

1 the terms of access, whether pipelines should be required
2 to offer open access and consideration of the unbundling
3 of services, and throughout this presentation we'll be
4 going through those issues.

5 Before we do, there's just one point we'd like to
6 make, that we agree with your views on the inclusion of
7 foreign ownership in deciding whether control should be
8 considered.

9 Moving on to the main part of our submission, we
10 believe that a focus on price ignores some significant
11 aspects of access to pipelines, specifically the terms of
12 access, and in particular we believe that there should be
13 a focus on the nature of the access regime vis-a-vis
14 common carriage versus contract carriage. We can envisage
15 a situation where two pipelines with the same kind of
16 pricing and revenue requirements but with different access
17 regimes could have very different benefits to acquirers.
18 Accordingly, we think that, when you are considering
19 whether to control, you should also consider these terms
20 of access.

21 We just highlight some of our concerns, particularly
22 with the common carriage regime in contrast with a
23 contract carriage; the tradability of rights, whether it
24 fosters a healthy investment climate, the certainty of
25 access, its consistency both with local practice and with
26 overseas in terms of local practice. NGC has a contract
27 carriage regime, for example, in transmission; at the
28 moment the partners are proposing a common carriage. We
29 believe common carriage has poor characteristics in
30 relation to economic efficiency, and we are also concerned
31 that it could lead to an increasing dominance of parties

1 who are vertically integrated in both the upstream gas
2 market and the transmission of gas.

3 Looking at economic efficiency, which is one of the
4 key drivers that the Commission's looking for determining
5 whether control is desirable, we believe that looking at
6 allocative efficiency, common carriage falls down compared
7 with contract carriage; it doesn't provide a mechanism to
8 ensure that capacity goes to the highest value use.
9 Rationing is purely via volume rather than price, and it
10 doesn't enable customer preferences to be reflected.

11 Of greater concern though is its potential impacts on
12 dynamic efficiency in that we believe it doesn't create
13 the right environment to facilitate investment in the
14 upstream and downstream gas sector. There is uncertainty
15 over users' access to the gas pipeline, both arising from
16 uncertainty regarding future gas finds and future gas
17 flows and/or future downstream gas developments, which may
18 call on the use of the pipeline. Plus, with a common
19 carriage regime, there is no contractual commitment on a
20 pipeline owner to deliver any given level of capacity as
21 it's a day by day service, and we think this is a real
22 concern for New Zealand.

23 Whilst at the moment the Maui pipeline, which is our
24 main area of concern, is unlikely to be constrained, it is
25 entirely conceivable that it could become constrained
26 within 5 to 10 years, but we've got a situation where
27 major decisions on long-lived assets such as new power
28 stations, LNG terminal, upstream production facilities are
29 required within the next 2 years, and this uncertainty
30 could detrimentally affect those investment decisions.

31 We'd also like to highlight that there are other terms

1 of the access to the pipeline which impact on acquirers of
2 that access. The balancing arrangements: Different
3 balancing arrangements will have different consequences
4 for pipeline users. Any penalty regimes relating to
5 exceeding or not deviating from nominated quantities, the
6 management of gas flows and information flows are
7 critical, the management of gas quality if off-spec gas
8 gets into the pipeline, and the access of users to invest
9 in the pipeline itself to develop its capacity through
10 investing in the likes of compression equipment, access to
11 creating a new connection on the pipeline. There's a
12 whole host of issues here which impact on acquirers and
13 the value to acquirers of using a pipeline.

14 Now, I acknowledge many of these are probably outside
15 the scope of the Commerce Commission and would probably
16 fall within the scope of another regulatory body, and we
17 note the proposals that the current co-regulatory
18 initiative for a gas industry body to undertake a lot of
19 the regulation, but nonetheless, we are asking that there
20 is a consistent approach between these different
21 regulatory bodies to ensure that any regime both for price
22 and access and other terms are consistent.

23 Just briefly, there appears to be a presumption within
24 the Commission's document that there will be open access
25 on all pipelines; we don't believe that this is
26 necessarily true on all pipelines, particularly bypass
27 pipelines. We believe it would be beneficial for all
28 pipelines, including bypass, pipelines to be required to
29 offer third party access, and we note that in most
30 overseas markets now there is that requirement on pipeline
31 owners to offer third party access whilst at the same time

1 respecting the contractual rights of people who may have
2 invested in the pipeline and have contracted for capacity.

3 A note that, we believe that the very evidence of the
4 existence of bypass pipelines, we believe, justifies
5 control. The fact that it has got to the situation where
6 it has proved economic for people to invest in what is
7 essentially a duplication in many cases of pipeline
8 capacity, we believe, is evidence of pricing by the
9 original pipeline owner which is not economic.

10 We note that in your assessment of the benefits of
11 control, there's something you overlooked in that many
12 parties expend considerable effort, Contact not the least,
13 in having to threaten bypass or even undertake bypass, and
14 that in itself can be a fairly costly and ultimately
15 wasteful activity.

16 With regards to unbundling, this relates to whether
17 the Commission should consider gas supply as an integrated
18 whole, both in terms of whether to decide upon control
19 and, more importantly in this case, when it actually comes
20 to control, and we would strongly urge that all aspects of
21 gas delivery are unbundled to as great an extent as
22 possible. Unbundling enables competition in those
23 services where competition is possible, and we note
24 metering and reconciliation in particular in this area,
25 and we believe it delivers more efficient outcomes in the
26 long run.

27 We also note that there is also another aspect of
28 unbundling, namely ownership unbundling between upstream
29 and transmission owners, and that most overseas regimes
30 have required legal separation at the very least between
31 energy supply and pipeline services, and that requirement

1 is largely driven on the basis that integrated suppliers
2 of gas and pipeline services have information advantages
3 over other players which they can exploit and potentially
4 also cross-subsidise the supply of gas.

5 In summary, Contact is not generally a supporter of
6 regulation, and we believe it should only be a last resort
7 if it can be shown that competition is ineffective and
8 there is evidence of excess profits or poor service
9 quality. However, in this instance we agree with the
10 Commission's general findings that control will deliver
11 benefits in that the pipeline services do not
12 exhibit competition, and there has been evidence based on
13 the Commission's analysis of excessive profits.

14 We think there is an element of understating some of
15 the benefits of control that we've been through regarding
16 service quality, principally the terms of access, and also
17 service unbundling. We believe control should cover all
18 the gas pipelines, and that control should be consistent
19 across the assets, both in terms of between different
20 pipelines, there should be consistent regimes, and also we
21 think there is benefit in having a consistent control
22 approach between gas pipelines and electricity lines,
23 especially where the same company owns both assets.

24 Finally, again reiterating, control shouldn't just
25 cover pricing but should also cover the provision of
26 access, the quality of the access and unbundling of
27 services, and we do note that in that respect the
28 Commerce Commission will need to coordinate, be mindful
29 of, the other regulatory regimes. Thank you.

30 **CHAIR:** Thank you very much for that.

31 I just wanted to come back to your comment about

1 underestimating the benefits of control, because we
2 haven't looked at the issue of service quality and terms
3 of access, and I believe you mentioned the bundling of
4 services.

5 I understand the point and I'm sympathetic to it, but
6 I'm not sure how we could have gone about taking it into
7 account, and I wondered if you had any thoughts on that?

8 **MR COATES:** As I understand it, the Commission does have an
9 ability to consider price revenue and quality of service.

10 **CHAIR:** That's right.

11 **MR COATES:** And, I suppose, we would argue that the quality of
12 a service encompasses more than just physical quality.
13 The quality of the service also covers the terms of being
14 offered that service.

15 If you had two identical products physically, the
16 terms of -- and were priced identically, but if they had
17 different terms of use for that product, we would regard
18 that as a different quality and you would choose the one
19 which had the higher quality terms of access to that
20 service.

21 **CHAIR:** What I'm not sure of is how you build it into a cost-
22 benefit analysis of the type that we will do for this
23 inquiry. I mean, in a control regime you struggle with it
24 as well, but just focussing on the Inquiry, how do we take
25 account of --

26 **MR LOVE:** Maybe I could add something to what Simon's said,
27 that in Victoria where VENcorp has recently looked at the
28 way that the market there runs, they have recognised that
29 maybe the issues that they should be looking at are just
30 not ones which they can quantify; maybe there are issues
31 that you can only qualitatively assess, and I think that's

1 probably true of some of the issues that we are raising.
2 Perhaps you can't quantify the benefits, but you can say
3 that -- look at it in a qualitative kind of way.

4 **CHAIR:** Right. I can accept that.

5 I wanted to come back to a comment that you make about
6 the way you might think about control, and in doing the
7 Inquiry in the draft we recommended control where we
8 thought the net benefits of that particular company were
9 positive, and you've suggested that, if one of the
10 companies should be controlled, they all should be
11 controlled.

12 I'm not sure what our jurisdiction is for considering
13 that. I mean, there's cross-over effects, spill-over
14 effects, I suggest, to what you're saying. We had a
15 company that, it may be the case -- hard to come up with
16 the example here, but undoubtedly the numbers are going to
17 move around a bit between now and the final; no doubt
18 about that.

19 Say we had a case where a company showed no excess
20 returns. I'm not sure that you're suggesting we would
21 have the jurisdiction to -- and negative benefits from
22 control overall -- I'm not sure we have the jurisdiction
23 to recommend control because two or three other companies
24 might show the opposite, and I would like you to comment
25 on that.

26 **MR COATES:** Well, with regards to the Wanganui example, we
27 believe that your analysis did show that there were
28 benefits.

29 **CHAIR:** Sure, which is why I'm using a hypothetical now.
30 Because, I mean, it may stay the way it is, but it may
31 actually shift the other way as well.

1 **MR COATES:** And also, with a threshold regime, as I understand
2 it you're not -- you're just setting an upper limit, and
3 if you believe a pipeline is demonstrating efficient
4 pricing, then that shouldn't affect that company. You may
5 also get perverse impacts where a company prices up to
6 that limit.

7 **CHAIR:** But, I mean, it's right to say in a threshold regime
8 you could -- at least to some extent you could minimise
9 the negative impact on companies that weren't
10 demonstrating any problems, but you still impose
11 compliance costs on them, and the Commission's very
12 mindful of that given our experience in the electricity
13 lines area. Even though there are a number of companies
14 that, not only did we say they weren't earning excess
15 returns, we said their returns were very low and we
16 provided -- in fact, more companies were in that group
17 than in the other, and there are at least a handful of
18 companies that aren't causing us any concerns on both
19 price and quality, yet we're imposing regulatory costs on
20 them that are quite significant by being part of the
21 threshold regime.

22 So, first of all, I'm not sure we have the
23 jurisdiction to recommend control where the test isn't
24 met. Second of all, even if we did, there seems to be
25 some valid questions to be asked about whether that's
26 appropriate, and I wonder about where the benefits come
27 from having all companies subject to a regime.

28 I'll put to you a question that some of the benefits
29 that I think you're after, wouldn't they be achieved
30 through other steps that are probably being considered,
31 such as improved information disclosure and some of the

1 governance issues around the other stream of work?

2 **MR LOVE:** I think that may be right. I think, when we were
3 thinking about control, we were thinking of the wider
4 aspects of the control as well, that there should be open
5 access and the quality of that access should be
6 controlled, so we weren't just thinking about price.

7 We're aware that there are a number of pipelines that
8 currently don't offer open access, and we think that they
9 should, and that the quality of that access should be
10 controlled. But, as you suggest, the regime that
11 Government's proposing, the co-regulatory regime, may have
12 some impact on that.

13 I guess part of what we're saying, we don't know yet
14 what that impact will be and how that relates to the work
15 that the Commission is doing.

16 **CHAIR:** We've had a number of submissions from parties that
17 suggested to us that, if the net benefits from control
18 were of a certain magnitude below a certain threshold,
19 other than simply saying if there's positive benefits the
20 Commission should not recommend control, it should
21 exercise wider discretion and almost say, just for
22 example -- and I don't want to suggest someone actually
23 said this, because I don't -- but I can't remember the
24 numbers and where people put the particular benchmark, but
25 they might say, well, \$5 million net benefit with
26 controlling one particular company is just not worth it
27 given all the risk and the uncertainty around it.

28 Do you have a view on some of those submissions about
29 that?

30 **MR COATES:** It's not something we focused on in our submission
31 to a great extent, but if you've done a test and shown

1 there are benefits, and I know that in your assessment you
2 did use fairly conservative assumptions, so you've already
3 given part of the element of doubt to the suppliers of
4 pipeline services, then to take things to an extreme, a \$1
5 benefit is still a benefit to New Zealand.

6 I think there are benefits of consistency.

7 **CHAIR:** One of the other issues that comes up and, you know,
8 the Commission itself has talked about this is, in the
9 event that -- and you commented yourself that we've looked
10 naturally at these distribution and transmission networks,
11 we haven't looked upstream and downstream, there is the
12 possibility that we might find net benefits but those net
13 benefits being achieved are premised on the notion that
14 they'll actually get to end consumers if some constraint
15 is put on the distribution in transmission companies.

16 There seems to be at least a reasonable argument that
17 there may be reasons why those -- even if those
18 constraints were put on, that those benefits wouldn't flow
19 through to end consumers; some of it might flow through to
20 retailers, but may not flow through to end consumers, and
21 so, if we don't have the required degree of satisfaction
22 that they would, should we think again about recommending
23 control?

24 I'd just like to invite your comment on that. We did
25 have a submission from Vector, for instance, about some
26 experience they have had about price reductions that
27 weren't passed on to end consumers.

28 So, do you have any comments on that?

29 **MR COATES:** I think, for prices not to be passed on would
30 indicate that there isn't sufficiently competitive forces
31 in the retail market. However, we do believe that there

1 is healthy competition in retail, and improving, and also
2 to make a decision in one market based on an expectation
3 of the success of another market is -- I don't know to the
4 extent to which you have that discretion in terms of the
5 definition of acquirers. I mean, ultimately the acquirers
6 are clearly consumers, but New Zealand does have
7 competitive -- or an open retail market, and one assumes
8 that, if a retailer was charging excessively, it creates
9 opportunities for other retailers to come in, and...

10 **CHAIR:** But would you accept that it might be valid for the
11 Commission to satisfy itself that we're not just setting
12 up a transfer from one player in the chain to the other
13 and that, at the end of the day, the end-consumer's no
14 better off?

15 Do we need to satisfy ourselves of that?

16 **MR COATES:** I suppose, if you thought that there was a risk
17 and that was going to continue in perpetuity, then I think
18 that would be a valid thing to consider. That's, given
19 that New Zealand does have a competitive retail market. I
20 personally don't believe that that would be the case.

21 **CHAIR:** What about the potential for the first leg in the
22 chain to capture any reductions that occur further down?
23 So, at the production end is there scope for rents to
24 possibly be increased at the production level if
25 transmission and distribution are controlled, and again,
26 not even get to the retail layer?

27 **MR COATES:** Here we think the biggest issue is regarding the
28 terms of access and the ability of vertically integrated
29 upstream and, with pipeline companies, being able to
30 benefit from the informational advantages they have over
31 all the other parties. For example, they have upstream

1 gas which, through the terms of access, for example, with
2 common carriage they can access the pipeline at will.

3 We are also concerned about the ability of other new
4 entrants in the upstream gas market to invest in the
5 upstream production facilities without having security of
6 access to the main means of getting that gas to the
7 market. So, it's there that we see the biggest concerns.

8 **MR LOVE:** I was just going back to whether users gain the
9 benefit. I think certainly for larger users who have the
10 ability to contract their own transportation services --
11 so, I'm talking about larger industrial sorts of
12 customers; usually if we're contracting those services on
13 their behalf it is a direct pass-through to them. Of
14 course, it may be not down at the level of smaller
15 customers where they simply can't contract for their
16 transportation arrangements, but I guess that's a fairly
17 small part of the overall gas market but, of course, there
18 are significant numbers of people involved in that.

19 **CHAIR:** I just had one other question then I'll ask my
20 colleagues to pursue questions they might have.

21 We had extensive discussion -- I don't know how much
22 of it you were able to hear -- on WACC. The Commission,
23 as you will be aware, decided to base draft
24 recommendations on taking the 75th percentile in the
25 range. We had submissions today, and it's in the papers,
26 that we should have gone maybe to 90% of the range or even
27 wide in the range quite significantly and then add a
28 margin even on the top of the range.

29 I'd like to ask whether Contact has any view on this
30 matter, because it can determine the result, basically; it
31 has a very big impact on whether a control recommendation

1 may or may not be made in any company's case.

2 **MR COATES:** I'm afraid that we didn't look in any detail at
3 the Commission's methodology in concluding the terms of
4 WACC, so we can't comment on that unfortunately.

5 **CHAIR:** It is over to Contact whether it chooses to do so, but
6 it's such an important matter to the outcome of the
7 inquiry; it would certainly be useful to the Commission to
8 have the input of one of the acquirers on this matter, and
9 so, I simply leave that with you to consider whether you
10 wish to do that in a cross-submission.

11 **MR COATES:** We will endeavour to make a submission.

12 **MS BATES:** I just want to ask you a bit about common carriage
13 vis-a-vis contract carriage, because that seems to be a
14 major focus of your submission, and I wanted to make sure
15 that I understand the differences legally, physically, and
16 how they impact on your company, or you consider they
17 might impact on your company.

18 So, if you just give me a brief explanation; take
19 Maui's current proposal as the example of how you think it
20 will work under common carriage as opposed to under
21 contract carriage?

22 **MR LOVE:** Under a common carriage regime, you don't have any
23 contractual rights that secure any capacity for
24 transportation; you just front-up on the day with your
25 request for the capacity you want to use on the following
26 day and then -- and when a number of other parties who are
27 requesting capacity on the day, and the Maui -- if it was
28 Maui -- would share that out, pro rata the available
29 capacity across the capacity request. So, you don't have
30 any long-term security about the capacity you have access
31 to, so that's one of our major concerns; we can't make

1 downstream investment decisions because we don't know how
2 much gas we'll be able to transport on the day to those
3 new plants.

4 Also, everyone --

5 **MS BATES:** In a contract carriage, what sort of terms are you
6 talking about?

7 **MR LOVE:** Under contract?

8 **MS BATES:** Yes, so you told me what would happen under a
9 common contract.

10 **MR LOVE:** Yes, you would normally contract for a fixed amount
11 of capacity over a fixed term so you have certainty.

12 **MS BATES:** So, what sort of terms would you be looking at?

13 **MR LOVE:** From a power station, you might be looking at 10 to
14 15 years of contractual rights to transport gas. I guess
15 it's the sort of investment you're making, probably around
16 10 to 15 years. For example, for Otahuhu we have
17 contracted rights, I think, for -- I think it was about 10
18 years, but I would need to confirm that with NGC.

19 **MS BATES:** And would your company guarantee volumes?

20 **MR LOVE:** No, we have a fixed amount of transportation
21 capacity, so on any day we have a right to transport gas
22 that uses up that capacity.

23 **MS BATES:** What if you don't use the capacity on that?

24 **MR LOVE:** We still pay for it, and if we take -- well, if we
25 transfer more gas than we have rights to, we'll pay
26 overrun charges.

27 **MR COATES:** Overseas there are sometimes -- one of the
28 concerns that people sometimes express with contract
29 carriage is that people can buy capacity and sit on it to
30 try and shut out other parties. That is not an inherent
31 problem of contract carriage because most regimes have a

1 "use it or lose it" mechanism, and that if you do not use
2 your capacity, the pipeline owner has the right to sell it
3 on to other parties and typically secondary markets
4 develop. So, if we believe that we're not going to use
5 our capacity, we can sell it on to someone else.

6 It's not just the likes of investments in gas-fired
7 power stations. You may or may not know that Contact is
8 looking into an LNG terminal because we're running out of
9 gas and we need to get some. The location decision of
10 that terminal could be affected by the likelihood of
11 access to the Maui pipeline. We're considering Taranaki,
12 we're also considering north of Auckland.

13 Likewise, if a third party or a new entrant
14 considering investing in an upstream gas facility or gas
15 field, I should say, if they don't have the security of
16 access to the pipeline, it's going to be much harder for
17 them to consider investing that, and indeed we've got a
18 view from a bank regarding the finance ability of projects
19 with contract carriage and with common carriage.

20 **MS BATES:** So, if we were to take your suggestion on board,
21 then would you expect the regulatory regime to impose on
22 the owners positive obligations to enter a contractual
23 arrangement?

24 What I'm trying to fish out is how it would work. You
25 may have some regulatory experience elsewhere which may
26 assist in this, but how would it work?

27 **MR COATES:** The precise mechanism, I wouldn't know. Part of
28 the issue here is that there's this other regulatory body,
29 the co-regulatory body which is being tasked with ensuring
30 access terms, but we think the two cannot be separated in
31 that the price and terms of access both have fundamental

1 affects on acquirers and should be considered as a whole.

2 In terms of overseas, I note that the European Union
3 is requiring that contract carriage be the norm on all
4 pipelines.

5 **MR LOVE:** As an example, in Australia there's a Federal
6 Pipeline Access Code and the code sets out the kinds of
7 offer that operators and owners of pipelines are required
8 to make, and so, it sets out a minimum offer they're
9 required to make, and I guess that's how we think the
10 regulation, I guess, ultimately would work in New Zealand,
11 that there's some sort of code which offers have to be
12 made. Now, whether that comes through the co-regulatory
13 body or through the Commission, we say that's all
14 uncertain, but all of that needs to be considered in
15 assessing the benefits of control.

16 **MS BATES:** Are you able to point to examples here, or overseas
17 probably, where common carriage has actually caused the
18 sort of difficulties that you have referred to?

19 **MR LOVE:** Yes, I think the best example of that is probably in
20 Victoria where they've just reviewed -- carried out a
21 recent review of some of the issues that we're talking
22 about.

23 **MR COATES:** They currently have common carriage; they're about
24 the only overseas regime which does still have common
25 carriage.

26 **MR LOVE:** And are proposing to implement a regime where there
27 will be contractual rights to capacity which can be
28 traded, because there has been concerns about the ability
29 to make downstream investments in power stations and the
30 like because of the uncertainty the regime has created.

31 **MS BATES:** Thank you very much, that's helpful.

1 **MR STEVENS:** I just wanted to explore that issue a little bit
2 more, particularly on the barrier to entry issue, because
3 obviously that's a concern where there is a constrained
4 delivery mechanism, for want of a better word, and you
5 mentioned that use it or lose it is one methodology for
6 overcoming the barrier to entry.

7 In some other jurisdictions they have looked at other
8 methodologies whereby the party willing to pay the highest
9 price gets the access at that point in time, and as also,
10 therefore, effectively utilising it to its best economic
11 capacity, and I'm thinking of the on-line auction trading
12 systems for access to such networks.

13 What's Contact's view of that methodology?

14 **MR COATES:** I'm not familiar with that example in particular.
15 With secondary trading of capacity, you do enable the
16 pipeline capacity to go to the highest value use, and if
17 you're sitting on capacity rights -- essentially, it
18 revolves around property rights and means that, to have a
19 proper investment climate you've got to have, kind of,
20 fairly well defined property rights, and if you have this
21 right to capacity and the value to you is \$10, if somebody
22 says, well, I'll pay you \$20 for that, then it does enable
23 the pipeline capacity to go to the highest value use.

24 With the pros(?) common carriage regime, there isn't
25 this ability to contract. I mean, say I knew Alex wanted
26 to use the pipeline and I wanted to use the pipeline, I
27 could say, well, Alex I'll pay you to stop using it so
28 much, but all the gas capacity that he was going to use
29 doesn't all go to me, it will just be pro rata'd amongst
30 all the remaining users; there isn't this same ability to
31 facilitate trading and ensure that the capacity does go to

1 the highest value use.

2 **MR STEVENS:** Just picking up one other point on Contact's
3 submission, that was the issue of bypass, and I think in
4 your submission you mentioned that bypass markets aren't
5 truly competitive, and I was just wanting to explore that
6 with you somewhat.

7 You don't see the provision of a bypass network as
8 bringing in further competition?

9 **MR LOVE:** I think we were trying to say that, when you look at
10 the detail, maybe bypass pipelines aren't the same as the
11 original pipelines, so we're trying to argue that there
12 should be open access on both the bypass pipeline and the
13 original pipeline.

14 **MR STEVENS:** Not that the bypass is uncompetitive?

15 **MR LOVE:** That's right. We're saying that, perhaps the bypass
16 pipeline, if there isn't open access, only provides
17 benefit to those who have access to it; I guess, the owner
18 of the gas pipeline. We're saying that that also should
19 provide open access as well so that you increase the scope
20 of potential competition.

21 **MR STEVENS:** Let's assume that it wasn't open access to the
22 bypass pipeline for the moment; do you see that as
23 bringing real competition to the market?

24 **MR COATES:** I suppose it does, but it's also, as you say,
25 evidence that the original pipeline owner was probably
26 charging excessively.

27 **MR LOVE:** I guess what we're trying to say, we can increase
28 the benefits of bypassed pipelines, but I think he's
29 probably right, that they do increase competition to some
30 extent.

31 **MR MELVILLE:** I understand Contact is a major owner of gas

1 metres, predominantly on the Auckland network.

2 Is that correct?

3 **MR COATES:** Yes.

4 **MR MELVILLE:** And you see gas metering as a competitive
5 market?

6 **MR COATES:** [Nods].

7 **MR MELVILLE:** Do you own a number of meters on networks other
8 than Vector, or on networks that own their own meters?

9 **MR COATES:** I think we're going to have to come back on the
10 precise -- I'm not an expert in Contact's metering.

11 **MR LOVE:** It's my understanding that the ability to put metres
12 in gas networks is more limited than the ability in the
13 electricity sector, but we perhaps can come back and
14 clarify that if you like. We're not directly involved in
15 Contact's metering business.

16 **MR MELVILLE:** Would you say it's more limited than
17 electricity; do you have any...?

18 **MR LOVE:** No, more limited than gas; the ability.

19 **MR COATES:** But that's not due to an inherent feature of
20 metering, it's due often to the terms imposed by the
21 distribution owner for use of their networks, and we cite
22 the example of Powerco in our submission. So, there is no
23 reason why metering couldn't be competitive in all parts
24 of the country; in some areas that terms of the pipeline
25 owner, the distribution owner, hinder the competition.

26 **MR MELVILLE:** Okay, thanks. Just one other one for myself.

27 You say that the Commission's focus on gas supply
28 through the whole delivery chain blurs the ability to look
29 at transmission distribution. I was just wondering, if
30 you've got some advice of what we should be doing
31 differently in relation, that you're saying that we're

1 looking at the whole gas -- I'm just a bit -- I can't
2 really understand the point you're trying to make there,
3 and maybe you can clarify that and have some explanation.

4 **MR LOVE:** I think that maybe we thought there were two points,
5 that in the end we thought we were looking at whether the
6 pipeline services, and so supply of gas, isn't really a
7 pipeline service, it's the supply of a transportation
8 service and other services associated with that.

9 We thought, if you looked at just the supply of
10 transportation services, it might be rather clearer that
11 there wasn't competition to supply those services.
12 Whereas, if you look at perhaps the bigger picture, look
13 at gas, it becomes rather more cloudy. I think we thought
14 that the other issue was that a pipeline owner who's also
15 an integrated supplier of gas is different from one who's
16 just a supplier of pipeline services, and by looking more
17 at gas supply perhaps you blur the distinction and perhaps
18 don't see some of the issues around the effects of, or the
19 potential effects you can get if you are dealing with an
20 integrated gas supplier and owner of a pipeline.

21 Very often in overseas regimes, as Simon mentioned,
22 there's the requirement to separate off the pipelines
23 service business so you avoid the potential cross-
24 subsidisation and effects like that that you can get.

25 **MR COATES:** I suppose our main concern is that the -- if you
26 decide upon control, is that the eventual control regime
27 does distinguish between these different elements of
28 pipeline services.

29 **MR WYDEVELD:** You spoke a bit about potentially undertaking
30 bypass yourself, and I presume that's because of a
31 competition reason, also because of cost.

1 My question was how significant capital contributions
2 that you might make to an incumbent? Is that an issue for
3 you guys, or not?

4 **MR LOVE:** I don't recall that we have done that, but the kind
5 of thing we were thinking about -- you know, to pose a
6 serious threat of bypass, you really have to start to get
7 involved down to the stage of perhaps seeking consents, so
8 it means that you have to have a design for your pipeline,
9 so there are quite significant costs in that.

10 Offhand, I don't recall any occasion where Contact has
11 made a contribution to a pipeline owner in order to
12 arrange -- I don't recall any specific instance where
13 Contact has made a capital contribution to a pipeline
14 owner to obtain an increase in capacity, but there may be
15 examples of that, because I do recall that it has been
16 raised.

17 **MR WYDEVELD:** Okay, thanks.

18 **MR ADAMS:** Just in connection to the access to the Maui
19 pipeline; are you aware of where negotiations are now on
20 the type of access regime that's been proposed?

21 **MR LOVE:** Yes, the Maui joint venture has recently requested a
22 further round of submissions on their proposal and, as I
23 understand it, we the industry is waiting for a response
24 to those submissions.

25 I just heard, in fact earlier this afternoon, that
26 they have established a website where -- I'm not sure if
27 it's a response to the submissions, but certainly the
28 submissions are on the website.

29 **MR ADAMS:** I take it, Contact will be making submissions on
30 that question?

31 **MR LOVE:** Yes, we've made a submission and we're just waiting

1 for a response.

2 **MR ADAMS:** I'm just trying to get a feel for whether the
3 pipeline owner would have more market power in it with a
4 common carriage regime as opposed to a contract carriage
5 regime.

6 I can see your argument as to why one might be more
7 efficient than the other, but why would a pipeline owner
8 choose a regime which is less efficient and, therefore,
9 place less -- give less value to its pipeline than the
10 other?

11 **MR COATES:** Good question. The thrust of our concerns with
12 this is, we believe that if the pipeline owner was an
13 independent pipeline owner, they would go for an access
14 regime which was of greatest value to that pipeline asset.
15 However, they seem to be proposing this alternative
16 regime, which begs the question why.

17 Clearly there are a number of issues with regard to
18 their ability to access; they have got the pipeline at
19 will to access the gas spot market when the prices are
20 high. Plus also, one of the economic efficiencies that
21 we're concerned about is the incentives on the upstream
22 gas producers, new entrant gas producers to enter the
23 market and invest in new gas fields. That ability, we
24 believe, is diminished and that could enhance the market
25 power of the upstream businesses.

26 **MR ADAMS:** But clearly, the users of the pipeline, like
27 Contact, would have different incentives to see different
28 regimes in place.

29 I mean, I can clearly see that the contract regime
30 would suit Contact better than any other, but is it not
31 possible that other users might have a different view on

1 it, and is there any particular reason why the Commission
2 should choose your preferred option rather than other
3 users'?

4 **MR COATES:** I think it is possible there may be other users
5 who may prefer a common carriage regime, particularly
6 those who are likely to only want to access the pipeline
7 intermittently, although having said that, if there was a
8 contract carriage regime with the ability to have
9 secondary trading of capacity rights, there would still be
10 the ability of these intermittent users to access pipeline
11 capacity.

12 We merely note that overseas there's this increasing
13 presumption, particularly from regulatory authorities, to
14 go for contract carriage, often because of concerns
15 relating to investment efficiency. Also in Victoria there
16 were concerns that you had Victoria with a common carriage
17 and other states with contract carriage, and that created
18 problems, and there has also been concerns -- I don't
19 specifically know whether the concerns with common
20 carriage overseas is with market power, but certainly the
21 concerns over vertical integration of pipeline and
22 upstream producer revolve around market power, and in the
23 European Union there's a requirement for legal separation
24 of these two activities.

25 **MS SARMA:** Just under threat of bypass again; what kind of
26 price reductions are you able to achieve?

27 **MR LOVE:** Through threatening bypass?

28 **MS SARMA:** Yep.

29 **MR LOVE:** We possibly can provide an example of that, but I
30 think it probably would need to be confidential.

31 **CHAIR:** If you could provide that in your cross-submission,

1 that would be good, thank you.

2 **MR ADAMS:** Could I ask also whether you could address the
3 issue of the example that Vector gave, where it's
4 suggested that 50% of -- gave an example in its
5 submission, I think it's 6.86, where it suggested that
6 retailers passed on just 50% of the reduction it made in
7 its pipeline charges.

8 **MR MELVILLE:** If you could also tie into that cross-submission
9 some information about metering, and particularly the
10 meters you own on networks other than Vector's, and just,
11 if you think metering is competitive, if you had any
12 points or examples of that.

13 **MR LOVE:** Yes.

14 **CHAIR:** Okay, unless there are any other remarks you'd like to
15 make -- [pause]. [No comments].

16 I'd like to thank Contact for the submissions that you
17 have put in and being willing to come and allow us to ask
18 you questions directly. It's very important for the
19 Commission to hear directly from acquirers, so we were
20 very pleased that Contact put in the submission and was
21 available for the Conference. We look forward to seeing
22 your cross-submissions, and I thank you both very much.

23 **MR COATES:** Thank you for the opportunity.

24 **CHAIR:** We now will have a submission from MEUG, and I will
25 ask Ralph, I think you're in the back row there, we'll ask
26 you to come forward please. Thank you.

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