the conduct of the Work Programme (for information purposes) and expenditures to be incurred, including the timing of same, on a Permit Year basis;
- The manner in which the development is to be managed;
- An estimated date for the commencement of production and an estimate of the annual rates of production;
- A delineation of the proposed Exploitation Area; and
- Any other information requested by the Operating Committee.

37. Once a development plan is submitted, the JV participants are required to accept or reject the plan. If a plan is rejected by any one of the parties, a Sole Risk Development option can be exercised by any of the parties to action the development plan.

38. John Bay noted that a development plan requires a unanimous vote by all JV parties for approval. However, he also noted that Shell and/or Todd could “fail to approve” a proposed Development Plan by insisting on modifications to the proposed Development Plan and “Directing the Operator” to prepare and submit a new Development Plan under Article 6.2(C) of the JV contract. Failing to approve a Development Plan is different from rejecting a Development Plan. A fail to approve decision does not entitle the other parties in the JV to seek Sole Risk Development.

39. Directing the Operator to submit a new plan requires [

]

INVESTIGATION

40. The investigation commenced in early April once the parties involved agreed to lift fact confidentiality. Letters were sent to the following parties requesting comment on the Todd acquisition:

- a. Contact
- b. Methanex
- c. Genesis
- d. OMV
- e. Shell
- f. NGC.

41. Replies have been received from Contact, Methanex, Genesis, Shell, OMV and NGC. The parties contacted do not feel the acquisition raises any serious competition issues. The parties contacted are more concerned over the effects of authorising joint marketing from the Pohokura field, which is being considered in the Commission’s Joint Marketing Authorisation.

42. In response to a request from Commission staff, Ian Millard assessed the differences between the JV 1955 and the Area of Mutual Interest Agreement (“AMIA”) between Shell and Todd, in order to determine whether the likelihood of Todd and Shell acting in a collusive manner changes under the new AMIA agreement.
43. John Bay, a gas industry expert currently providing consulting services on the Pohokura Gas Authorisation was asked to provide comment on the Todd acquisition.

MARKET DEFINITION

44. In Decisions 408 and 411, the Commission defined the relevant gas markets as:
- The current gas production market; and
 - The post-2009 gas production market.
45. The rationale for this distinction was the anticipated depletion date of 2009 for Maui. Since the Commission’s decisions, the estimate of the economically recoverable reserves from the Maui field was downgraded, and a redetermination of those reserves was completed on 7 Feb 2003 with the final report putting ERR (“Economically Recoverable Reserves”) at 2,582 PJs, 421 PJs less than the October 1989 ERR estimate.
46. In Decisions 408 and 411 the Commission considered that while different energy forms provide some competition to each other, it is not sufficient to include them in the same market. The Commission also defined the gas production market as encompassing transactions between the producers of gas and their customers. The customers in this market include, Methanex, Genesis, NGC and Contact.
47. In the Pohokura Gas Authorisation Draft Determination the Commission is changing the market definition used in Decisions 408 and 411. The Draft Determination states:
- “Following discussions with interested parties, the Commission has come to the conclusion that gas users are already taking into account the likely post-Maui situation.
 - The Commission therefore accepts that a clearly defined change in market circumstances will now be unlikely to occur in 2009. Further it accepts that change in the market is likely to be more gradual than it had anticipated in 2000.
 - The Commission notes that some changes will occur in the future and that these changes can have quite dramatic effects. This is inevitable given the ‘lumpy’ nature of changes on both the supply and demand side. For example, the discovery and development of a substantial new field, or the arrival or departure of a major gas user (for instance a petrochemical plant or an electricity generator) would each have an important impact on the market.

- In considering the current Application the Commission has decided that it is no longer appropriate to adopt different markets for different time periods, as it has done in its previous Decisions. The reason for this is that it is no longer possible or appropriate to identify specific break points in time, where circumstances change to such an extent that a different market exists. Having said that, the Commission will continue to take a forward-looking approach to the overall market and take into consideration any key changes that may occur. In addition, the Commission will look at changes in market circumstances across the lifetime of the field.

Conclusion on Relevant Market

48. In keeping with the conclusions reached on market definition in the Pohokura Draft Determination, the following market definition will be used:

- the national natural gas production (and first point of sale) market.

COUNTERFACTUAL

49. According to Todd the alternative scenarios to Todd purchasing a 9.8% interest from OMV are:

- OMV divests to Shell increasing Shell's interest in Pohokura from 48% to 58%.
- OMV divests to a third party, which requires the third party to purchase a [] stake in Pohokura in order to acquire a voting presence in the JV.

50. Shell increasing its stake from 48% to 58% does not alter the voting dynamic in the JV. Both Shell and Todd had pre-emptive rights to purchase Preussag's stake. However, Shell would not be permitted to increase its participating interest because of its requirement to reduce its interest in Pohokura to below 50% as a result of Decision 411.

51. A fourth entrant into the JV must secure an interest of [] or more to become a voting member in the JV. A new member of the JV holding less than [] would have no ability to protect its interests. The present proposal has OMV selling just under 10% of its interest in the JV to Todd. The sale of this amount gives OMV voting parity with Todd and makes it possible for OMV and Shell to take action on operating decisions without support from Todd.

52. It appears unlikely OMV would be willing to sell more of its interest to a fourth entrant, which would increase the difficulty of the JV reaching unanimity on development decisions. A more likely scenario is OMV maintaining ownership of the full 35% participating interest it purchases from Preussag.

Conclusion on Counterfactual

53. An outside party purchasing a stake in Pohokura of less than [] is unlikely due to the voting requirements of the JV. OMV's decision to sell Todd a less than 10% interest reflects OMV's intent to establish voting parity with Todd. I consider the appropriate counterfactual is Preussag selling a 35% interest to OMV and OMV maintaining a 35% interest in Pohokura. As OMV does not currently possess a significant interest in any other gas fields in New Zealand this scenario does not raise any competition concerns.

COMPETITION ANALYSIS

Market Share—Natural Gas Production Market

54. The Todd purchase of a 9.8% stake in the Pohokura field from OMV will result in Todd's total market share increasing from [] to []. Table 2 below illustrates estimated market shares for participants in the market in 2006 when the Pohokura field is scheduled to come on line.

Table 2: Estimated Market shares in 2006¹⁷

| 2006 | Shell | Todd | Preussag | OMV | Swift | Bligh | Greymth | Marabella | Total take per annum | Gas deposits as % of total market |
|---------------------------------|-------|------|----------|-----|-------|-------|---------|-----------|----------------------|-----------------------------------|
| Maui | [] | [] | | [] | | | | | [] | [] |
| Kapuni | [] | [] | | | | | | | [] | [] |
| Mangahewa | | [] | | | | | | | [] | [] |
| McKee | | [] | | | | | | | [] | [] |
| TAWN | | | | | [] | [] | | | [] | [] |
| Kaimiro | | | | | | | [] | | [] | [] |
| Pohokura | [] | [] | | [] | | | | | [] | [] |
| Rimu | | | | | [] | | | [] | [] | [] |
| Total | [] | [] | [] | [] | [] | [] | [] | [] | [] | |
| Market share Percentages | [] | [] | [] | [] | [] | [] | [] | [] | [] | |

55. The Commission's Practice Note 4 states competition is unlikely to be lessened "where the three-firm concentration ratio (with individual firm's market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%." The three firm concentration ratio post Todd's acquisition is []. While the addition of the 9.8% stake in the Pohokura gas field increases Todd's market share by only 2.5%, the acquisition puts Todd with a [] market share outside the Commission's safe harbours.

EXISTING COMPETITION

JV Partners

56. Todd submitted that post acquisition there is no change in the relationships between Shell/OMV and Shell/ Todd. The reasons cited were as follows:

- Development plan decisions require unanimity;
- If unanimity is not obtained, one or more parties could sole risk development;
- No party can exercise a veto.

57. Todd's contention that there is no change in the relationships between JV partners is based on the fact that development decisions require unanimous approval. Shell echoed this fact

¹⁷ Figures sourced from Shell and Todd estimates.

in its submission stating: “The voting thresholds, as set out above, could impact on development decision making but as approval of a Development Plan as a joint operation requires unanimity, an increase in Todd’s percentage does not give Todd a right (i.e. to approve the Development Plan) which it did not already have.”

58. As noted in Paras 38 and 39, the change in Todd’s participating interest gives it an ability to vote in concert with Shell to pass an operating decision on the timeframe required to submit a new development plan if the initial one is not approved. This is a result of Todd’s increased participating interest. The acquisition does alter the voting dynamic in the JV; the question is whether this change is sufficient to increase the likelihood of a substantial lessening of competition in the market.
59. Under both the counterfactual and post acquisition scenario Shell retains a veto right on operating decisions. Shell’s ability to delay development of the Pohokura field under development or operating decisions is not increased with the acquisition. Even without Todd’s support Shell could insist on modifications to the development plan and then refuse to agree on a time frame which would effectively stall the development until either Todd or OMV agreed to a time frame. If Shell wants to delay development, it can. If Todd’s interest is to delay it still has to have the support of Shell. As Shell’s support is always going to be required to delay it does not appear that Todd’s increased participating interest makes Shell more or less likely to seek delay of the Pohokura development.
60. OMV indicated in its submission it has an incentive to develop Pohokura as soon as possible. OMV stated: “OMV can only sensibly comment on its own incentives. In short, it has invested a substantial amount to date, and will be called on to meet further significant ongoing funding requirements. It is fully incentivised to secure a return on its investment as quickly as possible.”¹⁸
61. Considering that OMV’s only other gas holding is in Maui, the rundown of the field will leave OMV with only its participating interest in Pohokura. OMV’s incentive should be to develop Pohokura as quickly as possible. If OMV is seeking to develop the field as quickly as possible it seems unlikely the company would provide Todd with an increased participating interest that would then be used to slow development of the field.
62. Both Todd and Shell will have invested significant sunk costs into the field estimated at [] by the time the field is brought on line. There is a strong financial incentive for all three JV parties to secure a return on investment.

Customers

63. The four major buyers of gas (Contact, Methanex, Genesis and NGC) did not raise any substantial competition concerns over Todd’s increased participating interest. Contact indicated any concerns it has about the Todd acquisition are adequately addressed in its submission to the Commission on the Pohokura joint marketing authorisation. In its authorisation submission to the Commission, Contact stated:

- []

¹⁸ Letter from OMV 17 April 2003.

] ¹⁹

64. Contact raises the issue under joint marketing of a JV party blocking the development of Pohokura to increase the prices of uncommitted gas in other fields. However, the Todd acquisition does not increase Todd's ability to delay Pohokura. Todd and/ or Shell both presently possess the ability to delay development by not supporting a development decision unanimously.
65. Comments made in other submissions expressed concern over Todd gaining the ability to veto Shell and OMV objectives by itself. NGC stated: [

] ²⁰

66. Todd is not acquiring a participating interest where it could veto Shell and OMV objectives. While Todd could vote against Shell and OMV on a development decision where unanimity is required, this ability is the same both pre and post acquisition. The ability of Shell and Todd or Shell and OMV to pass an operating decision appears to allay the concerns NGC has regarding the Todd acquisition.
67. Phil Watson of Methanex stated: [

] ²¹

68. Methanex's comment on Shell's desire to develop Pohokura also casts doubt on a scenario where Shell is incentivised to act in concert with Todd on operating decisions to delay production from Pohokura to benefit uncommitted gas supplies in other fields.
69. An additional factor to consider when assessing Todd and Shell's motivation to delay development of Pohokura is the need for the JV to secure a cornerstone purchaser(s) of gas before the development of the field commences. This issue was discussed in Decision 411:
- "In order to develop the Pohokura field the Commission accepts that for a major new gas field to be financed, a "cornerstone" purchaser or purchasers of gas would be required to enter into a long-term contract to take a sizeable proportion of that gas before the field development commences. FCE has suggested to the Commission that it would be necessary to have contracts in place for perhaps []"

¹⁹ Contact Energy Submission to the Commerce Commission,

²⁰ Email of 17 April 2003 from Paul Hodgson, NGC

²¹ Email of 11 April 2003 from Phil Watson, Methanex.

70. To begin development of Pohokura the JV is likely to enter into a long term contract with a major user. Once this contract is signed, assuming all JV parties enter into the contract, the three JV parties will have a strong incentive to begin extracting gas from Pohokura in order to fulfil their contractual obligations.
71. Todd, Shell or OMV could delay the process of obtaining this contract by not agreeing unanimously to enter into the contract. A decision to enter into a long term supply contract requires unanimous support from the three JV participants both pre and post acquisition. Todd’s acquisition of OMV’s [] interest does not increase Todd’s ability to delay entering into the contract. Any of the JV partners could potentially delay development of the field by not supporting a long term contract with a prospective purchaser.
72. Once a contract is entered into, it seems unlikely Shell or Todd would have an incentive to delay gas production by voting in concert on operating decisions in an effort to stall the development of Pohokura to increase the value of uncommitted gas holdings.

Uncommitted Gas

73. Uncommitted gas, while part of the overall market is considered separately from total gas production as it is the only area in which Todd and Shell may be able to potentially exercise market power.
74. Todd and Shell provided the Commission with estimates to indicate the quantity of uncommitted gas available beginning in 2003. Commission staff also provided estimates of the amounts of uncommitted gas. The numbers in Table 3 reflect Commission estimates of the amount of uncommitted gas available beginning in 2003.

Table 3: Todd and Shell’s Uncommitted Gas Estimates in PJs

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|-------|------|------|------|------|------|------|------|------|------|------|------|------|
| Shell | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] |
| Todd | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] |
| Total | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] | [] |

[]
[]

75. []
[] 2005 is not relevant to this acquisition as it is before the earliest date which Pohokura is likely to be brought online. []
[]

76. Shell by delaying Pohokura would sacrifice the sale of 25.4 PJs in 2006 and 33.6 in 2007 (expected output from Pohokura in these years) to gain a higher price for its uncommitted supply of []
77. If Todd chose to delay Pohokura they would sacrifice the sale of 13.7 PJs of Pohokura gas in 2006 and 18 PJs in 2007 for the sale of []

78. Comparing the benefit of selling both committed and uncommitted gas supplies at \$4 a GJ in Table 4 below, there is clearly an incentive for both Todd and Shell to develop the Pohokura field. [

] This total value does not factor in the value of the additional condensates that would also be available for extraction. If Shell and or Todd delayed Pohokura they would be losing the potential profit from both the gas and condensates which clearly outweighs any returns they might generate from their uncommitted gas holdings.

Table 4: Estimated Value of Todd and Shell's Pohokura Committed and Uncommitted Gas Supplies

| | 2006 | 2007 |
|----------------------------------|------|------|
| Value of Shell's Pohokura Gas | [] | [] |
| Value of Shell's Uncommitted Gas | [] | [] |
| Total | [] | [] |
| | 2006 | 2007 |
| Value of Todd's Pohokura Gas | [] | [] |
| Value of Todd's Uncommitted Gas | [] | [] |
| Total | [] | [] |

*Estimates assume a \$4 GJ price

79. Additionally, any benefit Todd and Shell might gain by delaying Pohokura has to be considered against the capital costs invested by both parties to date in developing the Pohokura field. The Commission's Pohokura Draft Determination stated: "The CAPEX required to develop the field to produce 70 PJ per annum is in the order of []²² This investment also acts as an incentive for the two companies to seek development of the Pohokura field as soon as possible.

80. John Bay made the following comment on Todd and Shell's financial incentive: "It doesn't make economic sense to me that they would seek to defer Pohokura production. They all have significant capital invested and will have invested up to [] to bring the field onto production. Any delay would destroy a large amount of NPV, particularly from the deferred production of liquids, which is likely just as valuable as the gas. This is especially true for Shell. Their holding in Pohokura is substantially more valuable than the residual amount of value remaining in Kapuni (Shell's only other holding post-Maui)."

81. From the value of the uncommitted and committed gas supplies in Table 4 and John Bay's comments, there does not appear a sufficient financial incentive for Todd and Shell to justify delaying gas production from Pohokura. However, even if Todd and Shell have a financial incentive to delay production of Pohokura, Shell's ability to delay by exercising its veto right on operating decisions is largely unchanged. The lack of an apparent financial incentive to delay Pohokura undermines a contention that Todd's acquisition would lead to a substantial lessening of competition.

Conclusion on Unilateral Market Power

82. Todd's increased participating interest will allow Todd and Shell to pass an operating decision on the length of time required to resubmit a development for unanimous approval. This change increases the ability of Todd to act in concert with Shell to

²² Pohokura Draft Determination, p38.

potentially delay development. However, Shell has the ability in both the counterfactual and post acquisition to delay development by exercising its veto right on operating decisions. As Shell's incentives to delay or not to delay are not related to Todd's acquisition and Shell has the ability to act without Todd's support, the acquisition does not appear to alter the JV structure sufficiently to create a substantial lessening of competition.

83. This finding is supported by the lack of concern exhibited by market participants over the acquisition. In addition, the financial incentives provided by the sunk cost investment and the establishment of a contractual arrangement with a cornerstone purchaser make it likely all three JV parties will develop the Pohokura field as soon as possible.

COORDINATED MARKET POWER

Todd/ Shell Relationship

84. As stated above, the Commission was concerned the existing relationship between Todd and Shell might be strengthened by the acquisition and increase the parties' ability to collude and exercise market power.

85. While the increase in Todd's total market share is minimal, the acquisition does alter the dynamic in the JV arrangement with Shell and OMV. The current and post acquisition participating interests in the Pohokura JV are displayed below in Table 5.

Table 5: Todd's ownership stake in Pohokura pre and post acquisition

| Pre acquisition | | | | Post acquisition | | | |
|-----------------|-------------|---------------|-----------------|------------------|-------------|---------------|-----------------|
| | Pohokura JV | | Combined entity | | Pohokura JV | | Combined entity |
| Shell | 24 | 48.0% | 48.0% | Shell | 24 | 48.0% | 48.0% |
| Todd | 8.05 | 16.1% | 16.1% | Todd | 13 | 26.0% | 26.0% |
| Preussag | 17.95 | 35.9% | | OMV | 13 | 26.0% | |
| total | 50 | 100.0% | 64.1% | total | 50 | 100.0% | 74.0% |

86. The increase in Todd's participating interest in Pohokura alters the voting dynamic in the JV's Operating Committee. In order to pass a measure on an operating decision the JV Operating Committee requires a vote [] Pre acquisition Shell and Todd, together, could not override a vote by Preussag. Post acquisition Shell and Todd will be able to pass a decision without OMV support. OMV and Shell will also be able to act in concert to pass an operating decision without the support of Todd.

87. The question is whether the change in Todd's participating interest in the JV will give it an increased ability to act in concert with Shell to stop or delay development decisions for the Pohokura field. The rationale for Todd and Shell to delay development of the Pohokura field would be to capitalise on uncommitted gas supplies from other fields. As discussed earlier, this scenario is unlikely due to sunk cost investment into Pohokura and the greater financial return from selling both Pohokura and uncommitted gas

88. If the counterfactual scenario is considered where OMV holds a 35% stake in the Pohokura JV, Todd and/ or Shell can still withdraw support from a development decision

as those decisions require unanimity. However, John Bay indicates this is an unlikely course of action. “Firstly, it is very unlikely that Shell or Todd would actually “vote against” a proposed Development Plan. An outright rejection of the Development Plan could open the door to initiation of a Sole Risk Development by OMV (or Shell or Todd for that matter).” As it is unlikely Shell and/ or Todd would reject a Development Plan, the issue of concern is whether Todd and Shell’s ability to act in concert to pass operating decisions without OMV’s support could result in a substantial lessening of competition.

89. In Decision 408 and 411 the Commission characterised the Todd/ Shell relationship as the following: “As in its analysis of the current gas production market, the Commission considers that in most circumstances there will be a greater incentive on Shell and Todd to work together...The Commission does not consider that Todd would be an effective constraint on Shell post acquisition.”
90. While Todd and Shell may be more likely to work in concert than as competitors, the Commission noted in Decision 411 that Shell’s investment in the Pohokura field incentivised the company to attempt to recover its investment. “If the Pohokura JV is dependent on the electricity sector for cornerstone purchasers, production from the field may be put back to around 2008. From Shell’s perspective, this would result in a costly delay in recovering the substantial capital already invested in the field.” As noted above, Shell is under some pressure to achieve a return on the capital invested into Pohokura. It appears unlikely both Shell and Todd would be willing to delay development of the field.

- [

]

91. The conclusions reached in Decisions 408 and 411 on the JV relationship between Todd and Shell under the JV 1995 agreement are still valid under the AMIA between the two parties. While Todd and Shell are more likely to cooperate than compete in JV operations, Todd’s acquisition does not increase the incentives on Shell to delay development of Pohokura. As Shell retains the ability to delay development both pre and post acquisition with or without Todd’s support, the change in the voting structure does not substantially increase the chance of Pohokura being delayed.

Conclusion on Coordinated Market Power

92. Todd’s acquisition does not increase the incentives on Shell to delay development of Pohokura. As Shell retains the ability to delay development both pre and post acquisition with or without Todd’s support, the change in the voting structure does not substantially increase the chance of Pohokura being delayed.
93. Shell’s ability to exercise its veto right on operating decisions both pre and post acquisition and the lack of an apparent financial incentive to delay Pohokura development suggest the acquisition will not result in a substantial lessening of competition.

94. While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.

OVERALL CONCLUSION

95. The acquisition is not likely to result in a substantial lessening of competition in the national natural gas production (and first point of sale) market for the following reasons:

- Post acquisition, Todd's increased participating interest allows it to vote in concert with Shell to pass operating decisions. While this does increase the ability of Todd to delay development, the acquisition does not affect Shell's incentive to delay or develop the Pohokura field. Shell, through its veto right, can delay development with or without Todd's support in both the counterfactual and post acquisition scenarios.

As the likelihood and ability of Shell to delay development is not substantially affected by Todd's acquisition it does not appear there is a substantial lessening of competition as a result of the acquisition.

- It does not appear from the uncommitted gas figures, sunk cost investment in the field and the likelihood of securing a cornerstone purchaser for the Pohokura field that there is a compelling financial incentive for the two firms to cooperate to delay production of Pohokura.
- The major parties potentially affected by the acquisition have not raised any serious concerns over the transaction.
- While the acquisition does allow Todd and Shell to use operating decisions to delay development, the acquisition does not sufficiently increase the likelihood of Todd and Shell acting in concert to delay the development such that the acquisition will result in a substantial lessening of competition.

RECOMMENDATION

96. I recommend the Commission take no further action in regards to Todd's increased participating interest in the Pohokura JV.

Agree/ Disagree

Agree/ Disagree

Fritha Mackay
Manager
Market Structure

Geoff Thorn
Director
Business Competition Branch