



Commerce Commission Gas Control inquiry

Nova Gas Limited response to submissions on the draft framework paper

1. Introduction

- 1.1 Nova Gas Limited (**Nova**) made a short written submission to the Commission on the Draft Framework paper. It elected not to present at the subsequent conference. However, Nova is concerned that a number of inaccurate and potentially misleading statements were made by parties who made submissions at the conference. The purpose of this paper is to provide the Commission with clarification on those matters.

2. Powerco Submission

- 2.1 Powerco used Nova's Wellington network as an example of competition for distribution services. Powerco claimed that Nova was able to establish that network because of 'free' access to Saturn trenches. This is incorrect. Nova actually installed Saturn ducts in a few selected trenches along with its gas pipelines in parts of Wellington. This resulted in reduced disruption to the public and slightly reduced costs for both parties. However, the decision to build the bypass was made on economic grounds well before the opportunity to share trenches with Saturn eventuated. Very few Nova lines actually share trenches with Saturn; Nova's main lines from Tawa into Wellington and the Hutt Valley do not share trenches with Saturn and, accordingly, the cost saving was minor and had little impact on the overall economics of the project.
- 2.2 Powerco claimed that Nova cross-subsidises distribution and energy and is able to do so because Nova has access to large quantities of cheap gas from its shareholder, Todd Energy. This is incorrect:
- (a) Nova buys its gas from the Kapuni Mining Companies (KMCs), that is, Shell and Todd. Nova pays commercial rates for the gas and is not the only customer of the KMCs.
 - (b) The quantity of gas that is available to Nova is limited by the capacity of the Kapuni field, the KMCs entitlements to the Kapuni gas, and by the KMCs commitments to supply gas to other parties.
- 2.3 Powerco claimed that Nova builds up clusters of customers then migrates them onto its own network once sufficient load has been contracted. They appear to be referring to the recent extension of the Nova Lower Hutt Network into Seaview. In fact, Nova has been supplying gas to most of the customers that are being migrated onto the new Nova network for 3 to 5 years. During that time Nova has used the incumbent distribution network.



- 2.4 Powerco stated that “customer capture” by retailers disadvantages distributors. In fact, retailers must bear all the costs and credit risks associated with the retail supply of gas to end consumers. Those costs include meter reading, invoicing, customer support/ call centre and debt collection. Distributors do not provide those services and do not bear any of those costs; as a consequence they do not have any relationship with the end consumers. It is not clear how this disadvantages distributors - it is clearly more efficient for the network distributors to have a small number of large customers than a very large number of smaller customers.

3. Vector submission

- 3.1 Vector claimed that they compete with other gas distributors in most areas. Nova does not agree and notes that Nova has only approximately 10km of bypass network within the thousands of kilometers of network owned by Vector. NGC has a similar small amount of distribution pipe within Vector’s area.
- 3.2 Vector also referred to “customer capture” by retailers and cross subsidization by vertically integrated companies. We refer to our comments on those issues at paragraph 2.2 above.
- 3.3 It should also be noted that Nova Gas is not vertically integrated. Nova is substantially, but not wholly, owned by the Todd Energy group of companies. However, Nova operates as a separate company with separate management and a separate board of directors.

4. Genesis submission

- 4.1 Genesis claimed that Nova “possesses the ability to be anti-competitive by means of cross-subsidisation, given Nova Gas is also a retailer and offers bundled prices and has access to “cheap” wholesale gas by virtue of its ownership” (paragraph 3.3; see also paragraph 4.1).
- 4.2 Nova rejects those assertions and refers to the points made at paragraph 2.2 above.

5. Additional comments for the Commission

- 5.1 The Commission will already have an understanding of the following points but they are provided for the avoidance of doubt and in light of the comments of other parties during the conference.
- 5.2 *Nova Gas Limited*

Nova is a supplier of reticulated natural gas, primarily to industrial and commercial customers throughout New Zealand. It is one of a small number of gas retailers in New Zealand.



Nova competes with other gas retailers in common geographic areas. It purchases gas from the wholesale market through gas sales agreements. The gas is then typically supplied to Nova's customers through local pipeline networks, pursuant to transmission agreements with the owners of those networks.

In recent years, Nova has built approximately 100 km of gas bypass pipelines in Wellington, Porirua, the Hutt Valley, Hastings, Hawera, Papakura and Manakau City. Bypassing has, to a limited extent, allowed Nova to transport gas to its customers without the need for existing distribution networks.

The incidence and the threat of future bypassing by Nova has led to a more competitive gas supply market in New Zealand. As noted in the ACIL report to the Ministry of Economic Development (October 2001) at XV, "...bypass or the threat of it, has resulted in lower prices for some customers". Nevertheless, scale economies and the sunk costs involved in laying pipelines have seen gas distribution remain largely monopolised by existing pipeline owners. Where bypass is not feasible, retailers like Nova have no option but to contract with the local distributor.

5.3 *Landfill Gas*

The Nova networks have been built with the ability to supply customers a mix of treated landfill gas and natural gas. Until 2001 treated landfill gas from the Nova plant in Porirua was added into the Wellington network. The Nova customer network has a different contractual gas specification to that in the New Zealand pipeline network. Nova intends to construct a new plant at the Southern Landfill in Wellington that could produce around 15% of Nova's supply to its pipeline customers. Nova has also undertaken studies and work at various landfills in Auckland and other parts of New Zealand for the same purpose.

5.4 *Exemption to Pipeline Disclosure Regulations*

Nova has been granted an exemption to the Gas Pipeline Disclosure Regulations for two reasons:

1. Nova's networks are not monopoly assets. Customers connected to Nova's networks have a choice of network provider and always have the option of being supplied via the incumbent network.
2. Nova's networks have the ability to supply a blend of treated landfill gas, with a different contract gas specification to the NZ 5442 specification that applies in other pipelines.

5.5 *Competition for distribution services*

Nova has brought a new level of competition to the gas supply industry in New Zealand and, in particular, the gas distribution market. The introduction of bypassing by Nova has, in some areas, begun to weaken the monopoly position previously enjoyed by distribution companies.



In some areas the distribution companies' response has been to seek to prevent and/or restrict Nova in particular, and retailers in general, from competing with them in the provision of distribution services to end users by insisting on dealing direct with end users and refusing to wholesale distribution services to retailers. The comments in the submissions by distribution companies regarding "customer capture" by retailers and Nova building "clusters" of customers is evidence of their concern. Their response has been to use their dominant market position to force Nova and other retailers to contract for distribution services in ways which prevent this happening and therefore prevent competition for distribution services from occurring.

5.6 *Markets for distribution services*

There are only small areas or markets where true competition, that is actual or potential bypass competition, exists. In other areas competition could at best come from an alternative fuel. However, that has not significantly controlled line charges, as evidenced by the disparity between the ratio of end user price to well head price between New Zealand, Australia and the USA for the total delivered cost of gas (refer ACIL Report, section 4.7.2).

The distribution companies recognize these discrete markets in their pricing models. For example, Vector has implemented Zonal pricing with substantially lower pricing around Nova's network and the transmission gate stations. This zoning currently allows the distribution companies to cross-subsidise, offering very low pricing in areas where bypass exists, or could exist, to prevent competition, while pushing up prices in other areas to recover the revenue lost. Nova's bypass activities create real competition within small markets, however Nova's activities cannot control monopoly behavior in larger markets.