

20 August 2003



The Acting Chair
Commerce Commission
NGC House
The Terrace
WELLINGTON

Attention : David Steele (david.steele@comcom.govt.nz)

Submission to the Commerce Commission on Price Control for Gas Pipelines

Contact Energy Ltd (Contact) is a significant acquirer and onseller of gas in the New Zealand energy market. We welcome the opportunity to make this submission to the Commerce Commission's Natural Gas Control Inquiry (the Inquiry) which has been requested by the Minister of Energy.

Contact supplies electricity and/or natural gas to more than 600,000 businesses and homes throughout New Zealand. As one of the largest power companies operating in the New Zealand electricity market, Contact is responsible for over a quarter of the country's electric power generation. Contact acquires gas for the purpose of fuelling its combined cycle stations at Taranaki and Otahuhu. It also uses gas in a cogeneration plant at Te Rapa, steam turbine station at New Plymouth and, more rarely, in gas turbines at Otahuhu. It is the largest retailer of natural gas in the country, supplying some 40% of the retail market.

One of the key issues facing Contact is long term fuel replacement as the known gas fields become depleted. It is important for the Commission to be mindful of the negative effect that inefficiencies in the transmission and distribution of gas can have on the incentives for parties to prospect for and/or develop new reserves.

Timetable

The timetable is constrained by the reporting date set by the Minister of Energy and we consider that the overall time available is sufficient for the task facing the Commission.

However, we note that the timetable does not contain any provision for interested parties to make submissions that will be taken into account in the Commission's Draft Report. The way that the process is currently structured means that, after the Framework is settled, the only opportunity that interested parties will have to inject information into the process is during the period following release of the Draft Report. Even then, the time allowed for provision of feedback on the Draft Report is relatively short.

Contact submits that there is ample time between finalising the Framework and the planned release of the Commission's Draft Report for the Commission to receive substantive submissions and to take these into account in the Draft Report. We recommend that all interested parties be given a deadline of no later than 1 December 2003 to deliver submissions to the Commission.

Although we consider that the overall period of time allowed for this Inquiry is sufficient, Contact considers that the time periods allotted for:

- cross-submissions following the conference on the Draft Framework paper;
- written submissions on the Draft Report; and
- cross-submissions following the conference on the Draft Report;

are too short to allow for high-quality analysis of, and feedback on, the Commission's findings.

It is important to recognise that there is an inherent asymmetry between the owner/operators of gas transmission and gas distribution systems and their customers. The owners of the facilities are concentrated whereas the fees paid individually by users of those facilities form only a portion of the user's total cost structure.

As a consequence, it can be worthwhile for a gas distribution system owner, for example, to fund dedicated resources on a full-time basis who would focus on this Inquiry and related issues, and present their case accordingly. Acquirers, in contrast, are likely to need to divert resources from other functions. Accordingly, the relatively short time periods allotted for submissions and cross-submissions may limit the ability of acquirers to be able to undertake the necessary analysis and provide comprehensive submissions.

Importantly, there is also a considerable asymmetry of access to information. Although the Commission will, no doubt, be given access to commercially sensitive material, much of that material will not be seen by the acquirers and that makes our analytical task that much harder and, therefore, more time-consuming. Accordingly, any foreshortening of times for (cross) submissions will tend to favour the suppliers in this Inquiry.

Related Commission Work

The Draft Framework Paper refers to related work that the Commission has undertaken, specifically the:

- airfields inquiry;
- targeted control regime for electricity lines businesses; and
- determinations in respect of the telecommunications sector.

Contact welcomes the Commission's view that *"the Airports Inquiry has the most direct relevance and similarity to the current inquiry"*¹.

The Public Benefits Test

The Commission proposes an analytical framework which does not recognise any net public detriments/benefits from purely distributional effects, and focuses solely on the effect on economic efficiency.

Whilst we support the focus on economic efficiency, we believe the Commission needs to be very careful when it comes to applying this framework. Our caution arises because if the test is applied in a relatively simple static fashion, there is the real prospect that a monopoly provider could argue that efficiency is preserved, despite clear evidence of persistent monopoly rents.

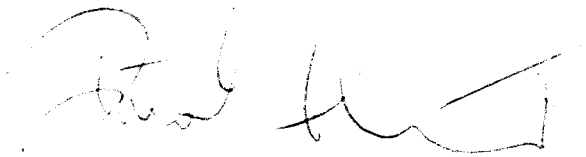
For example, a pipeline supplier could seek to argue that provided it minimised its production costs and did not offend the dynamic efficiency principle, it could charge whatever it liked as a 'fixed' charge as long as its variable charges reflected marginal costs. We do not believe that this outcome would reflect the intent of the Commerce Act or government policy.

We believe that great care will be needed in applying the allocative and dynamic efficiency tests to ensure that they properly capture the full range of economic welfare effects.

Conclusion

Contact appreciates the opportunity to make a submission to the Commerce Commission on the inquiry into gas pipelines. We support the broad thrust of the Commission's conclusions in the draft framework paper. We believe that the proposed approach would be enhanced by altering the inquiry timetable to allow greater input from submitters, and by the Commission clarifying the manner in which the public benefits test will be applied.

Yours sincerely



David Hunt

General Manager, Corporate Development

¹ Paragraph 1.16, Executive Summary, Draft Framework Paper.