

**PRESENTATION TO
COMMERCE COMMISSION:**

**GAS CONTROL INQUIRY
DRAFT FRAMEWORK PAPER**

Presenters

- Introduction – Victoria Heine, Chen Palmer & Partners
- Current market conditions – Steven Boulton, Chief Executive, Powerco
- Investment and investors – Barry Upson, Chairman, Powerco
- Behavioural regulation – Euan Morton, Executive Director, NECG
- Valuation issues – Peter Seed, Director, Peter Seed Ltd

Introduction

- Counterfactual
- Workable competition
- Net benefits
- The way forward

Counterfactual 1

- Current regime not an appropriate choice of counterfactual
- Rather:
 - Gas (Information Disclosure) Regulations 1997 likely to be strengthened
 - Government is currently formulating proposals for regulation should the Steering Group fail to produce a satisfactory outcome (i.e. consistent with the GPS)

Counterfactual 2

- Most likely scenarios are:
 - an Energy Commission regulating gas and electricity;
 - co-regulation, such as New South Wales model
- Either would provide for:
 - open access
 - terms of access to distribution systems
 - switching, reconciliation and metering

Workable Competition

“Workable” competition is relevant in two senses:

- (a) the s52(a) requirement for limited competition (s3(1))
- (b) the fact that the ultimate goal of any regulation is to seek to mimic a competitive market

Workable Competition 2

Limited competition:

- Difficulties within this test were identified by the MED and the provision is subject to review

“Our preliminary view is that the test of “limited competition” is too low and this could apply to many markets in New Zealand”

Workable Competition 3

- The concentrated nature of the gas industry is such that virtually any company could be captured by it;
- Workable competition falls on a spectrum between perfect competition and pure monopoly;
- What degree of competition is workable competition is a complex issue

Workable Competition 4

- Approach should be robust and realistic, bearing in mind the realities of the New Zealand industry

Epic “a workably competitive market may tolerate a degree of market power even over a prolonged period”

Workable Competition 5

- Purpose of regulation is to mimic competition
- But, should not attempt to mimic a theoretical, perfectly contestable market. The costs and risk of doing so are too high, even if it were possible to do so
- Correct approach is simply to seek to substantially improve on the unregulated market
- Commission should bear this in mind when hearing from subsequent presenters about the unusual features of the gas industry

Net benefits 1

- Section 52 requires an assessment of whether control is in the interests of acquirers
- The Minister has also requested the Commission advise on “the net benefits to the public of control”

Net benefits 2

- Net public benefit is a decision ultimately for the Minister, not for the Commission
- Minister may take wider range of factors into account than the Commission, acknowledged by Minister of Commerce in Cabinet Paper regarding decision not to impose control over AIAL
- In this context, the following could be relevant:
 - Government policy on energy efficiency and regulation;
 - Government policy with respect to the encouragement of investment in infrastructure, including foreign direct investment;
 - International treaty obligations;
 - Environmental matters; and
 - The Treaty of Waitangi, to the extent relevant.
- Powerco has reservations about the extent to which the Commission can or should consider these issues

Net benefits 3

- Control should not be recommended unless the benefits **substantially or significantly** outweigh the costs of regulation
- This is because of :
 - Regulatory risk associated with the Commission's approach (in particular the building blocks analysis);
 - Regulators should not seek outcomes that would be obtained in perfect competitive markets. A sensible objective is to improve significantly on unregulated outcomes;
 - Underlying property rights must be balanced with the need for regulatory oversight.

Way forward

- Commission must issue a Final Framework Paper – not provided for
- Need to undertake formal fact gathering to determine certain issues e.g. extent of interfuel competition