

20 August 2003

Gas Pipeline Inquiry
Commerce Commission
44-52 The Terrace
PO Box 2351
WELLINGTON

Dear Sir/Madam

GAS PIPELINES INQUIRY
Submission of OMV New Zealand Limited on draft framework paper

This letter is the submission from OMV New Zealand Limited on the Gas Control Inquiry Draft Framework Paper dated 16 July 2003.

An Overview of OMV

OMV New Zealand Limited ("OMV") is a subsidiary of the international OMV group with its head company in Austria. The New Zealand company was incorporated in February 2001.

The OMV group initiated interest in New Zealand through its purchase of Cultus Petroleum in 1999. Through this OMV gained 30% of the Maari permit.

OMV acquired a 10% interest in the offshore Maui field including the Maui pipeline in October 2002 from Shell Exploration NZ Limited.

In late 2002 OMV increased its interest in the Maari oil field from 30 to 69% and took over operatorship of the permit. A comprehensive work programme conducted in 2002 resulted in the successful appraisal well (Maari-2) drilled in January 2003.

OMV purchased interests of Preussag Energie in May 2003, which included interests in Pohokura and three onshore exploration permits. At this time OMV established a New Zealand business office.

OMV has participating interest in petroleum permits as follows:

- | | | |
|------------------------|-------|----------|
| 1. PEP38413 (Maari) | 39%* | operator |
| 2. PEP38716 | 27.4% | |
| 3. PEP38728 | 15% | |
| 4. PEP38459 (Pohokura) | 35.9% | |
| 5. PEP38481 | 25% | |
| 6. PEP38482 | 25% | |
| 7. PML381012 (Maui) | 10% | |
| 8. PEP38744 | 50% | |

* OMV is in the final stages of acquiring a 30% participating interest in this permit from its affiliated company OMV Petroleum Pty Limited.

OMV's current interest and involvement in markets directly related to gas transmission or distribution is through its 10% beneficial ownership of the "Maui pipeline" through Maui Development Limited (MDL) and the delivered gas contract between the Maui Joint Venture and the Crown.

Background to OMV's Key Concerns

Gas exploration and production involves large quantities of highly at-risk money. The process of exploration generally involves exploration companies spreading risk by owning only a portion of a large number of prospects in different regions. In general this requires a critical mass of specialist companies active and knowledgeable in each region all with significant balance sheets and expertise (usually involving multi-nationals). New Zealand is competing for international investment money which is mobile between countries.

While significant gas reserves are available in the near-term, and the country is prospective, the exploration rate for new gas in New Zealand is only a small portion of what is needed for sustaining the gas market in the long term. New Zealand has only a limited attractiveness due to the small and isolated gas market and relatively high exploration costs. OMV recommends the Commission give a high consideration to the need for New Zealand to be attractive to investment in exploration and production.

Potential explorers must perceive a viable and healthy gas market, with sufficient gas prices at the well head to justify investment with long term certainty. Explorers make very large capital intensive investments and are highly sensitive to perceived risk and reliance on local infrastructure. A key issue is the maturity of infrastructure and that downstream participants are receiving fair but not excessive returns. Another key interest is that local infrastructure providers are unable to change their returns and extract future rent from then captive investment.

Prices at the customer are constrained by alternative fuels. Alternative fuels for larger industrial customers tends to be coal and oil, while for smaller commercial and residential consumers the competing fuels are generally electricity, LPG and wood. The competition with alternative fuels is well illustrated with the current restructuring of the electricity market to alternative fuels using oil and coal (i.e. Genesis purchasing coal for Huntly power station, and Contact Energy converting New Plymouth power station to oil and constructing a Whirinaki oil fired plant etc).

The well head gas price is a net-back of the price to the customer. In the recent past, of the approximately \$15/GJ paid by residential consumers currently only approximately \$1.60/GJ is received by the producer (this is true for 80% of the gas supplied to the market from the Maui field). The low Maui gas price is a historical aberration that a sustainable market cannot expect to retain. For continued sustainability New Zealand must ensure the balance of the gas delivery market has not absorbed the wealth created by low gas prices, or if it has then that wealth is liberated.

In order to be attractive to international explorers New Zealand needs the perception and reality of fair returns in the value chain downstream of the seller. In order for the perception to be sufficiently convincing to enable large investments, from companies which often have only limited understanding of the local business environment, these investors need a transparent regulatory regime that will control their cost risk over the long term.

OMV supports the PEANZ submission on the New Zealand exploration environment.

Market Definition

1. What services are included in “gas services”?

OMV believes the inquiry should cover all of the transport system from the gas field production station (excluding dedicated spur lines transporting to an open access system) through to the customer including the customer meter. All this system has limited competition, natural monopoly characteristics and materially affects both the customer and producers prices.

2. What transmission businesses should be covered by the Inquiry?

OMV agrees with the Commission that the NGC transmission pipe systems (including the LTS line) and the Maui pipeline should be included in the inquiry.

OMV does not agree that the minor field-specific pipelines should be included such as the Westech Surrey Road pipeline. This would create unnecessary compliance costs where no control is necessary or sought by any party. Potentially appropriate tests would be whether the pipeline is;

1. dedicated to a gas field (or group of related fields under single ownership or by agreement between multiple owners),
2. owned or beneficially controlled by the field owner(s)¹,
3. not open access and
4. it is unreasonable to expect open access.

OMV believes it can be unreasonable to expect open access on field gathering lines and for short spur lines dedicated to delivering production into an open access pipeline system.

OMV does not consider that transmission between Taranaki and Huntly is different from Huntly to Auckland based in the parallel NGC and Maui pipelines. The NGC pipeline is very much smaller in capacity to the Maui pipeline, only able to carry a very small percentage of the market, and therefore is likely to price follow the Maui pipeline.

OMV considers transmission markets are geographically constrained. A buyer of gas in one location cannot substitute transmission with a pipeline in a different region and is practically constrained to the transmission supplier servicing their region.

3. What distribution businesses are covered by the inquiry

OMV agrees with the Commission with including all distribution lines. The distribution lines form a proportionally larger share of the residential price than the transmission system and have similar natural monopoly characteristics to transmission.

Identification of Acquirers

4. What other key acquirers should be involved in the Inquiry?

¹ Pipeline ownership can be contracted out through Build Own Operate Transfer contracts.

OMV is anticipating selling gas from its interest in Pohokura in the near future and has interests in other potential gas sales in the future. While OMV may or may not be the direct acquirer of transportation services for taking this gas to market (i.e. OMV may sell at the production station or at the customer), it has a high degree of interest in the transmission and distribution business. Therefore OMV considers itself and all gas explorers and gas producers as acquirers of transmission and distribution services.

Current Legislation and Regulatory Monitoring

5. *How effective are the current disclosure provisions?*
6. *Are there important aspects not adequately covered?*

OMV notes the reference to the ODV information disclosure regulations (s4.71), however ODV understands the ODV handbook is draft and not compulsory for gas pipelines.

As a gas seller OMV considers that the transport sector should publish asset valuations (such as audited ODV according to a common handbook), costs and return, on a consistent and internationally recognisable basis.

Efficiency

OMV urges caution in considering transfers of wealth as zero net public benefit. There is currently insufficient investment in gas exploration to maintain the market long-term. Any transfers of excess wealth from producers or customers to the transporters is likely to reduce gas well head gas prices and therefore adversely effect exploration to the detriment of public benefit.

Competition

OMV agrees with the Commission that competition between suppliers of pipeline services is limited and barriers to entry are relatively high due to; 1/ capital intensive long term infrastructure, 2/ planning and land ownership restrictions, 3/ lead times and 4/ economies of scale.

OMV agrees with the Commission that the extent of bypass pipelines is limited and should have little influence on the decision whether to control. Only the very largest acquirers are able to initiate by-pass agreements in niche circumstances and therefore exercise only limited countervailing power. Examples of the largest consumers obtaining special prices from credible by-pass threats appear to be examples of excessive pricing and market power.

There are significant capacity constraints on the gas transmission system. A particularly key one is from Huntly to Auckland. Rapid growth in electricity and other energy demand in the north means there are infrastructure limits into Auckland with a need to build either additional electricity lines or gas pipelines. Gas pipelines with local generation would be lower impact than new electricity transmission lines.

Normally removal of constraints in gas transmission needs to be pre-agreed with the transmission provider prior to committing to sale of gas to larger infrastructure projects, such as cogeneration plant or new generation plant. This makes a gas seller and buyer subject to the prices and terms of a monopoly seller of transmission services.

Control

OMV considers the first leg of the Section 52 test is clearly met in that pipeline services are supplied or acquired in a market in which competition is limited.

OMV also considers that the second leg, that it is desirable for pipeline services to be controlled in the interests of the acquirers, is also met. Explorers and producers need the perception and reality that in New Zealand they can acquire pipeline services on a fair and reasonable basis, without risk of later being a captive customer to an unregulated monopoly provider. The best way to provide that assurance is to install systems that clearly control prices to a fair and reasonable level. New Zealand also would benefit from ensuring an efficient and minimum necessary transmission fee to maximise the prices received by sellers and encourage development of production, or to minimise the price to consumers. Any moves to net back a higher price for explorers can only assist exploration activity in a market that is currently unsustainably under investing.

OMV acknowledges any regulatory regime must have due consideration to overhead costs. The sector is small relative to say the electricity sector and needs a simple and relatively low cost environment. However OMV considers that an appropriate cost effective regime can be readily created.

Conclusion

- 1 Gas explorers and producers are acquirers of transmission and distribution services,
- 2 Gas transmission and distribution services are acquired in a market where competition is limited,
- 3 Control is desirable from a explorers and producers perspective,
- 4 The Commission needs to give due consideration to excluding gas gathering and dedicated spur lines owned by field developers,

OMV is willing to answer any questions from the Commission. Contact can be made to:

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Yours faithfully

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