

BUDDLE FINDLAY

To
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From
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By
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Date
12 August 2004

Dear Simon

Controlled goods or services - scope of Commerce Commission powers

1. You have asked us to consider whether section 70 of the Commerce Act 1986 enables the Commerce Commission to regulate the terms of access to gas transmission pipelines.
2. In particular, you have asked whether, in setting a price or prices for gas transmission services on gas transmission pipelines, the Commission is empowered to require that those services be provided under a contract carriage regime.

Summary

3. We think that it is open to the Commission under section 70 of the Act to regulate the terms of access to gas transmission pipelines in the way advocated by Contact.

Relevant Commerce Act provisions

4. The Commission is carrying out an inquiry under Part 4 of the Commerce Act in relation to whether certain gas services may be controlled in terms of section 52 of the Act.
5. As you know, section 52 provides as follows:

52 When control may be imposed

Goods or services may be controlled if—

- (a) *The goods or services are, or will be, supplied or acquired in a market in which competition is limited or likely to be lessened; and*
- (b) *It is necessary or desirable for those goods or services to be controlled either—*

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- (i) *in the interests of persons acquiring the goods or services (whether directly or indirectly), if the goods or services are acquired from a person who faces limited or lessened competition for the supply of those goods or services; or*
 - (ii) *in the interests of suppliers, if the goods or services are supplied to a person who faces limited or lessened competition for the acquisition of those goods or services.*
6. If a good or service is controlled, section 70 of the Act enables the Commission to make an authorisation in respect of “*all or any component of the prices, revenues, or quality standards that apply in respect of the supply of the controlled ... services, using whatever approach it considers appropriate*”.

Discussion

7. As you are aware, the Commission has not exercised its powers under section 70 since the section was amended in 2001 and accordingly there is no case law to test the limits of the Commission’s powers under the section.
8. However, we think it is instructive to consider the legislative history of section 70.
9. The current version of section 70 was introduced in an amendment to the Commerce Act in 2001. Before that the section did not refer to quality standards or revenues at all, and only permitted the authorisation of a maximum, actual, or minimum price for controlled goods or services.
10. The genesis of the current section 70 is found in a discussion document issued by the Ministry of Commerce in April 1999. In that document the Ministry set out the reasons for the proposed changes, including the following:

“Price control by itself does nothing to encourage the provision of acceptable quality goods or services. It is entirely possible, in a market where competition is limited, that a company would attempt to recover the revenue it had been forced to forgo under price control by reducing the quality of the goods or services it provided. This issue is particularly important in a CPI-X regime where one obvious way to recoup the revenue foregone by the imposition of the regime is to simply lower the quality (and therefore the cost to the regulated company) of the service it provides. Since the regulated company is, under the New Zealand regime, operating in a market where competition is limited or likely to be lessened, it is highly likely that the users of the company’s goods or services will not have alternative sources of supply. The regulator may, therefore, wish to include in the price control an approach mandating a requirement that goods or services sold be of a specified quality.”

11. To address this issue, it was proposed to amend the Act to clarify that the Commission may “set any service quality requirements and any requirements for verifying service quality it deems necessary”. In recommending the changes to Cabinet, the then Minister of Commerce (Hon Paul Swain) discussed price control methodologies and then stated:

*“These price control methodologies aim to maximise incentives for firm efficiency and provide investors with a level of certainty. The Commerce Commission also needs to be able to set **any other parameters**, such as service quality, or allowing the company to pass on to consumers increased costs.”* (Emphasis added)
12. This policy was implemented in section 14 of the Commerce Amendment Act 2001, in the form of the current section 70.
13. In our view, this demonstrates that the Government envisaged that the Commission would need wide powers to determine what is to be provided so that the benefits of price control cannot be avoided by a controlled entity by changing in any way the quality of the controlled good or service.
14. Turning specifically to gas transmission services, characteristics of those services such as availability and delivery pressure obviously fall within the ambit of the Commission’s powers. However, we think that section 70 can also apply to terms of access.
15. In relation to gas transmission services provided by a pipeline owner, the terms of access offered to users of the pipeline are integral to the quality of the service. Setting a price without defining the qualities of the service will mean that the price set will be meaningless.
16. For example, a particular price for the transport of gas may mean one thing to a shipper if the capacity is allocated on the Friday immediately before the day the capacity is used, but may mean another thing entirely if the capacity is allocated on a tradable basis consistently over a 10 or 15 year period to reflect the expected life of a CCGT generating station or LNG terminal. This is the essence of Contact’s submission to the Commission in relation to the gas pipelines inquiry.
17. Without establishing the terms of access to be provided, the Commission will therefore be unable to effectively exercise its powers under section 70.
18. Accordingly, to ensure that the Commission can exercise its powers under section 70 for the purposes for which they were intended, we think that it is open to the Commission to regulate the terms of access to gas transmission pipelines in the way advocated by Contact.

19. Please contact us if you we can be of further assistance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tony Dellow', written in a cursive style.

Tony Dellow
Partner

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