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# **Gas Control Inquiry**

## **Draft Framework Paper**



*Oral submission to Commerce Commission*  
*1 September 2003*

# Contact Energy is a significant buyer, user and reseller of natural gas

## Contact Energy

### Company ownership

- 3rd largest company on NZ Stock Exchange
- 100,000+ NZ shareholders

### Electricity business

- 28% of generation capacity
- 29% of retail market

● 50% thermal

● 15% geothermal

● 35% hydro

■ original retail area

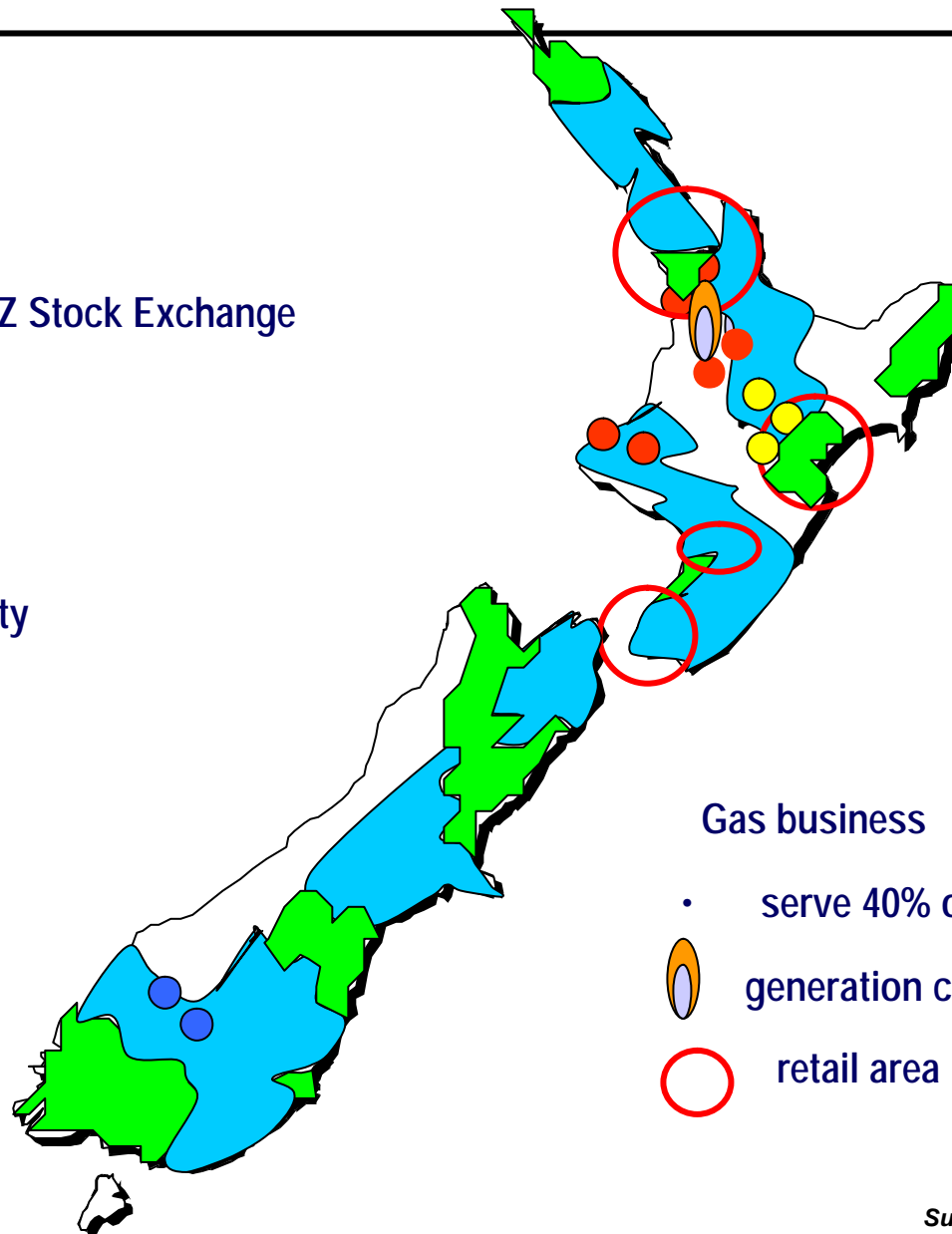
■ new retail presence

### Gas business

- serve 40% of retail market

○ generation customer

○ retail area



## Contact welcomes this inquiry into the potential net benefits of price control

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### Contact's view of inquiry

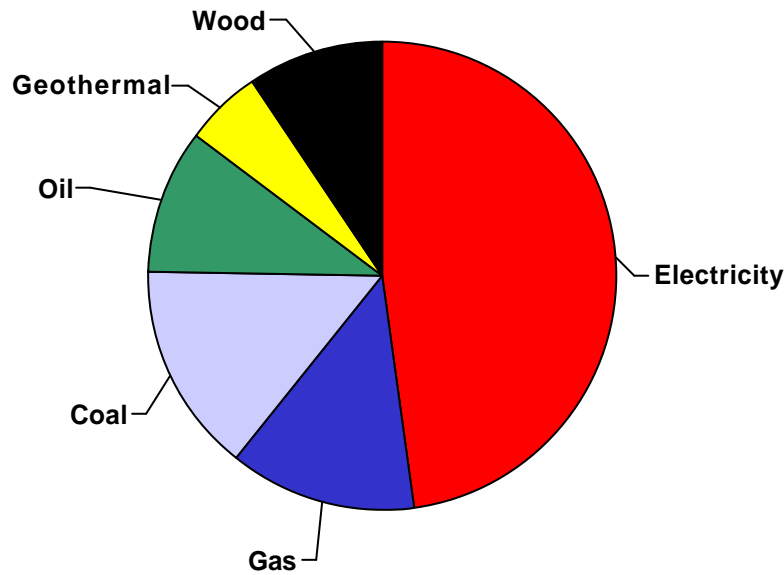
- Contact welcomes the Gas Pipelines Control Inquiry:
  - provides an opportunity to scrutinise a large and important sector within the economy
  - should help to ensure that gas plays a full role in meeting NZ's future energy needs - a critical issue going forward
- At this point in the process our focus has been on the 'big picture' issues
- Expect to engage in more detail at the next stage in the process

**Gas is a major contributor to NZ's primary energy supply - both for direct use and as an input to electricity production**

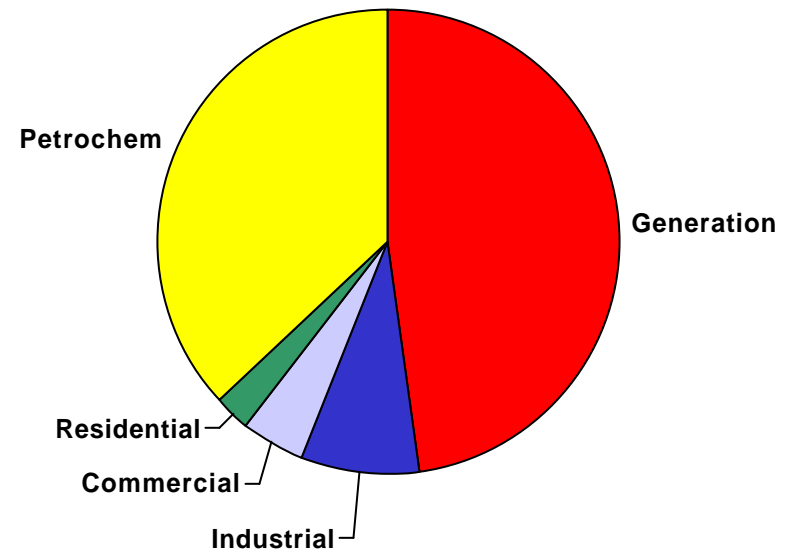
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## Importance of gas to NZ

**Non-transport energy sources**  
for YE Mar 2002 = 255PJ



**Gas Demand**  
for YE Mar 2002 = 236PJ



**There are many components of “gas services” - some clearly fall within the inquiry scope - others appear uncertain**

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## Services definition

Potential components of “gas services”:

- Transport of specification gas ✓
- Transport of non-specification gas ✓
- Gas blending ?
- Gas storage (i.e. linepack) ✓
- Gas compression ✓
- Gas flow management ?
- Metering ?
- Allocation and reconciliation services (e.g. UFG) ?
- Gas quality monitoring ?
- Odourisation ?

## Current disclosure regime appears ineffective for a variety of reasons

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### Disclosure regime

- Present disclosure regime is not effective:
  - ODV inputs not sufficiently standardised
  - difficult to relate disclosures to transport to specific customers or over specific distances
  - no readily accessible clearing house for information
  - information not suitable for rigorous analysis by 3rd parties
  - regime allows too many exemptions

## Contact supports the Commission's preliminary view of market definition

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### Definition of relevant markets

- Contact supports the Commerce Commission's preliminary view that there are two transmission markets:
  - market for transmission services between Taranaki and Rotowaro
  - market for transmission services in rest of North Island
- Contact would also note that definition should include transport of specification and non-specification gas

## Contact believes that there is circumstantial evidence of the use of market power

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### Evidence of use of market power

- Unable to make definitive assessment about whether market power has been used because of informational difficulties
- However, Contact notes that:
  - there are significant discrepancies in charges between some networks that appear difficult to explain based solely on customer density etc
  - there have been instances where threatened bypass has elicited significant reductions in charges for affected customers, and simultaneously charges have been increased for others not able to benefit from the proposed bypass
  - there have been instances of actual bypass, strongly indicating that charges by an incumbent significantly exceed marginal cost

**Contact believes that scope for inter-fuel competition is limited, other than in the longer term**

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## Inter-fuel competition

- Most gas users (by volume) find it very difficult to substitute for other fuels because they have large investments in specific assets:
  - process heat
  - petrochemical production
  - power generation
- Substitutability is greater at household level and SME level, but presence of sunk specific assets is also an issue

**Contact believes that scope for inter-network competition is very limited**

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## Competition between networks

- Competition is only feasible where:
  - there are overlapping networks - the only significant instance is the Maui line and the NGC northern transmission line - but northern markets require around 120 TJ/day and the NGC line is limited to 30 TJ/day
  - bypass is an economic option - e.g. areas of concentrated load such as CBDs
- Competition is not a realistic discipline for most parts of NZ

## Contact supports the broad thrust of the analytical approach proposed by the Commission

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### Framework for analysis

- Contact supports the Commission's general approach based around assessing the expected benefits and costs of control
- The Commission recognises that this is complex and requires:
  - assessing the level of efficient pricing based on empirical work and use of 'building block' models
  - comparison of actual pricing with theoretical efficient pricing
  - assessing the costs associated with applying a control regime as an ongoing feature

**Contact believes the economic efficiency tests will need to be applied with great care**

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## Public benefits test

- The Commission has proposed an analytical framework which does not recognise any net public detriment/benefit from purely distributional effects
- Contact supports the Commission's focus on economic efficiency, but notes that results can be sensitive to the manner in which the framework is applied
- For example, Contact would be concerned if a dynamically and productively 'efficient' operator could successfully argue that it could levy any fixed charge, provided its variable charge equated to marginal cost

**Contact notes that the potential costs of mis-application of control could be significant if it triggered under-investment in the sector**

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## Time consistency

- Whilst consumers of pipeline services (including Contact) could accrue considerable short term benefits from unjustified application of aggressive price control, we recognise that such benefits would not be sustained
- Such an outcome would seriously undermine incentives to invest in maintenance and expansion of pipeline assets
- Costs of under-investment in such a key sector could be significant
- Contact therefore urges the Commission to adopt a robust and time-consistent approach to the issue

**Timetable provides limited input from interested parties - allowing more time for submissions should raise quality of participation**

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## Inquiry timetable issues

Sept 03

Conference on draft framework paper  
Cross submissions following conference

6 months

Mar 04

Draft report from Commission

Apr/May

Submissions due on draft report

May/Jun

Conference on draft report

Jun

Cross submissions following conference

4 months

Nov 04

Final report to Minister

**Contact welcomes opportunity to make submission and looks forward to participating in the inquiry as it moves forward**

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## Conclusion

- Contact is a significant buyer, user and reseller of natural gas
- Contact welcomes the inquiry by the Commission
- At this point our comment is limited to the 'big picture' issues
- Contact supports the broad thrust of the approach proposed by the Commission
- Contact looks forward to participating in the inquiry in more detail as it progresses