PRESENTATION BY NOVA GAS

CHAIR: I'd like to reconvene this session and welcome the representatives of Nova Gas, and we would ask that you introduce yourselves for the record and begin your submission when you're ready. Thank you.

DR BERRY: Thank you, Madam Chair. I'll do the introductions and lead into the presentation.

First of all, introductions: To my left is Peter Reidy who is the Chief Executive Officer of Todd Downstream. Next to Peter is Chris Hall, General Counsel for today. The next member of our team is Hans van der Voorn, he's a director and independent shareholder of Nova and he was in fact the founder of Nova. Then finally, Hannah McKechnie from Russell McVeagh.

The focus of our presentation is very much going to be on the dynamics of bypass competition. Nova is, as you will be aware, a recent entrant. The extent of its bypass network is very small, it's only less than 1 percent of the national distribution market, and we'll talk to the competitive effect of Nova in two ways.

First of all, the effect that Nova has had on price competition since its entry around 1997 and then, secondly, looking at the behavioural aspects of the market. We'll have something to say about the competitive effect Nova has had which is evident from non-price responses of the incumbents.

Our presentation is solely focused on the s.52A requirement, as was our written submission. That, as we say, there is clearly workable or effective competition in all bypass areas in which Nova operates. So, therefore, we agree with the Commission's draft conclusion that there is no case for control of Nova. It follows that we will not be making any comments on the desirability or necessity of control in these circumstances. So, therefore, we won't be addressing s.52B.

There will be one final matter we'll touch on briefly relating to the form of control, and we realise this is not yet the forum in which to discuss this, but should an order for control be made, we thought it prudent to at least alert you to the real concerns that Nova holds about its competitiveness in a regulated market where there is the ability for price discrimination between competitive and non-competitive markets. But, we'll keep our comments very brief on that.

This leads into our presentation and we'll start with Hans providing some industry background that will inform the Commission about the entry of Nova, the background to the entry of Nova to the market and then, once Hans is finished, Peter will take over and talk about the current day operations.

So, I'll hand to Hans.

CHAIR: Thank you. I'm looking forward to this because it's not often we get to talk to the person who started a company such as this, so we will listen with interest.

MR VAN DER VOORN: I must admit, with hindsight we made a number of mistakes, so it was humorous to look back at some of our assumptions at the time. We started actually in 1994 with a view to developing the landfill project at Happy Valley in Wellington here. As I've said in the slide here, we started reticulating gas actively in 1997. Most of our customers are commercial/industrial, mostly greater than the 1 TJ per annum; we haven't targeted the domestic residential base at all. Most of our customers are in Wellington, Auckland, Hawkes Bay; we have pipelines in all those areas, we have also a small pipeline in Hawera, Taranaki, and our focus has been on supplying a total package to our customers, both energy and distribution and managing all that for them.

The way we developed was that we initially had the proposal to develop the landfill project at Happy Valley and supply that gas to the Wellington Hospital, and we're very confident that we'd all be driving Porsches around a couple of years later. It didn't happen because we didn't understand how the market worked in that the amount of money that people were paying for their gas was mostly delivery of the gas, not energy, and by delivering landfill gas, landfill gas, is actually only substituting the energy component. So we changed our model, we built a larger network with landfill gas being supplemented by natural gas.

So the initial focus was just landfill gas going direct to initial customers. We then realised that wasn't going to work; built a bigger network. So the realisation that the local delivery represented the largest opportunity, we then started working with customers; we were able to offer large customers significant savings. The initial ones were people like Taylor Preston Meat Works here in Wellington, Unilever, the Porirua Hospital and others.

As we got to talk more and more to customers we realised their issue was that they had dealt with monopolies over a long period of time. They recognised they were paying too much for delivery but there was little they could do about it, so we're able to in effect aggregate a significant customer base and, as part of the agreement with them, we laid lines to provide competition because that was what they wanted, and in many cases they were prepared to pay a little bit more to us than they had been offered by incumbents because they could see that at least with us there they would have competition going forward. I think that has probably exceeded their expectations now in the sense that prices being paid now are hugely less than they were at the time.

I gave a paper in March of 2000 to the New Zealand Petroleum Conference which, if you want it by way of background is available in the public domain, but I set out in detail all of the little issues that came up at the time; they were many and varied, and certainly it wasn't easy to get to where we got to, and I think it would be near impossible to do it again now.

So that covers that.

CHAIR: Why do you say it would be near impossible to do it now?

MR VAN DER VOORN: I think there was a large degree of complacency about bypass. People could understand the concept that you should have a bypass price, but I don't think anybody ever believed anybody would do it, so now that we've done it, the incumbent's behaviour's changed significantly. I think it's fair to say the easiest places, if you like, have probably been done, but the market behaviour is quite different now than what it was then.

CHAIR: We hear that the threat of bypass, coupled with alternative fuels, is sufficient to constrain the pricing behaviour of the large players in the market.

Would you go that far to say that?

MR VAN DER VOORN: I think there are selected areas whereby pass is possible, but I think in a generality you couldn't say that in general, no.

MR HALL: We're aware that that submission has been made, but in general terms, no, we don't agree with it. We don't consider the behaviour of the incumbents is sufficiently controlled, and Peter will talk later in the presentation about some of that behaviour which we consider negatively impacts on competition both in the bypass area and in the non-bypass area.

CHAIR: Okay, thank you.

MR REIDY: From the distribution perspective, Nova actually distributes gas through third party networks as well as its own network; in fact, up to 70 percent of our gas is distributed through third party pipelines. It's a small niche market, we've only go 110 kilometres of physical pipeline and we've got those graphs, some maps later on to show you where those pipelines are domiciled.

In terms of sources of gas, Nova currently sources gas from the Kapuni field. In future we will be sourcing gas from other areas, McKee, Mangahewa, Pohokura, as well as Kapuni, but certainly in other submissions it has been claimed that there has been some market price discount from TPM, and that's not accurate; we are paying the price for gas that we would expect and as we'll go through this presentation you'll see the competitors of Nova has been more about, as Hans said, the distribution of the component to the end customer.

MR VAN DER VOORN: Back to landfill gas.

Historically we aimed to source gas from our landfill project. We built a project in Porirua, we have a slide just outlining there is a photo on the left and on the right is a methodology. We don't propose to go into that in detail, but plant work's technically adequately.

We have found, as time has gone on, that there's an increasing environmental push, if you like, to divert the waste out of landfills, and particularly green waste which helps to generate the landfill gas, so in that particular landfill at Porirua the gas volumes have declined as electricity costs have gone up as well. So, we put that plant on standby in the electricity shortage in 2002 and our current proposal is to relocate that plant to Happy Valley where there is a much bigger landfill and larger gas volumes.

So in round terms the volume of gas we expect to get out of Happy Valley is in the range of up to 200,000 gigajoules a year. That represents about 8 percent of the gas volume in Wellington City. So it's a helpful addition.

As a background, when we first started looking at landfill gas we looked at the price customers were paying, that seemed quite a reasonable price that we could make money out of producing landfill gas. As we got on we realised that the energy component that we actually got for the landfill gas was quite low.

The market has now changed where, with the Maui field running down, the price of energy is going up again to the point where the landfill gas is an economic proposal but also a useful addition to the nation's energy supply.

Even though it's small, it has other environmental benefits as well as supplementing the natural gas that we have.

MR REIDY: Just one key point on the landfill. We have in our customer contracts contracted out of the standard gas specifications, so it has allowed us to put landfill gas into our pipelines. It's quite an important mix in our solution to end customers. As Hans said, we've got a big project due to come on in Wellington in 18 months.

In the next couple of pages we've got some maps which shows you our network. As we've said, we've got 110K of network in Wellington, Hawkes Bay, Hawera and Auckland. In Wellington we've got our largest network, approximately 60 kilometres; as you can see there, we extend through the CBD, Petone, Porirua. The red line is the NGC transmission system you can see where we connect into the Tawa gate and the black line is the Nova Gas dedicated distribution system.

In the Hawkes Bay we've got a smaller network, approximately 20 kilometres connecting to the Hastings gate, and there's primarily commercial/industrial customers on the particular route. Even though we pass residential customers in the Hawkes Bay, we aren't and haven't been connecting residential customers.

In the Auckland network we've got approximately 20 kilometres primarily in the East Tamaki market. The black line shows the pipeline. We've got a small market in Mangere, that's at quarter to 9 on your map, and the red line is obviously the transmission network where we connect into both the Hinua and Flatbush gate stations. The East Tamaki market is a very dense commercial/industrial sector of the market.

From bypass competition we agree that the Commission is correct in that there is strong competition in the bypass market. Really, competition has manifested itself in two ways: 1) price competition, and 2) non-price competition. We will go through some examples of both of those this morning.

Historically, though, and at the current time the majority of our customers being industrial customers, manufacturing customers; they use natural gas as a direct fuel source for production. As a consequence the distribution component, as Hans said, has been quite a high portion in previous times, and the cost of energy component has been a smaller component than distribution.

Nova's strategy has been an integrated one of packaging up both a natural bypass and a threat of bypass on the network to a lower delivered price through to the end customer.

Some examples of that are, in Wellington in 1998 there was one large customer here over 100,000 gigajoules per annum where the original distribution price from the incumbent was approximately $3 a gigajoule. We verbalise(?) these even though there might have been a daily rate and a variable rate, equivalent to $3 a gigajoule.

Nova's proposition was $1.60 a gigajoule giving the customer a substantial saving. Recently, in fact 3 or 4 months ago, the incumbent has reduced their price even further to 40 cents a gigajoule. So you can see from that example there's been a total reduction in the incumbent's price of 87 percent. You can see back in 1998 why there was an opportunity there for Nova to leverage the actual bypass, lay the pipeline, or the threat of it, to reduce the distribution price to the customer.

Second example in Hawkes Bay -- most recent example is that in November 2002 we approached a large customer, over 100,000 gigajoules per annum, and once again the distribution price in the Hawkes Bay has been very high as the transmission price has been; $3 a gigajoule. We represented a price of $1.32 a gigajoule with our pipeline. Recently Powerco has offered 82 cents, being a reduction of 73 percent on their initial price. So two examples of significant reductions that the incumbent has retaliated with in respect to our bypass activity.

Third example in Auckland; a large customer, again over 100,000 gigajoules. The distribution price here as recent as 1st January 2004 was $4.60 a gigajoule, a very high distribution price. We began building our East Tamaki bypass pipeline; for five years we had a negotiated agreement with the incumbent for lower prices for individual customers. That came to an end at 31st December last year and we could not get the price we wanted to continue to provide competition through to the customers, so we made the decision to build a 9 kilometre pipeline in the East Tamaki corridor.

As a consequence of that action, Vector the incumbent recently offered a distribution price to this particular customer of 97 cents compared to their published price of $4.60 in 2004; a massive reduction of 79 percent. That was primarily an attempt to prevent us from laying more bypass in that area.

So, there's three examples there of price competition and as we've shown, that we, Nova Gas, has had the ability and the intent to bypass, and that has achieved a lower local delivery cost for customers.

There have been some other examples of price competition, and particularly in the Auckland area Vector have launched a strategy called zonal pricing or distance pricing, and we've got some maps there to show you. Effectively though their methodology is how far the customer is from the Nova Gas pipeline.

Two years ago their pricing strategy was distance from the gate station, they've now narrowed that further down to look at where we're actively competing in the bypass market. They've come up with two new zones, a zone X which is 1K from Nova's pipeline and zone Y being 1 to 3K from Nova's pipeline. There's also a zone C which is nowhere near our pipeline, and they would perceive there's no threat there of competition hence prices have increased as per the matrix in our submission.

The next chart actually shows that graph, and this is Vector's graph and it's come up fairly clearly; I'll walk through that. This is the Auckland market. The red line is our network in the East Tamaki market. The blue line is zone X, or the new zone X which is 1 kilometre from the Nova pipeline, zone green being what zone Y, 3K. That's a new competitor pricing zone that the incumbent has established.

The black regions are the initial zone A which is 1K from the gate station and the yellow is zone B which is 5K from the gate station. The black dots are 9 key gate stations. So, you can see where we're perceived to be providing competition to the incumbent and lower prices to the customer, they have introduced a new price methodology.

The key point here is that, as you will see from our submission, is that particularly in zone C you've seen the prices increased by up to 16 percent since December 2002. Zone C is the yellow areas where there is the perception that we cannot bypass. Our view is that the bypass market is a niche close-quarter game, it's not widespread. Even on Vector's own submission this map shows that they would perceive competition to only be strict competition in the blue and green areas. In fact, the yellow area, being zone B 5K from the gate station, the prices have come up.

However, zone X which is the blue and zone Y being the green, the zone X price has actually decreased by up to 41 percent in two years.

We would perceive particularly the example in zone C, being the yellow, where prices have increased by up to 16 percent, as, in our view, discriminatory pricing which does have a threat to bypass; it does make it hard, makes it very very difficult, we don't believe that all the market is bypassable, we believe that it is a small, narrow market and this particular activity with pricing has been as a direct result of competitive activity of bypass.

CHAIR: Can I just ask you, when you make a decision to enter an area like that, you now know what the incumbent response is with time; I assume you're entering long time contracts before you enter, is that how you...?

MR REIDY: Correct.

CHAIR: Then, when the long-term contracts are up, you see this further undercutting of price; is that what's happening?

MR HALL: I think that can be addressed in two points of time. The first point is, this map shows a strategy on the part of the incumbent to prevent further bypass, and we would say the Commission can draw two things from that.

The first is that the competitor response is evidence of the competition that Nova provides, and the second thing that we'll talk a little bit more about later in the submission is, the response involves cross-subsidising between different localities. As Peter says, the price in areas around Nova's pipeline has decreased; prices in other areas which are largely residential areas have increased. The residential consumer, in other words, is subsidising the lower price being targeted to the commercial and industrial.

So I think in answer to your question, Madam Chair, the activity happens first at that point; there's the strategy to prevent the further bypass. So far as establishing the bypass network is concerned, from Nova's perspective it depends on two things obviously to justify the investment; one is a sufficient cluster of customers, and second, appropriate contract terms including duration so that the bypass can be built economically and a return can be made from it. Obviously, those two points, the prior behaviour and the subsequent behaviour are interlinked in so far as they affect Nova's ability to expand its bypass network.

MR REIDY: Some examples of non-price competition is, recently in fact one incumbent has refused to supply Nova with distribution prices. A recent tender in Wellington where there are 11 sites on Powerco's network, two sites in our

Nova network, we requested prices; these were not provided despite repeated requests, and at that time we could not reply to the tender and we were unable to compete for supply to all 13 sites. In actual fact, the reason for not giving these prices was a number, but in actual fact of the 11 sites, five other sites had the potential to be bypassable, but in fact there were another six sites that wouldn't have been bypassable. So, this particular example was very difficult for us by the incumbent refusing to deal or actually to give us prices.

There have been recent examples also where incumbents have requested that we align the term of the gas supply contract with the term of the distribution contract, and from a customer's perspective they're looking for long-term security of pricing and, as we've explained, particularly on distribution which is one of the highest components of delivered price. Our strategy has been to give customers security of pricing with a longer term distribution contract. However, in the energy market now, as you know, energy contracts on the retail side have become a lot more short-term.

So recently with some customers we've offered them a two year energy contract but a five year distribution contract to give them some security of pricing. This particular incumbent has said no they won't do that, they'll only give us a term of distribution that aligns with our energy term. That has made it difficult with respect to getting any return on investment, but in actual fact these principles have applied even if we don't lay a pipeline; even if the customers are in a non-competitive area, in terms of bypass this principle is still applied.

Other examples: As recently as two weeks ago one incumbent, large incumbent, offered different terms, contract terms and pricing direct to a customer than they offered to us. We have evidence of that where the customer has received a four year term with particular pricing, and yet we were not allowed to have access to that four year term; we were only given a two year term. The customer wants a four year term, the customer wants to deal with a supplier, from a supplier's perspective we can bundle up an integrated offer, energy and distribution, to the end customer.

There are some examples of price competition and non-price competition which effectively has been trying to control the price which Nova may on-sell distribution, but also control the way in which we can present a package to a customer. This particular behaviour is in response to our competitive behaviour by laying pipelines. In actual fact, we never started out wanting to be a bypass operator; the actual bypass has been a response to get competition through to end customers, and there has been retaliatory price and non-price competition.

We do believe that, particularly on the pricing area the Discriminatory Response Act can act as a barrier in the bypass market to expanding and further competing. It certainly provides competition, and we would believe that some of the activities are unfair in that it has stopped us, as we showed you in the example there, in Wellington, that we were not able to expand our network to our other customers in the Wellington market.

In summary we do believe, as you have suggested, there is strong competition in the bypass market and therefore no case for control, although we do have some concerns which we will discuss now in terms of what form regulation may take and the potential impact and threat on the ability for Nova as a small niche player to work in a niche bypass market.

CHAIR: Can I just ask you a question before you go on.

You may have read Contact's submission; they make the point that -- maybe I should clarify this with you first. My understanding is, you don't allow any third party access to your pipeline, nor do you necessarily agree to provide services to anyone who may seek it from you. Is that right?

MR HALL: That is right.

CHAIR: They've suggested that that's not an optimal outcome and I think their position, if I understand it correctly, is that all -- if some gas pipeline businesses are controlled, all pipeline businesses should be part of the regime, and there's of course an issue around what the test is and whether we even have the option to consider that as appropriate.

But leaving that to one side for now, I did want to get your comment on the Contact position, if you would please.

MR HALL: We're obviously aware of the submissions Contact has made in this and in other fora, and Contact obviously has an axe to grind on the question of access in particular. As I say, that has been dealt with in several fora at the moment.

So far as Nova's position is concerned, there are at least three compelling reasons in our view why it's not appropriate or necessary for Nova to grant access to its lines to other parties. The first is that it follows from the essential theme of our submission; Nova exists in a competitive market, it provides that competition, therefore there's no case for imposing that sort of control or outcome on Nova.

Secondly, this pipeline, as Peter and Hans have said, and the contracts that have been entered into with customers have been established with a view to supplying a mixture of natural gas and reticulated landfill gas. Nova has not adopted the NZS 5442 specification in its contracts and intends to continue to supply landfill gas in its pipeline, which makes it inappropriate for other gas of a different specification of the NZS 5442 specification to be mixed in that pipeline.

Thirdly, obviously this pipeline was built to supply particular customers, and in the course of its corporate history only a very small number, a handful of those customers, have left Nova and therefore the line is dedicated so far as capacity is concerned to supplying those customers.

CHAIR: So, there's not excess capacity on those lines?

MS HALL: Correct.

CHAIR: The other question I wanted to ask you, and that is, we've heard a lot of submission that market circumstances have changed dramatically and with gas being in rather short supply, demand exceeding it, the threat of bypass, just the difference in -- the narrowing of the gap between gas price and alternative fuels, that constraints in this market are much stronger now in the gas pipeline markets, much stronger now than they have been in the past and likely to remain so for some time, and yet your observations to us about the price increases, say -- I think it was in the Vector network -- doesn't seem to suggest that market circumstances are biting in the way that others have suggested to us. To be fair, it wasn't Vector who made that submission; they're coming up later in the day.

But, I'd just like your comment on that, because you're involved in these markets, and how do you see the current dynamic in the market in terms of structural change and the extent to which competition may be more -- there may be more constraints on the exercise of market power than there was in the past?

MR HALL: We're aware of the parties who have submitted that. There is a greater level of constraint in the market than has historically been the case.

We accept that energy prices are trending upwards, but our experience does not bear out a submission that there is a similar trend in distribution prices. The examples that Peter has in the slides show that, if there have been reductions in distribution charges, they tend to only have been in limited geographical areas around Nova's bypass network, and that in fact those decreases have been offset by increases in other areas, primarily to residential consumers.

The Commission may be aware that NGC has recently signalled a significant increase in its distribution prices and so that the market evidence, so far as Nova is concerned, does not bear out those submissions.

MR REIDY: The transmission prices recently, as you're aware, have increased by 10 cents a gigajoule; 22 percent. That has a massive impact on end customers' costs and, as Chris said, wouldn't give evidence to the constraint that other parties are stating.

CHAIR: Just one other question I wanted to follow-up now, and I'll direct it to Dr Berry. That is, a number of parties have suggested to us we have a much wider discretion than we might normally have because of the way the Minister framed the questions that were put to us, and different parties have suggested we might exercise that discretion in quite varied ways, and to date the Commission's taken the view that we will approach the recommendation based on the test, I think as you have looked at it, but there is a suggestion that we could go wider than that and potentially opens up the Contact suggestion about, if we were to accept it, which is, I wouldn't want to suggest one way or the other, but I just want to ask you what your interpretation is of what the Commission can recommend. Clearly we make a recommendation based on the 52 test, and generally consistent with Part 4 of the Act, but how much wider can the Commission go given the questions put to us by the Minister?

DR BERRY: Can I just hesitate and suggest, maybe I'll do something in either cross-submission and just think through, because I'm not quite sure that I know the concise definition of the material. I have read the Contact submissions, but haven't had a chance to see the arguments that they've put before you in the last day or so.

Just for the record, I do not accept that the Commission has jurisdiction to look at the access question that Contact raises. I think, as the Commission has rightly indicated in its Draft Report, the Commission's recommendations are limited to questions about, in essence, the transportation of gas. So, it is simply that distribution component, as I see it, that is in the terms of reference, but can I just pause there and perhaps if you wanted to frame a question with more specificity, I could perhaps answer it in the cross-submission?

CHAIR: Okay, we'll come back to you on that.

It would be useful for us if you did come back in cross-submissions on that point because I think it's not just Contact; a number of parties have suggested that we shouldn't restrict ourselves to the tests as it is in Part 4 of the Act. Please continue, thanks.

MR REIDY: Our last slide really is in terms of a form of regulation. I suppose Nova has a few concerns in that, if control is to be imposed the current ability of the incumbents to engage in price discrimination is real.

The example particularly there is in zone C in Vector's activity as well as non-price activities. There are prices outside of bypass that can be set to subsidise competition in bypass areas; for example, residential. I mean, we know and there are examples of larger industrials where Nova will never bypass, where their distribution rate is still at the very high published rate, and lots and lots of examples there. Bypass is, in our view, only -- is quite a narrow market. But, we would ask that and we would like to make a further submission to look carefully at the form of control.

We initially support a price cap regulation if that was to be imposed, but we would like to come back with further examples of how competition, if it wasn't imposed, particularly in our bypass markets to stop effectively incumbents putting prices up in non-bypass areas to at least achieve their overall WACC; that would have some concern for us. It would still allow the current, what we believe discriminatory behaviour to happen, and we'd like to come back to you in further time.

CHAIR: Does it surprise you -- I think NGC, and I hope I don't get this wrong, I'm sure they'll let me know in cross-submissions if I do -- I think they told us something like 37 or 38 percent of -- about 37 percent of the time they charge the published price and the remainder is priced lower than that.

I may be wrong, but I think that's what they said. Are those the sort of numbers...?

MR REIDY: Are they talking -- it depends whether they're industrial market, commercial, residential; if you're talking the whole gas market obviously a residential customer at published prices, I would expect it to be higher than that. Certainly where competition is for bypass, I haven't seen a published price yet, but there are lots of examples where other incumbents are passing, setting published prices in non-bypass areas, but you'd have to look at the way they've defined the market.

MS HALL: Whether they do it on volume or customer number. If you're talking about customer number, Peter, what you're saying, the number is likely to be much larger than that.

CHAIR: I don't want you to answer this now, but you may wish to -- in cross-submission I think it would be interesting for the Commission to get a sense of where you see future bypass opportunities. How much of the market do you potentially see as contestable through bypass, because while you've encountered difficulty, you've continued to invest in pipeline and obviously continuing to look at opportunities, so it would be interesting for us in cross-submissions -- I know it's commercially sensitive information -- to get a sense of that if you could, and indications of the sort of assumption s that might sit underneath that analysis, if that's possible.

MR HALL: We can certainly do that.

In essence, we will say the opportunities for bypass are much less now than they historically have been precisely because some of the responses from incumbents that we've been talking about this morning, and obviously the reason we highlight that, although we have made complaints, formal complaints to the Commission about some of those activity, and those inquiries will no doubt take their course, but so far as today's forum is concerned we highlight those examples as being compelling evidence in our submission of the fact that Nova is having a competitive effect where it establishes those bypass networks. The responses of the incumbents evidence that.

CHAIR: Would you have further comments you wanted to make in your submission before I ask my colleagues if they have questions?

MS BATES: I just wanted to ask you, in the examples that you gave where the incumbent had responded by reducing price -- offering a big reduction in price, what actually happened?

MR REIDY: If I can take you -- there is one example here particularly that Hans was very much involved in the Wellington market. You've got to remember, when Nova came to the market they offered and delivered substantial savings to end customers on distribution, so there is a loyalty factor out there in the market with the Nova brand. But this particular customer looks very seriously at the price, new price. However, at this stage Nova was able to offer an energy component as well as a pipeline component, whereas the other alternative was only a pipeline, but it was extremely competitive. In fact, Nova was forced to reduce its price slightly to compete.

MS BATES: You haven't lost any contracts yet as a result of this?

MR REIDY: Yes, we have lost two, three, but also remember, the contracts for customers historically have been on 4 to 5 year terms, so we're now starting to enter -- the last year particularly we're starting to enter the time these contracts are rolling off. Every one now is a very competitive arena, particularly in areas where the incumbent will go direct to the customers and not offer us the same terms and conditions, so the playing field sometimes is not that even.

MS BATES: I think you said that the contract period had shortened up?

MR REIDY: On energy.

MS BATES: Yeah.

MR REIDY: Historically --

MS BATES: Not on distribution though.

MR REIDY: Historically, when Nova first started, they would have offered a 5 year distribution in energy. Now what's happening is that some customers who have wanted a shorter term energy have been happy to take a longer term distribution. So now, for example, customers can still ask for 5 year distribution, maybe 2 year distribution and 2 year energy; 5 year distribution and 2 year energy.

MR STEVENS: You may have already provided the information to the Commission, but I was interested in your comment and the submission that some of the residential customers in the zone C, as you term it, are prices that have increased from the incumbents.

I was curious as to -- I think you made a comment that some large energy users still had high prices when they were -- I was trying to get a feel, I guess, as to whether the larger energy users were having -- had previously been subsidised by the residential consumers and this was just a rebalancing, or in fact if it was a true subsidy as you're mentioning it now?

MR REIDY: In fact in that zone C the way the Vector pricing works is, it's dependent upon meter capacity, so they'll talk about group 1 and group 4. In actual fact, group 4, which is a large industrial, their prices have increased by 16 percent. So it's not actually the residential, the residential has increased by 5 to 8 but it's right across the board, it's commercial, industrial and residential. Particularly in their pricing the large meter capacity in zone C has increased by 16 percent.

MR SELL: This may be asking for the same information that Commissioner Rebstock's already sought, but just to clarify, I think we would be particularly interested in understanding effectively the size of the market that's in zone X, Y and A. It's not just a question of where future contestability exists, it's basically everything which the incumbent may view as being subject to the threat of bypass at the moment.

MR HALL: Perhaps the best way to address that is when we respond to Madam Chair's question about the bypass network existing in potential.

We're aware that some of the incumbents have submitted that essentially the entire market is potentially bypassable and, therefore, the entire market is competitive and there's no case for control. Obviously, we have a very different view, and as evidence of that we would point to things like the fact that the competitor responses are only occurring in narrowly defined geographical areas around Nova's network.

MR SELL: I guess what I'm hearing is that you're really endorsing the idea that bypass threat is constraining prices in the equivalent of Vector's X, Y and A zones; they may be quite small geographically, but I would suspect they're a much higher proportion of the overall load than the map would indicate.

I guess that's what we'd like to get a feel for.

MR REIDY: If you look at it -- and we will refer in detail -- look at it from a volume perspective, a large amount of volume in the Auckland market is off the Westfield gate, 12 petajoules. We don't have any bypass pipelines in the Westfield gate and there are considerable large customers around that area that still have large distribution prices.

MR SELL: They would be in zone A on this map?

MR REIDY: No, in actual fact they would be in -- they'd probably be -- some would be zone B, which would be 5 kilometres from the gate station; others would be in zone C in the yellow.

MR SELL: We're happy for you to draw your own judgments as to where you think the boundaries of the contestable threat that you propose might be, and it may or may not be

Vector's map there.

MR VAN DER VOORN: Can I make a comment on how we bypass?

When we did the initial ones for instance in the Hutt Valley we had a whole lot of confidentiality agreements with customers, so we signed up a customer and they were bound by confidentiality, so nobody else knew. That gave us enough time to go and sign up a sufficient critical mass to go and build a pipeline. That situation doesn't arise any more, and easy to sell a story of a big bad monopoly or fabulous Nova Gas; it wasn't a hard thing to sell.

The market is vastly more complex now so that message is not that easy to sell. That whole notion of being able to line up seven or eight customers under confidentiality just doesn't exist any more. So it's much easier for an incumbent to counter what was our strategy five years ago than it is now. They understand the strategies, you just can't keep playing the same game. It isn't just about price.

All they had to do to stop us going to the Hutt Valley for instance was target one customer and do a cosy deal with that one customer, we never would have bypassed all the others. I think that's the main difference between now and then.

MR HALL: Can I just, so I understand the question; is the question directed at getting an understanding of Nova's view of the bypass market not necessarily solely by reference to geography but also by reference to total load? Is that the thrust of the question?

MR SELL: Well, it's bypass threat. I must admit, we should and will ask the incumbents the same questions. Maybe we're being a bit cheeky asking that of yourselves as well, but really we're interested in getting a perspective on the extent of the existing market where prices by incumbents may be subject to some sort of discipline, whether it's from actual bypass or just their perception of the threat of bypass from the likes of yourselves, and we're not necessarily asking for that now; I think in cross-submissions would be fine.

MS HALL: As I say, we're happy to address that in cross-submissions. The general proposition would be in so far as some of the incumbents have submitted that the entire market is bypassable and competitive. We don't accept that for a minute. It's a much narrower market than that, tightly geographically defined around the existing bypass network. Then you get into the question, well, what is the competitive effect of the potential bypass network? That becomes more complex because different parties will have different views on what is potentially bypassable and what is not.

I think there are significant complexities if one wants to go that extra step and define a potential bypass market with getting an objective statement of what that market is and what sort of control, if any, should exist in it. It's much easier to define it in the first step in relation to the existing network. There would be a justification in doing that in so far as the rate of implementation of bypass is slowing significantly, so you've got a critical established geographical framework there that you can work around.

MR SELL: I'm reluctant to prolong this question too much more because I'm aware of the time constraints we're under.

Can I just add one further comment on it.

That is, really where my question is coming from is from the comment that you've made that the Commission, if it was going to impose control, may well need to look at the ability to price discriminate and not just impose control in aggregate on the entity, and I think there is some validity in that argument which I think needs to be considered, but it obviously begs the question, if you're going to try and control down at that level, are you looking at controlling 10 percent of the market or 90 percent of the market, assuming that's feasible. It's another complexity obviously, but it just would be helpful to quantify that.

MR HALL: It's fair to say that we are still thinking through the complexity around those things and that's why it's probably best for us to address it in cross-submissions. Having said that, obviously we are able to say now that we would consider the market to be significantly narrower than others have said.

Historically Nova, I guess, has been relatively neutral to the concept of regulation. The message we are seeking to convey is that the reaction to the competition that Nova has created, while evidence of that competition -- which is we say the relevant thing for today's inquiry -- is also concerning in so far as it constrains the expansion of competition, and we submit that that's something the Commission needs to have regard to. If it's going to impose control, it needs to think about some of those behaviours in deciding on any method of control.

Obviously, there's a whole another round of inquiry to on that, but we would say if, for example, an across the board price control tool was adopted that didn't constrain the ability to cross-subsidise between competitive and non-competitive segments of the market; I guess we would say it hasn't had the effect that we think it should have, because we would still have a situation where the development of competition is constrained, that that doesn't seem to be a desirable outcome from our point of view.

MR SELL: I understand what you're saying on that.

MR ADAMS: I think it's correct to say that, if you don't bypass NGC's network at all, is there something about NGC which makes it less vulnerable to bypass than other distributors?

MR VAN DER VOORN: In the early days we need their active cooperation to be able to build gates off the transmission system, and so there was certainly a perception that perhaps taking them on was a bit more than we were capable of at the time, because we were quite a small company of course, and all of our competitors were very much larger and well-financed compared to ourselves, so we were always a bit wary about taking them on directly, and subsequently they've merged the management of their distribution and transmission system, which made that doubly difficult.

MR ADAMS: So, you'd still be reluctant. We shouldn't get you to divulge too many of your plans for the future, but you still see there's a problem about --

MR VAN DER VOORN: For instance, if we were to contract with a customer on the expectation we would have to build a separate gate off their transmission system, I guess we would see significant risk there.

MR HALL: In getting the agreement with NGC?
MR VAN DER VOORN: In a timely manner, yes.
MR HALL: Not that there's a reluctance; it's a view on how difficult that would be to achieve.
MR VAN DER VOORN: It increases the risk.
MS BATES: Just for you, Mr Berry. I note you're going to do cross-submissions on the jurisdictional question and in particular the limit of the Commission's jurisdiction to make recommendations. I just note that in -- you may have noted this yourself, but in the previous Part 4 of the Commerce Act the headings related to declarations of price control; price was in the whole -- dictated the ambit in that previous part, and in this new part there's no reference to price, it's just reference to control, so that would indicate that there was some intention to widen the jurisdiction beyond just price, I think.
DR BERRY: I understand that, and also you need to read it in conjunction with Section 70 which goes beyond pure price as well.
MS BATES: So, it goes beyond price; it includes quality, I think you'd agree, so it's where you draw the line, I think?
DR BERRY: Right. But I'll address in particular the questions raised by Contact pertaining to access as well. I took it that was at the heart of the concern.
MS BATES: If we had no jurisdiction to make recommendations, is there anything preventing us from discussing the issues in our report?
DR BERRY: I'll come back to you on that.
MS BATES: We may want to do that, because the fact that we don't have jurisdiction now doesn't mean that's set in

concrete forever. If we think it's something that ought to be looked at, then we would want to say so, I think, maybe; I'm just alerting you to that possibility.

MR HALL: The Commission is no doubt aware the question of access to pipelines, both specific to Maui and in general, in relation to the industry is being dealt with in two other fora at this time. Of course, Maui open access as we understand it is being addressed in an industry consultation process, and the Gas Industry Self-Governance Group is tasked with looking at, amongst other things, the question of access.

MS BATES: We are aware of that.

CHAIR: Okay, can I ask if Nova has any further submission they would like to make?

MR HALL: No, thank you.

CHAIR: I'd now like to thank you indeed for appearing, and I do apologise again for keeping you waiting. It is always useful for us to talk to senior people in an organisation, to have a Chief Executive and Director and General Counsel here is very useful to us, so we're grateful to you for the submission today, the written submission, and we'll look forward to the cross-submission when it comes. I think some of the material we've asked you for, in particular, we really can get no other place, so I will thank you in advance for being helpful to us on that front, so thank you very much.

I'd now like to ask Wanganui Gas to come forth please, and we will have that submission next.

***