



NOVA GAS LTD

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Public Version

Gas Pipelines Inquiry
Commerce Commission
PO Box 2351
Wellington

Cross-submission following gas pipelines inquiry conference (22 and 26-28 July 2004)

Executive Summary

1. The geographic extent of the bypass markets is []. There is no easy way to draw precise boundaries of the bypass markets. However, a pragmatic and common sense way to address the issue is to draw a boundary extending no further than [] from Nova's existing network.
2. Nova estimates that only []% of total North Island commercial and industrial load is supplied to customers in competitive, bypass, markets. In the case of Auckland, Nova estimates that about []% of total volume is supplied within [].
3. The Commission does not have jurisdiction to make any recommendations to the Minister that Nova be controlled. Nova participates in markets in which competition is not limited or likely to be lessened. There is no case for control by virtue of section 53(a) of the Commerce Act 1986 ("the Act"); that is the end of the matter, so far as Nova is concerned.
4. The Commission does not have jurisdiction to consider issues of access in the course of the current inquiry.
5. If the Commission proposes to make incidental or consequential comments on access issues, it will need to carefully consider whether it would be acting ultra vires. What the Commission proposes to say will need to be considered in light of the Commission's powers, as conferred by the statute.

6. There are natural justice considerations which the Commission must take into account. It will not be safe for the Commission to comment at this time on access issues, or to make incidental or consequential comments on such issues. The issue of open access has only been tangentially put on the table. The issues the Commission might address have not been made known and, accordingly, there has not been an appropriate opportunity for interested parties to make submissions in relation to what the Commission may propose to say.

Opportunities for further bypass

7. The Commission has asked Nova to comment on the level of potential future bypass opportunities. In Nova's view, [

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9. [

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10. [

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11. Over the last couple of years the incumbents have implemented strategies to prevent further bypass. As Nova showed at the conference the incumbents have dropped their prices by up to 90% to combat the threat of Nova's entry. They are only able to price at the reduced level by offsetting the reductions with price increases in non-competitive areas. [

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12. The incumbents also use non-price strategies to restrict competition, including in non-bypass areas. In some cases Powerco has refused to offer Nova distribution prices for customers. This is to prevent Nova from forming a relationship with the customer through its gas supply agreement and competing for the customer's business. Nova's competitors have in some cases required Nova to align the term of its distribution contract with its energy contract and have offered lower distribution prices directly to customers than it offers to Nova. Incumbents have

also tried to control the price at which Nova can on-sell distribution. These techniques all aim to restrict Nova's ability to compete in the distribution market generally, and also prevent it from installing additional bypass networks. These practices have been the subject of several complaints that Nova has made to the Commission over the last two years. Unfortunately those complaints have not progressed since they were made.

13. In summary, for the reasons given above, [

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The area of the bypass market

14. The Commission has also asked Nova to comment on the potential size of the competitive bypass market. Nova submits that bypass markets make up only a small percentage of the total North Island distribution market and can be defined geographically by reference to Nova's existing networks.

15. Although market definition is an imprecise art, Nova considers that guidance can be taken from the approach in the telecommunications wholesale decisions¹ where the Commission defined competitive markets as being within a specified distance of TelstraClear's network. If such an approach is taken, Nova submits that the geographic area of bypass markets should be limited to the area within [] from Nova's bypass pipelines.

16. Defining the bypass market as within [] of Nova's network is consistent with [] and recognises the maximum distance that Nova would consider extending its existing network to reach a new cluster of customers.

17. [

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18. [

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19. [

¹ See TelstraClear Wholesale Application Final Determination, 12 May 2003 and TelstraClear Residential Wholesale Final Determination, 14 June 2004.

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20. [

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21. Although Nova has only been able to give evidence of zonal pricing in the Auckland market, we anticipate that price discrimination is carried out within similar distances of Nova's network in Wellington and Hawkes Bay.
22. Nova estimates that approximately [] PJ/annum of gas or []% of the total Auckland volume of [] PJ/annum is supplied to customers within []. The annual demand of the total North Island commercial and industrial gas market, excluding large co-generation plants and Ballance Agri-Nutrients Limited, is approximately [] PJ. Of this, Nova estimates that only [] PJ or about [] % of total North Island commercial and industrial load is supplied to customers in competitive markets within [] of Nova's networks.
23. The identification of the boundaries between competitive bypass zones, and other non-competitive zones, will assume importance in respect of both the recommendations the Commission can make and ultimately how any controls may be administered. As noted below, the Commission only has jurisdiction to recommend control in non-competitive markets. Accordingly, the activities of Nova and the other competitors within the bypass zones are not open to be controlled. However, the activities of Nova's competitors outside of the bypass zones are open to potential control (for example, in the form of a price cap.) There is precedent in Australia that reflects that pipelines can be part-regulated and part-unregulated in such manner².

Legal Submissions

24. The Commission has invited legal submissions relating to what the Commission may now have power to recommend to the Minister in the final report.

Background

25. The gas pipelines inquiry was initiated by a letter from the Minister to the Commission dated 30 April 2003 requesting that the Commission conduct an inquiry into goods and services connected with gas transmission or distribution. The Commission was instructed to report back to the Minister on its view as to whether those services should be controlled under section 53 of the Act. The letter set out the terms of reference for the Commission's inquiry and sought the Commission's specific advice on:

² See the Minister's Final Decision on the Application for Revocation of the Moomba-Sydney Mainline (MSP) and Canberra Lateral pipelines dated 19 November 2003.

- 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 purpose of its advice on the matters covered in [that] 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.
26. This letter of request was followed by an exchange of letters between the Commission and the Minister clarifying the interpretation of the types of services subject to the inquiry.
27. The Commission then issued a Draft Framework Paper on 16 July 2003. In that paper the Commission considered that the three letters exchanged with the Minister made up the terms of reference of the inquiry. It interpreted those terms as follows:
- The terms of reference require the Commission to report under section 56 as to whether an Order in Council under section 53 of the Commerce Act should be made in relation to goods or services supplied by persons in market directly related to either a natural gas transmission system or a natural gas distribution system or both.*
28. In reaching its view on the imposition of control, the Commission considered that it was able to have regard to the matters listed in paragraph 25 above.
29. The Commission invited submissions and held a conference in relation to the Draft Framework Paper, on 1-4 September 2003. No submissions were made by any parties that the terms of reference be extended to include issues of access to pipelines. Nova notes that Contact Energy Limited (“Contact”) participated at the Draft Framework conference and although it touched on the scope of the inquiry, its submissions were limited to the definition of “gas services”. Contact did not raise open access issues at that point.
30. The Commission’s Draft Report was published on 21 May 2004. This continued to interpret the terms of reference as described above. At paragraph 2.15 the Commission stated:
- In conducting this Inquiry, the Commission considers that the Minister’s request relates to two key functions, being connection to a gas distribution system or gas transmission system, and transport of gas over that system.*
31. Nova notes that there was no reference to open access issues in the Draft Report.
32. Contact in submissions on the Draft Report and at the following conference, raised open access issues for the first time in the course of this inquiry. In summary, so far as these submissions relate to Nova, Contact contends that:

*By-pass pipelines should be required to offer open access, with gas services subject to the same control regime as other pipelines.*³

33. The Commission has requested that Nova address the Commission's jurisdiction to consider access to gas pipelines under the gas control inquiry.

Issues

34. The relevant issues can be framed as follows:

- (a) Does the Commission have jurisdiction to make recommendations to the Minister regarding open access to Nova's bypass pipelines?
- (b) If the Commission does not have jurisdiction, does it have express or implied powers to make incidental or consequential comments relating to this issue?
- (c) In either case, do principles of natural justice preclude the Commission from recommending, or making incidental or consequential comments on, access in the final report ?

Each of these issues will be dealt with in turn below.

Jurisdiction

35. The Commission's jurisdiction is limited by the relevant provisions of the Act and the terms of reference set out in the Minister's letters dated 30 April and 9 July 2003. For the reasons set out below, the Commission does not have jurisdiction to make recommendations to the Minister regarding open access to Nova's bypass pipelines.

Scope of the inquiry

36. Part IV of the Act governs the control of goods and services. Section 53 provides for the Governor-General to declare goods or services to be controlled by Order in Council on the Minister's recommendation. Control may only be imposed if the goods or services satisfy both limbs of section 52, namely:
- (a) The goods or services are, or will be, supplied or acquired in a market in which competition is limited or likely to be lessened; and
 - (b) It is necessary or desirable for those goods or services to be controlled in the interests of either the suppliers or acquirers of the goods or services.
37. The Commission's power to report to the Minister on whether or not control should be imposed is contained in section 56. That section allows the Commission to compile such a report on its own initiative or following a request from the Minister. In compiling its report, the Commission may have regard to "all matters it considers necessary or desirable".

³ Paragraph 1.3 Contact Energy Limited's Submission to Commerce Commission, 2 July 2004

38. If the Minister declares pipelines services to be subject to control under section 53, the Commission has the power under section 70 to make an authorisation in respect of “all or any component of the prices, revenues or quality standards that apply in respect of controlled goods and services, using whatever approach it considers appropriate”.
39. Of relevance also is section 55, which prohibits any person from supplying controlled goods or services other than in accordance with the terms of an authorisation.
40. As Commissioner Bates QC noted at the conference, Parts IV and V of the Act were amended by the Commerce (Controlled Goods or Services) Amendment Act 2001. Prior to the amendments, Part IV was headed “Control of Prices – Imposition of Price Control”, and all references to control in that Part were to “price control”. This can be contrasted with the current text of the Act, which refers simply to “control”. Section 70 was also amended to give the Commission more flexibility as to the terms of authorisations. The original Act only allowed the Commission to authorise maximum, actual or minimum prices for controlled goods. This can be compared with the wider powers of authorisation in section 70 set out in paragraph 38 above.
41. The Commission is undertaking the gas pipelines inquiry pursuant to a request from the Minister. The scope of the inquiry is dictated by the above legislation and the express terms of reference in the Minister’s letter of request set out in paragraph 25 above.

No jurisdiction to make a recommendation regarding open access to Nova’s pipelines

42. As noted above, section 53(a) only allows control to be imposed on goods and services supplied in markets where competition is limited or likely to be lessened. Contact’s submission does not address the tests imposed by section 53(a). This is a fatal flaw in Contact’s submission, so far as it relates to Nova.
43. The Commission accepted in the Draft Report that there was workable or effective competition in bypass markets. Nova has since given evidence of its experience of vigorous price and non-price competition in those markets. The Commission also heard submissions from other interested parties that concur with the view that competition in bypass markets is not limited. Nova submits that there is workable or effective competition in the bypass markets and therefore its services do not satisfy the test in section 52(a). It follows, on this ground alone, that the Commission has no jurisdiction to impose any type of control on Nova’s services.
44. Even if the Commission was able to control Nova’s services, the scheme of Part IV does not anticipate regulation of access issues. This can be taken both from the plain wording of Part IV and from the fact that it does not address access issues.
45. Under section 70, the Commission can grant authorisations in respect of any component of “prices, revenues, or quality standards” that apply in respect of the controlled services. Contact suggests the term “quality standards” is wide enough to encompass authorisations providing for open access to gas pipelines.

46. While Nova accepts that the amendments made to Parts IV and V of the Act in 2001 indicate that there was an intention to widen the Commission's jurisdiction beyond just price, Nova does not accept that the amended provisions were intended to cover questions of access. The aim of the amendments was to give the Commission greater flexibility to impose modern regulatory methodologies that it had no power to impose prior to the amendments (for example CPI – X and sliding scale regulation)⁴. The reference to “quality standards” was included to reflect its relationship with price control. It prevents a controlled firm from decreasing its costs and maintaining its margin by providing goods and services of a lesser quality. There is no equivalent relationship between prices and access and Nova submits that quality standards were not intended to cover access regimes. “Quality standards” do not empower the Commission to require a supplier to supply those goods or services to any person.
47. This interpretation of section 70 is supported by section 55, which provides that no person can supply a controlled good or service other than in accordance with an authorisation. Sections 55 and 70 cannot be read consistently if an authorisation under section 70 could extend beyond the terms of supply to requiring actual supply of a controlled good or service.
48. Further, if Part IV of the Act was intended to be cover access issues then it would need to have included a detailed access code addressing issues of the kind identified in the Telecommunications Act 2001 and Part IIIA of the Australian Trade Practices Act 1974. An access code would be expected to include such things as a process for submitting and considering applications for access, access principles and pricing methodologies.⁵ The Act simply does not have the machinery required to provide for access and Parliament did not intend it to be used as a regulatory access regime.
49. The relevant provisions of the Minister's terms of reference also preclude an examination of open access issues. The Minister has only requested the Commission to consider whether an Order in Council can be made under section 53 and to provide specific advice on the four items listed at paragraph 25 above. There is no express reference to open access in the Minister's letter requesting the inquiry and a consideration of open access issues can not be implied into any of the items listed in the letter. Although the Minister's fourth bullet point appears to be wide, the Commission is only able to consider matters relevant to a decision on whether control should be introduced, which open access is not. Further, the final bullet point must be read ejusdem generis with the other matters in the list. Each of the three preceding matters relates to the control of gas pipelines under Part IV of the Act. Open access issues do not, and are therefore not, within the terms of reference prescribed by the Minister.
50. By way of further background, it is relevant to note that development of open access regimes is being progressed or considered in another forum, which is subject to Ministerial oversight. This reflects that the Minister clearly does not intend the Commission to consider and report on these matters in the context of the gas pipelines inquiry.

⁴ Commerce (Controlled Goods or Services) Amendment Bill Information Package, Ministry of Economic Development, 25 May 1999.

⁵ Contact also noted other practical problems that need to be address under access regimes, such as “use it or lose it mechanisms: see Transcript, 22 July 2004, pages 165-167.

51. The Gas Industry Steering Group ("GISG") established by the gas industry is a body mainly of Chief Executives that has been working on industry governance matters over the last approximately 12 months. The Commission will be aware that, after considerable work, the GISG recommended to the Minister that a co-regulatory model be adopted for the gas industry, and that the Minister accepted that recommendation. The model accordingly forms part of the Electricity and Gas Industries Bill, which is currently before Parliament.
52. As the second stage of its work programme, the GISG will be examining specific work streams relating to industry governance, including pipeline access matters. The GISG proposes to develop open access proposals that will apply to all transmission and distribution systems. Such proposals will be placed before the Minister for his consideration and acceptance.
53. Given the considerable work being done by the GISG, and the Ministerial oversight of that work, there is no need for the Commission to consider open access issues in the context of the gas pipelines inquiry and the Minister clearly does not expect it to do so.

Express or implied powers to make incidental or consequential comments

54. The Commission also invited Nova to comment on whether the Commission could comment upon matters in the final report in respect of which it did not have jurisdiction to make recommendations: (Transcript, 27 July 2004, 89-90). Nova understands this question relates primarily to the submissions made by Contact. Notwithstanding that Contact argued that the Commission's recommendations in this inquiry should extend to matters such as the provision of access and unbundling of services, and issues involving vertical integration, Contact did acknowledge that such matters are probably outside the scope of the current inquiry. Contact rightly noted that such matters are currently under separate regulatory review, and their concern was to ensure that there was co-ordination between the Commission and the other bodies reviewing matters such as access: (Transcript, 22 July 2004, 154, 166-67).
55. Accordingly, we understand the Commission to be asking whether it can in its final report address matters which the Commission considers "ought to be looked at", for example by the other so-called regulatory bodies (which for the moment are of a voluntary industry nature), notwithstanding that these matters are not within the Commission's jurisdiction. The Commission could be making such supplementary statements to alert these other bodies to matters which may have implications under the Act. Alternately, the Commission may be attempting to send signals to those potentially involved in the design of regulatory regimes, should voluntary solutions not be found.
56. The Commission's proposal to make such additional comments raises the issue whether such observations would be ultra vires the Commission's powers.
57. A useful discussion of the Commission's functions and powers is contained in the decision of the Court of Appeal in *Commerce Commission v Telecom* [1994] 2 NZLR 421. This case related to an inquiry which the Commission commenced on its own initiative into competition in the telecommunications sector. The

Commission's report criticised the operation of the disclosure regulations which were then in force as well as the conduct of the main operator in the market.

58. The source of the Commission's power in that case was said to be section 25(b), which is a broad provision relating to the dissemination of information for the purposes and provisions of the Act. The Court accepted that the doctrine of ultra vires was to be liberally applied and that the Commission would not exceed its powers if what it did might fairly be regarded as incidental to, or consequential upon, its legislative powers. In that case the Court held that the Commission's inquiry and report went beyond the incidental or the consequential.
59. It is against these principles that the Commission must assess what it can now say in its final report.
60. There are limits to what can be said in the abstract about this issue. We do not know what the Commission proposes to say. It is conceivable that the Commission may not act ultra vires in the making of additional statements. The source of the legislative power here would be Part IV of the Act, potentially in combination with section 25. Further, it may well be that the Commission's comments will be aimed at achieving compliance with section 36 of the Act. It follows that the Commission's statements may legitimately be incidental to, or consequential upon, these express legislative powers. But it will be a question of degree and, as the *Telecom* decision demonstrates, there can be a fine dividing line in determining what may be incidental or consequential.

Natural Justice

61. Finally, we draw the Commission's attention to issues of natural justice relating to its deliberations on access issues at this time, both in terms of whether such matters can be the subject of a recommendation, or an incidental or consequential comment.
62. Upon what basis and in relation to what evidence would the Commission consider open access issues? And what would be the detail of any findings or comments the Commission might propose to make on access? The parties to this inquiry have not properly been put on notice that the Commission may proceed down this path, and moreover, there has not been a full opportunity or any meaningful opportunity for submissions on access issues.
63. For guidance on this issue, we draw the Commission's attention to the decision of the Privy Council in *Treaty Tribes Coalition v Urban Maori Authorities* [1997] 1 NZLR 513. In that case the Privy Council overturned a decision of the Court of Appeal in which the latter interpreted the term "iwi", on the basis that Court of Appeal had not given the appellants sufficient opportunity to be heard. While the question of the meaning of "iwi" was "on the table" the appellants were never put on notice that the Court of Appeal intended to decide that issue. They did not know what question the Court of Appeal had posed itself and were deprived of the opportunity to make submissions and provide further evidence on the interpretation of "iwi".
64. Open access issues are only tangentially "on the table", as a result of Contact's submission after the Commission's Draft Report. The Commission has given no

guidance as to if, and how, it intends to take access issues into account. Nova, and the other parties to this inquiry, therefore do not have adequate information about the question that the Commission may pose itself and are unable to make pertinent submissions and provide evidence on open access issues.

65. Accordingly, it would be unsafe for the Commission at this time to make any recommendations, or incidental or consequential comments, on access in the final report.