

1 presentation this morning and my two colleagues will take
2 the role of the network operator. You'll see in the oral
3 submission there is a retail written submission, we refer
4 to that, then the network written submission, then we have
5 some concluding comments and obviously time for questions.

6 Just to recap and we did take you through this but
7 just I think it's important that we reinforce this to you,
8 that the company consists of two trading divisions. There
9 is the network division which trades as GasNet and the
10 commercial division which trades as Wanganui Gas on our
11 own networks because we have very good brand loyalty in
12 Wanganui and the environment around Wanganui regions, and
13 Direct Energy where we trade off network and that's our
14 off network brand which we sell in places like Auckland,
15 Taranaki and the Hawkes Bay.

16 Then to cope with the Commerce Act with the separation
17 of those divisions we have a corporate and administration
18 division which effectively provides on a semi-contractual
19 relationship support mechanisms to the two trading
20 divisions.

21 Turning first to the network division, as we've said
22 before it operates six discrete pipeline networks, 11,000
23 connections, and we refer to the users connected to our
24 networks as connections not as customers, effectively the
25 customers are the six retailers. We're 5 percent of the
26 national market approximately, approximately 3 percent of
27 the network in length.

28 The networks provide gas distribution services to six
29 retailers. It makes those services available to all of
30 the retailers. It behaves in a non-discriminatory manner,
31 obviously in compliance with the Commerce Act. It offers

1 posted prices, it does offer contestable gas measurement
2 systems. We believe that's a discrete part of our
3 business, we choose to be in it. We offer gas measurement
4 system, hardware, not only on our own network but also on
5 other people's networks as well. That part of the
6 business has 12 direct employees.

7 The commercial diversion consists of effectively two
8 bits, the first being energy trading, we trade gas and
9 electricity. The gas we trade North Island wide, we have
10 89,000 of our own direct gas customers. We have a
11 relationship with Mercury Energy where we manage all of
12 their wholesale gas and transmission arrangements for
13 their 12,000 odd gas customers, and in return Mercury
14 Energy handles for us the retail of electricity to about
15 1,500 customers that we have in Wanganui city. It's
16 interesting that our energy trading is actually
17 predominantly more off network than on network which is
18 obviously a significant change from when the industry was
19 deregulated where we were 100 percent obviously on our own
20 network because that was the way the franchises were set
21 up.

22 As an adjunct to that the commercial division has an
23 appliance sales and installation business. Just to remind
24 you, we believe that it's very important for domestic
25 consumers to be able to buy appliances, that's the way we
26 believe networks grow, and Commissioner Bates I heard you
27 say you've recently purchased some gas appliances, we
28 believe it's important for network growth that customers
29 can get access, ready access to both the appliance and the
30 installation, and so our commercial division, effectively
31 on behalf of our network division, provide those services.

1 We believe that's why our penetration rate is somewhat
2 higher than the other networks.

3 That commercial division has 12 direct employees.
4 Then the corporate and administration division provide
5 services to the two trading divisions effectively managing
6 the shareholder relationships, public relations, the
7 management of treasury and financial, personnel
8 administration, IT and property management and that
9 section has six employees.

10 Our structure for this oral submission is that firstly
11 I will address our energy trading which we refer in the
12 submission as retail because I think that's how you know
13 it, energy retail, and then my two colleagues will in turn
14 address separate parts of our network submission, then
15 I'll come back for the concluding comments and the wrap
16 up.

17 Firstly wearing my retailers hat, I think you will
18 find that the key points in our written submission from
19 our retail section is that while not discounting the
20 importance of the economic aspect of your inquiry we
21 believe that operational behaviour can be a significant
22 cost generator for the retailers, and we're somewhat
23 disappointed that that hasn't been part of the Draft
24 Report. We have instances here of very stringent
25 application of prudential requirements, advanced billing
26 for network services and zone pricing which you've
27 obviously heard some comment about previously from Nova
28 Gas. We believe those are issues that in fact do impose
29 higher costs on energy retailers and because those higher
30 costs can't be absorbed by the retailers they are in
31 effect passed straight through to the consumer.

1 **CHAIR:** I guess the question that we need to put our minds to
2 is whether that type of behaviour is an indication of
3 market power or would you still see these behaviours in a
4 competitive market.

5 **MR GOODWIN:** Again wearing my retailers hat I'd say no. The
6 stringent application for prudential requirements is
7 imposed by one lines company, the other three accept that
8 our company with its history, its trading record, is able
9 to meet its debts by due date. One company chooses not to
10 accept that and imposes very stringent prudential
11 requirements on us and that is a cost to us which again we
12 pass on to our consumers.

13 The billing in advance is effectively two of the
14 network operators choose to bill in advance. We believe
15 it's an administrative nightmare for both them and for us
16 because there's all these catch-ups and wash-ups and
17 things which go on for months and we address a bit more of
18 that in the written submission. But administratively very
19 costly and again it has to be passed on to the consumer.
20 Two networks choose not to bill in advance and our billing
21 relationships with them are very simple.

22 The zonal pricing, again you've heard, I don't think I
23 need to elaborate on what Nova Gas has told you this
24 morning about zone pricing. We don't believe that it's
25 appropriate, particularly when we see that the prices to
26 consumers outside the immediate area around those bypass
27 networks or the gate stations are in fact -- their prices
28 are going up we believe to compensate for the reduction in
29 revenue where the bypass is a threat.

30 **CHAIR:** Does the issue of bypass come into your area at all?

31 **MR GOODWIN:** Are you talking to me as a network operator? As

1 a network operator, yes, we have been threatened with
2 bypass on two occasions. On both occasions our published
3 pricing was adequate to prevent that from happening.

4 **CHAIR:** If it hadn't been what would you have done?

5 **MR GOODWIN:** We would have negotiated whatever rate was
6 appropriate to meet the bypass threat. It's ridiculous
7 for us to have stranded assets lying in the ground and for
8 somebody else to have equipment and asset running
9 alongside.

10 **CHAIR:** Doesn't that cause you trouble with your position
11 you've just stated on zonal pricing?

12 **MR GOODWIN:** Zonal pricing is different to bypass pricing.
13 Bypass pricing is a direct economic threat, whereas zonal
14 pricing we believe is meeting a threat by making somebody
15 else pay for it. If the network's revenue is neutral and
16 they're able to cut prices to the extent they have where
17 there is a threat, we believe that the rest of the
18 consumers are making up the difference.

19 **CHAIR:** Isn't that what would be happening if you cut your
20 prices in response to entry?

21 **MR GOODWIN:** Our revenue would go down. We would do either an
22 optimisation or an EV exercise on that piece of pipe, the
23 revenue would come down and the way we prepare our total
24 revenue would come down accordingly.

25 So we believe in summary from the retailer that the
26 end user pays for the increased administration costs and
27 it's interesting, we notice this behaviour is more
28 prevalent where the network operator owns both the gas and
29 the electricity network. There's less incentive on them
30 to be very proactive and competitive on the gas because
31 effectively if the gas doesn't get distributed, then the

1 consumer's using an equivalent amount of electricity and
2 they own the lines anyway so for them it's no great issue.
3 Where we have someone who is exclusively a gas network
4 operator they are very keen to see gas go through their
5 networks.

6 That concludes the retail submission, Madam Chair, do
7 you want to elaborate on that or shall we move on to the
8 network?

9 **CHAIR:** I might see if my colleagues have questions on that
10 bit before we continue.

11 **MS BATES:** Just following up on Commissioner Rebstock's
12 questioning about what you would do in a bypass situation,
13 and you say you wouldn't impose the costs on any other of
14 your customers, but is that a moral decision or are you
15 constrained in actual fact from doing that?

16 **MR GOODWIN:** I think that's just a moral decision. Our
17 methodology effectively takes -- we apply an appropriate
18 return on to the valuation of the network assets. If we
19 devalue any one of those network assets with an economic
20 valuation calculation we don't get the return on it, so
21 it's what we've consistently applied since we set up that
22 type of pricing model.

23 **CHAIR:** Thank you, please continue.

24 **MR GOODWIN:** I'll pass over to Geoff.

25 **MR EVANS:** Thank you Chairman, good morning. Just before I
26 start it's probably appropriate just to mention in my
27 capacity as network manager I bring in an operational
28 management perspective to our presentation. I am an
29 engineer, I'm not an economist, an accountant or a lawyer.

30 **CHAIR:** We'll count that in your favour today. I can say that
31 since I'm an economist you see.

1 **MR EVANS:** I've seen plenty of reasons this morning why I
2 should be an economist as well, it's obviously a very in-
3 depth topic. Just following on also from Mr Goodwin's
4 comment earlier, between Mr Coe and myself we provide
5 continuity in the network manager role since 1989,
6 effectively 15 years. Combined with Mr Goodwin's position
7 as CEO since 1993 we believe we have a very good
8 understanding of our business, in particular over the
9 review period of the inquiry, so it certainly helps from
10 our point of view.

11 I'd like to now just take you through the structure of
12 our presentation in regard to the network submission, and
13 over the next few slides we intend to address a conclusion
14 of our submission; the statement of exclusions which
15 effectively is what we don't propose to talk about today,
16 or have talked about in our written submission; a number
17 of key issues which have been addressed in our written
18 submission; further comments to that submission and
19 operational implications.

20 Given the time constraints this morning it probably is
21 conceivably possible, but if we had only time to present
22 one slide this one would in fact be the one. The only
23 question we would pose would be which one of the three of
24 us would actually present it, it's fallen to me at this
25 stage. But in conclusion, and the following slides will
26 support and follow on from this, it is our belief that
27 further control of gas networks is not required.

28 However, if the Commission considers further control
29 is necessary, then we believe that the initial form of
30 control should be to monitor behaviour of the specified
31 entities by way of a threshold approach. If a breach is

1 subsequently observed, then control only those entities
2 observed in breach. Control should be entity-specific
3 and, based on the Draft Report, should exclude Wanganui
4 Gas.

5 **CHAIR:** There was one submission that suggested that while we
6 didn't recommend control for Wanganui Gas where excess
7 profits, however defined, how we define them, and that if
8 there was something like a threshold regime you might be
9 subject to that and I noticed in your last slide you
10 focused on the control aspect of a regime. Are you
11 suggesting you'd accept that you should be subject to a
12 threshold regime if that's what was put in place?

13 **MR GOODWIN:** If we breached it, we're not entirely sure that
14 your threshold is as we would have it at this stage, but
15 if we could agree on what the threshold was then yes, if
16 we breached it we'd be subject to further control.

17 **MR COE:** Could I just add to that. In regard to the concept
18 of threshold, the company's performance, it probably
19 advocates that there should be essentially common rules
20 for distribution company activities and we talk about that
21 a little bit further in the submission. In regard to this
22 it's a question of the performance of the entity
23 acceptable within certain bounds and that is the point in
24 regard to threshold that's been discussed here, or we're
25 putting forward. So while there may be volatility about
26 behaviour year to year, is it within an acceptable range,
27 if so go no further.

28 **CHAIR:** This comment that you made in the slide about gas
29 networks should not be controlled, I take it despite what
30 you've just told us from the perspective of the retail
31 business, you believe that those companies that you're

1 doing business with should not be controlled at the
2 distribution -- you're expressing a view not just about
3 Wanganui Gas but also about the other distributors and
4 transmission operators.

5 **MR GOODWIN:** Yes, you can understand my dilemma.

6 **CHAIR:** I can understand it, especially after hearing your
7 first submission.

8 **MR GOODWIN:** Thank you for the understanding. Yes, we believe
9 that there are some behaviour aspects that do need to be
10 monitored, but we're not convinced that further control is
11 necessary. We will talk in fact further about the Draft
12 Information Disclosure Regulations handbook that was
13 published in 2000. We're convinced that had that gone
14 into legislation that would have given the Commission a
15 whole lot more information than you currently have
16 available to you. We actually placed quite a considerable
17 amount of importance on that document. We believe there
18 are ways in which the networks can be reviewed without
19 further control, the type of which the Commission's
20 currently speaking.

21 **MR EVANS:** Just following on then to exclusions, effectively
22 what we're not intending to speak to directly today. The
23 economic welfare arguments, modeling issues including WACC
24 and the capital asset pricing model, the transmission or
25 upstream field production processing related pipelines.
26 It's quite apparent there's quite a substantial level of
27 discussion, debate and resources committed to other
28 related topics and clearly we believe that that's been
29 adequately covered such that we don't need to cover that
30 ourselves.

31 **CHAIR:** There may be a few questions at the end where we might

1 want to ask you your view on particular matters but if
2 you're happy to take those questions we'll bring them at
3 the end.

4 **MR EVANS:** That's fine. Moving on then to key issues,
5 Wanganui Gas should only consider the non-contestable
6 assets and therefore urges the Commission to reconsider
7 the asset base used for analysis of network business
8 performance. The product and service definition is
9 effectively the non-contestable asset base and it should
10 exclude gas measurement systems or GMS.

11 There should be a clear and consistent definition of
12 distribution systems which basically, in simple terms,
13 means that there should be a like for like entity basis
14 for comparison. There's implied conditionality through
15 lack of recognition by the Commission that the
16 distribution business can exist without its own metering
17 services business and vice versa.

18 And just a point to note that GMS or Gas Measurement
19 Systems is in fact under the Draft Gas Information
20 Disclosure Handbook 2000 seen as other business.

21 **CHAIR:** So your position on the meters is that the meters are
22 contestable, is that right?

23 **MR EVANS:** Yes.

24 **CHAIR:** And should be excluded from the analysis?

25 **MR EVANS:** Yes.

26 **CHAIR:** If they're included in the analysis it tends to -- I
27 mean arguably it tends to soften the increase of the
28 overall asset base and if it's contestable you'd probably
29 assume competitive prices are being charged, so you're
30 basically spreading any excess returns elsewhere over a
31 larger asset base, and it seems to me, it may not be

1 ideal, but given data limitations with some of the
2 companies it's not something that is adverse to the
3 company.

4 **MR COE:** Madam Chair, if I could just make a couple of
5 observations. Firstly in the written submission from the
6 company we provided some information regarding looking at
7 what we'd consider to be the non-contestable asset base
8 and the contestable, and the contestable in this case
9 being the GMS. That's just running numbers that we've
10 previously provided under the Section 70E, under those
11 results it would tend to suggest that they're are slight
12 improvement in the reduction in the excess profit as
13 determined by the Commission's model.

14 The second point is there is only a portion of the GMS
15 market looked at currently. There is a retailer, gas
16 retailer, gas and electricity retailer who has a
17 significant position in the GMS market which is not
18 presented as part of this type of analysis, and further
19 there are some gas distribution network companies which
20 don't have GMS components either in their business make-
21 up, so one ends up with a situation of not comparing, in
22 our view, apples with apples, put simply, they are the
23 observations.

24 **MR GOODWIN:** Provides some inconsistency when you're comparing
25 those networks who have no GMS. There is one retailer who
26 owns a lot of GMS and they're not considered under the
27 inquiry, so we don't believe GMS should be. We accept the
28 point you're making.

29 **CHAIR:** Doesn't affect you adversely though does it?

30 **MR GOODWIN:** Minor.

31 **CHAIR:** Do you think it does affect you adversely to have some

1 of those assets in your analysis?

2 **MR COE:** Once again if I could respond to that, in regard to
3 the specific numbers we provided originally back in
4 February placing those into the Commission's model as it
5 stands, the answer is yes. There has been, I think,
6 considerable discussion and debate about aspects of the
7 model per se, and this probably goes back to the
8 overarching issue of control or no control from our
9 perspective. We are not for one moment saying that we are
10 expert in providing specific advice or assistance or
11 making particular positions in regard to the model. We
12 have just merely taken the model and used it.

13 **MR WYDEVELD:** I was just going to make the comment in terms of
14 the Section 70E data there was an issue which you know
15 about, how the metering revenues and expenses were
16 allocated, do you agree there's sensitivity around that
17 that could affect the result you're suggesting?

18 **MR COE:** Absolutely, it's an imperfect world, the data that
19 was provided has never been structured in the way that it
20 needed to be absolutely accurate. Within human error and
21 adjustments made which we believe are reasonable, it's as
22 accurate as we can provide. In terms of sensitivity
23 around the numbers with respect to the excess profit
24 result for the company in aggregate, being modest to start
25 with we believe that the impact would be also modest.

26 **MS SARMA:** Just on the question of meters, what is your policy
27 when you do the network revaluations, what is your policy
28 on meters, do you treat them differently than the rest of
29 the network, or what do you do with it?

30 **MR COE:** Again the process since adoption of ODV methodology
31 back in 1997 GMS, as with all assets, are approached at a

1 replacement cost and then aged, so they are treated in
2 exactly the same way as other network assets.

3 **MS SARMA:** So when you revalue the network the meters would
4 get revalued as well.

5 **MR COE:** That's correct and consistent with the position the
6 company has taken in regard to the Gas Information
7 Disclosure 97 regulations the valuation that's provided
8 and reported by gazette includes GMS and we've
9 consistently stated that.

10 **CHAIR:** Sorry for that long diversion, you can continue.

11 **EVANS:** Wanganui Gas believes that the Commission should
12 reconsider the basis upon which analysis of network
13 business performance is undertaken. As seen in our
14 written submission, Wanganui Gas promotes the use of
15 benchmarking studies in preference to the building block
16 approach. The limitations to this approach relate to data
17 and it may not be the mechanism is wrong, but more that
18 the information is unavailable. As supported possibly by
19 the Draft Gas Information Disclosures Regulations 2000 if
20 they'd been implemented.

21 International benchmarking allows regulated and non-
22 regulated behaviour to be observed. The building block
23 analysis has shown to be sensitive to WACC and obviously
24 other parameters and substantial debate.

25 **CHAIR:** You wouldn't have been disappointed with the limited
26 comparative information that was done. It's awkward to
27 ask you what you had anticipated might be the case, but
28 are you comfortable with the extent to which we've used
29 the comparative information that we've got?

30 **MR COE:** Madam Chair, we would like to make some comment on
31 that a little bit further down the path in this

1 presentation.

2 **CHAIR:** Generally did it confirm your own -- as being
3 participants in a market you must have had some sense of
4 where you would sit vis-a-vis other players. Did the
5 ranking, not just for you but for others, make sense to
6 you, but do you want to come back to that later?

7 **MR COE:** If we could.

8 **CHAIR:** That's fine.

9 **MR EVANS:** Wanganui Gas considers that it operates in a
10 separate energy transport and metering market and that
11 separate metering market should be recognised.
12 Effectively there's two separate markets. Wanganui Gas
13 remains of the view that it operates in an energy
14 transportation market. If we limit the energy form to gas
15 then Wanganui Gas views itself operating in a natural gas
16 and LPG transportation market. Irrespective of whether
17 either market is seen as workably competitive a
18 transportation market does not include energy measurement
19 services for third parties.

20 **CHAIR:** You'd put LPG in the same market as natural gas for
21 our purposes?

22 **MR GOODWIN:** It's certainly a competing fuel. One of the
23 advantages LPG has is that it doesn't have any fixed line
24 charges. People can fill a bottle or bottles big or small
25 and they pay effectively a very very nominal rental for
26 that bottle. So yes, we actually sell quite a few LPG
27 appliances into places that don't have reticulation of
28 natural gas. What we try and do is use LPG as a means of
29 getting a critical mass to then go and reticulate with
30 natural gas because ultimately it's cheaper, but there are
31 some places like in the outskirts of Wanganui, Raetihi,

1 Ohakune, where we sell a lot of natural gas and one of the
2 advantages is that the fixed charges are very very small.

3 **MR EVANS:** Just the last bullet point there, a separate energy
4 gas measurement services market would enable all
5 participants within this market to be considered.

6 With regard to disclosure Wanganui Gas considers that
7 all network businesses should be subject to a minimum
8 level of disclosure. As mentioned previously the Draft
9 Gas Information Disclosure Regulations 2000 are in
10 abeyance. There should be a consistent manner for all
11 pipelines conveying natural gas for a reticulated market.
12 The first level we believe would be technical and safety
13 issues, effectively setting minimum requirements and if it
14 was controlled the second level would cover financial and
15 asset information.

16 **MS BATES:** Why would you only do that if it was controlled?

17 **MR COE:** It would be in addition to what is currently provided
18 rather than exclusion.

19 **MR EVANS:** Wanganui Gas also considers there is no simple
20 pass-through mechanism for costs associated with further
21 control to acquirers. We see there as being two acquirer
22 groups, retailers and end-users. The cost of further
23 control is likely to ultimately fall to retailers with
24 certain pass-through to end user, whether individual or
25 mass market contract. Benefits of further control are
26 certain to pass to retailers with less certain pass-
27 through to end user. And pricing path smoothing required
28 to avoid pricing shocks.

29 **CHAIR:** It seems to me you're suggesting the retail part of
30 the business is not competitive, would that be your view
31 that it isn't?

1 **MR GOODWIN:** Certainly not, but retail at the moment is
2 struggling with increasing gas prices, wholesale gas
3 prices more than doubled in the last 12 months,
4 significant rises and to avoid pricing shocks we simply
5 can't pass those price increases through to the consumer
6 in one hit, they're going to be phased.

7 So again, putting my retail hat on I would say that
8 if you passed through some savings from the network
9 operator to the retailer I'd keep them until such time as
10 I could get my margins back up to where they should be and
11 then perhaps reconsider. The only thing that would stop
12 me from doing that is if some retailer passed those
13 savings through instantly, then I would be uncompetitive,
14 but I can't see that happening.

15 Retail is a difficult business at the moment with the
16 price of gas. I was going to say out of control.
17 Effectively, as I say, increased in the last 12 months to
18 a level that is of major concern with future gas prices
19 still not certain.

20 **CHAIR:** Is this just a timing issue, at some point retailers
21 are going to have to pass-through more of the cost
22 increases and you would use the opportunity of these
23 benefits from control as a way to do what is inevitable
24 rather than -- it's not really the case that the end
25 consumer doesn't get it, it's just that you will time it.

26 **MR GOODWIN:** It will be a buffer for a period of time, yes.
27 But then depending on how competitive the retailers are at
28 the end of that phase in period, you could then argue that
29 maybe the consumer might not end up with it, it may just
30 be an advantage to the retailer. But whereas retail
31 margins have been quite tight in the very early days of

1 trading until everybody started being able to sell all of
2 their committed gas, they then became a lot better, but
3 lately they're quite appalling simply managing out the
4 contracts that we've got. Effectively we're buying gas at
5 twice what it was costing us to sell it to the customer at
6 the same price as we were 12 months ago.

7 **MR EVANS:** With regard to dynamic inefficiency Wanganui Gas
8 considers that it needs to be quantified as a disbenefit
9 of further control. A gas pipeline business is a very
10 long-term investment.

11 Forecast investments based on counterfactual.
12 Investment will be avoided, delayed or cancelled. We
13 believe there is the need for explicit cost allowance in
14 the model.

15 With regard to the draft ODV Handbook, Wanganui Gas
16 considers that the Commission should not rely on the
17 historical draft for current valuation analysis. It's
18 unreasonable to assume it's a workable surrogate for 2004
19 and beyond. There was quite substantial industry
20 consultation in 2000 which wasn't incorporated into the
21 document, it serves value now only historical from our
22 point of view. In fact the Commission's expert advises
23 that there is issues to resolve in the document itself and
24 therefore we consider it needs consultative review based
25 on future promulgated regulations.

26 That effectively concludes my presentation, or my part
27 of that presentation, unless there are any questions I'd
28 like to hand over to Mr Coe.

29 **CHAIR:** Please continue, thank you.

30 **MR COE:** Thank you. As Mr Goodwin's indicated, I have worked
31 for some time with Wanganui Gas but am currently principal

1 or director of my own company JT Consulting and am
2 assisting WGL clearly today in that capacity.

3 In terms of brief background I have approximately ten
4 years of experience within the gas industry in a number of
5 capacities, four of those years as network manager with
6 Wanganui Gas Limited. In addition I have about another
7 ten years of experience within the electricity industry in
8 New Zealand starting my career as an electrical engineer
9 in the Haele days of predating Electricorp and ECNZ but
10 with that overall state entity.

11 Just if we can move to the first point, and this
12 hopefully will pick up on some of the comments about
13 productivity here. I intend in the next few slides to try
14 and pick up a few points relating to the Draft Report that
15 the Commission has released and either associated
16 documentation to that report or submissions from others.
17 So I'm sort of collectivising a number of points.

18 The first that I would like to touch on is business
19 uncertainty. As I've been able to be here last Thursday
20 and all of yesterday this is the recurring theme, and
21 while I don't wish to bore, I think it is met with total
22 sincerity that there are issues around the distribution
23 business that are uncertain and WGL is of the opinion that
24 these are likely to be of greater uncertainty as opposed
25 to the immediate history.

26 I heard this morning from either an expert or
27 Commission staff, I think it was an expert, about the
28 future being perhaps more certain. Our view is that it's
29 likely to be more uncertain. The reasons for that go to
30 the supply availability. This is the whole gambit from
31 perception in the marketplace that there isn't going to be

1 enough gas, that post Maui the world will stop through to
2 basically where the gas is going to be, what quantity,
3 what quality, and what infrastructure impacts that would
4 have at a transmission level. Obviously these comments
5 are at a distribution level, but what impacts that would
6 have at a transmission level to enable that gas to come to
7 market.

8 Companies like Contact Energy have commented very
9 recently to the Commission about the possibility of LNG,
10 liquefied natural gas which is another variable into the
11 mix.

12 Wholesale gas price trends and volatility, we heard a
13 significant amount about that as well. There is no
14 question from WGL's perspective as a distributor that it
15 is only responsible for a portion of the delivered price
16 and where there are other drivers on that delivered price,
17 if they are affecting the competitiveness of gas to its
18 other fuel competitors, electricity through liquefied
19 petroleum gas etc then that will have a significant, or
20 can have potentially a significant impact on either the
21 base level of activity of the company or future growth.

22 Competitive actions, just in the last couple of hours
23 the Commission's had a submission from Nova Gas so that's
24 one type of competitive action. Clearly the company is of
25 the opinion that it operates within an energy market, it
26 has made those comments to the Commission previously and
27 again in its submission and again today. Further, if
28 that's not, or that concept doesn't prevail then it
29 believes it doesn't operate in a competitive market or
30 rather there are competitors in terms of delivery of the
31 goods or the service, in this case gas, that it has to be

1 conscious of.

2 Energy form substitution, I've essentially covered
3 that to a degree. A comment that has come through from
4 previous submissions and from the Commission's document
5 about gas being an essential service or words to that
6 effect. Gas, and it's something I've been thinking
7 independently about -- it goes to the core of the question
8 of control. In my time in the gas industrial, which as I
9 said spans approximately ten years in different positions,
10 I was actually an employee of Natural Gas Corporation for
11 about five years ago, well, I don't believe that anyone
12 that I was talking to or have talked with believes that it
13 is an essential service, or has any special given rights
14 vis-a-vis perhaps what is available within electricity.

15 On that basis there is always a threat of what could
16 happen if pricing is not deemed to be reasonable within
17 the market it operates. It is always there in the
18 background and I would suggest that it is, if not
19 explicit, definitely an implicit control over behaviour.
20 There is examples pro and against that particular view but
21 that is something I think I would like to have noted.

22 **CHAIR:** We just heard that in response to some of these
23 factors that you've talked about the retail margins are
24 being squeezed. Do we see in Wanganui's case the same
25 squeezing of margins in the distribution business? In
26 other words do all these market circumstances lead you to
27 take the same approach in your pipeline business as you do
28 the retail business?

29 **MR GOODWIN:** Madam Chair, you heard Mr Wilson comment
30 yesterday about where large businesses find alternative
31 fuels that are cheaper than the transmission are prepared

1 to reduce their price. The same thing applies certainly
2 to our network and there is one customer that I can think
3 of specifically on our network who effectively came to the
4 retailer and said I can't afford to pay these prices for
5 natural gas, you have to either match coal, I think was
6 the alternative fuel, or we're converting our plant to
7 coal. So the retailer negotiated with both NGC
8 transmission and Wanganui Gas Networks for reduced prices
9 for both their services for that one client and they were
10 then passed through to that client and that client now
11 stays as a natural gas consumer.

12 **CHAIR:** I understand that in the case of one client, but if I
13 understood you correct in the retail business the whole of
14 your retail margin is being squeezed and you're absorbing
15 that. Are you, because of these market circumstances,
16 also in the distribution areas, your entire pricing
17 structure basically leading to a squeeze of margins in the
18 distribution area, are you constrained there in the same
19 way you are at the retail end?

20 **MR GOODWIN:** The threat I think has still to be fully
21 realised. But the retailers are going to be going out to
22 their consumers very shortly with proposed price
23 increases, and they will incorporate some of the increased
24 costs from the network operators. I think it will be the
25 response to that where the network operators may have to
26 accept that some customers have an inability to pay more
27 and they will either effectively negotiate around those
28 prices or lose the load. I don't think it's quite
29 happened yet. The gas industry tends to operate around a
30 1 October year, so everybody seems to put their prices up,
31 wholesale gas, transmission and most of the networks

1 operate at around a 1 October contract commencement, so
2 we're coming up to that now.

3 **CHAIR:** What did you do last October at the distribution end,
4 did you change your prices in any way?

5 **MR GOODWIN:** Marginally. Less than 5 percent. Simply passing
6 on some increases that had been incurred on some issues; I
7 forget exactly.

8 **CHAIR:** You're an integrated business, seems to me if you feel
9 threatened at the retail end in terms of seeing your
10 market disappear on you, clearly you have the ability to
11 take action with respect to distribution prices as well as
12 retail, but a 5 percent price increase is not a small
13 increase, and especially given last October these market
14 circumstances would have been well foreseen at that point,
15 and I might anticipate that if the distribution business
16 was constrained by these market circumstances in any
17 significant way that there's no way you could have put
18 through a 4 or 5 percent price increase.

19 **MR GOODWIN:** The thing about the wholesale gas was the price
20 really went up when the Pohokura gas was sold which was
21 within the last three months. I think everybody's
22 expectation was that that gas would sell for a lot less
23 than it did and that set a new market price and that's
24 what's going -- as soon as Pohokura which is the
25 replacement fuel for Maui is set at the price that it has
26 been, everybody else's gas is now going to be set at the
27 same price. That's just an issue of availability. So I
28 don't think you're entirely correct in saying that we have
29 experienced, or that those prices were anticipated 12
30 months ago.

31 The other thing too is that Wanganui Gas Retail may

1 well approach Wanganui Gas Network but they have no
2 greater voice with the network operator than does any of
3 the other five retailers. So it could come from one of
4 the six, it could be all six singing the same song with
5 the same message. But you're right, the network operator
6 will either have to try and absorb some of those price
7 increases or risk losing some of its load.

8 **CHAIR:** Is that built into your forward planning now.

9 **MR GOODWIN:** No, not at this stage.

10 **MR COE:** Could I just add on that point that over
11 approximately the last four or five years the distribution
12 pricing in aggregate in terms of the actual published
13 tariffs have either been held constant or reduced. So the
14 October year, or the discussions in the last few minutes
15 that Mr Goodwin's responded to has been in the most
16 recent year, but it's not typical of that longer period.
17 The company has worked hard at its cost structures,
18 because again I go back to a point I made earlier, there's
19 an implicit if not explicit constraint on the
20 competitiveness of the product vis-a-vis its alternative
21 energy forms, so there is, within the company, a self-
22 policing of the charges that it can make and should make
23 consistent with the overall needs of the company to its
24 shareholders and to the stakeholders.

25 **CHAIR:** What is the self-policing, because I think my previous
26 questions were trying to get at whether that in fact was
27 happening and I got the distinct impression that it
28 wasn't, so I'll just ask you again to explain to me what
29 you mean by self-policing.

30 **MR COE:** Based on the fact that it's a discretionary fuel
31 rather than an essential service or fuel, the company

1 stands back and basically looks at what is a reasonable
2 pricing for the services that it provides and is conscious
3 that pricing signals can have impacts into the
4 marketplace; bottom line the dollar value or charge to the
5 end user. So it's sensitive to that and the self-policing
6 I was referring to was the condition, the internal process
7 of challenge and robustness to ensure that the prices it
8 is publishing are as reasonable and fair as it can make,
9 consistent with the requirements to return a reasonable
10 return to its shareholders etc.

11 If we can move on to productivity and we'll touch on
12 this in the next slide as well. There are probably a
13 number of points. To start off with you asked a question
14 about the -- I think you're referring to the Meyrick &
15 Associates report comparative benchmarking of gas networks
16 in Australia and New Zealand and did we have a reasonable
17 expectation or did the company have a reasonable
18 expectation of the results.

19 As you're well aware there are a number of tables and
20 graphs and the like, or charts in the report, so I will go
21 immediately to figure 12 which is model 3 at page 42 of
22 the report. Again, not presuming to be an expert in this
23 area, the thrust that I take from the work here is that as
24 one improves the understanding of the market one's working
25 in and the entities; their size, their densities, their
26 comparability, and one makes further improvements to the
27 modeling assumptions, one moves closer and closer to this
28 model 3. In doing so relative performance of New Zealand
29 companies, vis-a-vis Australian companies improves.

30 Specifically in regard to Wanganui Gas, while it would
31 be fair to say the company is very pleased in the position

1 it has, or is shown on this graph, or chart, it is not
2 surprised, it has worked hard and continues to work hard
3 to have cost structures which demonstrate good use of the
4 investment that's been made, and to produce the output at
5 a reasonable level of input cost.

6 To make comment more generally about other New Zealand
7 companies I think we'd be a little bit more reticent to do
8 apart from saying that the Meyrick & Associates have made
9 a number of comments about the size and shape of the
10 various entities and how that can affect the results as
11 shown. I think it is one of those identified difficulties
12 with benchmarking per se that it's difficult to get an
13 apples with apples comparison and the perfect world
14 doesn't exist in reality and one organisation is very
15 hard, therefore to be precisely looked at vis-a-vis
16 another.

17 The company has indicated previously and again today
18 that it still prefers and recommends the benchmarking
19 approach, it believes that it's a useful, and with
20 improvement in data, a plausible way of looking at
21 performance.

22 If I could just move on just slightly, I appreciate
23 we're not in a position to ask questions, but I'll float
24 an open statement. I am left without understanding in
25 regard to this report whether in fact the Australian
26 companies referred to and included are deemed to be in
27 themselves productive or non-productive or less productive
28 or poor productive, whatever the language needs to be,
29 than in aggregate or by specific example vis-a-vis the
30 New Zealand companies.

31 What we've got is the comparison, yes, and the report

1 clearly shows that depending on the company used to base
2 the results, you've got I think it's something like a 5 to
3 30 odd percent variation between productive levels with an
4 aggregate taken and shown in the report which the
5 Commission also uses of I think 21 percent in aggregate
6 they are more competitive.

7 But unless I've misread it I don't believe there's a
8 response or a statement that says the Australian companies
9 are productive or aren't productive, just merely that in
10 comparison New Zealand companies are or aren't.

11 **CHAIR:** I think it is a comparison, there is no statement that
12 the Australian companies are efficient, but Dr Lawrence,
13 you're confirming that that's the case. Occasionally we
14 let people ask questions, especially if we know the
15 answer.

16 **MR COE:** Squeaked in there under the radar. If I could move
17 on a fraction further, the second report that is produced
18 by Meyrick & Associates productivity growth in
19 New Zealand, gas distribution networks, there's some
20 indication there of looking at the Wanganui data but that
21 didn't proceed and therefore the analysis was based on NGC
22 data specifically. The rate or the total factor annual
23 productivity growth given at the end of the analysis
24 period is 2.8 percent per annum, and there's a qualifier
25 in the report that says that it's a relatively high trend
26 rate.

27 Yesterday if I heard correctly from Dr Lawrence he
28 made a comment that the productivity gains could be
29 possible where there are lower penetrations. The reason I
30 raise these points is that Wanganui Gas is of the opinion
31 that it is productively efficient, in fact we'll go

1 further than that in a moment.

2 On that basis, while it accepts that this is a piece
3 of work that's been done and it has no comment to make
4 about NGC's productive efficiency or otherwise it's not
5 sure that that is an appropriate efficiency level for WGL,
6 and further that if the gain that's referred to and it's
7 put in the model another 1 percent, if that is driven by
8 the concept that there is lower penetration and therefore
9 by increasing penetration the rate will arrive at what
10 would be 3.8 percent, then for Wanganui Gas Limited its
11 largest in principle network being Wanganui city is a very
12 mature and highly infilled network and therefore we would
13 see that there'd be some conflict between the reality that
14 the company faces and that particular assumption.

15 Moving specifically to the slide, we've made sort of
16 an open question there I suppose, do these companies
17 demonstrate poor productivity? I don't perceive in any of
18 the work and once again I'm not critiquing it per se, that
19 there's an indication that any New Zealand distribution
20 company or specifically Wanganui Gas are poor performers
21 in terms of productive efficiency. NGC, as you are well
22 aware, has looked at the US comparator and have made
23 comments regarding that work and the results it provides.

24 The comment really here is, is it a question of there
25 is poor performance, productivity, efficiency, or is there
26 just efficiency at a particular level which could possibly
27 be enhanced? One can always strive for that. In the work
28 I suppose there's almost a connotation that the
29 New Zealand companies are not good productive
30 organisations, and I don't think that's shown.

31 I believe, or the company believes that there is self-

1 interest to be productive, if there can be a cost
2 reduction then that can improve the bottom line without
3 materially affecting the rates or published prices to
4 achieve that.

5 Also in terms of productivity, or sorry the
6 efficiency, it must be remembered that the companies have
7 to operate and maintain actual networks rather than ODV
8 equivalents. The key message there is that the optimised
9 components or those components which are optimised out of
10 a valuation or written down still exist and still have to
11 be maintained as long as they are in service condition,
12 i.e. Pressurised with natural gas. So that the
13 distinction is non-trivial depending upon the amount of
14 optimisation and EV write-down applicable.

15 I suppose this is where I'm getting to. In regard to
16 Wanganui Gas specifically the issue is, is there excess
17 returns or superior performance? Clearly in terms of the
18 Commission's report etc this is a difficult area, but by
19 the fact that it may be difficult to measure does it
20 therefore not exist? That's an open question. The
21 company would be of the opinion that modestly it would be
22 hopefully a superior performer and therefore ignoring any
23 debate or discussion about the Commission's model and
24 aspects thereof, the modest positive value given by the
25 net acquirers benefit test is due or could be said to be
26 due to superior performance.

27 **CHAIR:** I guess it would be fair to say we rarely have a
28 company come in here and tell us anything other than that,
29 which won't surprise you, and I accept that there's some
30 evidence here that that might suggest you have a point,
31 but there's limitations to it. But I guess like any

1 Regulator would want you to demonstrate to us why that
2 might be the case and why you think you might have been
3 able to sustain that for long periods of time and it's got
4 to be something more than just a statement that that's
5 what we would hope.

6 How do we differentiate that from what we would hear
7 from most other companies? I'd be most surprised if NGC,
8 Vector and Powerco didn't make precisely the same point.
9 I can assure you every lines company who has ever appeared
10 before the Commission has virtually made the same point
11 and not everyone can be a superior performer, so I just
12 would like a better sense of what it is you think that
13 demonstrates, in Wanganui's case, that this is superior
14 performance on an ongoing basis.

15 **MR GOODWIN:** Would you perhaps like us to flesh out that
16 comment in a cross-submission?

17 **CHAIR:** That would be great, thank you, that's a good idea.

18 **MR COE:** In regard to the next point, distribution portion of
19 delivered price, the company made comment in its
20 submission that it perceived in regard to this aspect of
21 the Commission's Draft Report that it saw distribution
22 price as somewhere between in the order of about 10 and
23 moving possibly towards the 40 percent offered within the
24 report as the average.

25 Subsequent to that submission we've been in a position
26 to look at what others have said and it appears our 10
27 percent or thereabouts is at the minor end and one company
28 suggests up to 50 percent, but there is weighting from 15
29 to 40, 30, there's a range of numbers. I think a range of
30 numbers is probably accurate because a range of numbers
31 suggests different weightings dependent on the part of the

1 market or the type of consumer that is being discussed
2 from the larger commercials through to small residential.

3 The issue here that the company wishes to make is that
4 by having an average and stating the average at 40
5 percent, it does, in our opinion, not take into
6 consideration this type of issue, and we've suggested in
7 the written submission that depending on the weighting you
8 choose, number of connections through to gigajoules
9 transported, you will move that weighted average one way
10 or the other. Again while we're not making any specific
11 comment about elasticities we note that there's an impact
12 on that, depending on what value you take.

13 Quality of service, I'd like to come back to this a
14 little bit later again. Essentially the concern there,
15 and we note the point made by the commercial and others,
16 is defining what the service is, and we believe it's the
17 transportation of gas in this case, defining the current
18 measure for that service, the level, and bearing in mind
19 and has been said by others that the service that's
20 provided is a function of the ongoing investment in the
21 business.

22 Threshold for application for further control. This
23 really we've touched on at the beginning the presentation.
24 Standing back from the modeling assumptions and modeling
25 work, I will make the comment that I think there's a
26 degree of noise around a number of these issues and the
27 concept that the company is putting forward here is that
28 to try and get above that noise so that if control is
29 found necessary it is without doubt or closer to
30 probability one so that's the concept there.

31 The Gas Information Disclosure handbook is something

1 that we've touched on. We'd like to make comment about
2 it. I don't know whether the Commission has this
3 document, I presume it has. I'll just merely put it up at
4 the moment. It's a part of two. The other document is
5 the ODV handbook which came out in 2000, was put out by
6 the Ministry of Economic Development.

7 The Gas Information Disclosure handbook which is the
8 parent document of the two goes to something like 30
9 pages. In particular it covers item which I think are
10 germane to the concept of control or rather information
11 disclosure. The 97 disclosure requirements are as they
12 are. The 2000 disclosure requirements that were
13 extensively enhanced or would have been and inside the
14 disclosure handbook is the accounting of separation and
15 allocation of cost, the ACAM approach. The Commission's
16 made comment about that, but it goes through in some
17 detail and talks about what is and isn't inside the non-
18 contestable component of the activity, and also it goes
19 into significant detail about asset management planning
20 and inside that it talks about quality of service and the
21 reporting.

22 I suppose the comments that the company wishes to put
23 to the Commission is that if the in abeyance 2000
24 disclosure regulation changes had in fact gone ahead,
25 there would be a different level of information available
26 to all parties, including the Commission than there is
27 today, and in part this goes back to the concept of
28 benchmarking. The Gas Information Disclosure handbook
29 provides quite extensive requirements that would have been
30 in place in terms of the information that all
31 organisations would have provided.

1 Hindsight's perfect vision again, but it would have
2 been interesting to compare what from 2000 onwards the
3 data available to all parties would have been and whether
4 we would necessarily be at this juncture. At the same
5 time I believe WGL is of the opinion that this type of
6 review is part of the current structure and is part of the
7 light-handed regulatory environment that the country
8 enjoys and this industry enjoys currently.

9 The concept is that the enhancements were significant,
10 not minor; significant.

11 **CHAIR:** I think that's a valid point, and it won't surprise
12 you that the Commission to a large degree was disappointed
13 in the quality of information available to us. It was
14 certainly the case with some companies, more than others,
15 but I think we still have to remember, though, that that
16 revised handbook was done not with these purposes in mind,
17 even if it was significantly enhanced, which I wouldn't
18 dispute what you're saying at all, but it may well be
19 going forward you'd need further enhancements, I don't
20 know, but it is the case that that handbook, even in its
21 revised form, was not done with our purposes in mind and
22 we're about to get into that process on the electricity
23 side, that will be the next hearing probably in the energy
24 market that the Commission does.

25 And it's the same thing, that there have been
26 improvements made over the years, but still now when we
27 look at it for our purposes it doesn't fully meet those
28 needs, and we would agree with the general view that if we
29 had better information then less pressure is put on the
30 threshold regime in the case of electricity because there
31 is far better information available to make judgments

1 without having to go through very complex analysis of the
2 companies on insufficient data, so I think that's a good
3 point.

4 **MR COE:** Indulging in terms of time, we've got a few more
5 slides to go.

6 **CHAIR:** What I was wanting to do is I think we need to break
7 at 1 o'clock, if we get to slide 27 that's fine, if we
8 don't, I want to take the time that is required, so I'm
9 making the assumption you'll be available to continue
10 after the lunch hour.

11 **MR GOODWIN:** Sure.

12 **CHAIR:** Let's take it as we go, we'll break at 1 o'clock and
13 pick up wherever we stopped. I apologise for having to
14 have that break in your presentation.

15 **MR GOODWIN:** That's fine.

16 **MR COE:** Thank you for the indulgence, I think it's useful
17 that we can work through it and hopefully cover the points
18 that are of interest to you.

19 I just want to pick up a point that is not on this
20 slide that links to the presentation from Nova Gas this
21 morning, and it's a general point. Nova Gas indicated
22 some pricing that they were able to cover to other
23 parties, or end-users vis-a-vis the incumbent. Just for
24 general information I suppose to the Commission, it may be
25 useful to put some of that information in a slightly wider
26 context.

27 That is, Nova Gas Limited have indicated that they
28 target specific or small groups of large end-users and
29 aggregate them together and for the purpose of bypass or
30 their services. In that regard it's somewhat more
31 analogous to a large off-take from the transmission system

1 in that you have a piece of pipe servicing one or a very
2 few number of end-users.

3 That is in contrast with a typical network
4 infrastructure which have many many small connections, and
5 thus it basically changes the dynamics in terms of the
6 capital intensiveness and also volume throughput. So I'm
7 not and WGL is not making a comment in regard to the
8 numbers, just around the concept of how a number could be
9 arrived at.

10 **CHAIR:** It doesn't, though, take away from the fact that
11 presumably the incumbent had all of those advantages as
12 well and the price differential was still very large.

13 **MR GOODWIN:** I don't think we should debate that.

14 **MR COE:** Moving on to operational implications. The next few
15 slides are WGL's view of the impacts that it sees of
16 control, now this is further control rather than the
17 current level of control through disclosure etc. It has
18 categorised them under two general headings, one direct
19 and the other indirect. It does believe that if further
20 control is applied then there will be increased use here
21 of resource consumption of all types, financial, human,
22 costs, equipment; the implication of this is the cost of
23 the business will change, increase.

24 Greater operational and capital budget challenge. The
25 comment really pivots around this, there is robust
26 challenge inside the organisation. Others have mentioned
27 comments about managerial market and capital market etc.

28 The company perceives that its operational and capital
29 budget will be further challenged within this process.
30 It's indicating there that further control will mean
31 diminished investor enthusiasm for non-routine capital

1 projects. Non-routine capital projects here is for the
2 company probably larger subdivisions, definitely
3 extensions to the network, larger say greater than one
4 kilometre, it could be a figure smaller than that, but
5 just to provide some sort of feel for the size.

6 **CHAIR:** Why would larger subdivisions be in that group of what
7 would become marginal for you?

8 **MR COE:** Two reasons for that. Firstly that because the
9 principle network operated by Wanganui Gas is a mature
10 market and other economic factors related to the region
11 the number is not as high, so the frequency therefore non-
12 routine. Secondly, I think it may be a useful point
13 anyway, WGL does not make an assumption that having gas is
14 seen by the property or the subdivision investor or
15 speculator as a must have, and others have made comment
16 along these lines.

17 The network needs to therefore basically provide its
18 services and to do that it essentially is putting capital
19 up-front with no guarantee of return. While obviously
20 subdivisions are potential strong users or end-users who
21 live in those subdivisions are potentially high users of
22 gas, that is not proven and there is therefore the risk.

23 **CHAIR:** What's your experience with new subdivisions? If you
24 invest your money in a system putting gas into them, do
25 you find that the uptake warrants the investment? You
26 must have some experience from that.

27 **MR GOODWIN:** Certainly it's a lot easier to sell a new gas
28 connection into a brand new home than it is to convert an
29 existing home. But even so, the subdividers are often
30 reluctant to even let us put the pipes in the ground at no
31 cost and you heard Mr Wilson talk about some subdividers

1 wanting payment to actually allow us to put the pipes in
2 the ground.

3 **CHAIR:** Have you made those payments?

4 **MR GOODWIN:** Thankfully our local authority is a little more
5 enlightened than that, it actually makes it a requirement
6 that the trench be made available to us.

7 **CHAIR:** So in that case it's probably well worth your while if
8 it's easier to sell into those houses than convert
9 existing.

10 **MR GOODWIN:** It is, but I think the point Mr Coe's making is
11 if there is a relatively large subdivision you may not get
12 the pay back in a period of time that the shareholders are
13 looking for. And I'd have to say Wanganui probably is not
14 a growth city, there aren't that many subdivisions going
15 on and those that are, sections are not occupied for five
16 to ten years. So there is a long lag before we start to
17 even see some return on our investment and I'd have to say
18 that our shareholders are far more demanding now to see a
19 return on those investments. NGC talked I think in terms
20 of 20 year pay backs, we've got some investment that we'd
21 probably have an NPV on at 40 years.

22 **MR COE:** Do you wish to start the next slide?

23 **CHAIR:** I think this is probably an opportune time to break
24 for the lunch hour. We'll adjourn now until 2 o'clock and
25 then continue with Wanganui Gas, so thank you very much.

26 **Adjournment from 1.00 pm to 2.00 pm**

27 **CHAIR:** Okay I'd like to reconvene this session now with
28 Wanganui Gas and we'll ask you to proceed. Just for the
29 record of the meeting I know that a Director of Wanganui
30 Gas has been able to join us, so I'll just let you briefly
31 introduce him and then we can carry on with your

1 submission.

2 **MR GOODWIN:** Thank you Madam Chair, yes, I'd like to just
3 record that Mr John Hosegood who is a Director of Wanganui
4 Gas has joined us for the rest of the session, and now
5 over to Mr Coe.

6 **MR COE:** Thank you. Before we broke for lunch we had moved on
7 to operational implications of further control and this is
8 the second slide, we're just starting at the top. Here
9 we're talking about, we believe that further control will
10 mean additional costs relating to the implementation of
11 the regulatory mechanism. This really goes to the point
12 of compliance and the level of compliance, the aspects of
13 compliance that have to be met by the company.

14 Next, increased dependency on sophisticated tools such
15 as asset management and network monitoring and analysis.
16 Network companies have a number of tools already. The
17 issue here is that for Wanganui Gas in particular network
18 monitoring and analysis tools are quite limited and the
19 costs associated with having that type of technology has
20 been to date not seen as necessary on a cost benefit
21 basis. Moving forward depending on the type of control
22 and its form, there may be a requirement to, we believe
23 there will be a requirement for more sophisticated use of
24 such tools and therefore there is another cost
25 implication.

26 In regard the valuation itself, the company now has
27 done three formal revaluations, 97, 2000 and 2003 and
28 while it undertakes that on a rigorous basis it can see
29 looking forward that the degree of optimisation and the
30 technologies necessary to enable it to meet possible
31 requirements placed on it by regulation will intensify and

1 on that basis the actual cost to actually achieve the
2 valuation will increase, vis-a-vis today.

3 This last point is of significant concern. The
4 company believes that there will be reduced effort to
5 encourage end user uptake growth. This is both in terms
6 of the number of users and the range of end user
7 applications per user. Just to expand slightly, given the
8 largest network, and you may recall from this morning the
9 largest network that the company owns and operates is in
10 Wanganui city which is a mature market environment with
11 high penetration by New Zealand standards, and the concern
12 is that the growth in numbers is modest, may be impacted
13 by the effects of control, or the ability of the company
14 under control to actually expand the number of
15 connections.

16 On the next slide I touch on the subject of pressure
17 upgrade and I'll leave the comment in regard to some end
18 user applications, but essentially getting the connection
19 is one thing, the number of types of appliances which are
20 used in a home or at an end user facility generally is
21 where the up sale is and that from a network perspective
22 provides additional volume. The volume is valuable.

23 **CHAIR:** I'm not sure I understand the connection here. What
24 would drive you for it not to be worth your while once you
25 have the connection to increase the volume in the uptake?

26 **MR COE:** Underneath this point -- I should have actually said
27 it initially, thank you for the subsequent question --
28 over the last probably three or four years there has been
29 probably an implicit becoming an explicit trend whereby
30 the network itself needs to get involved in marketing or
31 stronger marketing of the use of gas and less of a focus

1 by retailers on this particular aspect.

2 The concern is that if control is in place, depending
3 on its form, we are projecting out here now, it may be
4 that the ability for the company to justify that expense
5 is reduced vis-a-vis today and therefore is an effect
6 associated with the control.

7 The marketing of gas, and we talked about subdivisions
8 earlier, the marketing of gas of course from a network
9 perspective, as the network does not have a direct
10 relationship with the end user, in almost all
11 circumstances, it is relying on others to demonstrate and
12 validate the use of gas and therefore potentially to up
13 sale. As I mentioned a moment ago this from network's
14 observation is something which is now becoming networks
15 must do, retailers are less incentivised to do. That's
16 really where that comment was going to.

17 **CHAIR:** What's driving the retailers from doing less
18 currently?

19 **MR GOODWIN:** Perhaps if I could answer that as the retail
20 representative, a retailer may sign up a consumer and may
21 only have that consumer for a period of three to six
22 months, they may then change to another retailer. So for
23 the retailer to put a lot of money investment into getting
24 a connection may actually end up with very little value to
25 them if that consumer chooses to change retailer. The
26 only sure part of it is that all the while that consumer's
27 drawing gas, they're drawing gas through the network.

28 **CHAIR:** I can understand that, I guess I'm still unclear what
29 the mechanism by which you decide to reduce your effort as
30 a result of control to attract growth.

31 **MR GOODWIN:** Perhaps if I could answer that from network point

1 of view, as we discussed earlier some of the pay-back
2 periods for subdivisions are quite extensive and there is
3 pressure coming from shareholders that if we can't get a
4 return within, as we said NGC talked about 20 years, we're
5 typically longer than that. There's not the driver on the
6 developer to put gas in. The incentive is very much on
7 the network operator. Then even sometimes we have to
8 provide a further subsidy, a cash subsidy to just get the
9 consumer to connect.

10 So I think the point Mr Coe's trying to make is that
11 if there were further controls on our ability to spend
12 that money without getting a return on it, then it may
13 discourage us from going to that extent.

14 **CHAIR:** It seems to me this simply comes back to whether the
15 return you're allowed is sufficient and I'm not sure that
16 regulation per se has that effect, but we'll give some
17 consideration to that, thank you.

18 **MR COE:** If I could add; one aspect that was talked about,
19 this is back in 2000 with the in abeyance regulation
20 changes, there was no ability to have within the asset mix
21 things which we referred to or has been referred to as
22 pioneering assets. Go back say 20, 30, 50 years assets
23 which were in the ground and operational and providing a
24 return today were invested in by parties who weren't sure
25 about what the outcome would be and therefore have made
26 very long-term investment cycles.

27 Part of that moving forward is captured by this point,
28 that in marketing and I use it in a general sense,
29 incentives to actually grow the market grow seeds slowly.
30 Discretionary fuel competing in the market that gas works
31 in and competes in, these things can take quite

1 considerable time. So the message here really is if there
2 is increased cost, is that an acceptable level of cost in
3 the regulatory model? That was really the focus.

4 Moving on to indirect issues. WGL believes that
5 further control may mean a detriment to network growth.
6 We've touched on this already coming back since lunch. The
7 issue here is investor confidence which may lead to
8 capital scarcity. As in any market situation if it's
9 perceived that a return can be gained elsewhere, which is
10 higher than the retain in the marketplace that we're
11 dealing with here today, then there will be a lesser
12 tendency for capital to be moved to that, which may
13 therefore reduce the ability of networks to grow.

14 Other presenters have made comments about even the
15 situation where part of a network has reduced in its use.
16 There is a need for other parts of the network to be
17 expanded or developed. So it's not a static situation,
18 it's a dynamic situation in that regard.

19 There is some concern that depending on the pressure
20 on operational costs which is brought about through the
21 control mechanism there may be impacts on maintenance both
22 in terms of delays in undertaking maintenance or the
23 frequency at which maintenance is occurring on asset types
24 which links to the concept of deferred maintenance. As a
25 responsible network owner WGL would endeavour to meet all
26 the statutory requirements, health and safety
27 requirements, but there are issues around maintenance
28 where there is some judgment as to when things can be done
29 and need to be done, and we see that as maybe an area that
30 flows from the control.

31 **MS BATES:** Could I just ask you a question about that, if that

1 were true wouldn't you risk a reduction in quality?

2 **MR COE:** Yes, you may recall in the earlier slides we talked
3 about quality of service and issues around defining what
4 it is today and the level. I mentioned further that in
5 the in abeyance 2000 handbook there's quite extensive
6 requirements in regard to such matters.

7 Once again it's hard to contrast, we're dealing with a
8 light-handed regulatory environment through information
9 disclosure today and we're forecasting, projecting what
10 may be in this slide and we cannot be sure obviously what
11 the maybe will be. Therefore it may be that the
12 requirements are quite explicit and these issues won't
13 occur. We've stressed it by saying they may, we're just
14 projecting some thoughts in regard to operational matters
15 as seen by the company.

16 Detriment to renewal of existing infrastructure
17 assets, delay, defer or decommission. There are real
18 issues around the ability to obviously return, get a
19 reasonable return on the assets and the risks associated
20 with those assets and there may be situations either in
21 WGL's case or in other networks where it is deemed
22 preferable to decommission rather than to attempt to do an
23 infrastructure renewal because of the impact that would
24 have on the company recovering that investment over future
25 years. It possibly links to the duration of control.
26 Again this is all assuming control is in place and the
27 fact that we're dealing with possibly three, five -year
28 cycles in comparison to 60 to 70 year life-spans of the
29 assets.

30 Finally there, reduced incentive to upgrade the
31 network, system losses and delivery pressure. System

1 losses is something that historically has been a feature
2 of the gas industry, this is movement from wet gas through
3 to natural gas which is a dry gas, and on most networks is
4 a modest issue today moving forward.

5 The second issue, delivery pressure, is one which is a
6 little bit more -- it's definitely tangible, it needs a
7 little bit of expansion. Wanganui Gas operates quite an
8 extensive component of its network at low pressure. Low
9 pressure as it uses is 2 kPaG, 2 kilopascal gauge. A
10 number of modern appliances, particularly high demand
11 appliances, are being designed for European markets and
12 imported, run or are desired to run at in the order of 2
13 and a half maybe 3 kPaG. Therefore there is a mismatch
14 between this segment of the network and the ability to
15 provide that service.

16 The ability of a network to resolve this particular
17 issue, should it wish to, is via a pressure increase.
18 While simple to say, is quite expensive and intensive in
19 terms of time resources to achieve because the equipment
20 at end user location has to have an adjustment, plus there
21 are requirements under the New Zealand standard 5 to 58
22 which covers gas distribution that requires the rate at
23 which you could do a pressure upgrade. So therefore it
24 may become unattractive in certain regulatory
25 circumstances to upgrade the network and therefore in
26 itself limiting the ability for growth, because some of
27 the appliances coming on the market do require these
28 higher inlet pressures.

29 In terms of further and direct issues following from
30 possible further control, planning uncertainty, this links
31 to the fact that gas distribution businesses are long-term

1 and therefore they have a long-term horizon in terms of
2 planning. The form of regulation, the period, the review
3 mechanism and any determinations which occurred will
4 obviously impact on that over time.

5 Possible Regulator intervention with impact on
6 business planning, purely possibly speculation, but given
7 experience of regulatory scenes situations, particularly
8 overseas, not outside the realm of possibility.

9 **MR STEVENS:** Wouldn't this actually decrease your uncertainty?
10 If, for example, control was brought in, wouldn't it
11 actually decrease your uncertainty? You'd be operating in
12 an certain environment. At the moment you're operating on
13 the possibility that there may at some stage in your
14 future planning be regulatory intervention, I would have
15 thought that intervention would actually increase
16 certainty as to what you've got.

17 **MR COE:** I'd certainly concur with you that it would increase
18 one component of the mix which, in terms of the planning
19 horizon, there would be clarity as to price level or cap,
20 or some other aspects made explicit through the regulatory
21 mechanism, but other aspects would remain. So to a
22 degree, yes, there would be improvement. The other aspect
23 I think is the regulatory review period and the impact
24 that may have.

25 **MR STEVENS:** That's why I was curious in your previous slide a
26 number of the impacts you were mentioning, you would
27 presume that any good business earning a normal return
28 would want to achieve the best in those areas and I
29 presume that you'd agree that any regulatory intervention,
30 if it did occur, would still enable a business to operate
31 as normal with a healthy WACC.

1 **MR COE:** I don't think I would disagree with any of those
2 comments at all; healthy WACC, whatever that number is
3 etc. The ability for a company to operate, and this again
4 is trying to move into a realm which we don't have and
5 therefore we don't know exactly what control would be if
6 it was invoked, but we're trying to provide some
7 indication of what Wanganui Gas sees as potential issues
8 for it, and they are speculative and we have said they may
9 occur.

10 In terms of the next point, faltering generic growth
11 of market as financial resource reallocations occurs.
12 We've touched on this a little bit earlier. I think it's
13 important to acknowledge, or reinforce that over the last
14 number of years there has been a move on to distribution
15 network companies to provide greater focus and resources
16 to actually grow the market. Again discretionary energy
17 form in a marketplace does require ongoing reinforcement
18 of the benefits of using gas vis-a-vis other alternates
19 etc.

20 Next point there, detriment to incremental capture of
21 existing network utilisation. Infill and ability to
22 connect to latest user technology sold. We've touched on
23 the technology issue, I mentioned that a moment ago with
24 the higher pressure appliances. Infill, essentially we're
25 talking about here is the ability to capture those
26 potential end-users who basically are deemed to be mains
27 frontiers, that the gas pipeline reticulated system runs
28 past their door.

29 The final one there is, and it's been touched on by a
30 number of parties, including the Commission, is a change
31 in the business behaviour within the regulatory cycle.

1 The thought here is, yes, explicitly there would be change
2 because there would be a different operating environment
3 because of the regulation, but also that that in itself,
4 those changes would have further impacts on the way the
5 organisation operated. Thank you.

6 I'd like to now pass back to Mr Goodwin to provide
7 concluding comments.

8 **CHAIR:** I'm going to take questions at the end of the
9 concluding comments.

10 **MR GOODWIN:** I thought for a moment you didn't have any.

11 **CHAIR:** No, you don't have to worry about that.

12 **MR GOODWIN:** Thank you. Again swapping hats if I can just
13 come back to what we've told you about retail, I think the
14 one message we want the Commission to take from our
15 presentation regarding retail is that we accept that you
16 can't ignore the economic aspects of the Draft Report, but
17 we would exhort you not to overlook behavioural aspects
18 because we do believe that there can be unnecessary costs
19 for acquirers in the way different networks behave. So
20 that's it really from the retail point of view, that's the
21 one message.

22 Looking at the network when we tried to put together
23 what were our concluding comments to wrap this up, we went
24 back to our presentation to September of last year and
25 looked at the way we wrapped it up last time and in fact
26 we believe that with very few exemptions the five
27 following slides which we presented to you in September of
28 last year are still consistent with our message, so
29 perhaps if we just whizz through those.

30 We believe our distribution prices are constrained by
31 energy source substitutability; we did then, we still do

1 now. We believe that increasing wholesale prices may make
2 gas less competitive. That was a very prophetic
3 statement; in September of last year wholesale gas was
4 less than half of what it is now. So that's certainly
5 been borne out.

6 Dual fuel retailers can alter their behaviour to
7 promote the fuel that provides the most economic return.
8 Again we've talked about how electricity companies, the
9 distributors can have an impact, but also dual fuel
10 retailers can decide to push one particular market,
11 particularly those that have generation available to them.
12 If they choose that their best use of gas is for
13 electricity generation, then that's where the gas will go
14 and there won't be gas available for the natural gas end
15 use market.

16 Retailer pricing strategies, end user charges, there
17 was I think more competition then than there is now. I
18 think everybody at the moment is retrenched to a large
19 degree to try and see how the new price increases are
20 going to impact on them, but ultimately we will get to a
21 stage where retailers will start competing and they, as I
22 think the Chair's already pointed out, they may have some
23 impact on the charges that the network is able to levy to
24 keep end-users on natural gas.

25 The public perception of gas unavailability, although
26 Pohokura has now been sold, or the first tranche has been
27 sold and the Maui gas run-down has been agreed by the
28 party, there's still a very strong public perception that
29 gas is going to run out in the short-term. One retailer
30 of the moment is running a very public campaign about
31 electricity but as part of it they constantly refer to the

1 fact that Maui gas is running out.

2 In the mind of the public, gas is still Maui gas and a
3 lot of them still perceive that gas is running out.
4 Through our retail appliance showroom we're still getting
5 comment, well we were going to look at installing that gas
6 appliance but we believe gas is running out, so we still
7 believe that is an issue that is going to constrain our
8 distribution prices to keep people buying gas.

9 Regional economic focus. The point there was that we
10 are operating in effectively the South Taranaki, Wanganui,
11 Rangitikei region, all the while that's doing particularly
12 well then there's an ability for the network to do well.
13 It's a sector which is primarily primary produce, if the
14 primary produce sector comes back then so will our ability
15 to earn revenue from our necessary work.

16 The last point on the market was the fact that the
17 territorial local authorities and developers had a lack of
18 awareness of gas. I take that even further now; except
19 for our own TLA there's also a lack of enthusiasm for gas,
20 probably for the reasons mentioned above.

21 Point 3 on that slide, the threat of bypass. We
22 maintain that our proactive pricing methodology identified
23 the bypass risks candidate and prevented the likes of Nova
24 who have spoken to you extensively about bypass. I know
25 Dick Adam asked the question why was there no Nova Gas
26 bypass on the NGC network, I'm not sure that the answer he
27 got was necessarily all that there was, but I believe the
28 reason there is no Nova Gas bypass on the Wanganui Gas
29 network is that we had our bypass pricing risks identified
30 and we priced accordingly at the early stage and I would
31 add that we do have Nova Gas as a retailer operating over

1 our network.

2 The next slide talked about the gas pipeline
3 businesses, they were referred in the initial framework
4 report as GPBs so we've retained that terminology, again
5 characterised by large long-term capital investment and
6 you've had lots of information delivered to you over the
7 last few days talking about the length of term and the
8 difficulty in getting a return on some of those
9 investments.

10 Second point's consistent, the investment risks
11 associated with GPBs are greater than those associated
12 with ELBs and we still maintain that is entirely correct,
13 everybody must have electricity, gas is still a fuel of
14 choice.

15 The next point, returns under the regime must be
16 commensurate with those risks, obviously that's something
17 that we've made a point of today and certainly others have
18 as well.

19 Discrete networks are defined by geographic location.
20 Effectively we are constrained by our geographic location,
21 we didn't go and do business in another location because
22 we don't have networks there. There are some abilities to
23 obviously bypass price, but I think Nova's convinced you,
24 certainly made a case to you that a lot of those bypass
25 opportunities have gone.

26 GPBs require certainty and stability from the
27 regulatory regime, again many cases have been made to
28 convince you of that, or try and convince you of that, and
29 that we believe that investment in innovation could suffer
30 and we've talked earlier about that.

31 The next one we put up in September last year is

1 prescriptive control required? We believed at the time
2 that the benefits of a prescriptive regime would outweigh
3 the costs. I believe in our ways in Wanganui Gas's case
4 that was your conclusion, it wasn't the conclusion with
5 the other networks but certainly the point we were making
6 was it would outweigh costs in our case and we believe
7 that's been proven.

8 Net benefits of control might not be passed to the
9 end-users by retailers and we've talked about that earlier
10 on today, so I think that premise still holds true.

11 WGL will bear a disproportionate share of control
12 costs, I think that's acknowledged in the Draft Report.

13 Prescriptive control of Wanganui Gas is unnecessary,
14 that's certainly the conclusion of the Draft Report.

15 WGL continues to achieve cost efficiencies which it
16 shares with both retailers and owners. I think again
17 you've agreed with our comment there in the conclusion of
18 the Draft Report.

19 The analytical framework, we prefer benchmarking we've
20 stuck to that, we still believe that's the most
21 appropriate methodology but we were acknowledging that
22 there are issues obtaining comparability and I think that
23 comes back to some of the data that you found difficult to
24 obtain.

25 We thought the building block approach was complex,
26 intrusive and expensive, we still believe that holds. We
27 believed last year that ODV was the most appropriate
28 methodology, we still believe that's the case and we
29 believed then that there should be an allowable return to
30 support superior performance and we still believe that is
31 the case.

1 The counterfactual, the last slide, we believe that it
2 wasn't appropriate to assume the status quo, we still
3 believe that holds true. We believe the counterfactual
4 needed to reflect the impact of the Information Disclosure
5 Regulations as they are and the proposed changes to them.

6 Significant changes in the Government objectives for
7 the gas industry and we've seen a lot of progress in the
8 last 12 months. I know you've had some comment made to
9 you that those objectives allied with the industry self-
10 governance initiative in your opinion may not necessarily
11 bring about a reduction or a maintenance of costs, but I
12 do believe that there is a willingness by the industry to
13 make sure that whatever initiatives they can take to
14 prevent heavy-handed Government regulation, they will and
15 we've got to the stage now where the Gas Industry Steering
16 Group is about to form a company which will pick up on the
17 latest Government Policy Statement with regard to gas and
18 implement those recommendations.

19 The other point we made is that we cannot continue to
20 reduce costs at the same rate that we have achieved under
21 the current regime. We believe that holds true as well.

22 Now is your chance.

23 **CHAIR:** I just wanted to ask you one question and that relates
24 to the NGC shareholding in Wanganui Gas. I'd like to get
25 a sense of how that shareholding plays out in terms of the
26 interests of that shareholder in your business and I'm
27 particularly interested in how their interest is manifest
28 in terms of your decision-making, is there any input in
29 the setting of prices or revenue requirements or rates of
30 return or anything such as that?

31 **MR GOODWIN:** NGC has the right under the sale of the quarter

1 shareholding, 25.1, to them by Wanganui District Council
2 to appoint two directors to the company. Those two
3 directors obviously have some areas where there could be
4 conflicts for them. They are very very aware of them,
5 they keep reminding themselves and us of those potential
6 conflicts and they make every effort to ensure that there
7 are no conflicts in practice.

8 I would suggest that what NGC brings to our table is a
9 certain experience in the gas industry that the other
10 directors don't have, they tend to be people who are
11 governance directors who are aware of the issues around
12 governance, good governance and they're looking for
13 management to perform to those standards.

14 The NGC directors, however, bring an understanding
15 and experience in the gas industry which the directors
16 otherwise would not have. I think what it enables the
17 board to do is to seek either a different point of view
18 from that being professed by management or to seek
19 endorsement of the comments management's making. NGC, I
20 think, is a very willing shareholder from the point of
21 view of wanting to assist the company but certainly does
22 not influence the direction that the company takes to try
23 and meet their own ends.

24 For instance, when NGC got themselves out of mass
25 market retailing there was naturally considerable
26 discussion around our board table whether we should follow
27 the same trend. Management made a sufficient case that we
28 should stay in retailing and stay in appliance retailing
29 and that was accepted by the board in general.

30 So I think they bring no undue influence, they offer
31 us assistance if we need it, they offer us a sounding

1 board for understanding issues, but we negotiate with NGC
2 people over wholesale gas, over transmission and over
3 network services and the directors stay very well clear of
4 any of those issues.

5 **CHAIR:** What I think I would like to know in cross-submissions
6 rather than here today is what involvement the NGC
7 directors have in approving and discussing your pricing
8 strategy in the bits of the business that we're interested
9 in here in this inquiry. I'm not going to ask you to
10 answer that question here, but I'd like you to come back
11 to us on that.

12 **MR GOODWIN:** That's from a network perspective?

13 **CHAIR:** That's right, so if you could do that I'd be grateful
14 to you. I'll just ask my colleagues if they have further
15 questions.

16 **MS BATES:** The first one, you said again that you wanted us to
17 take note of what you consider to be inappropriate
18 behaviour on the part of the distribution.

19 **MR GOODWIN:** Some of the distribution companies.

20 **MS BATES:** Yes. My point is there are only a couple of ways
21 of dealing with that, one is general competition law and
22 that behaviour may or may not be in breach of the Act, or
23 some form of regulation, what else would you do?

24 **MR GOODWIN:** I think the former would be preferable to us and
25 I think those are probably moves that we may need to take.

26 **MS BATES:** The other thing I just wanted to get a sense of and
27 we may have this information, if we have someone can tell
28 me, but I want to get a sense of in your company how much
29 of your volume goes to the various sectors, i.e.
30 Residential, commercial, industrial, do you do any
31 generation, can you just give me a profile of that by

1 volume and perhaps by revenue percentages?

2 **MR GOODWIN:** Can we respond to you with that information?

3 **MS BATES:** Yes.

4 **MR GOODWIN:** I could give you some rough figures but I'd
5 rather do it directly.

6 **MS BATES:** Cross-submission would be fine.

7 **MR GOODWIN:** Assuming all of our networks is about 1.1 PJs, we
8 will give you an analysis by volume to each sector.

9 **MS BATES:** And by revenue.

10 **MR GOODWIN:** So that's the three sectors we would consider to
11 be domestic, how would you break the second, the business,
12 commercial/industrial to us tends to be an end use rather
13 than a category. We could do it in meter sizes which
14 tends to imply the size of the customer.

15 **MS BATES:** I'm not sure, what would be best?

16 **MR COE:** The company did provide information going back about
17 July last year, which provided some breakdown as to
18 groups. So what we could do is refer to that.

19 **MS BATES:** Yes and see if it needs to be updated, yes that
20 would be fine.

21 **CHAIR:** We'll now turn to Dr Lawrence please.

22 **DR LAWRENCE:** I just have one point of clarification to
23 follow-up on a comment Mr Coe made before lunch in regard
24 to productivity. You were saying that Wanganui is
25 essentially a more mature network than the other
26 New Zealand systems and hence the penetration rate is
27 likely to be more stable, or there's less scope to
28 increase it, put it that way, I just wanted to flag that
29 we recognise that and you made some comments regarding
30 productivity growth rates and again we recognise the
31 special circumstances of Wanganui in that context, and

1 also particularly its small size which is one of the
2 important reasons why it wasn't included in the
3 productivity growth study.

4 We also made some comments regarding variability in
5 Wanganui's data and I note that in your confidential
6 submission you've addressed some of those issues and thank
7 you for doing so. But the main issue that I wanted to get
8 on to was that you actually come through looking very good
9 on the productivity level comparisons after we adjust for
10 some of the important density differences. You have what
11 might be viewed as an important inherent advantage in
12 terms of your customer density and that relates back to
13 the maturity of the system and the higher penetration rate
14 that you probably have. You don't have that advantage, in
15 fact you have, if anything, a disadvantage in terms of
16 your energy density relative to the other New Zealand
17 networks.

18 What we try to do in our level study is undertake an
19 adjustment that tries to put everyone on a reasonably like
20 with like footing in terms of density using an average
21 density and without going into the details there's quite a
22 strong theoretical reason for using the average rather
23 than someone that's not on the average as the basis for
24 that standardisation.

25 Going back to Commissioner Rebstock's question again
26 before lunch, it would be really useful to us to get more
27 information from you as to whether the adjustment that
28 we've undertaken really does adequately adjust for those
29 density differences. In other words is your really good
30 performance on the basis of our results on model 3 the
31 result of really genuinely good performance, or is it

1 because we're not fully adjusting for the density
2 advantage that you have in terms of customer density.

3 I would encourage you to think about those issues and
4 give us what information you can on that, drawing on your
5 knowledge of the industry and compared to the other
6 utilities in your cross-submissions. I appreciate you may
7 be reticent to do it in the current forum, and I believe
8 there's also an option for that information to be supplied
9 confidentially if that is your wish.

10 **MR COE:** Certainly on behalf of the company as I'm assisting
11 the company whatever information we can provide to assist
12 I'm sure will be done. I've taken a note of the general
13 query, but if there's any additional information that you
14 think needed to be included I'm sure that will be taken
15 into consideration.

16 **MS BEGG:** I just had one question on slide 19 which was about
17 dynamic inefficiency and you suggested the dynamic
18 inefficiency of control should be quantified as a
19 disbenefit. The Commission did model dynamic inefficiency
20 as a disbenefit of further control and we did that through
21 modeling a missing market which might result from a lack
22 of investment and we also modeled a loss of quality in
23 terms of increased interruptability on the network and the
24 discount that applies to that for customers.

25 I just wondered had you not picked up that we'd done
26 that or are you suggesting here that there are other
27 dynamic inefficiencies that should be included or as CRA
28 had some comments on how we'd modeled the missing market,
29 is your concern that we've done that inappropriately? I'd
30 just like a little bit of clarification around that.

31 **MR COE:** The short response is on reflection the company has

1 probably incompletely picked up what the Commission has
2 done. But further to that given the discussions
3 particularly from CRA we would be, or the company would
4 probably be more comfortable with an alternate treatment
5 as suggested.

6 The dynamic efficiency, or in this case inefficiency,
7 is something that is of ongoing concern because of the
8 long lived assets and while it's well understood by the
9 Commission the concern is if there is an ability to earn a
10 return on the assets over that full life then there will
11 be an imbalance, however it is structured. So that's
12 probably the position.

13 **MS BEGG:** The Commission recognises that is a concern and
14 that's why it included some modeling of dynamic
15 inefficiency, but if in your cross-submission you have
16 comments on what we've done and whether you'd do it
17 differently or whatever we'd be happy to look at that.

18 **MR COE:** Certainly, and I think I'd like to add that one of
19 the concerns is the ability to switch in and switch out.
20 The expansion or contraction of the network is again a
21 long-term aspect, and the point I think in regard to
22 dynamic efficiency is that, if I understand correctly, the
23 assumption that after the first year normal investment
24 would restart, then we'd probably have some concern about
25 that modeling treatment. We'll go to it.

26 **MR MELVILLE:** It just relates to the Commission's statement in
27 the Draft Report that ultimately all costs of control will
28 fall on acquirers and we've defined acquirers as both
29 direct and indirect. I know you've had some discussion
30 about where those costs are going to lie in relation to
31 the retailers won't be able to pass them on. I just

1 wanted to clarify whether you still thought or did think
2 that costs of control will ultimately fall on acquirers
3 when we have a definition of being indirect and direct, so
4 that's retailers and consumers, or do you think that is
5 not the case?

6 **MR COE:** I'll just kick off anyway, the focus of the written
7 submission and the oral submission today is that while
8 there will be a trend to 100 percent pass-through of
9 benefits it's probably a question of timing and the
10 constraint to that timing, and Mr Goodwin made a comment
11 that it is possible that in the end not all benefits will
12 flow through.

13 **MR MELVILLE:** Just one other point on the direct costs of
14 control, the Commission's allocated some compliance costs
15 and we've allocated Wanganui Gas significantly lower than
16 the other companies, and you've stated in your submission
17 that you didn't think that should be the case and the size
18 of Wanganui Gas shouldn't be taken into account the way
19 we've done it. If you've got some additional information
20 of why Wanganui Gas as a small company would incur the
21 same costs of control as one of the other companies I
22 wonder if you could put that in the cross-submission.

23 **MR COE:** If I could respond to that, the comment in the
24 submission was more towards the percentages or portions of
25 the components which went to the total number. The reason
26 for saying Wanganui as a smaller company should have a
27 smaller cost is one that the Commission has made, so it's
28 really that first point that was being targeted for the
29 consistency across the components within the overall cost.

30 The other point that was made in the submission is
31 that on the costs that the Commission sees of itself in

1 terms of its activities, it has not distinguished between
2 Wanganui Gas and the other companies, so there was a
3 question of inconsistency of treatment from that
4 perspective also.

5 So I suppose in a nutshell is size the appropriate
6 determinant of what those values should be or proportions
7 of, and whether the costs for company A are going to be
8 twice or three times the cost of company B. It's
9 subjective in that sense, but the specific point with
10 regard to the detail rather than the actual specific
11 quantum. Obviously if the Commission took a view that the
12 costs were higher that would have a direct impact on the
13 modeling and therefore the value perceived as excess
14 profit or superior performance. So there is some
15 sensitivity around that I'm sure.

16 **MR MELVILLE:** I appreciate that.

17 **CHAIR:** Do you have any further comment you'd like to make?

18 **MR GOODWIN:** No thank you.

19 **CHAIR:** That leaves it for me to thank you then, Wanganui Gas,
20 for this submission and also the previous assistance that
21 you've given the Commission and I have a sense that you've
22 always made yourselves available on a helpful and
23 cooperative basis and it does make these inquiries much
24 more manageable from our vantage point, so we're grateful
25 to you, and as I've indicated to the other companies it is
26 useful indeed for us to have Chief Executives attend and
27 be willing to answer questions along with the senior
28 management, and in this case a consultant, but someone
29 who's been a senior manager for some time with the
30 company, it is useful to have direct contact with you, so
31 we're grateful that you've made the time and we'll thank

1 you for that and look forward to the cross-submissions,
2 thank you very much.

3 I'd now like to ask the representatives of Vector to
4 please come forward and we're not going to take a break
5 now, we'll take a few minutes simply to reset up for
6 Vector.

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