

12 June 2003

Mr John Belgrave
Chairman
Commerce Commission
PO Box 2351
WELLINGTON

Dear Mr Belgrave

COMMENTS ON PROPOSED PROCESS FOR GAS PIPELINES INQUIRY

Thank you for the opportunity to comment on the process the Commission proposes to follow for the inquiry into gas pipeline services.

Our primary comment relates to the content of the Framework Paper that the Commission intends to publish on 8 August. We agree that publishing a Framework Paper would likely result in a better separation between the Commission formulating the framework and methodologies for the inquiry, and the application of the framework and methodologies. We agree that this separation would be an enhancement to the process compared to that followed for the airports inquiry.

However, we believe the Commission should first set out its analysis of the legal framework for this inquiry before it publishes the Framework Paper. How the Commission interprets the legal framework, including its terms of reference, will influence considerably how it formulates the other aspects of its proposed Framework Paper, especially the economic framework for the inquiry.

By including its analysis of the legal framework in the same paper as its approach to the inquiry and proposed economic framework, the Commission risks having to re-issue the Framework Paper should weaknesses be exposed in its legal analysis. A better approach for all parties would be for the Commission to:

- a) Release a legal analysis paper.
- b) Consider written comments on its legal analysis.
- c) Release the Framework Paper.

The process would then resume as set out in the Commission's media release of 30 May 2003. In suggesting that the Commission makes explicit its legal analysis prior to releasing the Framework Paper we are conscious that this is a difficult area of the law. We note that the Minister of Commerce has asked her officials to report on problems in applying the provisions of Part IV of the Commerce Act, as revealed by the airports inquiry. We believe that these difficulties reinforce the case for the Commission to set out up front for comment its interpretation of the legal framework.

We consider that a decision on whether or not to recommend price control requires a two step analysis. The first step involves establishing whether control *may* be imposed. The Minister must not make a recommendation to the Governor General that control be imposed unless he is satisfied that the goods and services meet the threshold for control to be imposed as set out in section 52 of the Act:

Section 52 provides that goods or services may be controlled if:

- a) The goods or services (in this case gas pipeline services) are supplied or acquired in a market in which competition is limited or likely to be limited; and
- b) It is necessary or desirable for those goods or services to be controlled in the interests of persons acquiring the goods or services (whether directly or indirectly).

However, the Minister has asked the Commission to report to him, not just upon whether gas pipelines *may* be controlled, but on whether control *should* be imposed. The tests set out in section 52 provide the minimum, but not necessarily sufficient, thresholds for the Commission to conclude that control should be implemented. A broader range of matters will be relevant to a decision on whether control should be imposed.

In his letter to the Commission the Minister states:

"In reaching its view on whether control should be introduced, I ask for the Commission's specific advice on:

- whether gas pipeline services may be controlled in terms of section 52 of the Act;
- the methodology that the Commission considers appropriate for valuation of pipeline assets for the purposes of its advice on the matters covered in this letter;
- the net benefits to the public of control; and

- any other matter that the Commission may think relevant to a decision on whether control should be introduced.

This list appears to constitute a broader range of matters for the Commission to consider, relative to those it considered in the airports inquiry. In that inquiry the Commission considered that the initial Ministerial request constrained it to considering "market conditions".

If, as we believe is the case, the Commission is being asked to consider a broader range of matters, then this will have implications for its approach to the inquiry and its proposed economic framework. For example, a net public benefit analysis would ignore wealth transfers between suppliers and acquirers of services. Wealth transfers are however relevant if the analysis is limited to the benefits of control to acquirers of services.

This distinction was critical in the airports inquiry, as the Commission found that control of Auckland airport would result in benefits to acquirers and recommended control. The Minister, however, concluded that control would produce negative net benefits to the public (i.e., a reduction in overall economic welfare) and decided against recommending control.

The Commerce Act does not provide explicit guidance to the Commission in forming a view as to whether control *should* be imposed, or how it should weigh the matters on which the Minister has sought specific advice (for example a benefit to acquirers versus a reduction in public benefit). How the Commission interprets its legal framework will therefore determine the nature of its investigation.

The Commission's media release of 30 May suggests that the Commission has not yet worked through the implications of the broader range of matters it has been asked to consider. For example, in commenting with regard to its proposed Framework Paper the Commission says the paper will include the:

"proposed economic framework for the inquiry, including relevant economic efficiency considerations (e.g., principles for pricing, asset valuation & WACC) and the Commission's proposed approach to the analysis for determining whether control is necessary or desirable".

The phrase "whether control is necessary or desirable" appears to be a reference to section 52 (i.e., the test as to whether control may be imposed). However, in order to conclude whether control "should" be imposed, the Commission will need to undertake a net public benefit test. The economic framework for evaluating net public benefit may well be different from that used to determine whether control is necessary or desirable to acquirers.

For these reasons we believe it important for the Commission to set out its legal analysis, before proceeding to release its Framework Paper.

We trust you find these suggestions useful.

Yours sincerely

Simon Mackenzie
GROUP GENERAL MANAGER NETWORKS