



N O V A G A S L T D

Gas Pipelines Inquiry

July 2004

Key submissions



- Nova provides a competitive stimulus in bypass markets
- Competition is not “limited or likely to be lessened” in any of the markets in which Nova operates
- Accordingly, there is no case for control of Nova’s pipelines
- If control is imposed on other pipelines, then the Commission needs to take into account the ability of incumbents to price discriminate when deciding upon the form of control

Background to Nova's operations



- Supplier of reticulated gas since 1997
- Mainly commercial and industrial customers with annual demand of greater than 1TJ per annum
- Most customers are situated in Wellington, Auckland, Hawkes Bay
- Nova supplies both energy and distribution services to most of its customers

Development of Nova's business



- Initial pipeline set up to deliver LFG (landfill gas) to Porirua Hospital
- Model developed to build larger network with LFG supplemented by natural gas
- Realisation that local delivery represented largest opportunity for cost savings
- Agreement with customers to provide competition for delivery resulted in bypass being extended

Distribution



- Via third party distribution networks and Nova's own bypass pipelines
- Nova has installed approximately 110km of bypass distribution pipelines - less than 1% of the national distribution system
- 70% of gas supplied by Nova is distributed via third party pipelines

Sources of gas - Gas fields



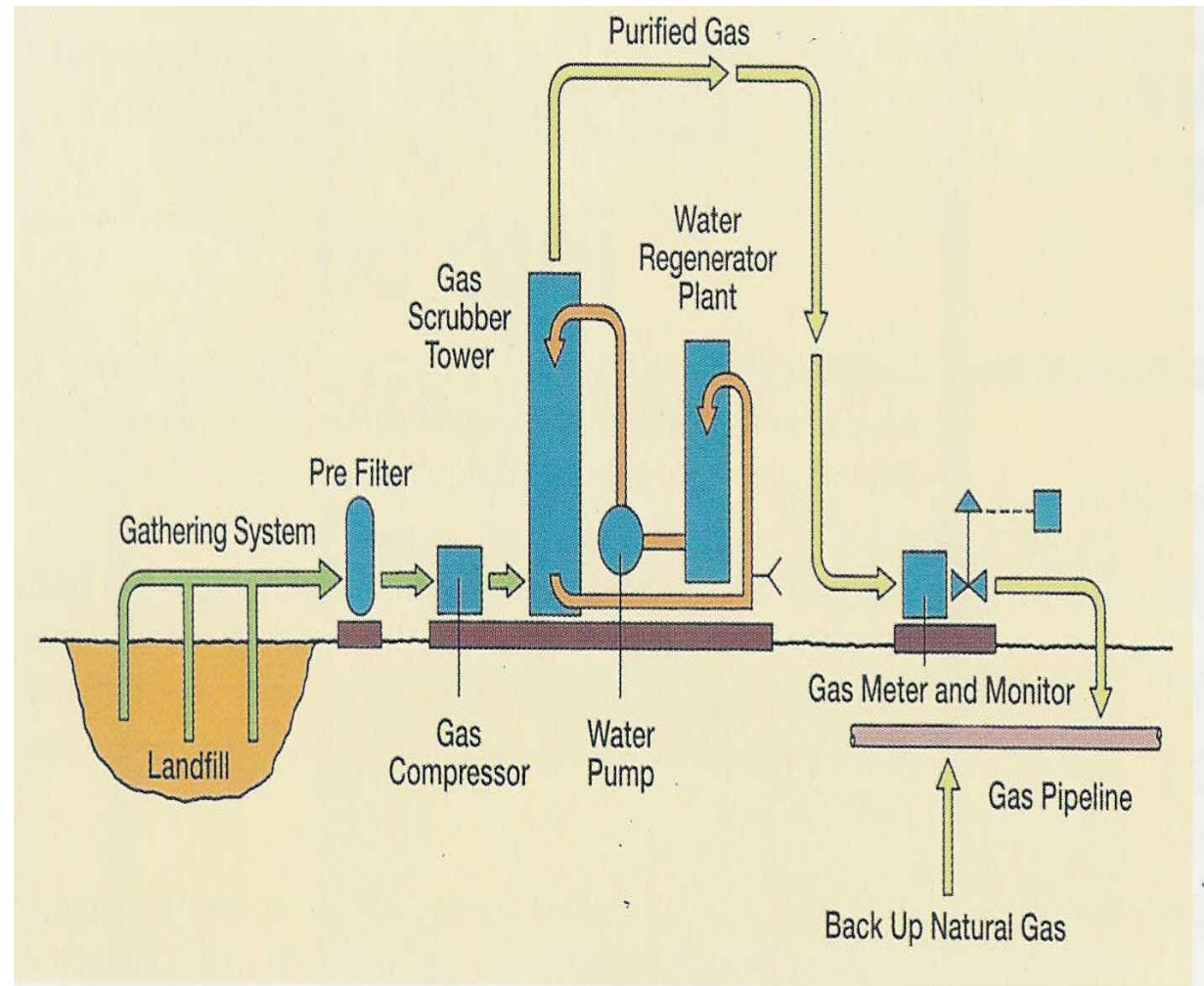
- Currently from the Kapuni field
- Nova is likely to source gas from the McKee and Mangahewa and Pohokura fields in the future

Sources of gas - Landfill gas



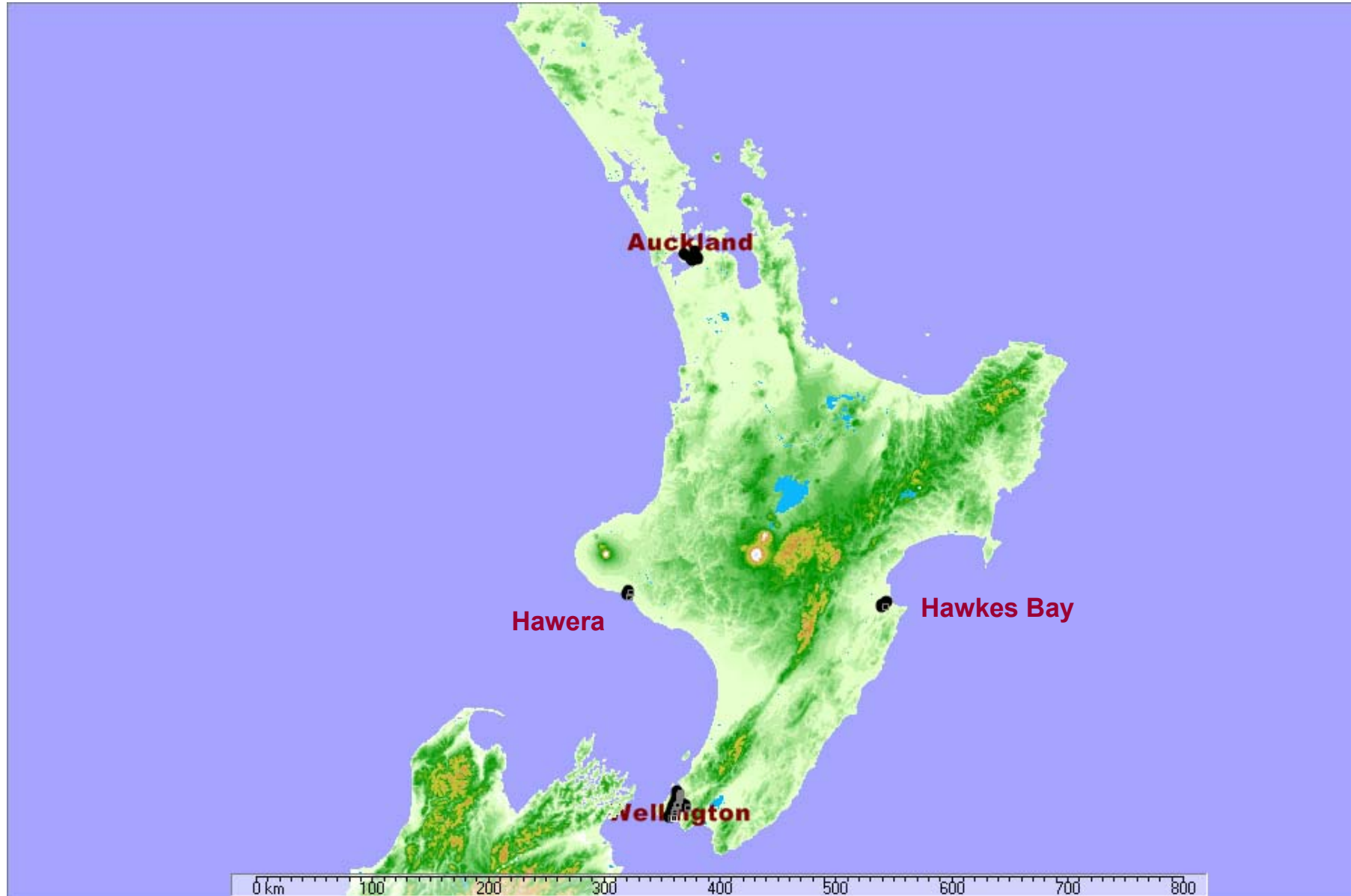
- Historically, Nova sourced gas from its landfill extraction project
- Nova is looking to construct new landfill extraction plants
 - eg Happy Valley landfill, which is likely to supply 15-20% of Nova's current Wellington demand

Landfill gas extraction process

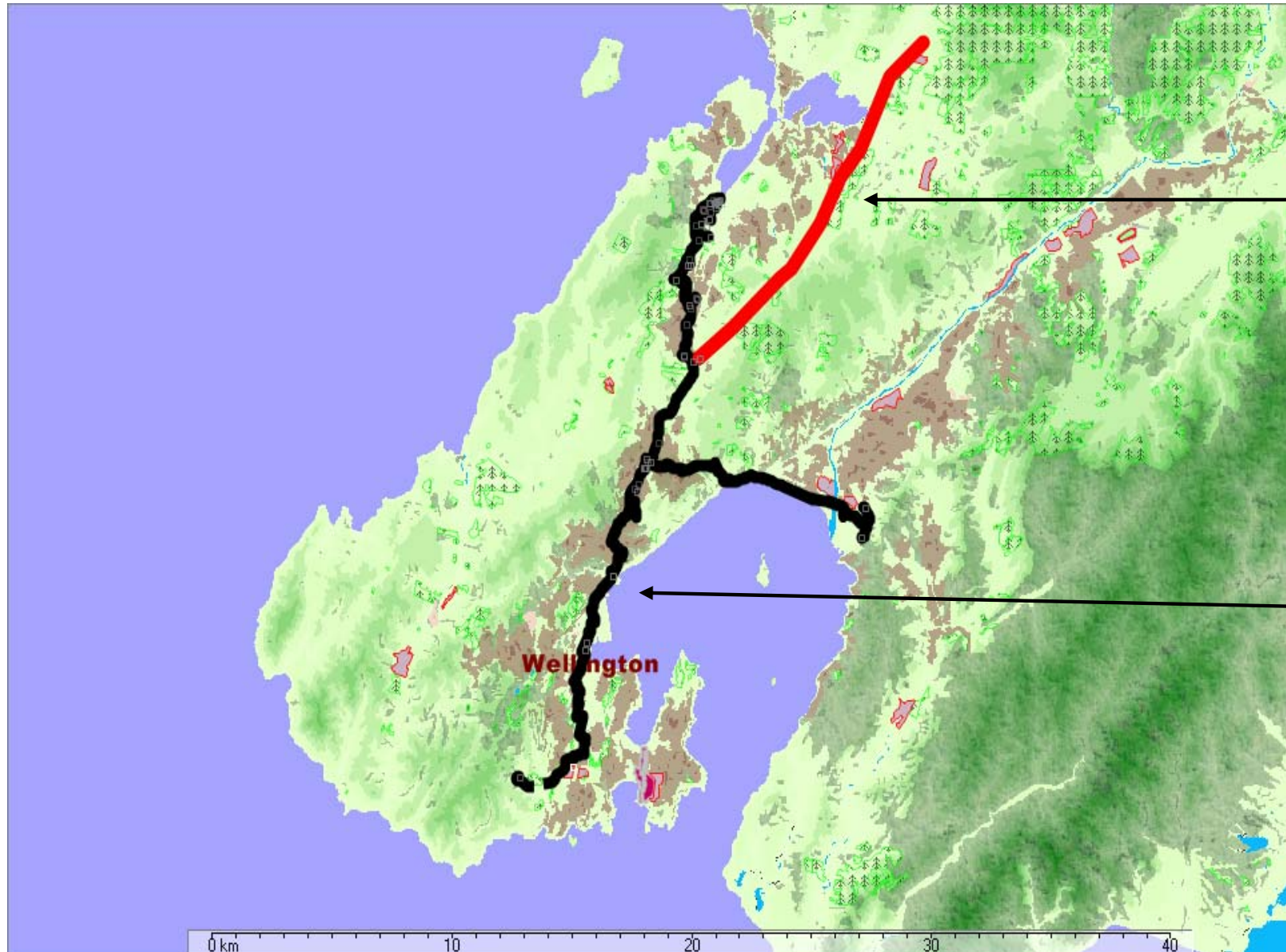


The Nova Gas process.

Map showing Nova's networks



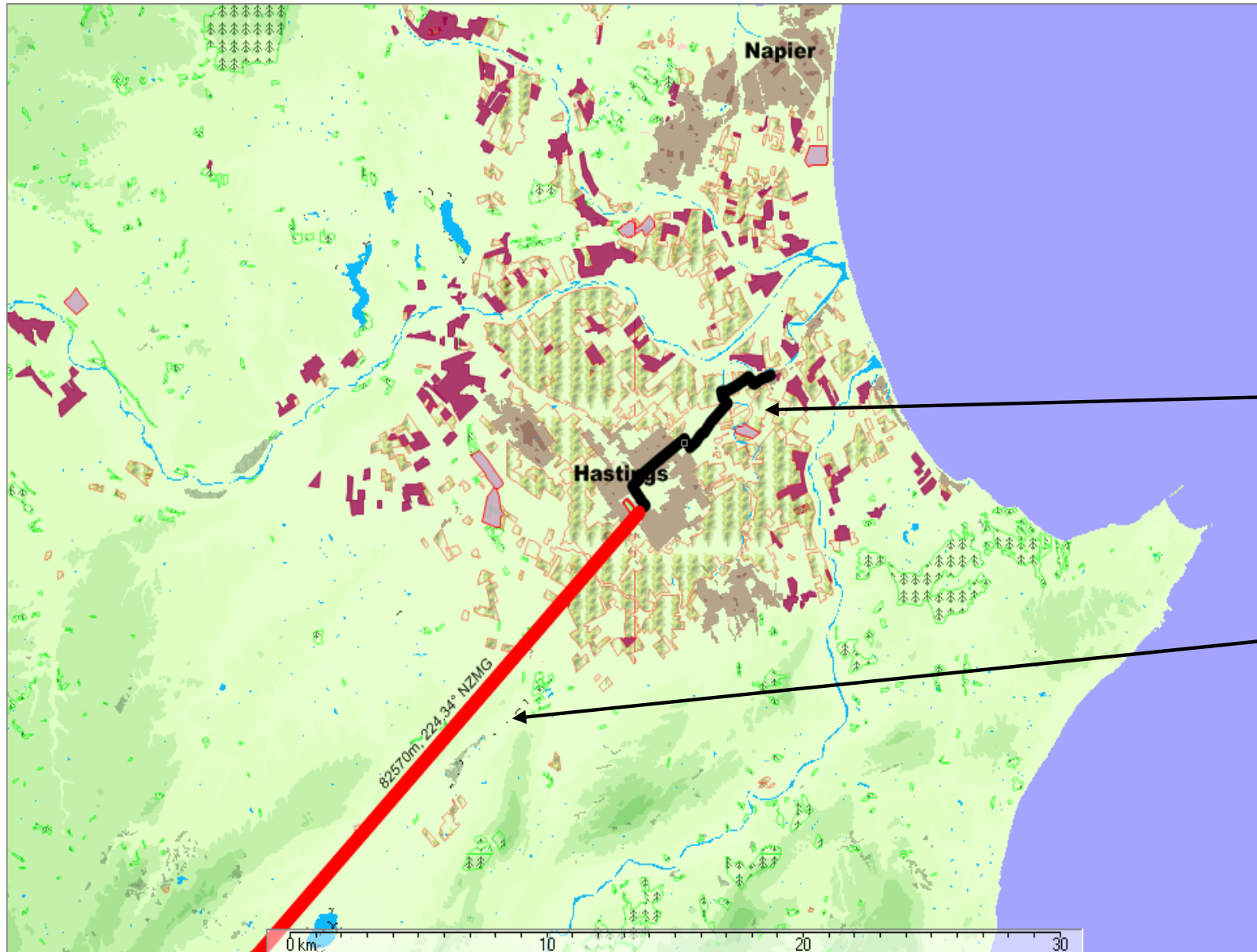
Wellington network



NGC
transmission
network

Nova network

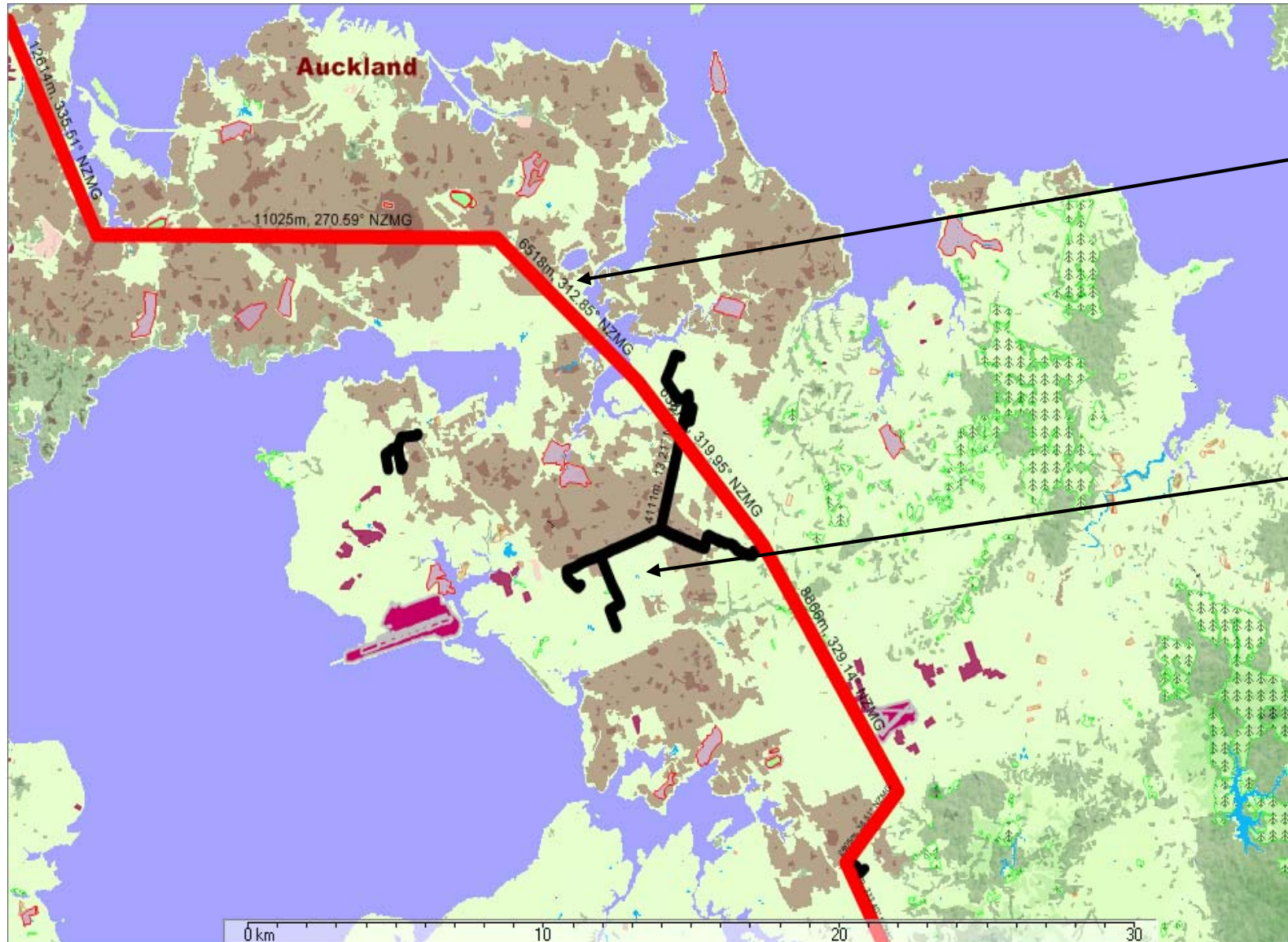
Hawkes Bay network



Nova network

NGC
transmission
network

Auckland network



NGC
transmission
network

Nova network

Dynamics of bypass competition



- The Commission is correct that there is strong competition in the bypass market
- Competition has resulted in lower prices in bypass markets
- Nova has typically been able to offer customers savings of 50% on the distribution component of prices

Example 1: Wellington Customer



- Original distribution price in 1998 \$3.00/GJ
- Nova offered a distribution price of \$1.60/GJ



- Powerco recently offered a distribution price of approx \$0.40/GJ
- Total reduction in incumbent's price: \$2.60/GJ 87%

Example 2: Hawkes Bay Customer



- Original distribution price in Nov 2002 \$3.00/GJ
- Nova offered a distribution price of \$1.32/GJ



- Powerco recently offered a distribution price of approx \$0.82/GJ
- Total reduction in incumbent's price: \$2.18/GJ 73%

Example 3: Auckland Customer



- Original distribution price as at 1 January 2004
\$4.60/GJ
- Nova begins building East Tamaki bypass pipeline



- Vector recently offered a distribution price of
\$0.97/GJ
- Total reduction in incumbent's price: \$3.63/GJ 79%

Competitive response to bypass



- Price competition - incumbents have reduced their distribution prices by up to 90% in response to Nova's entry
- Non-price strategies to restrict competition

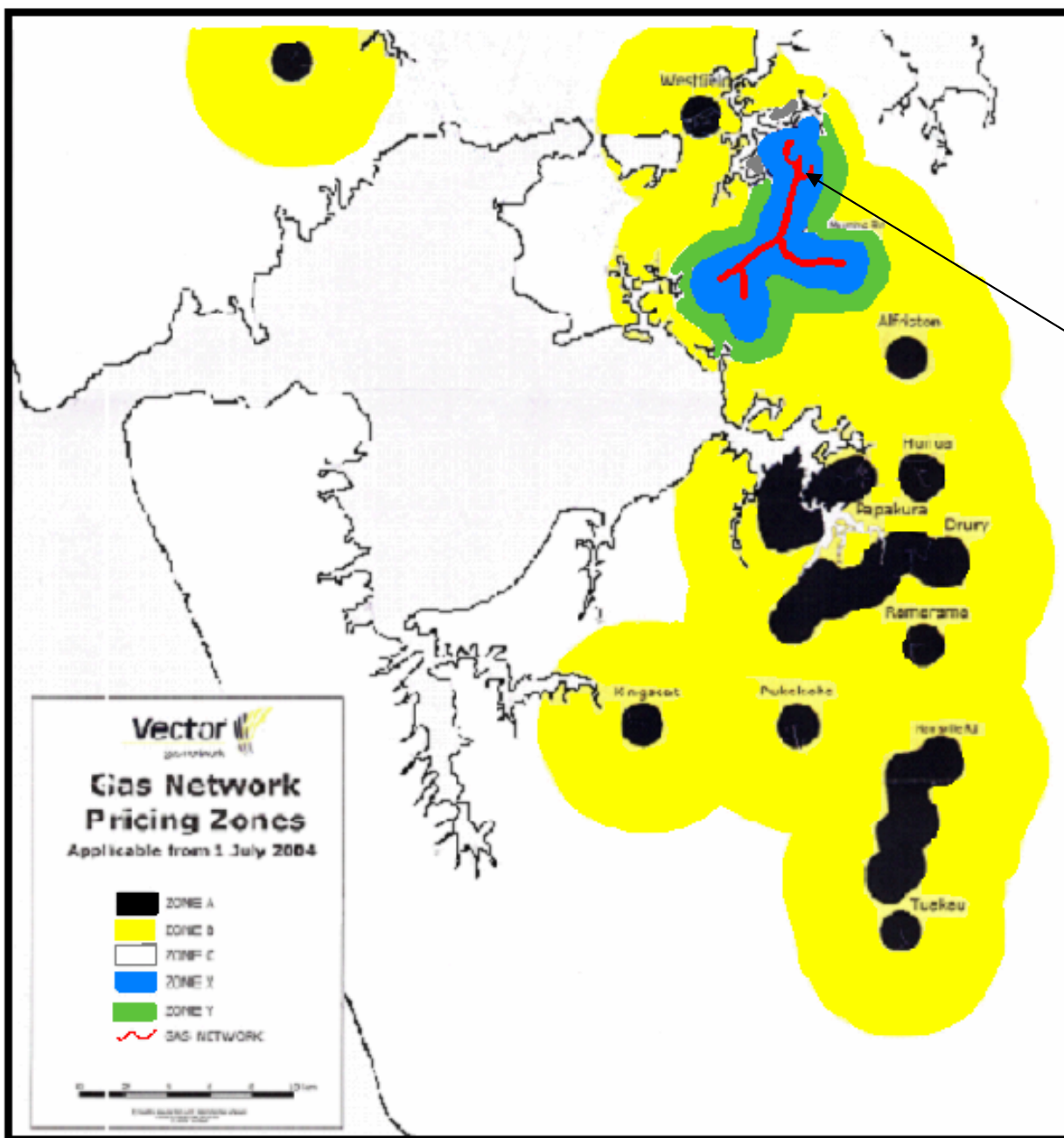
Price competition



- Vector prices vary according to how far a customer is from Nova's bypass pipelines
- Prices in zone x (less than 1km from Nova's pipeline) and zone y (between 1 and 3 km from Nova's pipeline) have decreased
- Prices in zone c, where there is little or no threat of bypass, have increased

Zonal pricing map

Nova East
Tamaki pipeline



Refusal to supply prices



- Powerco has refused to supply Nova with distribution prices to prevent it from competing to supply to potential bypass customers
- Example: Wellington customer
 - 11 sites on Powerco network and 2 sites on Nova network
 - Nova requested Powerco's distribution prices on 14 May 2004
 - Pricing was not provided despite repeated requests
 - Customer extended the tender period until 28 May 2004 but Powerco still had not provided prices by this date
 - Nova was unable to compete for supply to all 13 sites

Non-price competition



- Requiring Nova to align the term of its gas supply contract with the term of the distribution contract with the network owner
- Offering lower prices and different terms to competing retailers and/or directly to Nova customers than to Nova
 - Example: Hawkes Bay customer - Powerco offered prices and a 4 year contract directly to a customer but would not offer the same terms to Nova

Non-price competition



- Controlling the price at which Nova may on-sell distribution



- Incumbent response is a barrier to entry and prevents expansion and competition around existing and potential bypass markets

Summary



- There is clearly strong competition in bypass markets and therefore no case for control of Nova's services

Form of regulation



- If control is to be imposed on the industry, the Commission must take into account the ability of incumbents to engage in price discrimination
- Prices outside of bypass can be set to subsidise competition within bypass areas
- Nova will make further submissions on this issue at the appropriate time