



Presentation to Commerce Commission Gas Pipelines Inquiry Conference on Draft Report

Oral Submission - 27 July 2004

Overview

- ❖ Introduction of Presenters
 - Trevor Goodwin – Chief Executive
 - Geoff Evans – Network Manager
 - Jim Coe – JT Consulting Ltd

- ❖ Company Structure - brief revisit
- ❖ Oral Submission
 - Retail written submission
 - Network written submission

- ❖ Concluding Comments

Company Structure

Wanganui Gas Limited (WGL) consists of:

Two Trading Divisions:

- ❖ Network Division (trades as *GasNet*)
- ❖ Commercial Division (trades as Wanganui Gas & Direct Energy)

Supported by:

- ❖ Corporate and Administration Division

Network Division

- ❖ Operates 6 discrete pipeline networks
- ❖ 11,000 connections (5%) - 354 kilometres (3%)
- ❖ Provides gas distribution services to 6 retailers
- ❖ Services available to all retailers
- ❖ Non-discriminatory behaviour
- ❖ Offers posted prices
- ❖ Offers contestable Gas Measurement Systems
- ❖ 12 Direct employees

Commercial Division

- ❖ Energy Trading (Gas & Electricity)
 - North Island wide – 9,000 direct gas customers
 - Mercury Energy – 12,000 gas customers
 - Wanganui City – 1,500 electricity customers
 - Sells over two-thirds of gas off-network
- ❖ Appliance Sales and Installation
- ❖ 12 Direct employees

Corporate and Administration

Provides services to Trading Divisions:

- ❖ Shareholder Relationships
- ❖ Public Relations
- ❖ Financial and Treasury Management
- ❖ Personnel and Administration Support
- ❖ IT and Property Management
- ❖ 6 Employees



Oral Submission Structure

- ❖ WGL's Energy Trading (Retail) Submission
- ❖ WGL's Network Submission
- ❖ Concluding Comments





Retail Submission

The key point of the written submission is that the operational behaviour of networks can impose unnecessary costs:

- ❖ Stringent application of prudential requirements
- ❖ Billing for network services in advance
- ❖ Zone pricing with “neutral” revenue take





Retail Submission

Each of these trading conditions reduces a gas retailer's competitive position when compared with energy substitutes

- ❖ End-user pays for increased administration costs
- ❖ More prevalent where gas and electricity networks under common ownership



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Network Submission

❖ Presenter: Geoff Evans – Network Manager

Network Submission - Structure

❖ WGL's Network Submission

- Conclusion of submission
- Statement of exclusions
- Key issues
- Further comments
- Operational implications

Network Submission - Conclusion

- ❖ That further control of gas networks is not required
- ❖ However if Commission considers further control necessary then
 - initial form of control should be to monitor behaviour of specified entities by way of threshold approach
 - if a breach is subsequently observed, then control only those entities observed as in breach
 - control should be entity specific and thus, based on draft report, exclude WGL

Network Submission - Exclusions

WGL is not intending to speak directly to:

- ❖ Economic welfare arguments
- ❖ Modelling issues including WACC/CAPM
- ❖ Transmission
- ❖ Field production/processing related pipelines

WGL acknowledges the substantial level of discourse on these and related topics raised by others and their experts in submissions and considers relevant matters have been covered.

Network Submission – Key Issues

- ❖ WGL urges the Commission to reconsider the asset base used for analysis of network business performance.
 - Product and/or service definition - non-contestable asset base
 - Like for like entities modelled and/or compared
 - Implied conditionality
 - Draft Gas Information Disclosure Handbook 2000 - “Other Business”

Network – Key Issues (Cont)

- ❖ WGL believes that the Commission should reconsider the basis upon which analysis of network business performance is undertaken.
 - WGL promotes the use of benchmarking studies - operational focus
 - Limitations to this approach relate to data
 - Draft Gas Information Disclosure Regulations 2000
 - International benchmarking allows regulated/non-regulated behaviour to be observed
 - Building block analysis - sensitivity to WACC parameter setting (and debate) etc.

Network – Key Issues (Cont)

- ❖ WGL considers that it operates in separate energy transport and metering markets and that a separate metering market should be recognised.
 - WGL remains of the view that it operates in an energy transportation market
 - If limit energy form to gas then it views itself a operating in a NG/LPG transportation market
 - Irrespective of whether either market is seen as workably competitive, a transportation market does not include energy measurement services for third parties.
 - A separate energy (or gas) measurement services market would enable all participants within this market to be considered

Network – Key Issues (Cont)

- ❖ WGL considers that all network businesses should be subject to a minimum level of disclosure.
 - Draft Gas Information Disclosure Regulations 2000
 - Consistent manner for all pipelines conveying natural gas for reticulated market
 - First level - technical and safety issues
 - If controlled, second level - financial and asset information

Network – Key Issues (Cont)

- ❖ WGL considers that there is no simple pass-through mechanism for costs associated with further control to acquirers
 - Two acquirer groups to consider - retailers and end-users
 - Cost of further control likely to ultimately fall to retailers with certain pass-through to end-user (whether individual or mass market contract)
 - Benefits of further control certain to pass to retailers with less certain pass-through to end-user
 - Pricing path smoothing required to avoid pricing shocks



Network – Key Issues (Cont)

- ❖ WGL considers that dynamic inefficiency needs to be quantified as a disbenefit of further control.
 - A Gas Pipeline Business (GPB) is a very long term investment
 - Forecast investment based on “counterfactual”
 - Investment will be avoided, delayed or cancelled
 - Need for explicit cost allowance



Network – Key Issues (Cont)

- ❖ WGL considers that the Commission should not rely on the now historical draft 2000 ODV Handbook for Gas for current valuation analysis
 - Unreasonable to presume workable surrogate for 2004 and beyond
 - 2000 industry consultation not incorporated
 - Historical value only
 - Commission's expert advises issues to resolve
 - Needs consultative review based on future promulgated Regulations

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Network Submission

❖ Presenter: Jim Coe – JT Consulting Ltd

Network – Further Comments

WGL makes observations and responses to a number of comments regarding network activities raised within the Draft Report - Public Version or submissions thereon.

- Business Uncertainty - supply availability, wholesale price trend and volatility, competitive actions, energy form substitution, not an essential service, regulatory form
- Productivity improvement - do these businesses demonstrate poor productivity, self interest to be productive, actual network not ODV network operated.

Network – Further Comments (Cont)

- Excess returns or superior performance - measurement difficult therefore does not exist?
- Distribution portion of delivered price - average value concept, elasticity impact
- Quality of service - define service, define current measure of service (level), service is a function of on-going investment
- Threshold for application of further control
- Draft Gas Information Disclosure Handbook

Network - Operational Implications

There are a range of operational implications of further control which WGL believes the Commission should be conversant with, contexted by business environment uncertainty. These have been assembled under “direct” and “in-direct” issues.

❖ Direct issues - Further control will mean

- Increased resource consumption - financial, human costs, equipment
- Greater operational and capital budget challenge,
- Diminished investor enthusiasm for non-routine capital projects

Network - Implications (Cont)

- ❖ Direct issues – Further control will mean
 - Additional cost relating to implementation of regulatory mechanism
 - Increased dependency on sophisticated tools such as asset management information, network monitoring and analysis etc.
 - Increased cost of network valuation
 - Reduced effort to encourage end-user uptake growth both in number of users of gas and range of end-use applications per user

Network - Implications (Cont)

- ❖ Indirect issues - Further control may mean
 - Detriment to network growth - if investor confidence leads to capital scarcity
 - Detriment to maintenance - if pressure on operational costs delays or lowers frequency of maintenance (deferred maintenance)
 - Detriment to renewal of existing infrastructure assets - delay, defer or decommission
 - Reduced incentive to upgrade network - system losses, delivery pressure

Network - Implications (Cont)

- ❖ Indirect issues - Further control may mean
 - Planning uncertainty - long term horizon
 - Possible Regulator intervention with impact on business planning
 - Faltering generic growth of market as financial resource reallocations occur
 - Detriment to incremental capture of existing network utilisation - in-fill and ability to connect latest end-user technology sold
 - Change of business behaviour within the regulatory cycle



Concluding Comments

❖ Presenter: Trevor Goodwin – Chief Executive





Concluding Comments - Retail

- ❖ While not ignoring the economic aspects of the draft report WGL Retail believes that the Commission should ensure that network behaviour does not impose unnecessary costs for acquirers.



Concluding Comments - Network

The following five slides are lifted without modification from WGL oral submission to the Commission on 2nd September 2003. WGL believes they aptly summarise it's position today. They cover:

- ❖ Competitive Markets
- ❖ Gas Pipeline Businesses
- ❖ Is prescriptive control required?
- ❖ Analytical framework
- ❖ The Counterfactual

Competitive Market

- ❖ WGL's distribution prices are constrained by
 1. Energy source substitutability:
 - Electricity and LPG can substitute for gas – the reverse is difficult
 2. Market :
 - Increasing wholesale prices may make gas less competitive
 - Dual fuel retailers can alter their behaviour to promote the fuel that provides the most economic return
 - Retailer pricing strategies – end-user charges
 - Public perception of gas unavailability threatens gas usage
 - Regional economic focus
 - TLA / Developers' lack of awareness
 3. The threat of by-pass:
 - Proactive pricing methodology reflects identified by-pass risk candidates

Gas Pipeline Businesses (GPBs)

- ❖ GPBs are characterised by large long term capital investments
- ❖ Capital is returned over long periods of time
- ❖ The investment risks associated with GPBs are greater than risks associated with ELBs
- ❖ Returns under the regime must be commensurate with these risks
- ❖ Discrete networks defined by geographic location
- ❖ GPBs require certainty and stability from the regulatory regime
- ❖ Investment and innovation could suffer

Is prescriptive control required?

- ❖ It is yet to be demonstrated that the benefits of a prescriptive regime will outweigh the costs
- ❖ Any net benefits of control might not be passed to end users by retailers
- ❖ WGL will bear a disproportionate share of control costs
- ❖ Prescriptive control of WGL is not necessary
- ❖ WGL continues to achieve cost efficiencies which it shares with both retailers and owners

Analytical framework

- ❖ Benchmarking is preferred but recognise there are issues with obtaining comparability
- ❖ The building block approach appears to be complex, intrusive and expensive
- ❖ ODV is the most appropriate methodology to determine asset valuations (in use; understood; robust; transparent; consistent with dynamic efficiency criteria; allows comparability)
- ❖ Allowable return to support superior performance

Counterfactual

- ❖ Not appropriate to assume status quo - existing regime
- ❖ The counterfactual needs to reflect the impact of other proposed changes to:
 - Gas Information Disclosure Regulations
 - Government objectives for the Gas Industry
 - Industry self-governance initiative
- ❖ WGL can not continue to reduce costs at the same rate as it has achieved under the current regime



Questions

❖ Further Questions

❖ WGL thanks the Commissioners and the Commission personnel for their time and attention

