Gas Pipelines Inquiry

Draft Report Conference –

Post-Conference Information

Submission to Commerce Commission
13 August 2004

INTRODUCTION

This report sets out the supplementary information that was requested by the Commission during the course of Contact's conference presentation.

An Annex has also been provided on a confidential basis outlining the arrangements Contact has negotiated with various parties relating to threatened pipeline bypass, and relating to any contributions Contact has made to pipeline capex.

THE METERING MARKET

The market for metering generally appears to work well. In most cases there are few problems with regards to enabling retailer third party access to meters.

Similarly it is a contestable service, with the ability for retailers to install their own meters if they so wish. However, we note that in the vast majority of cases, in both gas and electricity metering, this has not occurred, with the retailers generally being content to use on a third party basis the meter currently installed in the customers' premises. Out of our incumbent base of some 130,000 gas meters, only 60 or so customers have decided to switch to another meter provider. These are all commercial customers, and almost all due to the meter provider "bundling" the meter charge in a non-transparent way with the network charge.

The biggest area where this is an issue is in PowerCo's region, where they require gas retailers to use their own meters. Similarly, PowerCo prefers to offer bundled charges that include Transmission, Distribution and Metering making it difficult to determine the meter lease component.

The breakdown of our gas metering base is as follows

	Residential	**Commercial**	**Total**
Auckland	70,100	4,400	74,500
Hawkes Bay	5,500	300	5,800
Palmerston North	24,500	700	25,200
Wellington	25,200	1000	26,200
Total	***125,300***	***6,400***	***131,700***

The network company in Auckland is Vector, and for the rest of Contact's areas it is PowerCo.

RETAILER PASS-THROUGH OF LINE CHARGES

You asked at conference whether the Commission should take account of the likelihood of retailers passing on network charge reductions to end consumers when determining whether to impose control on network companies.

We acknowledge that some retailers in the past have not fully passed-on network charge reductions (both electricity and gas). However, we can report that Contact has a policy of always passing on changes in network charges to customers "at cost".

This included the recent network charge reduction which Vector alluded to in its submission, and which some retailers did not fully pass-through. Accordingly, Contact's competitive position has improved relative to other retailers, and we would hope to win more customers as a consequence.

This illustrates the principal comment we made on this issue at conference, which is that retail is a competitive activity, and the forces of competition should therefore compel retailers to pass-through network charge reductions for fear of being under-cut by competitors.

Only if the Commission believed that retail competition was not working now, and in the foreseeable future, do we believe it should take account of such factors in determining whether to impose control. However, we believe retail competition is sufficiently strong to ensure that all retailers become compelled to pass through network charges at cost in the same way that Contact currently does.

ON WHAT BASIS CAN THE COMMISSION CONTROL THE TERMS OF ACCESS AS WELL AS THE PRICE?

We have sought legal advice on this issue and attach their note on this issue. The upshot is that, although this aspect of control has yet to be tested, we believe that the Commission has the authority to recommend such control under Section 70 on the basis that the government, when it introduced this amendment, clearly intended that the "quality" of service cover "any other parameters" which would affect the value of a service to acquirers.

WHAT WACC IS APPROPRIATE FOR PIPELINE COMPANIES?

The weighted average cost of capital for a particular company, as the name suggests, is a measure of how much it will cost that company to raise funds through the capital markets.

Rather than attempt to develop a complex model to establish what the WACC "should" be for each company, Contact has simply spoken with the capital markets (or more precisely the equity analysts who cover the particular companies) to determine their views.

Given that the views of the capital markets will ultimately determine the cost of raising finance, we believe this approach has merit in determining the "actual" cost of capital faced by the pipeline companies.

The results of this brief review are as follows:

Pipeline co.	Analyst[1]	WACC (post-tax nominal)	Methodology
NGC Holdings	A	7.9%	Officer
	B	7.6%	Officer II
	C	7.9%	Lally
NGC Pipes	C	7.4%	Lally
NGC Tx	D	6.9%	?
NGC Dx		8.1%	?
PowerCo	E	7%	?
	B	7.4%	Officer II
	C	7.6%	Lally

[1] Although some of this information is publicly available, some brokers provided the information to us on a private basis. Accordingly, we have made the identify of all the brokers anonymous.