

1 **MS WELSON:** First of all, I will just start off introducing the
2 key points from the PEANZ submission and then handover to
3 Dr Patrick who will talk to a number of the specific
4 questions that you've asked in the Draft Framework paper.

5 First of all, just a brief background of PEANZ, which is
6 the Petroleum Exploration Association of New Zealand. It is
7 a trade association with the objective of promoting the
8 interests of petroleum producers and explorers in
9 New Zealand.

10 PEANZ represents a number of members who are actively
11 involved in the oil and gas exploration industry in
12 New Zealand. Members of PEANZ are both acquirers and
13 suppliers of gas services, as they have been defined for the
14 purposes of this inquiry. PEANZ's comments are given from
15 the overall perspective of the exploration and production
16 sector rather than from any individual commercial or company
17 perspective.

18 I just wanted to go through and touch on the key points
19 from the PEANZ submission. The first of these is that
20 natural gas is a critical component, an essential ingredient
21 of the New Zealand economy, and continues to be, or will
22 continue to be so for both the medium and the long-term.
23 Continued and increased exploration is therefore crucial.

24 There's two issues that impact on New Zealand's gas
25 supply; one obviously is the maintenance of gas, and that's
26 where exploration and production come in, and the other is
27 ongoing investment in transmission and distribution. If
28 we're going to grow the gas market we need reliable
29 delivery.

30 The second point that we're going to focus on today
31 touches on the need for transmission and distribution.

1 Within that there's two types of pipelines that we're going
2 to talk to; one is what we've described as gas field
3 development pipelines, and the other is the multi-use
4 transmission system, which gets the gas from a region right
5 around the country to the markets.

6 The next point is that gas suppliers and gas purchasers
7 have very little flexibility around transmission and
8 distribution services. The gas supplier is dependent on
9 those services to get its gas to market. The gas purchaser
10 again is located in a specific area, and doesn't have a lot
11 of choice, alternatives, to switch if there's only one
12 transmission system servicing that area. Where a gas
13 purchaser does have a choice, it's to switch to an
14 alternative fuel if the overall delivered price of gas is
15 not competitive.

16 And at that stage I'll hand over to Dr Patrick.

17 **DR PATRICK:** Thank you. I think it's commonly understood that
18 the game that we're in is very high risk, it's very highly
19 capital intensive, and that New Zealand competes on an
20 international stage for investment capital, and you've only
21 got to be reminded of the Shell announcement a couple of
22 weeks back about suspension of exploration activity for 2004
23 to realise what sort of game -- you know, what the
24 international exploration investment game is about.

25 Potential explorers have got to see a viable healthy gas
26 market with sufficiently good gas prices, and a long-term, a
27 longevity of a contract to enable them to then make an
28 investment decision in favour of development of any new gas
29 discovery; that's absolutely crucial. So, any market risk
30 perceptions will influence availability of investment
31 capital.

1 As Liz has said, gas competes with alternative fuel. We
2 mentioned in the submission, the immediate challenge is to
3 actually grow the gas market in New Zealand, but it's
4 always -- we've always at the back of our mind realised that
5 large gas users, who are the principal purchasers of gas,
6 are able to switch fuel, and we've got three examples in our
7 submission; there's the Huntly Power Station fired up on
8 coal, Contact Energy installing oil at New Plymouth Power
9 Station, and a dry year reserve risk at Whirinaki at this
10 stage on distillate which is a liquid petroleum, and larger
11 industry can also switch from gas to coal using the same
12 boilers that they've had.

13 **MS BATES QC:** Can I just ask you this: Do you think that's a
14 response to the very real situation we seem to have of a
15 shortage of gas? Have they done that in response to that
16 situation?

17 **DR PATRICK:** I think it's a mix of reasons. Certainly, there is
18 the post Maui gas shortage. That seems to be largely
19 affecting Methanex at this stage, you know, as the purchase
20 of 42%, but yes, there is obviously a concern that there's a
21 potential gas shortage, particularly for thermal generation,
22 but there's also the interest in dry year reserve and the
23 delays on Project Aqua, so I think there's a mix there which
24 is all having a bearing on that.

25 **MS BATES QC:** Yes. Thank you.

26 **DR PATRICK:** Once gas has been discovered, a significant issue
27 around field development is availability of and risks
28 relating to infrastructure to get the gas to market. I
29 think OMV noted in its submission the key issue is the
30 maturity of infrastructure and that downstream participants,
31 i.e. The transport providers, are receiving fair but not

1 excessive returns, and we'd agree with that.

2 So, we'd just urge the Commission to be aware of and
3 take into consideration the importance of maintaining
4 New Zealand as an attractive exploration environment, which
5 includes the consideration of that downstream, that
6 transmission component.

7 **MS BATES QC:** Got to be able to take it somewhere?

8 **DR PATRICK:** You haven't got a gas field unless you sell it.
9 Some people say you've got it when you've discovered it, but
10 no, you haven't got it until you've sold it, so it has to go
11 somewhere.

12 **MS BATES QC:** In paragraph 7 of your submission you gave a
13 number of reasons why natural gas is a critical element in
14 New Zealand's energy supply mix, and they mostly relate to -
15 - well, not mostly relate to them -- yeah, they do mostly
16 relate to generation of electricity. Would you agree?

17 **DR PATRICK:** Yes.

18 **MS BATES QC:** As being the critical point?

19 **DR PATRICK:** Yes.

20 **MS BATES QC:** What I want to ask you is something that came up
21 yesterday is, is there any public interest in developing gas
22 as a fuel that goes more directly to the consumer rather
23 than through the generation process?

24 **DR PATRICK:** I'm sure there is, and it's something that we're
25 interested to grow, it's something my colleagues in the gas
26 association are interested to grow, the Green Party of
27 course, it's a big platform for them, more direct use of gas
28 rather than what is perceived to be the inefficient
29 conversion of gas to electricity but which then goes into
30 houses which can be fired on gas anyway.

31 **MS BATES QC:** So what are the advantages, not the environmental

1 ones so much -- not that I'm not interested in those -- but
2 what are the economic advantages of more direct consumption?

3 **DR PATRICK:** I couldn't answer that at this stage. [Pause].
4 Liz just pointed out -- I mean, the domestic, we call it the
5 domestic market at the moment, is 1% of the amount of gas,
6 it's a very small amount. Even if we grow it five-fold, if
7 we had 10 petajoules of gas supplying the domestic and small
8 commercial market in New Zealand, you still wouldn't develop
9 a gas field really based solo on that, you really are
10 looking at that big user, and if Methanex does pull out of
11 the country, those big users right now are thermal
12 electricity generation industries. So, we're sort of
13 betwixt and between, there are big industries around that
14 can use quite a bit of gas but again, not that sort of
15 level.

16 **MS BATES QC:** So the importance of the transmission is for the
17 big users?

18 **DR PATRICK:** I think, if you look at the whole system,
19 transmission and distribution, it's important to everybody;
20 I mean, I've got gas on at my house, it's pretty important
21 to me. In terms of, for example, field development, a new
22 discovery wanting to be produced and it's able to deliver
23 big volumes and, yes it's going to be the big users. Then
24 again on the other side of the coin we have Westech with its
25 Surrey well, Surrey field, which is now being produced
26 through a small line into the NGC system. Okay, that goes
27 to the Methanex plant, but it's a small volume contract.

28 **MS BATES QC:** Thank you very much.

29 **DR PATRICK:** You asked a number of specific questions in your
30 Draft Framework paper and our submission didn't identify any
31 answers to any particular questions at that stage, but we

1 thought it would be appropriate to sort of address some of
2 them orally, so if you wouldn't mind we'll do that.

3 **CHAIR:** That will be useful, thank you.

4 **DR PATRICK:** We don't propose to respond to any issues relating
5 to pricing issues, although we'd like to reserve the
6 possibility of doing so at some point, you know, should that
7 become necessary or desirable.

8 So we'll go straight to question 1, what services are
9 included in gas services? We would simply note that the
10 Government in its March 2003 Government Policy Statement on
11 the gas industry has invited the industry to develop
12 protocols, standards, conventions which apply to wholesale
13 gas trading, and these include quality standards, balancing
14 and reconciliation, as well as trading of excess and of
15 shortfall quantities of gas, and it also requires the
16 industry to establish an open access regime across
17 transmission pipelines.

18 Now, all of these in our view are interlinked in some
19 way or another with gas transmission services. However,
20 they are matters which should be, and I think it's fair to
21 say Government anticipated they would be, developed by
22 industry in accordance with that Government Policy
23 Statement. Therefore, we don't believe they should be
24 included within the ambit of gas services for the purpose of
25 this inquiry.

26 We believe the focus of gas services should be the
27 pricing of transmission and distribution of gas, and
28 included in this should be any pricing associated with an
29 interconnection into an open access pipeline by any other
30 pipeline; what we call a field development pipeline.

31 Question 2: What transmission businesses' systems should

1 be covered by the inquiry? We acknowledge the definition of
2 "transmission system" in the terms of reference is wide; it
3 captures all the pipelines from the outlet flang of a gas
4 processing facility through to the gate station supplying
5 gas for distribution or to the gas customer where it doesn't
6 enter a distribution system.

7 But, there are two quite distinct types of transmission
8 pipeline. One is what we call a field development pipeline,
9 and the other one is what we'd call the general transmission
10 pipeline. I've handed out a diagram, and I'll take you
11 through that to try and explain some of the -- what people
12 think are complex but are actually quite simple arrangements
13 around -- in a gas field.

14 If we start with the well heads on the left-hand side,
15 the standard stock normal, I suppose, line would be the one
16 from the top left-hand side, you have a gas gathering line
17 going into a production station, a gas gathering line
18 I believe is outside the terms of the inquiry.

19 From the production station you've got a couple of
20 options there. One up to a specific end-user, and so you're
21 therefore looking at a sole supplier of gas from its
22 production station delivering gas to a sole contract, a sole
23 user, and I've got an example there, for example the Waihapa
24 Production Station up to the Stratford Power Station.

25 Now, that pipeline wouldn't have existed if that
26 contract hadn't been there, if that end-user hadn't have
27 been there. The field development includes that pipeline.
28 In other words, the field can't be developed, can't be
29 produced without that pipeline; that's a field development
30 pipeline; even though it's downstream from the production
31 station, it's an integral part of the field development.

1 Or you can have, again from the production station going
2 straight across to a transmission line, and this is -- I
3 just said, the Surrey line to the Natural Gas Corporation,
4 the NGC's LTS line to Methanex. Again, the Surrey field
5 would not have been developed without that pipeline, it's an
6 integral part of the pipeline, it's part of the economics,
7 the investment economics of the pipeline; it's even brought
8 into the royalty calculations, so again we call that a field
9 development pipeline.

10 Coming down to the bottom left, here's a curly one that
11 you may not have thought about, and that is that there is
12 the occasion where gas is re-injected into the ground.
13 There are some situations where gas can be produced at a
14 rate greater than the contracts for supply. That gas comes
15 out with condensates in it, liquids; those liquids are the
16 really valuable bit of the petroleum stream, so you can
17 produce the gas a bit more quickly than you are contracted
18 to supply to a customer, remove the liquids, make your money
19 that way, and put the gas back down in the ground again and
20 use it like a vacuum cleaner to vacuum up the liquids. That
21 does happen. It's a gas re-injection line; again it's
22 downstream of a production station, but it's a field
23 development line, it's not going anywhere, it's not sold,
24 it's not passed on to anybody.

25 **MS BATES QC:** I'm sorry to interrupt, but explain to me what
26 actually happens to that gas that's re-injected? Can it
27 never be used?

28 **DR PATRICK:** No, it will eventually be used, it's part of the
29 gas reserve that is available, it's just that at a
30 particular point; say, for example, at Kapuni they can
31 produce more gas than they were contracted to sell. They

1 could take that extra gas out, remove the liquids from it,
2 make their money, poke the gas back down in the ground again
3 and essentially recycle it, it will eventually be used once
4 the field starts running down.

5 **MS BATES QC:** So it's actually held underground?

6 **DR PATRICK:** Oh yes, it goes back into the reserve it came from.
7 You just pump it under there at the same pressure or
8 slightly higher pressure when it came out and it migrates
9 back into the formation.

10 **MR STEVENS:** Dr Patrick, I wonder if I can ask you a bit of
11 clarification. On the top right-hand side you've got the
12 field development line as you call it to the top end-user
13 there, and then you compare that with a field development
14 line which is going straight into the open access
15 transmission line; but your argument that that is also a
16 fuel development line because it's for a sole user.

17 I can somewhat understand the one going to the end-user
18 at the top whereby you can't send it anywhere else, but I'm
19 having difficulty understanding where, if once you put it
20 into that open access line you can easily switch between
21 end-users if you so desire.

22 **DR PATRICK:** The key is once it's into that line. The
23 distinction I'm making is that field development line stops
24 at the interconnection with that open access line, that's
25 where it stops. You're right, once it's in that open access
26 line -- and you will remember back I talked about
27 interconnection fee and so on, it's at that point downwards,
28 yes that we would say that's not a field development line,
29 that's just that direct line across.

30 **MR STEVENS:** So your argument is that if it's an open access
31 line, that's where it differs from a single line where

1 you've only got one purpose?

2 **DR PATRICK:** Yes.

3 **MR STEVENS:** I might follow up again later.

4 **DR PATRICK:** Yes, by all means.

5 Finally, if we go to the middle left we have a little
6 strange thing in New Zealand where we have a gas gathering
7 line going into a production station, this is the Rimu
8 Production Station at south Taranaki. That gas is then
9 taken up to the Waihapa Production Station for -- it could
10 be either pumping on to someone else, to a client, or for
11 further treatment and then pumping on.

12 So in actual fact you've got a link between two
13 production stations, those two production stations are owned
14 by the same company and run by the same company. Again we
15 would suggest that that's a field development line even
16 though it is -- again there's a line downstream, a
17 production station, it's a field development line rather
18 than a transmission line.

19 **MS BATES QC:** So those two stations, different parts of one
20 process?

21 **DR PATRICK:** Yes.

22 **MS BATES QC:** Okay.

23 **MR STEVENS:** Could I then follow up on the point about fuel
24 development line from the production station to the open
25 access line. What would happen, therefore, if you allowed
26 someone else to interconnect into that fuel development line
27 to enable it to get to the main open access line, as you
28 call it, and then it no longer becomes a field development
29 line I presume?

30 **DR PATRICK:** That's an interesting one. It's not a specific --
31 it's not dedicated to one particular field and, therefore,

1 no, yes, right.

2 **MR STEVENS:** So I guess the issue therefore becomes, it's more
3 in the nature of how the party wants to deem the particular
4 line as opposed to any particular inherent nature in the
5 line itself? So I guess where I'm getting to with the
6 question is, is your argument therefore, if you deny an open
7 access on a line, therefore it becomes a field development
8 line because you're not allowing others to interconnect into
9 it. On that basis could a major transmission line then
10 become a field development line if the sole party using it
11 doesn't allow others to join?

12 **DR PATRICK:** Possibly. I think the other -- probably the more
13 common way is, if one thinks about, for example, a Maui line
14 which is a dedicated field development line. I mean the
15 whole thing was constructed, its capacity, everything was
16 set up to deliver X amount of Maui gas to the market. It's
17 a field development line. There wasn't any room for
18 anything else. Now, that's gonna change once the volumes of
19 Maui gas start declining, would be able to become an open
20 access line.

21 But the more unusual scenario is the fact that a field
22 development line is dedicated to the field insofar as it's
23 delivering from that field a certain amount to somewhere,
24 and during the life of that field, whilst the field is
25 producing the volumes of gas designed to go down that line,
26 and it will be a contract term, you know, that determines
27 that it's 10 years, 15 years, 5 years or whatever.

28 But whilst the field is delivering that, there really
29 isn't any room for anyone else in that line, but once the
30 field starts declining down, yes, you may get the situation
31 where you start having an opportunity for open access and

1 other parties coming in. I think that tends to be the way,
2 I think, rather than having someone banging the table and
3 saying no we're not gonna have this as an open access line
4 just for the sake of it.

5 **MR STEVENS:** Then on what basis would you make the determination
6 as to when something stops being a field development line,
7 and should more appropriately be an open access line?

8 **DR PATRICK:** Interesting question. I think, turning it back on
9 its head; if you've put the line in and owning the asset,
10 you want that asset used as much as it possibly can. So, as
11 the initial field owner, the initial developer of the field,
12 will be very keen to make sure that that line is used
13 efficiently and effectively, so when his supply of gas
14 starts falling away, he'll be looking to bring people in to
15 keep that line going and make a return on it.

16 **MR STEVENS:** If there was a hypothetical situation where you had
17 a competitor owned a field right next to your field and that
18 you had spare capacity on your line and they didn't, are you
19 suggesting therefore that you would allow a competitor to
20 connect into your line?

21 **DR PATRICK:** Why not? I mean...

22 There's money to be made in leasing pipeline capacity.
23 **[Pause]**. I mean, that's a straight commercial decision. I
24 mean once you've got the asset, if you're not using it to
25 its maximum, if you can make money by leasing it to someone
26 else, it's just a commercial decision between the two
27 parties, the asset owner and anybody else, an another
28 adjacent field owner.

29 **MS BATES QC:** Can you clarify this for me, the one on the top
30 left-hand corner goes straight to the big production
31 station, but it doesn't go to the little one?

1 **DR PATRICK:** Well, they're two different examples. There's the
2 one at the top left and the one at the middle left.

3 **MS BATES QC:** I thought that the big one and the little one were
4 part of a connected process?

5 **DR PATRICK:** In terms of the line from the middle left wellhead,
6 yes, but in terms of the -- I mean, more often than not a
7 gas line will just go to the one production station; from
8 there it's taken out to market, rather than the two.

9 **MS BATES QC:** Okay, thank you.

10 **DR PATRICK:** We would suggest therefore that these sort of field
11 development pipelines are not covered by the Commission's
12 inquiry or in the alternative that the Commission should
13 conclude that it's not necessary nor desirable for gas
14 services related to field development pipelines to be
15 controlled.

16 Our submission in writing addresses in detail why we
17 have adopted this position and I believe OMV and Swift,
18 their submissions support ours. In summary, just going back
19 through it, field development pipelines have been
20 constructed as an integral component of field development in
21 the full part of production infrastructure rather than
22 transmission.

23 We've talked about, they carry gas from a process of
24 selecting directly to a consumer or a multi-use pipeline.
25 They're specifically designed to optimise the field asset
26 and gas supply arrangements which underpin the development
27 of the field. They're part of the overall infrastructure
28 cost, they're a significant part of the capital base which
29 is used to determine the royalty payment under the 20%
30 royalty arrangement on any field. And for that reason it's
31 part of the delivered gas price in any gas supply

1 arrangement entered into to underwrite or secure field
2 development up-front. There's no separate transmission
3 arrangement.

4 The significance of a field pipeline, field development
5 pipeline costs on the final delivered gas price will depend
6 on the extent of pipeline infrastructure required as to
7 probably distance, capacity, access and so on, the size of
8 the field and the total development cost of the field. Is
9 it on-shore, is it off-shore, all of those sort of matters.

10 Field development pipelines do not impact on competitive
11 or potentially competitive gas markets, and if I can refer
12 you back to the Gas Information Disclosure Regulations, you
13 will recall there's a schedule in the back there where
14 there's a list of specifically exempted pipelines. They're
15 exempt from the provisions of the regulations. Now, they're
16 exempt because they're field development pipelines.

17 To quote from an MED regulations newsletter:

18 "The Ministry recognises that certain gas pipelines do
19 not impact on the competitive or potentially competitive gas
20 markets, which therefore propose to exempt owners of such
21 pipelines completely from the requirements of those
22 regulations."

23 So, what we're submitting here is nothing more, nothing
24 else really than reinforcing what's in place behind -- the
25 rationale behind the Gas Information Disclosure Regulations.

26 As I said, field development pipelines are unlikely to
27 be of interest to other parties during the production from
28 the particular field for which they were constructed,
29 because they were constructed to deliver a certain amount
30 from that field to a certain destination, there isn't really
31 any room to get into that line at that stage.

1 Return now to question 7 and 15, we'll sort of put them
2 together: What are the relevant markets for gas transmission
3 and distribution and to what degree will the Maui pipeline
4 assuming open access in the NG system compete? We would
5 agree with the Commission's view that gas distribution
6 markets are defined by geographic regions within each
7 discrete distribution network is located, but geographic
8 scope of gas transmission markets is not so easily defined.

9 The transmission system in New Zealand is essentially
10 point to point, it's not a network like overseas in America
11 or some of the other countries. Almost all of the regions
12 where gas is available to end-users have only one
13 transmission pipeline getting gas to that area. The
14 exceptions to this are the Taranaki region, basically
15 because that's where the gas production facilities are and
16 its network of pipelines, and between north Taranaki and
17 Huntly where there are the two parallel transmission
18 systems, there's the Maui line and the NGC line.

19 There's no obvious geographic market delineation but at
20 the end of the day geographic distinction's unlikely to be
21 particularly helpful in determining whether or not there's
22 market power. If one pipeline is going to act as a
23 competitive constraint on another, there are essentially two
24 factors that really have to be met. Pipelines must provide
25 alternative routes to the same end-user or end-users. And,
26 the competitive constraint, obviously will be stronger if
27 the pipelines could be accessed by some or all of the same
28 gas sources. So you're looking at essentially two good open
29 access lines going from, say, Taranaki into the Auckland
30 region side-by-side. However, there would still be some
31 competitive constraint even when the start points of the

1 pipeline are not concurrent.

2 The second point is the capacity of the pipelines really
3 must be similar, so that a gas supplier or purchaser has a
4 real choice as to the delivery options available to them.
5 For example, a major gas user might not be able to get
6 access to the NGC line at the moment; it has to use the Maui
7 line, there's no cap on that. So, if the pipelines are of
8 similar capacity, similar access, again that makes it a far
9 more competitive market.

10 Question 9: How substitutable are electricity and other
11 energy sources for gas in commercial and industrial and
12 residential applications? I think we noted that in our
13 submission. Quite easily substitutable, and there are quite
14 a few medium-to-large industrial companies that we know of
15 that are looking already to coal, whereas they've been
16 burning gas in their boilers up to now, they're looking to
17 go back to coal, and the electricity generation as well.

18 Question 10: Does inter-fuel competition constrain
19 transmission and distribution charges? Maintaining
20 stability and growth in the wholesale gas market is critical
21 for long-term sustainability of gas exploration and
22 production, and to minimise disruption of the overall energy
23 market. Transmission and distribution are integral aspects
24 of the gas market, because they're the means by which the
25 gas gets to market obviously. Consequently transmission and
26 distribution pricing are significant factors in the
27 delivered price of gas. Inter-fuel competition is a key
28 issuer to the upstream industry and it's a real constraint
29 on the development of further gas supplies. Probably not a
30 key influencing factor for pipeline charges though.

31 Delivered price of gas, including transport must be

1 competitive with our alternative energy options available to
2 the end-user. So, alternative energy options are a natural
3 constraint on the long-term price of gas as a competitive
4 fuel. If pricing of the transport component of the
5 delivered price permits successive or unnecessary profit
6 taking by the transport providers, this reduces the return
7 available to the explorer and producer. This then affects
8 well economics and field development economics which
9 otherwise may not be accepted.

10 **MR STEVENS:** Dr Patrick, can I just pick you up on that last
11 point that if the transport component is too high the
12 returns to the explorers etc are reduced.

13 Would that apply in a gas constrained market as we find
14 ourselves now? In other words, where demand is exceeding
15 supply?

16 **DR PATRICK:** Where demand is exceeding supply; that's a good
17 question. [Pause]. I'll have to probably defer on that
18 one, get back to you on that one, if you wouldn't mind.
19 Yes, if I could think about that and get back to you.

20 **MR STEVENS:** Thank you.

21 **DR PATRICK:** Obviously, that whole package of field economics,
22 field development, transmission pricing and just the return
23 to the explorer and producer, the impact of that on the
24 producer's decision or the explorer's decision to develop
25 the field needs to be borne in mind. It is an impact on
26 whether or not a gas field, a new gas discovery, for
27 example, is going to be developed, and we can look at some
28 gas finds on the East Coast of the North Island for example
29 which are at the moment stranded gas supplies. Because the
30 economics of getting the gas to market just isn't there at
31 the moment.

1 **MR STEVENS:** Do we have some examples on the East Coast where
2 they have actually successfully drilled and found gas and
3 that they're unable to get to market because of the
4 transmission lines?

5 **DR PATRICK:** Yeah, there is a reserve up at Wairoa, in that
6 area, Westech.

7 **MR STEVENS:** And that could be a producing well today, is that
8 what you are saying?

9 **DR PATRICK:** I believe so. It's a pity Kevin Johnson my Deputy
10 Chairman wasn't here, he could have given you details on
11 that. But again if you'd like some details on that we could
12 probably give those to you.

13 **MR STEVENS:** Thank you.

14 **DR PATRICK:** Questions 13 and 14, we've again linked together:
15 Do gas transmission or distribution firms currently exercise
16 market power? And question 14: What degree of
17 countervailing power do industrial commercial and
18 residential users have? I think Elizabeth said, because the
19 gas market lacks any depth, it tends to be concentrated on
20 the upper half of the North Island. Gas sellers really have
21 little choice about who or where they're gonna sell their
22 gas, and so, they have very little flexibility to choose or
23 exercise any constraint on transmission providers; it's
24 pretty much a one horse race when it comes to getting gas to
25 market. There is no alternative.

26 That's probably all we need to say or would like to say
27 at the moment. I'm quite happy to field any questions.

28 **MR STEVENS:** Just one further question, if I may, Dr Patrick.
29 You mentioned in the last point there that gas sellers are
30 constrained having to use the transmission to get to their
31 market. Presumably obviously a lot of the main bulk of the

1 market is obviously large users such as your Methanex and
2 your electricity generators. Would that preclude embedded
3 users into the systems, using the terminology that you call
4 the "field development lines"? In other words, would we see
5 possibly in the future large users embedding themselves
6 closer to where the production facilities are?

7 **DR PATRICK:** Now, I knew the answer to this, but I can't
8 remember what it is. It's something to do with who pays
9 what in terms of transmission. I think gas do electricity
10 to join into the Transpower system who don't; it's something
11 like that. So, it came up recently, if a large gas field
12 was discovered off the East Coast of the South Island, would
13 you take the gas to the North Island, to Huntly, or would
14 you shift Huntly to the South Island and transport the
15 electricity? I can't remember the answer to it. Again, you
16 might know better than me which --

17 **MR TAYLOR:** No, I'm not sure of the response, that's why I was
18 curious if you knew.

19 **DR PATRICK:** I'll chase that up, I'll get that information to
20 you. There is a difference transporting the electricity via
21 the Transpower system versus transporting gas, and it does
22 drive one of the options.

23 **MR STEVENS:** Clearly there's losses with electricity, as you
24 transport, I'm not too sure what the thermal efficiency
25 losses would be.

26 **DR PATRICK:** Yes, there are losses, yeah, over Cook Strait up
27 the HVDC line there is loss, yes.

28 **CHAIR:** I just wanted to ask you a few questions about your
29 particular role in the industry that you represent, and I am
30 curious about whether you canvassed the views of your -- I
31 assume you have members for the purposes of this

1 presentation, and I wanted to get a sense of whether you
2 think the interests of the various parties that you have
3 listed in your appendix, they're likely to have a common
4 view on the extent to which they're likely to have a common
5 view on the key issues that we will be considering in this
6 inquiry?

7 **DR PATRICK:** They certainly seem to. I mean, it's an open
8 regime, so when we were invited to make the submission on
9 the Draft Framework paper, that's every member gets to know
10 about that has an opportunity to put in a submission, you
11 put in comments and so on, several drafts have gone through.
12 What you've got is the concerted effort of the co-ordinated
13 mass, if you like to call it that.

14 **CHAIR:** Right. I wondered if you'd ever had a role in trying to
15 develop any sort of codes or principles around access to gas
16 pipelines? Do you have any -- have you ever played that
17 sort of role in the industry?

18 **DR PATRICK:** The association is part of the process looking at
19 Maui open access, so we're built into that and we also
20 liaise with what we call the Gas Association, there's a Gas
21 Association of New Zealand that basically runs from those
22 open access pipelines down. So we are the exploration,
23 production, delivering it to point X, point X downwards is,
24 believe it or not, another association called Gas
25 Association. They tend to get more involved in that, but in
26 some of the access issues, yes, we are involved, we are in
27 the process working our way through those.

28 **CHAIR:** When you look at these access issues, what are the key
29 areas for dispute, in your experience?

30 **DR PATRICK:** That's a good question. Key areas of dispute?
31 There are some key areas which may not necessarily be of

1 dispute, such as the system by which the -- you know,
2 basically the balancing system, in other words, is it going
3 to be on a, you know, a day by day put up your bids,
4 reconcile those against the demand bids, and the management
5 of that is, it's a key area; I wouldn't say it's a key area
6 of the dispute, but it's certainly a very interesting area.

7 Obviously, the costs of being involved, you know, as a
8 producer in a new open access regime is pretty important.
9 So, the pricing by the asset owner of access by producers is
10 obviously something that we tend to take quite a bit of
11 interest in, in how that's calculated.

12 **CHAIR:** Has the issue of responsiveness of pipeline services to
13 the users of the pipeline been an issue in your experience?
14 Or, is it sort of, here it is and this is what we can offer
15 you?

16 **DR PATRICK:** That's pretty -- it tends to be more of a
17 commercial consideration, but certainly in the -- for
18 example, the Maui access, open access with the -- yeah, the
19 putting up of bids, comparing those with the demand bids,
20 which will fluctuate, including amongst some of the big
21 users there's a potential to fluctuate and the balancing
22 around that, I think the whole system has to be very
23 responsive to demand.

24 So, whatever the demand requires, it has to be produced,
25 and in fact the issue tends to be a situation -- or the
26 point of concern would tend to be a situation where the
27 demand on a particular day, or for a particular period
28 cannot be supplied, and whether that's through the actual
29 volume of gas able to be delivered, or whether it's
30 something related to that; for example, some of the smaller
31 fields need to be pressurised again to the Maui line, for

1 example, the costs of pressurising that small field, low
2 pressure gas into the Maui system may preclude that gas
3 getting into that line. So, those sort of technical issues
4 related to the deliverability of the gas to the market which
5 is fluctuated.

6 **CHAIR:** I wondered if you could, and you may not be able to, but
7 give us a bit of an update on how these discussions are
8 going on the Maui -- access to the Maui pipeline?

9 **DR PATRICK:** I'm unable to actually. I haven't heard anything
10 about that for a month. One presumes the process is still
11 underway and, you know, the nuts and bolts of the system are
12 being bedded down, but that's a presumption.

13 **CHAIR:** Okay, all right. Thank you.

14 **MS BEGG:** I had one question. You mentioned that the price
15 charged by the transmission lines affects the returns to
16 producers. The lines companies suggest to us that if
17 there's a substantial threat of regulation or actual
18 regulation, it may reduce their incentives to invest, to
19 extend the network or to maintain it.

20 I wondered, from a producer's point of view, would you
21 be more concerned about the possible effect of regulation on
22 those incentives to invest in extending the reach of the
23 network, versus your concern about higher prices taking some
24 of the share of the producer's rent, I guess, from
25 production of gas.

26 **DR PATRICK:** Interesting trade on question, wasn't it? That was
27 a dirty one.

28 Take a look at the Maui line, it was produced at a
29 ridiculously cheap price for 20 years at huge volumes,
30 versus some of the new gas contracts coming on-stream,
31 smaller volumes that are being priced, so there's always

1 that trade-off there. There really is no one answer to that
2 question; we would certainly like to grow the gas market,
3 and to do that we need more transmission distribution
4 systems, so we need that investment, we need the current
5 investment maintained.

6 It's pretty important, otherwise we don't sell gas, we
7 just stick to liquids, so that's a critical part of it. But
8 on the other side of the coin should the return to the
9 producer go so low, is it's not worth selling the gas then
10 we just poke it back down on the ground. So, good question,
11 no one answer I'm sorry.

12 **MR MELVILLE:** I've just got a question regarding the diagram you
13 supplied today, and in particular the field development
14 lines. As you've stated, that the terms of reference for
15 this inquiry will refer to transmission system, and the
16 transmission systems definition from the information
17 disclosure regulations state that transmission system means
18 that part of a system that conveys gas from the point where
19 the gas leaves the gas processing facility to the boundary
20 of the gas works or gate station outlet flang supplying gas
21 for distribution or to a gas consumer.

22 So, my take from that is that, looking at part of the
23 system that -- it's part of the system that takes the gas
24 from the gas processing facility either to distribution or
25 to a gas consumer. Just looking at your diagram there, the
26 bottom gas re-injection line, it does indeed take it from a
27 production station, which in this case is a processing
28 facility, but it re-injects it back into the ground.

29 My take on that; it would fall outside the transmission
30 system definition because it's not taking it to a
31 distribution system, it's not taking it to a gas consumer.

1 **DR PATRICK:** Correct.

2 **MR MELVILLE:** Also likely the middle one as well, which is going
3 from production station to production station; again, that
4 would fall outside the definition of transmission system?

5 **DR PATRICK:** Yes, I think I would hope so. Just as a rider on
6 your definition from the regs though, as I said, there is
7 that exemption for those, I think it's Schedule 2,
8 pipelines. So, yes, you can read the definition of
9 transmission system, but then you go to one of the clauses
10 which actually says, but having said that, here are some
11 field development pipelines in the schedule which we are
12 exempting from the provision, so despite the definition
13 there are some exceptions.

14 **MS WELSON:** So, when you are bringing this diagram to us, that
15 is your point, is that what you are saying? You weren't
16 arguing that we had in fact detailed these as being included
17 in the inquiry?

18 **DR PATRICK:** We're just keen to make sure that -- make sure, if
19 we can, that you understood where we were coming from with
20 regard to field development lines and what they mean.

21 **MR MELVILLE:** It was also to give you a picture of what happens
22 in the various pipelines related to a field.

23 **CHAIR:** Any further questions from staff? [**No questions**]. Did
24 you have further comments that you would like to make?

25 **DR PATRICK:** Not me, but we do have a couple of points we need
26 to get back to you, if we may.

27 **CHAIR:** Yes, I'm probably going to set a time at the end of next
28 week for people to come back with material that we've asked
29 for. I haven't discussed it with the staff yet so they'll
30 probably tell me in the morning tea break that I've given
31 too much time, but at this point that's what I'm planning to

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1 do. We are keeping a list of the issues that we've asked
2 people to come back on and I will read those out at the end
3 of the proceedings and formally set the date by which I want
4 the responses, but it is likely to be close of play the end
5 of next week.

6 It's again over to me to thank you both for your
7 presentations and again I'd just like to say that we are
8 happy to give you the time to consult with your other -- the
9 other members of your party who were not able to be here
10 today because of illness, and we'll look forward to reading
11 those submissions. So, thank you once again.

12 Now, we have Meritec scheduled to appear at 10.15, and I
13 just want to see if they are available now? [**Pause**]. No,
14 okay. Then I will adjourn this session until 10.15 at which
15 time we will hear the submission from Meritec. That session
16 is scheduled to go to 10.45. Thank you very much.

17

18 **Adjournment taken from 9.25 am to 10.17 am**

19

20 **CHAIR:** I'd like to now reconvene this session of the Commerce
21 Commission's Conference on the Gas Pipelines Inquiry Draft
22 Framework paper.

23 Next on the schedule we have a submission from Meritec,
24 and I'd like to welcome you now and ask you to state your
25 name for the record, and start your presentation when you're
26 ready. Thank you.

27

28

29

30

PRESENTATION BY MERITEC

1
2
3 **MR WABNITZ:** Thank you Madam Chair, good morning everybody. My
4 name is Guenter Wabnitz and I'm from Meritec. Meritec is an
5 independent consulting firm formerly known under the name of
6 Worley Consultants, which used to be a New Zealand company
7 up to about a year ago, owned by its employees, and is now a
8 company, an AECOM company, which is an American consulting
9 firm, large international firm and we are going to trade in
10 about a month's time under the name of Maunsell, which was
11 the British-Australian sister, or daughter company of AECOM,
12 and Meritec and formerly Worley has had a long-term
13 affiliation with the gas industry or the energy industry.

14 One of our main lines of consultancy is power
15 engineering, but also infrastructure consulting. We are
16 mainly engineers, but we have also economists and other
17 professionals, and we -- I myself have been in the industry
18 for more than 20 years in Europe and in New Zealand, and in
19 many different parts of the industry starting from
20 exploration and production down to utility businesses and
21 I've also worked for utilisation companies of energy.

22 So, we cover also, as a company Meritec, we cover the
23 whole spectrum of the industry, and we are not paid by any
24 of the industry participants, so I'm just doing this because
25 my heart is with the industry and with the public, but also
26 with the company, and I try to share some of my experience
27 and answer questions that you might have.

28 I have regrouped the points of my presentation from my
29 initial -- from my submission, but in essence it's quite
30 similar, and I would like to focus on the four major
31 objectives that were stated in the Commerce Commission

1 paper. So, whether the gas services may be controlled for
2 reasons of competition or efficient pricing. Also, whether
3 there is an appropriate methodology for asset valuation,
4 then to talk about the net benefits, with a point of net,
5 and any other matters that the Commerce Commission might
6 like to consider.

7 I would like to go straight away into the first point,
8 the question of competition and efficient pricing. I feel
9 quite strongly that there could be a benefit in the
10 definition of the boundaries of the market, and what we want
11 to look at, because this has also been mentioned in previous
12 presentations and will come up again, so whether to only
13 look at transmission and distribution, or whether to take a
14 more wider picture of the industry which would include also
15 the production and utilisation of the gas. I will come back
16 to it in detail a bit later.

17 Then, of course, it may be worth also looking at the
18 process of gaining evidence about competition pricing
19 issues. Then it might be quite worth to look also at the
20 various scenarios of Government control we have had in the
21 past, which is not that long ago, and also to consider the
22 type of efficiency which might be important in the future
23 scenario of the industry.

24 So, starting with the various aspects of the industry,
25 or the boundaries, I would like to address these five
26 distinct areas which have impact on the customer's
27 perception of competition and of making decisions or
28 choosing the energy supply. It's really, the production,
29 transmission, distribution, retail and even the appliance
30 aspect of it.

31 Now, the Commerce Commission inquiry was initially only

1 about the transmission and distribution, and it has probably
2 even the power to only look at either of these two areas.
3 But, in the end it is the customer who makes the choice, and
4 who would need to be the person or the legal entity that
5 complains or raises the question of whether there is
6 competition or monopolistic pricing.

7 If you start at this end, from the user of the energy,
8 then the user has to pay for the whole lot, from production,
9 including the appliance cost. This is particularly clear
10 when it comes to residential pricing decisions. So, if the
11 ordinary residential customer wants to convert heating or
12 cooking appliances from electricity mostly, sometimes from
13 coal to gas, he or she would make an assessment of the total
14 cost, and he would go to a retailer and the retailer would
15 bundle this all together, and this used to be the
16 traditional way of pricing gas, and it only has been
17 introduced in -- maybe 10 years ago, that all of these
18 components have been split up.

19 So, the consumer actually doesn't distinguish whether
20 there is a transmission part in between or a distribution
21 part. This is, I think, a reason why the Commission could
22 look at it from a wider point of view and say, we look at
23 the total gas as a market unit and this comes then to the
24 point of inter-fuel competition.

25 I was tempted to put some prices into these various
26 blocks where there's A, B, C and A2 and B2. I didn't do it,
27 otherwise I would have gotten into trouble with some other
28 people in the audience here and that would have been
29 straightforward. But this is another way of looking at it,
30 to look at impacts of elements on transmission, for
31 instance, on the total effect on the price.

1 Just as a very rough estimate, if you would have a
2 residential customer who pays say \$20 per gigajoule for the
3 gas overall through the year, including fixed and variable
4 charges, the transmission component might be as big as 15%.
5 Now, if the Commerce Commission has, for instance, the idea
6 of only regulating transmission, and with the purpose of say
7 keeping the price or reducing the price by a few percent,
8 say 10%, the overall impact on the cus -- at the customer
9 end would be 10% or say 15%, which is 1.5%. So, one could
10 argue, how big is the impact of price control to the end-
11 consumer and whether it is worthwhile making a huge
12 democratic effort to get to this small output.

13 I mean, this was a very rough estimate here, suggested
14 approach, but it shows that the potential benefit that might
15 come out of this inquiry might be very small in comparison
16 to the risks that are involved, including political, but
17 also purely costs risks, and this might be a way of looking
18 at it differently from only looking -- going straight away
19 and saying we only look at transmission and distribution.

20 Another point is the -- when we consider the inter-fuel
21 competition, it might be worthwhile to look at the total
22 New Zealand energy scenario, and this is a diagram which I
23 have copied from the website, and sorry it's not very clear
24 to read in the small print, but probably most of you will be
25 familiar with that diagram. It shows the various flows and
26 proportions of the various fuels that make up our energy
27 supply. Gas contributors from the energy input to about, a
28 bit more than 25%. But we have to consider that a large
29 proportion, which is the purple branch, goes into methanol,
30 which is nearly half of the gas volumes that goes into
31 export, and this will finish pretty soon.

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1 Another large part is the electricity supply, which
2 leaves something like maybe only a sixth of the volume that
3 goes to the industry and commercial and residential
4 customers. Now, the transmission -- in particular the
5 distribution systems mainly -- or the assets that are linked
6 to these systems are mainly linked to this small part, these
7 40 petajoule.

8 There's the part that goes to Auckland power stations
9 through the Maui pipeline at Huntly, but as an overall cost
10 in the transmission system the large majority of the assets
11 that are in the ground are related to the 40 petajoule that
12 goes into industry, commerce and to residential customers,
13 and particularly the distribution system is mainly linked to
14 the residential system, and the reason why it has been
15 expended over the last 30 years is because we have had price
16 of coal in the past that favoured the development of
17 residential distribution, and so companies have put a lot of
18 effort and assets into the ground for this part of the
19 market, which is only in the order of 6 petajoules, which is
20 a tiny proportion of the total energy seen in New Zealand.

21 So, we are looking at the two components of the
22 industry, the transmission and distribution system which
23 only supplies a very small amount of the total energy demand
24 in New Zealand, and this puts the whole effort of this
25 inquiry also into a different perspective, possibly.

26 Just briefly about the history of price control; it's
27 not that long ago, only 10 years, that we actually changed
28 from a price controlled environment to a free market
29 enterprise in our gas industry, and admittedly we were some
30 forerunners in the world.

31 I believe there are now a number of countries who also

1 have started to deregulate their gas industries, or energy
2 industries, and it's particularly interesting to see Europe
3 doing a similar exercise, which is, of course, quite a
4 different scale to New Zealand's situation here, and it's
5 much more complicated because there are inter-country supply
6 agreements and so on, it's much more complex. But
7 nevertheless, we have changed from a regulated environment
8 to a deregulated environment, and in a way that I believe
9 the overall outcome was quite positive to the industry; in
10 parts it was painful but it also had some positive outcomes.

11 So while we look at the pre 1992 era where a big -- I
12 don't want to say "mistake" -- but an outcome was that the
13 Maui gas was sold very cheaply and was given away in the
14 form of methanol to export markets, and also burned in low
15 efficiency processes, like some power stations with only 30%
16 efficiency, and it also encouraged a cross-subsidised
17 market, particularly the residential market at the cost of
18 industrial markets, which is why in the past 92 era when the
19 industry was deregulated, companies like Nova Gas had a good
20 chance to get into the market and to tackle these industrial
21 markets who had to pay premium prices for the effort that
22 was involved to supply these markets.

23 The deregulation has also brought open access to the
24 pipelines. I believe that the pricing structures that have
25 been put into place both by the transmission companies and
26 the distribution companies better reflect the true efforts
27 in supply, and while they might not be perfect yet, but it
28 definitely has improved from an economic point of view.

29 And the disclosure information regime that was
30 introduced in 1997, which is not that long ago, has also
31 brought some good outcomes. The first few years we have had

1 these Ernst & Young reports which compared the industry and
2 it's still carried on to a degree by another firm now, and
3 which is quite a good tool for companies who want to enter
4 the market or want to trade energy and so on.

5 So, from this point of view, we have now a very short
6 history really in the deregulated market, in particular with
7 the disclosure information, and this has also impacted on my
8 final statement which I would like to summarise after my
9 presentation.

10 Now, another key important aspect, I believe, is to look
11 at the future energy supply and what impact any deregulation
12 might have on this. Now, I want only to point out the
13 dynamic efficiency that needs to be retained in the market
14 because I believe there will be ongoing increase in the
15 demand in residential and commercial gas supply, partly
16 based on the growth of our population, but also in the way
17 the consumers would like to use the energy. Gas is not
18 only -- used to be marketed as a cheap fuel, but in the
19 future it will be rather marketed as a premium fuel with a
20 high-energy output per time unit.

21 So, we change from an efficiency point of view on price
22 to a point of an effectiveness that gas is a very effective
23 fuel that can produce instant heat at a very high rate,
24 which is particularly clear when you think of your own home
25 environment. With an extra gas pipe you can heat up your
26 house instantly within a very short timeframe because you
27 are limited with your electricity supply to a very small
28 rate of triggered electricity that can heat your house. The
29 same applies to the industry; you want to have a very high
30 rating, and this is what gas can supply, and what actually
31 is installed in our distribution and transmission networks,

1 so that these networks have this additional capacity to
2 provide short-term capacity to the market.

3 Unfortunately, there is a bit of debate about our
4 reserves at the moment, and some companies have indicated
5 that they're a bit frustrated about not finding enough gas.
6 I think overall there is still good prosperity because
7 exploration hasn't been done to a large extent, but on the
8 other hand I have seen countries like my own native country,
9 Germany, that had a certain peak in development and after a
10 certain -- after this peak there might be a slow decline; it
11 doesn't happen instantly because there's ongoing exploration
12 and enlargement of existing gas fields, but at a certain
13 stage this is what happens, whether it happens in 5 years,
14 10 years or 20 or 50 years it's debatable, but eventually it
15 will happen. So, this is an ongoing concern particularly
16 for an island country like New Zealand.

17 Another aspect is that -- well, we have a shift of
18 energy demand. So, if we see that gas reserves are
19 declining, we have to find other energy forms, and we will.
20 We could import oil, but we can get our domestic reserves,
21 like we can increase water, Project Aqua, wind energy might
22 come into play and there might be other forms of energy,
23 also energy savings could be a very big impact.

24 So, there is a lot of alternatives to gas, and this is
25 what I would emphasise with my earlier graph on the various
26 forms of energy, that there are a lot of alternative fuels
27 around. If you look at gas as the whole and not only as
28 transmission and distribution, then there is this kind of
29 competition.

30 A large part of the disclosure information, kind of,
31 activity over the last few years is the valuation debate,

1 and this is an ongoing issue and probably the most important
2 aspect of control. Therefore, the Ministry of Economic
3 Development has attempted to provide a draft handbook for
4 this ODV valuation, and I have been personally involved in
5 parts of this.

6 Definitely, this -- the industry waits for some clear
7 guidance and a rulebook, and this has not been promulgated,
8 and I believe just because of a lack of resources of
9 Ministry and they have been distracted by other more
10 pressing issues. I strongly promote, sort this out, whether
11 it is the optimum valuation methodology or not, but that
12 there is a benchmark for valuation and some clarity to the
13 industry, because otherwise this will be an ongoing debate
14 and nobody quite understands how to value the business.

15 If we look at the net benefits to the public, on the
16 firsthand the positive benefit of any price control might be
17 lower tariffs. I'm sure this is what the Minister of energy
18 would like to see. But on the other hand, if this would be
19 achievable there are a lot of potential costs and risks.

20 The biggest cost that was apparent in the industry over
21 the last change from a regulated to a deregulated state was
22 the cost of change, and I personally have seen a lot of
23 disruption of the business and the gas industry being so
24 small, I believe can't afford to have this scale of
25 disruption.

26 So, I would rather promote small changes, step-by-step,
27 and more cautious changes. Of course, there are other risks
28 like the long-term security of supply if there is not enough
29 interest in investment, compromised safety if everybody's
30 distracted with minimising the costs, and of course the
31 costs of bureaucracy, inefficient use of gas and

1 environmental costs.

2 I want to come to a conclusion, well, faster the better.
3 Other matters that need to be considered is the management
4 of the process of this inquiry, but also the control.
5 I believe it is important also to the public to show
6 evidence that there is in fact monopoly abuse or monopoly
7 pricing mentality in the industry, and this needs to be
8 somehow demonstrated by possibly statistics to show over a
9 period of time how the prices have changed. And I
10 personally believe there has been too little time to show
11 this, because really the information disclosure regime is
12 only 5 years old and effectively companies doing ODVs is
13 only 3 years old; that was the first draft of the ODV
14 handbook, and it was in these 3 years' time companies were
15 stuck in the deregulation process and restructuring of their
16 businesses, and had very little time to actually produce
17 very good data and processes to do a good job on the
18 information disclosure, and I also believe that you need
19 some more time to see statistical changes in pricing.

20 So, this could have impact on the way, how the
21 Commerce Commission would propose any implementation of
22 changes, and definitely the timing is important.

23 Now, if the Commerce Commission, for instance, comes
24 with a conclusion that there is not a very strong point of
25 evidence of monopoly pricing, and also there is large
26 competition as in the gas industry as the whole, or as
27 inter-fuel competition, the Commission could take the stand
28 to say, well, we give the whole process another 5 years or
29 so time to monitor whether there is actually monopoly
30 pricing and then review the process of control at a later
31 stage. This would maintain the "threat" of price control

1 and keep the companies honest, and this might benefit the
2 companies in the meantime to improve their systems and the
3 Ministry of Economic Development to improve for instance the
4 ODV handbook.

5 These are, in principle, my key messages. So, first of
6 all, look at the industry as a whole and concentrate on the
7 wider issues of inter-fuel competition. Allow the industry
8 to have some form of stability to actually consolidate the
9 deregulated environment, but also to improve the efficiency
10 of their operation, and to maintain flexibility for future
11 market developments, and to see what happens now with all
12 the new gas finds and with our supply side.

13 Then look at the valuation methodology and particularly
14 set some clear guidelines on the methodologies. One issue
15 in particular here which I found a bit of a difficulty is,
16 there are some inconsistencies which could be addressed very
17 soon; something like inconsistencies with FRS3 for financial
18 reporting.

19 Look at the net benefits and kind of estimate the risks
20 in terms of economic risks, and find possible ways of
21 managing the process which is more co-operative and gives
22 the companies more time to prove what is the economic
23 situation in this industry.

24 **CHAIR:** Okay, finished with the presentation?

25 **MR WABNITZ:** Yes.

26 **CHAIR:** Okay. I want to go back to a point you made about, you
27 talk about the post regulation period. You indicated that
28 you believe their prices had adjusted reasonably strongly in
29 that environment and were far more efficient than they had
30 been in the past. And yet later on in the presentation you
31 talk about the need to give the disclosure regime longer in

1 order to have information to base views like that on.

2 I want to get a sense of what evidence you have that
3 prices in that post deregulation period have actually moved
4 towards what we might think of as efficient prices?

5 **MR WABNITZ:** NGC, for instance, has put out pricing policies
6 based on capacity and distance which is much different to
7 the earlier regime, and this element is also in the
8 distribution part that companies have capacity component and
9 a connection component with fixed costs and variable costs,
10 and it is a very complex situation because there are various
11 different sectors, like the residential market, industry
12 markets, individual components and probably the retailers
13 would be in a much better position to give you a kind of
14 brief overview of the various pricing options that are there
15 today.

16 Also the fact that Nova Gas has entered into the markets
17 which were previously cross-subsidised, like the industrial
18 markets in the companies, was an indication -- so the shift
19 from, with this change that the incumbent companies have
20 reduced the industrial prices and increased the residential
21 prices much better reflects the investment that companies
22 have done in these areas.

23 And if you would analyse the investment, for instance of
24 a distribution company, you will see that, say, 75 to 80% of
25 the investment is in the residential market, it's all the
26 little pipelines that go to every people's house, between
27 services, and it is very -- it's a very low cost to supply
28 bulk gas to a large company, and this is why newcomers like
29 Nova Gas could easily bypass the existing system and feed
30 gas to these companies, and this might be key evidence that
31 you can see it has happened, that companies have actually

1 bypassed the system, and overall you would think it must be
2 uneconomic to have two parallel pipelines in one street,
3 which in effect it is.

4 Had they been able to negotiate with the incumbent
5 companies to wheel their gas through the system this would
6 have been overall a more economic way of dealing with it,
7 but the fact that at this early stage the incumbent
8 companies haven't even quite understood how to price these
9 traditional industrial markets, it had the legacy of having
10 higher prices to these companies beforehand has enabled
11 companies like Nova Gas to do this kind of bypassing and
12 they have gained a large proportion of the market now in
13 terms of volume, maybe not in terms of total revenue so
14 much, because a lot of the revenue is linked also to the
15 residential market which have higher prices than the
16 industrial markets.

17 **CHAIR:** What about the areas where there's no head-to-head
18 competition where bypass isn't possible? I mean, it may
19 be -- may very well be the case that the companies are
20 basing their pricing structures on something that relates
21 far more closely to actual costs, but it doesn't necessarily
22 tell me whether they're charging monopoly prices or not.

23 **MR WABNITZ:** Well, I mean the very large consumers, or the
24 largest ones are probably the power companies in Auckland,
25 or Huntly and Auckland. So, if you discount the New
26 Plymouth power stations, or the Taranaki power stations
27 which have very little length of pipeline involved in the
28 delivery of gas, so they basically have only the cost of the
29 local gas production, and low transmission or very little
30 transmission or distribution.

31 So, if you look at the only large ones, like the

1 Auckland power stations, they in fact have competition as
2 soon as the Maui pipeline is deregulated, because companies
3 will exactly calculate what does it cost to lay a third
4 pipeline in parallel, and it's worthwhile doing for large
5 stations like in Auckland; and I believe there have been
6 studies made to consider to put up another pipeline up to
7 Auckland, just for the same reason as Nova Gas has bypassed
8 at the far end distribution pipelines, and so, it is very
9 possible to actually do these kind of bypass calculations.

10 Whereas the ODV -- with the ODV handbook for instance,
11 you just need to take the prices given there as a first
12 benchmark to do your own calculations and it's not very
13 complicated to come to a conclusion what it will cost you
14 per gigajoule to deliver gas from Taranaki to Auckland.

15 **CHAIR:** I understand that you had an involvement in the
16 development of the ODV handbook. Is that correct?

17 **MR WABNITZ:** That's correct, yes.

18 **CHAIR:** I'd be interested in hearing what you see as the main
19 strengths of that handbook and where you think some further
20 refinement might be desirable, if you're prepared to comment
21 on that?

22 **MR WABNITZ:** The main strength is that it gives the industry
23 like a rulebook. I believe in a society of our size it is
24 very good to have kind of simple rules to manage your
25 business, and the initial intent of this handbook was like a
26 benchmark for disclosure information; it was not meant to
27 regulate and the Ministry of Economic Development has always
28 pointed this out, that we don't want to regulate, we want to
29 have kind of open regime where people disclose information,
30 and for this purpose it gives a very simple methodology to
31 come to some form of valuation on the basis of replacement

1 cost.

2 Now, some of the elements of the gas ODV handbook have
3 simply been adopted from the electricity ODV handbook
4 because it was the same background and the same industry.
5 I believe the handbook could probably look closer at some
6 gas specific industry aspects, and such as the economic
7 valuation, which also has been in the electricity industry,
8 but I think this is one of the weak points of the handbook,
9 that it is probably too hard to come to an economic
10 valuation conclusion as suggested in the ODV handbook.

11 From Meritec's point of view, we have a lot of dealings
12 with other infrastructure organisations, particularly with
13 City Councils and water and roading infrastructure, and
14 these organisations adopt the ODRC only and they don't look
15 at the economic valuation aspect, and I have the feeling
16 this is probably the more logical -- an easier way of
17 concluding at a valuation, just look at ODRC and leave away
18 the economic valuation aspect because there are too many
19 unknowns and speculations of economic -- of the economic
20 aspects of the -- particularly in markets, in market
21 development, in security. They can't be really forecast and
22 put into an economic model, and I think this is the greatest
23 area of where the handbook could be improved.

24 **CHAIR:** Okay.

25 **MS BATES QC:** Thank you. I do have a few questions, and I'll
26 start with this one. The reticulated gas seems to, on the
27 figures that I've been provided with for the year
28 ended September 2002, seems to take up about 18% of the gas
29 production and I guess you'd agree with that, sort of
30 accords with what you've been saying?

31 **MR WABNITZ:** Yes, that's approximately right.

1 **MS BATES QC:** What I want to ask you is, how likely do you think
2 investment in reticulated gas is if it's right that the gas
3 supply is declining?

4 **MR WABNITZ:** On the average, the distribution networks that were
5 in place have, say, an age of 20 years because a large part
6 of the development has happened in the late 80s or in the
7 80s and 90s. The kind of economic life that is used in the
8 ODV calculations is about 65 years, so the assets are
9 relatively young.

10 But I believe that the current reserves, including the
11 prospective reserves, will at least last for another 30 to
12 40 years for this sector, for the reticulated industry,
13 because purely on pricing the reticulated sector will be the
14 last one that will disconnect because of increased
15 production pricing.

16 So, the ones that are mostly affected are like the power
17 industry that might pay \$4 or \$5 per gigajoule, and they
18 only pay for the front end and through their conversion
19 they -- and losses of energy through the conversion process,
20 the electricity price quadruples or something like that.
21 So, they would be the first ones that would drop out if gas
22 prices increased due to an imbalance of demand and supply.

23 So, the last end of these 18%, they will be the ones who
24 can afford to consume or to benefit off the luxury of an
25 effective fuel, and with continuing exploration and fuels
26 this industry's likely to even last longer than only 30
27 years. So, they will be well able to afford the pricing,
28 because also you have to consider, electricity, fuels,
29 imported fuels, all the energy prices will increase as well.
30 So, if gas will get less, somewhere some other sources have
31 to be tapped in, and --

1 **MS BATES QC:** So you don't think that uncertainty of supply is
2 an issue for the reticulated market?

3 **MR WABNITZ:** Not at this stage, no.

4 **MS BATES QC:** It's just that Powerco told us yesterday that the
5 actual growth had been pretty flat over, I think probably
6 you can say the last 5 years, in that --

7 **MR WABNITZ:** Yes, this is possibly due to this effect -- you can
8 look at growth in terms of numbers, which is basically the
9 reticulate -- the domestic market or the residential market,
10 and that's still happening, but in terms of volumes, there
11 hasn't been much growth because some of the large industrial
12 customers have been disconnected partly due to entrants like
13 Nova Gas, but partly due to alternative fuels because it
14 becomes effective for some of these companies to utilise
15 alternative forms of fuels, such as coal or diesel fuel and
16 so on, and a lot of these big customers have had these
17 alternatives before, and they still kept them as an
18 alternative. So, they can easily switch from gas to diesel,
19 for instance, and they still have tanks in place and dual
20 fuel burners and it's also very easy to convert, for
21 instance, if you have got a steam company --

22 **MS BATES QC:** I understand what you are saying that the growth,
23 you think, has been flat because of the availability of
24 switching to the industrial sector?

25 **MR WABNITZ:** Correct, yes.

26 **MS BATES QC:** Just turning to the transmission costs for one
27 moment, completely ignoring the reticulated gas, because the
28 transmission costs probably -- well, 42% of the gas goes
29 apparently to petrochemicals, principally Methanex.

30 **MR WABNITZ:** Yes.

31 **MS BATES QC:** And, I don't know if they have dedicated

1 transmission or not?

2 **MR WABNITZ:** They have partly, but you have to consider, they
3 are all very close around the Taranaki area, so it's like
4 the rolling costs, if you have to only travel 5 minutes you
5 need less road than you have to cross the country.

6 **MS BATES QC:** So for us, looking at the transmission costs
7 there, do you think that's an issue for us or not?

8 **MR WABNITZ:** Not for the very large companies. The only
9 transmission component that is an issue is for the Auckland
10 Power Station -- Huntly and Auckland. So, there's -- they
11 have very large volume and it's another 35% of the gas goes
12 into electricity generation. But then of course, there is -
13 - part is Taranaki, but then the difference is the
14 transmission for base load electricity is very flat. So
15 while you have got a very large energy throughout the year,
16 the capacity per time unit is not as great because it is a
17 flat 24-hour load.

18 Now, in the future scenario this might change quite
19 possibly, that gas turbines become more like peak energy
20 supplies, it's a scenario like in Europe; you would have a
21 base load, like coal, I don't want to talk about nuclear or
22 anything --

23 **MS BATES QC:** Please, don't.

24 **MR WABNITZ:** But water and wind, but gas because it's so
25 flexible, because you can turn it on and off very quickly,
26 it can cover peaks and this might cause future -- the future
27 load on the networks to be much more ups and downs in time -
28 - in terms of time.

29 **MS BATES QC:** What about in terms of the actual quantity used
30 overall? Do you think we'll be predicting a decrease in the
31 quantity of gas used for electricity?

1 **MR WABNITZ:** That's a question of pricing really. So for
2 instance coal or imported fuels could compete with the gas
3 price. Now, companies are looking now for alternatives like
4 coal imported from Australia, which is probably cheaper than
5 produced locally, and there will be environmental aspects to
6 how costly is the cleaning up of the exhaust.

7 **MS BATES QC:** Okay. So, just in terms of looking at the
8 pricing, or the costs of transmission, you think it's Huntly
9 and Auckland that's the --

10 **MR WABNITZ:** The key issue there for the transmission of
11 volumes, yes.

12 **MS BATES QC:** Okay. Just this proposition that's been put to us
13 that it's actually inefficient in a way for, in energy
14 terms, for gas to be used to run generation plants and
15 convert -- you know, it should go -- let me try and put that
16 better. That it would be more efficient for the gas to go
17 directly to consumers, than to go through their whole
18 generation thing to produce electricity. Do you have a view
19 on that?

20 **MR WABNITZ:** Yes, I agree with that view too. I have to say,
21 the efficiency of power generation has improved over the
22 last 10 years, so the first generation power station had
23 single cycle turbines of say 30% efficiency in the
24 generation, but then of course there are additional losses
25 on the transmission and distribution side.

26 So, in the end what came to the consumers was maybe less
27 than 30% of the initial value, and with scarce -- you get
28 basically 80% or more than this that goes to the consumer
29 end. So, from this end it is also more ecologically sound
30 to burn the gas directly where it is used, like in end-
31 users; I fully agree with that, yes.

1 **MS BATES QC:** Okay, just to turn to ODV for a minute. It was
2 put to us by Powerco that ODV should make allowances for
3 valuing things like customer lists and operational
4 information, all under the sort of heading of "intangibles".
5 Do you have a view on that?

6 **MR WABNITZ:** Yes, not a very strong view. I think this is more
7 like an accounting issue and I'm not an accountant myself.

8 **MS BATES QC:** Okay, so you'd prefer not to answer that one?

9 **MR WABNITZ:** Yes.

10 **MS BATES QC:** What about valuation of easements? Do you have
11 any view on that?

12 **MR WABNITZ:** This has been discussed in the past to a certain
13 extent --

14 **MS BATES QC:** If you don't, please just say.

15 **MR WABNITZ:** Yes, I have a view, but I'd rather not say it in
16 this audience.

17 **MS BATES QC:** Why is that?

18 **MR WABNITZ:** Well, there are -- again, it's partly an accounting
19 issue, whether how to look at the --

20 **MS BATES QC:** But it makes a difference for assessing rates of
21 return, so it is --

22 **MR WABNITZ:** Yes, right. The view, I can easily say, I think it
23 has little impact on the distribution networks because the
24 distribution have very few easements. So, I have discussed
25 this morning, there have been some arguments yesterday in
26 Powerco's presentation, which I didn't attend the afternoon.
27 I think the largest part is in the transmission area, and
28 I believe that easements are a true value to the companies.
29 So, they have been acquired historically and with being
30 there and having the right of access to the land, this is a
31 true value.

1 Now, the question is whether this is a physical value,
2 like in the same area as pipelines, or say just hardware, or
3 whether this is more an intangible value, like market value,
4 and this is in the same direction as your first question
5 with like accounts, intellectual property and so on. So,
6 this comes into the field of how you look at easements from
7 the past and also international experience, easements have
8 been regarded as a physical value as part of the replacement
9 cost, and this goes all into the philosophy of ODV and how
10 it is put together, and from this philosophy which has been
11 given by the Government as a guideline, the easements have
12 good right of being there and being valued, and it is
13 probably quite correct and the firms that have been involved
14 in the past in looking at easements have taken this stance.

15 In the last few valuations that I have done, I have
16 followed this, but then you would -- if you look at the
17 total picture of what you want to value and then you have to
18 look at whether easements are part of the intellectual asset
19 of a company, like it's more like an intangible, and that
20 includes market power and all these parts, which then need
21 to be -- they could be taken outside of the physical aspect
22 but then that needs to be reflected in the total market
23 value of a company, that these marketing values are
24 somewhere being accounted for.

25 **MS BATES QC:** Yes, okay. So, if you get down to how should you
26 handle them in the handbook.

27 **MR WABNITZ:** Yes.

28 **MS BATES QC:** We don't know yet?

29 **MR WABNITZ:** Well, at the last review of the handbook, which is
30 only a few months -- half a year ago, which never -- the
31 Ministry didn't come out with the outcomes, it was actually

1 recommended to the Ministry to have a look at how to deal
2 with easements because it has been discussed before, and it
3 is partly -- could be a legal aspect, could be an accounting
4 aspect, but it needs to be looked at the same way, once you
5 start looking at what kind of return of asset is
6 appropriate, do you have a return purely on the ODV or is
7 there also a component for intellectual property like
8 intangible ones.

9 **MS BATES QC:** Okay, I understand.

10 **MR WABNITZ:** This is a combination. This hasn't been sorted out
11 yet.

12 **MS BATES QC:** Okay, one last question and you may or may not
13 know the answer. Under the 1992 Gas Act, are you familiar
14 with that Act?

15 **MR WABNITZ:** Yes, more or less.

16 **MS BATES QC:** Is there a statutory easement provision in there?

17 **MR WABNITZ:** I don't think so, no.

18 **MS BATES QC:** Thank you, that was very kind.

19 **MR STEVENS:** Mr Wabnitz, just turning to your comments on
20 dynamic efficiency, one of the points that you made was the
21 ease for the larger industries to switch from gas to coal
22 and oil. Do you have any view on the current proposals of
23 the Government's response to Kyoto and how that would affect
24 that ease of switching?

25 **MR WABNITZ:** Well, gas is still a cleaner fuel than coal, and
26 that can be also quantified in the amount of carbon that is
27 put out by combusting either of these two products, but it
28 has still carbon dioxide emissions, so it's not as good as
29 wind or hydro.

30 If the Government, for instance, puts a tax on carbon
31 emissions, and methane emissions, we have had this

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1 flatulence tax debate, then there will be an impact on this,
2 and it will -- companies will balance the total cost,
3 whether to go for coal or for gas or another fuel.

4 So, natural gas has still the best value in terms -- the
5 least carbon emissions of all the fuels and from this point
6 of view it has an advantage over oil and coal, and this is
7 why it will be probably still quite an attractive fuel for
8 also for power generation, but also for residential
9 customers.

10 **MR STEVENS:** So I guess my question then is, would you see large
11 industries switching from gas to coal or oil?

12 **MR WABNITZ:** It's a pure question of economics. What impact
13 will the carbon tax have and what is the price of gas. So,
14 if there are -- at the moment gas overall is still probably
15 cheaper than oil and coal if you consider all the other
16 costs, like transport, storage, handling; and that's the
17 reason why gas is used, and it's probably not quite
18 justified because it is a premium fuel, and with now
19 increasing gas prices, from whichever part of the industry,
20 whether it's from the production side or even from the
21 transmission and distribution side, it will have a positive
22 impact.

23 So, the Government is a bit in a catch-22 situation
24 because on the one hand it would like to have energy
25 efficiency, but reducing gas consumption, so an increase of
26 price, whichever way, would help doing this, but on the
27 other hand the Government wants to control monopoly pricing
28 and keep the price down, so it is not that easy and probably
29 the best one for the Government would be to put a higher tax
30 on it so it can gain revenue from it, from the Government's
31 point of view, but as from an economic point of view it is

1 very tricky because you have -- gas price increases will
2 have a positive environmental effect by reducing of total
3 gas consumption in whichever form.

4 So people put more insulation into their homes,
5 industrial processes might become more energy efficient,
6 some people might not use gas at all for, for instance,
7 melting of steel or other large energy consumptions,
8 production might be done overseas or so -- domestic
9 production will just be not efficient any more at higher
10 energy prices, or we have to concentrate on farming and on
11 fishing again, so it has a lot of impacts that kind of
12 pricing.

13 **MR STEVENS:** Do you think any RMA issues will also impact on the
14 ease of switching?

15 **MR WABNITZ:** Yes, quite likely. I can't see that it has a very
16 large impact yet. It will have an impact on the power at
17 the front end, but I don't believe it will have a very large
18 impact on the distributed -- the residential end for
19 instance. It's not a very large part of it, because the
20 biggest part of the value is in the transmission,
21 distribution and appliance.

22 So say, if the cost for residential and gas is \$20 per
23 gigajoule on the average and the production is \$4 per
24 gigajoule at the cost of gas; then, if you add another few
25 percent on carbon emissions, that hardly will impact on the
26 total cost of the residential market. But it will have an
27 impact at the front end.

28 **MR STEVENS:** Thank you.

29 **MS BATES QC:** Just to pick up on that RMA stuff. They also have
30 a problem with having to get consent through that process;
31 one's cost and two, it takes an awfully long time to do it.

1 So, would you agree that that's the case?

2 **MR WABNITZ:** Well, I mean, this is the same question farmers
3 would have; how efficient is it to go to this level of
4 taxation and bureaucracy which is involved in that? The
5 Government could also bundle it all together and do it at a
6 national level alternative.

7 **MS BATES QC:** So, bypass the RMA process?

8 **MR WABNITZ:** Yes.

9 **MS BATES QC:** So you could switch to coal?

10 **MR WABNITZ:** Well, I mean --

11 **MS BATES QC:** I'm just putting a simple example here.

12 **MR WABNITZ:** I haven't got a very strong opinion on this. It's
13 probably worth putting some more effort into this and
14 looking at it from an economic point of view, and also
15 looking at what is the bureaucracy cost in it compared to
16 the value that is gained with allocating these environmental
17 issues to individuals. I think, as a small country, it
18 might be much more worth looking at it at a national level
19 and reduce the taxation effect. I'm not a very large fan of
20 taxation matters.

21 **MS BATES QC:** Okay. We'll leave it there. Thank you very much.

22 **MS BEGG:** I just had one question. You note that the cost of
23 delivered gas is made up of a whole lot of components, the
24 production cost, transmission, distribution, retail, costs
25 of switching to appliances. And that the delivered price of
26 gas is constrained by inter-fuel competition. Then you gave
27 the example of price control perhaps reducing the price of
28 transmission, say by 10%.

29 The question I have is, do you think if price control
30 did reduce the price of transmission or distribution by say
31 10%, would that result in delivered gas prices reducing, or

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1 would you find that producers could take the opportunity to
2 increase the energy component price so that the delivered
3 price would stay the same but the share between
4 transmission, production, distribution or retail would
5 change?

6 **MR WABNITZ:** Yes, this is a possibility. There is definitely
7 pressure on the industry to look at the value of gas
8 delivered to the customer as a whole, and how effective the
9 mutual control is amongst the five players in the industry,
10 and we must not forget that the appliance retailers are a
11 large part of the industry, like Rinnais and so on, and the
12 industrial appliance retailers, and they have kind of --
13 they understand each other and they talk to each other to a
14 degree, and I believe that there's a possibility that that
15 might happen. So, if you keep one element like the -- if
16 you control only the element of transmission for instance,
17 the other ones could well gain from this partial control.

18 **MS BEGG:** So the producers did make the point that the returns
19 to them are quite dependent on -- well, are somewhat
20 dependent on the transmission charges. So, if the
21 transmission pipelines monopoly pricing, their re returns
22 are reduced, but presumably that also says if transmission
23 prices are reduced, they will take the opportunity to
24 increase their prices.

25 **MR WABNITZ:** Yes, I mean, the front end, like large industrial
26 customers, are more affected by the transmission component
27 than by the distribution component because there's very
28 little distribution component in their price, it's mainly
29 the transmission part, and then if it's only production and
30 transmission, the impact of transmission price change is
31 somewhat larger than if you have got the whole swag of

1 distribution and retail and appliances.

2 **MR WILSON:** I've got a question about your written submission.
3 In your written submission you suggest that -- I'll just
4 quote from it; you assume the industry has a strong self-
5 interest in co-ordinating through pricing mechanisms both
6 the demand and supply of the business, this is a reference
7 to the pipeline businesses.

8 Can you cite any evidence or give any examples that
9 illustrate that, you know, sophisticated pricing mechanism,
10 or how that co-ordination is achieved? Did you have
11 anything in particular in mind when you wrote that?

12 **MR WABNITZ:** Well, information disclosure is probably the best
13 way of looking at it, and you can read what NGC's pricing
14 methodology is, you can calculate approximately what you can
15 expect as a consumer when you are at a certain location and
16 have a certain capacity, and you can -- and mostly the
17 retailers do this kind of assessment, of what is paid at
18 which end.

19 So, where you can again get the gas a bit cheaper from
20 Nova Gas or Todd or other gas producers, and then they can
21 bargain -- well in the transmission end it's -- I think you
22 can bargain with NGC too to negotiate prices. I haven't got
23 a lot of evidence because I'm not in the -- I don't do much
24 in this retail end, but I believe that happens, that they
25 bargain about, and say, well, prove your pricing component
26 to us and at the very large end customers like Contact or
27 whatever, Genesis, if they think about building a power
28 plant they definitely consider negotiating and talking to
29 NGC, and I know that they do, and then they will make the
30 calculations and consider alternatives like LPG or coal or
31 putting another pipeline up and all this.

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1 I mean, this is done all the time for customers, and for
2 the large ones. For the smaller ones it's a question of,
3 you can't always look at individual consumers because it
4 just costs too much time and effort to do all these
5 calculations, like for a residential customer; you can only
6 do it on an aggregate basis, but even for a domestic
7 customer you can have a certain bargaining power, and I
8 don't know whether there are any consumer institutions that
9 would do this for residential customers.

10 I mean, you're probably the only one who is not directly
11 involved in the front end part of the industry, if there
12 would be the Consumers Institute that could investigate it.
13 It's not very complicated, they just have to do their
14 homework and I suppose a lot of residential customers
15 haven't got the knowledge and the time to do this homework,
16 and the lobbying to lobby for them, but I still think there
17 are opportunities to doing this.

18 **CHAIR:** I just want to check with you, Mr Wabnitz, if you have
19 any further comments that you'd like to make to the
20 Commission?

21 **MR WABNITZ:** In view of the time and of looking at the people of
22 Wanganui Gas, I rather think I wouldn't, thank you. But I'm
23 happy to answer questions later on if you want to have any
24 certain -- if you want details on this or any further
25 questions, I'm happy to do this.

26 **CHAIR:** Okay, all right. Then I'd like to thank Meritec for the
27 submission.

28 It's quite useful for the Commission to have people who
29 are independent to the companies that are directly affected
30 by an inquiry such as this, to have you come forward and
31 submit to us, so we're grateful to you.

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1 With that, now we will be adjourning this session
2 until -- I believe it's 3.30 -- 3.30 this afternoon, at
3 which time Wanganui Gas will be presenting. So, until then
4 we will adjourn this session for now. Thank you very much.

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Adjournment taken from 11.25 am to 3.30 pm

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1 speaking for GANZ in any way, and I would find it difficult
2 to find a consensus within GANZ; its members range from some
3 of those who are involved, although they're involved in the
4 network part of the gas industry, they're also involved
5 upstream and downstream.

6 So, GANZ has made a decision that each of its member
7 companies will make their own presentations to you, and most
8 of them have, or will do so at a later stage. So, just a
9 point of clarification, that I am not here in any way
10 representing the Gas Association of New Zealand.

11 Turning to our presentation, it's predominantly in two
12 parts. The first part is to just give you a brief outline
13 of the company, how we got to where we are what, we do, and
14 a little bit about us.

15 The second part will be addressing our written
16 submission to the Commission, and Mr Coe will speak to that.
17 After that I'll make some comments which I'd like to respond
18 to with some issues which the Commissioners have raised in
19 presentations so far that we've witnessed since we've been
20 here, so there's a couple of points of clarification we'd
21 like to give you. Mrs Taylor's got a comment for you, and
22 then we'll be happy to answer all the questions that you
23 want.

24 So firstly, we're going to have a look at some
25 historical milestones of the company, have a look at our
26 company structure and how we manage the requirements of the
27 competition law, and then we'll be looking at key points
28 from our submission.

29 The company has a very old and long history. It was
30 formed in 1879 to produce and distribute coal gas in the
31 city of Wanganui. In 1902 that company was acquired by the

Wanganui Gas

1 borough council of the day and things remained pretty static
2 through until 1970 when natural gas was reticulated through
3 the southern pipeline, and it was then reticulated through
4 Wanganui as well replacing the coal gas. There was a period
5 of significant growth in the use of natural gas and the
6 expansion of the pipeline reticulation at that stage.

7 In 1980 the gas companies, as they were, entered into
8 contracts for the purchase of Maui gas called "The 1980
9 Agreements". They were quite interesting, and you heard
10 reference from Powerco yesterday about franchises; well,
11 that's exactly what these contracts did. They set up
12 franchise areas in New Zealand and each of those gas
13 companies that held a franchise had both the network and
14 retail aspects of the gas business. They did have some take
15 or pay commitments but they weren't particularly onerous,
16 and they prevented competition except at an extremely high
17 level between the franchise companies in their franchise
18 areas. So, it's not a situation that would meet with
19 today's legislative framework.

20 In 1986 the Commerce Act was passed into law and that
21 obviously started bringing about changes to the
22 relationships that were based on the 1980 contracts. In
23 1992 the limited liability company Wanganui Gas Limited was
24 formed under the auspices of the Energy Companies Act.

25 The Wanganui District Council owned all of Wanganui Gas.
26 Concurrently at establishment of the company it sold its gas
27 assets, so Wanganui Gas Limited, and then sold 21.5% of its
28 shares in the company to Natural Gas Corporation.

29 In 1994 price control was removed. Now, it's
30 interesting to note that the natural gas industry was the
31 very last of the major industries to be removed from price

1 control. We'd been under Commerce Commission price control
2 for the previous approximately 8 years and, prior to that,
3 Ministry of Energy price control.

4 In 1997 we moved into the new wholesale gas and
5 transport contracts, these were the open access agreements
6 which meant that gas was purchased at injection point into
7 the high pressure transmission system, and the retailers
8 then negotiated transmission and distribution contracts for
9 the transport of that gas to their consumers at the end of
10 the network.

11 In 1997 the Gas (Information Disclosure) Regulations
12 were promulgated and they started to apply to gas companies
13 shortly after.

14 In 1998 there was a period where there was an enforced
15 separation of electricity lines and energy introduced by the
16 national Government of the day. This resulted in a number
17 of companies who had both lines and energy, and pipes and
18 gas to separate their businesses and they picked either the
19 distribution aspect of their business or the energy retail
20 aspect of their business and quit the other parts, and there
21 was quite a lot of movement at that stage; there were
22 acquisitions and mergers and we saw the likes of Enerco and
23 those sort of companies start separating out their
24 activities. Wanganui Gas, because it had no electricity
25 interests, was not forced to separate and chose not to. So,
26 at that stage we made a decision to retain both the energy,
27 retail and the gas distribution part of the business.

28 In 1998 the Gas Pipeline Access Code was adopted. This
29 was developed by a voluntary group that called itself Gas
30 House. This set into a Code a number of behavioural aspects
31 that pipeline operators undertook to abide by. Wanganui Gas

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1 was one of the inaugural members of the Gas House group and
2 was a very early adopter of the Pipeline Access Code. It's
3 very interesting to note that that Code, although developed
4 voluntarily, is still used and to a large degree abided by,
5 by all of the gas pipeline operators. So, I think it was a
6 very clear demonstration of the ability of the gas industry
7 to develop and adopt a voluntary Code and then abide by it.

8 In 1999 our company published its Information Memorandum
9 consistent with the Gas Access Code, Gas Pipeline Access
10 Code, and in 2002 the Wanganui District Council transferred
11 its shares into a wholly owned holding company.

12 Now, looking at the company structure, obviously the
13 competition law and information disclosure imposed certain
14 behavioural changes on our company from the way we did
15 business under the 1980 agreements. So, we established two
16 trading divisions, the first of which is the network
17 division which trades its brand as GasNet and it trades as
18 GasNet, and it operates the company's networks which we'll
19 address in a second.

20 The other division is the commercial division, which
21 we'll have a look at in a second as well, but that looks
22 after all of the contestable business that Wanganui has.
23 Those two trading divisions are supported by a corporate and
24 administration division which provides services to both
25 divisions.

26 Looking firstly at the network division, it operates six
27 discrete pipeline networks ranging from Waitotara in the
28 South Taranaki region in the northern part of our area,
29 right down to Bulls in the southern part of our area in
30 Rangitikei, and includes Wanganui City and Bulls and Marton.

31 The company on the six discrete pipeline networks has

Wanganui Gas

1 11,000 connections which equates to about 4% of the total
2 number of natural gas connections in the country, and it has
3 about 350 kilometres of pipe which equates to about 2%. So,
4 it just gives you an idea of the size of Wanganui Gas in
5 relation to the whole of the industry.

6 The network division provides gas distribution services
7 to six retailers trading over its networks. It provides
8 services to those retailers and to any other retailer that
9 wants to come along so long as they are prepared to sign and
10 abide by a pipeline access agreement, which is a document
11 which is made available to all-comers and it treats all of
12 those retailers in a non-discriminatory and equitable
13 fashion.

14 The network division has to abide by non-discriminatory
15 behaviour consistent with the Pipeline Access Code and with
16 the Commerce Act.

17 It offers posted prices, so anybody who wants to know
18 what the prices are, they're readily available and they're
19 also disclosed under information disclosure.

20 It offers contestable gas measurement systems, both on
21 its own network and on other people's networks as well. It
22 has 12 direct employees.

23 Looking at the commercial division, it operates the
24 company's energy trading business, both gas and electricity.
25 It trades North Island wide, it has 16,000 gas customers.
26 One of the aspects of trading only on our own network was
27 that we were very limited by geographic spread, so we had
28 geographic risk and we also had a very limited number of
29 business types, so the move -- as soon as the open access
30 agreements came, there was a move there to get trading off
31 network so that we could spread our geographic and company

1 type risk.

2 In Wanganui City it has 1200 electric customers who are
3 predominantly dual fuel, so they are included in 16,000 gas
4 customers, and we did that triumphantly to make ourselves a
5 more complete retailer, so that if people wanted to buy
6 their energy from a dual fuel supplier, dual energy
7 supplier, we could meet their needs.

8 **MR STEVENS:** Mr Goodwin, in terms of your own network, you
9 obviously are one of those six retailers, or those six
10 additional retailers?

11 **MR GOODWIN:** No, we are one of the six.

12 **MR STEVENS:** And in terms of the open access network that you
13 run, are the terms and conditions that your commercial
14 division operates under available for the other retailers to
15 see?

16 **MR GOODWIN:** Yes, it has exactly the same pipeline access
17 agreement.

18 **MR STEVENS:** And if there was ever a problem with your pipeline,
19 is that problem equally shared amongst the six retailers, or
20 would you drop others off before yourself?

21 **MR GOODWIN:** With regards load shedding, that's actually an
22 industry agreement and it's done by consumer type rather
23 than by retailer who's allocated to that consumer. So, for
24 instance, if there was a crisis, as there has been in recent
25 years, the retailers get -- have an agreed shedding plan and
26 those that can be shed first, go first, and typically those
27 that are going to be able to shut down their production
28 without any loss of production or loss of plant would go
29 first. Electricity generators tend to be the first off the
30 network. And those that, like hospitals, rest homes and
31 domestic consumers are the last.

1 But, to answer your question, no there is no bias; in
2 fact the retailer -- sorry, the network operator actually
3 takes no notice of who the retailer is, is it's simply left
4 up to the retailers to shed those loads.

5 **MR STEVENS:** Does your commercial division have any relationship
6 with the other retailers that use the network division's
7 pipelines?

8 **MR GOODWIN:** It buys and sells gas to and from those other
9 retailers, yes.

10 **MR STEVENS:** Have you ever had cause to have a dispute with the
11 other retailers whereby you actually lose your leverage of
12 the network division to be able to resolve some issues?

13 **MR GOODWIN:** No.

14 **MR STEVENS:** I'm thinking more of a Time Warner v Disney Channel
15 case in the US where we had an owner/operator of a network
16 use that relationship to force behaviour elsewhere.

17 **MR GOODWIN:** No, I am sure our network manager would be appalled
18 to think that I would think that that was ever a
19 possibility.

20 **MR STEVENS:** It's a possibility, but you've never done it?

21 **MR GOODWIN:** No, I would say the way our company has tried to
22 establish itself, it's not a possibility either.

23 **CHAIR:** Can I just ask you a question about the business, and
24 you've given us the number of customers. What I'm wondering
25 is, is it a growth -- is this a growth business or are you
26 continuing to connect customers and...?

27 **MR GOODWIN:** On the network?

28 **CHAIR:** Yes.

29 **MR GOODWIN:** Yes, it is, but it's a very low growth. Somewhere
30 between 1 to 2% would be our annual connection growth. Off
31 network it's not a matter so much of growing network

1 connections, it's a matter of gaining customers for the
2 retailer from other retailers.

3 **CHAIR:** And what do you find there, is that a -- is there a lot
4 of switching that goes on?

5 **MR GOODWIN:** There has been, but at the moment with gas
6 availability constrained I think everyone's pretty much
7 satisfied with the load they've got; they've balanced their
8 load with their available wholesale gas, and I don't think
9 there's lot more marketing going on at the moment.

10 **CHAIR:** And on the -- in terms of your industrial users, what's
11 happening in that part of the business? Is that a --

12 **MR GOODWIN:** On network or retail?

13 **CHAIR:** Either one.

14 **MR GOODWIN:** On network, very dependent on the health of the
15 region that our networks are in, which is effectively south
16 Taranaki, Wanganui, Rangitikei. Not a lot of industry
17 development in that area, heavily weighted towards the
18 primary sector, but no dairy processing. So, not a lot of
19 growth. Off network we've been very successful in picking
20 up a large number of quite large industrial consumers.

21 **CHAIR:** Do you see any trend is shifting away from gas, as an
22 energy source?

23 **MR GOODWIN:** Certainly there are a number of industrial, or we
24 prefer to call them business and residential, but business
25 consumers are certainly addressing their options at the
26 moment, and perhaps it's a point we could come back to in
27 relation to Commissioner Bates' comments about the ease of
28 switching.

29 **CHAIR:** Okay, thank you.

30 **MR GOODWIN:** Our commercial division actually sells more of its
31 wholesale gas off network than on network. We also run in

1 that division an appliance sales and installation business.
2 We believe that, to encourage connection to the networks,
3 potential consumers need to have appliances available to
4 them that are well displayed, well demonstrated, and have
5 expertise around the selling of them and well installed.

6 So, we believe that it's an integral part of growing the
7 network to have appliance sales available. Now, because
8 it's contestable business, we choose to leave that in our
9 commercial division, but you may recall that Steve Boulton
10 from Powerco was talking about the money that they were
11 putting in to try and grow network connections. Well, we
12 believe that one of the ways that we can do that is to have
13 an appliance sales section, because before you get anyone to
14 put in a new connection they need to have the appliances and
15 they need to be comfortable that they're appliance s that
16 they're going to be happy to use.

17 **MS BATES QC:** That's part of your business, is it?

18 **MR GOODWIN:** That's part of our business, yes. That goes back
19 to the old gas company regime where you simply walked in the
20 front door of the gas company, in the old franchise days,
21 and it was a one stop shop; you could buy your appliance,
22 you could have your gas retail supplied, you could arrange
23 for the connection, you could have your HP, everything was
24 done for you, and we still offer that service. Whereas,
25 most of the gas companies that have gone either network or
26 retail, neither of them see it sitting comfortably in their
27 business, so they don't do it. We believe that's a barrier
28 to network growth. That commercial division has 12 direct
29 employees.

30 Those two trading divisions are supported on a semi-
31 contractual relationship by a corporate and administration

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1 division which provides services to the two divisions
2 managing shareholder relationships, public relations,
3 financial and treasury management, personnel and
4 administrative support, IT and property management, and it
5 has six employees.

6 **MS BATES QC:** Can I just please take you back to something that
7 I don't think I understood, and I want to clarify it before
8 I move along. That's, that you sell more gas off network?

9 **MR GOODWIN:** Yes.

10 **MS BATES QC:** And that's to industrial customers, did you say?

11 **MR GOODWIN:** It's a mix. By customer number, very largely
12 domestic consumers, but by volume very definitely industrial
13 consumers. For instance, we supply --

14 **MS BATES:** This is a silly question but what networks do those
15 customers use?

16 **MR GOODWIN:** Wherever they happen to be; we supply gas in
17 Auckland, Hawkes Bay, Taranaki, Wellington; so our energy
18 business sells gas all over the North Island.

19 **MS BATES QC:** So, you sell it to retailers?

20 **MR GOODWIN:** No, we are the retailer; we sell it directly to the
21 user.

22 **MS BATES QC:** Sorry, you sell it to other --

23 **MR GOODWIN:** We sell it to the consumer.

24 **MS BATES QC:** To the consumer?

25 **MR GOODWIN:** Yep.

26 **MS BATES QC:** For use not on networks?

27 **MR GOODWIN:** No, we use Powerco's network in Taranaki, we use
28 Powerco's network in Hawkes Bay, Vector's network in
29 Auckland and so on.

30 **MS BATES QC:** I'm glad I clarified that with you, I understand
31 what you mean now.

1 **MR GOODWIN:** So, from the point of view of the energy trading
2 business, they buy the gas in New Plymouth or in that area
3 from the wholesaler, they reserve capacity in the pipeline,
4 the high pressure transmission pipeline to get it down here,
5 or up or across, they then reserve capacity and pay for the
6 use of the local area distribution networks, and they bundle
7 all of those component charges and they sell it to the end-
8 user in a manner which is agreeable and attractive to the
9 end-user.

10 So, if we can bundle all of those component costs and we
11 can do it at a price or a service level that the consumer
12 feels is better than the competition, then we win their
13 business. For instance, we've just picked up, about 18
14 months ago, all of Goodman Fielders' business throughout the
15 North Island.

16 **MS BATES QC:** Who were they previously using?

17 **MR GOODWIN:** With Contact. But they chose to come with our
18 company. We trade off our own network as Direct Energy, and
19 we trade on our own network as Wanganui Gas. There's very
20 good brand loyalty to Wanganui Gas in our region, but not so
21 in regions other than Wanganui.

22 **MS BATES QC:** Thanks, that's interesting.

23 **MR STEVENS:** Do you show your line charges separately -- your
24 fixed charges separately to your variable charges?

25 **MR GOODWIN:** Yes, we do. In retail?

26 **MR STEVENS:** Yes.

27 **MR GOODWIN:** Depending on what the customer is, but certainly
28 from the point of view of -- well, do you mean line charges
29 or fixed charges?

30 **MR STEVENS:** I'll correct myself; fixed charges first.

31 **MR GOODWIN:** Yes, if you look at the domestic consumers, say

1 pick one in Manawatu, they will be paying a daily fixed
2 charge and a variable charge based on the volume of gas that
3 they use. And those fixed charges may incorporate the
4 transmission fixed charge, it may incorporate the
5 distribution company's fixed charge, and it will also
6 incorporate the cost of reserving the gas, because when we
7 book the gas we have to pay a component part of it, whether
8 we draw it down or not, and that's an element of take or
9 pay.

10 **MR STEVENS:** Have you ever disclosed those elements of the fixed
11 charge separately?

12 **MR GOODWIN:** We have to disclose them under information
13 disclosure. At the moment retailers have to disclose those
14 as well. The suggestion is that in future retailers won't
15 need to, but at the moment we do, yes.

16 **MR STEVENS:** Thank you.

17 **MS BATES QC:** Just one, I think you might have said; does your
18 off gas network -- you obviously sell more gas, it's a
19 bigger part of your business in terms of revenue?

20 **MR GOODWIN:** It is, in terms of revenue, yes, it is.

21 **MS BATES QC:** What about in terms of growth? How does it
22 compare with the network stuff?

23 **MR GOODWIN:** Well, again it's -- the retailer has been able to
24 make gains in customer acquisition, but that hasn't
25 necessarily resulted in network growth for the network on
26 whose network we're using to trade on. So, all we've done
27 is to take the customer off another retailer, but that
28 hasn't resulted in growth for that network operator.

29 **MS BATES QC:** Okay, thank you. If I could pass over to Mr Coe
30 for the next part of our submission.

31 **MR COE:** Thank you, Trevor. For the record, my name's Jim Coe,

1 Network Manager at GasNet, which is owned by Wanganui Gas
2 Limited.

3 Looking at our submission key points, I wish to actually
4 look at five topics. The first is competitive markets. The
5 second is gas pipeline businesses. The third relates to, is
6 prescriptive control required. Fourthly, the analytical
7 framework, and finally the counterfactual.

8 Starting with the competitive market, and I apologise,
9 this is quite a busy slide. We see that distribution prices
10 are constrained by -- in three ways. Firstly, the energy
11 source substitutability. There's been some discussion
12 already at this Conference about substitution of gas,
13 electricity, LPG, and rather than spend time specifically on
14 this point I just wish to indicate that Mr Goodwin will be
15 making some comments at the end of the presentation
16 regarding some specific examples that have occurred within
17 Wanganui Gas areas.

18 I'd like to focus a little bit more on the area I've
19 identified there as "market", and I should say -- a point I
20 wanted to say from the outset, I'm sorry, that this is
21 actually a perspective, a practical perspective as an
22 operator within the environment.

23 In terms of the market, we perceive there are a number
24 of possible causes to constrain network or distribution
25 prices. Any increase in the wholesale price of gas may in
26 fact make gas less competitive. This goes to the question
27 of substitutability and the area where, in part, the
28 electricity wholesale price or delivered price is created
29 from the burning of gas versus the direct use of gas.

30 We note that dual fuel retailers, or dual energy source
31 retailers, may alter their behaviour to maximise the

1 economic returns to the fuel that can achieve that for them.
2 On this basis, if energy and gas are sold by the same
3 retailer, there may be a desire to maximise returns based on
4 the electricity component of their business at disbenefit of
5 gas.

6 In terms of retailer pricing strategies, end-user
7 charges, we'd like to remind the Commission that from a
8 network's perspective the end-user does not see the
9 specific -- sorry, while they will see the component of the
10 final cost to them, which relates to distribution services,
11 they will see the cost to them will be packaged as the
12 retailer wishes it to be packaged. So, it may be fully
13 fixed or it might be fixed plus variable, and therefore may
14 not relate at all to the way the network has presented its
15 component of cost to the retailer.

16 Without doubt, there's a public perception that gas
17 unavailability is an issue, and within this potentially a
18 constraint on pricing. If the end-user feels that gas is
19 not going to be available, then they will not be as
20 incentivised to either increase the use of gas or switch to
21 gas in the first place.

22 Regarding regional economic issues, Wanganui Gas is a
23 regionally focused company from a network perspective, and
24 as such we are constrained by the region we live in and the
25 prosperity of the region.

26 The final one there I have put in specifically because
27 it's an issue that may be of interest to the Commission,
28 TLA, territorial local authorities and developers working to
29 put in place, for example, a new subdivision, housing
30 subdivision, have in our experience limited awareness of
31 gas, and we have examples where developers will in fact not

1 include gas as part of their package to incentivise people
2 to either buy a section or move into the potential new
3 subdivision.

4 Equally, the TLA may not actually require, as part of
5 their consenting process, the inclusion of gas reticulation
6 or the opportunity to do so.

7 What does this mean for us? On a number of occasions
8 GasNet has been advised at very short notice that we have an
9 opportunity to put gas reticulation into a subdivision
10 because there's going to be a trench laid for wastewater and
11 electricity etc. So, in total there are issues around
12 awareness of gas.

13 **MS BATES QC:** On that subdivisional question, do you have
14 instances where the TLA will specify that as a condition of
15 the resource consent?

16 **MR COE:** Yes, I can't provide you with a specific TLA name here
17 and now, but yes, they do exist.

18 **MS BATES QC:** They do exist. Is it a growing practice, do you
19 think, or it's just happening sporadically?

20 **MR COE:** We would like to think it was increasing, but I can't
21 give you any empirical information.

22 **MS BATES QC:** And in terms of an opportunity to sell the idea to
23 the developers, well then, aren't -- isn't that information
24 sort of reasonably accessible from the councils? As I think
25 the councils are able to tell you what consents -- what
26 applications for subdivision are in front of them?

27 **MR COE:** Agree entirely with your point. I think the only
28 comment I could add is, from a developer's perspective the
29 cost of rolling out the subdivision is borne initially by
30 the developer, and hence, there are development risks, and
31 if it's -- if gas, which is normally the case, perceived

1 purely as an optional or elective source of energy to
2 reticulate, it's not in the basic game plan.

3 **MS BATES QC:** So you say it really only becomes part of the base
4 game plan where the territorial authority has made it so?

5 **MR COE:** Or the people, or the parties that are going to buy a
6 section or use perhaps some sort of commercial entity or
7 activity within that subdivision have knowledge or
8 experience of gas, or wish to have the use of gas, and,
9 therefore, they will indicate to the developer that the
10 inclusion of gas is valuable and a requirement that they
11 would look for.

12 **MS BATES QC:** Is it a sector of the market that's being
13 targeted?

14 **MR COE:** Sorry, in regard to the subdivisions?

15 **MS BATES:** Yeah. You know, is your business targetting the
16 developers as a sector of its business?

17 **MR COE:** We, as GasNet, the network operating division, have
18 taken the opportunity to encourage developers to utilise gas
19 and include gas, and we try and work with them when we can.

20 One of the concerns is lead time. We often are the last
21 party to be advised that this is going -- that work is going
22 on, and normally it's at the point where resources have been
23 committed to put in the pipe trench or what have you.

24 The final point there is in regard to the threat of
25 bypass. Wanganui Gas took a proactive position in regard to
26 its pricing methodology and identified bypass risk
27 candidates and has therefore priced accordingly to those
28 particular parties via their retailers.

29 Moving on to the gas pipeline business, GPB, we believe
30 that our business, as other businesses of this type, are
31 characterised by large long-term capital investments; that

1 the capital is returned over the long period of time by way
2 of depreciation.

3 Linking these two points together is something which is
4 a little bit different to the electricity scene, and we'll
5 link into that point next; is the initial investment is
6 predicated on low infill. If I'm talking now in a general
7 sense a subdivision or going down an existing street, the
8 gas main or gas reticulation will normally be constructed
9 with low initial connections assumed. And thus, over the
10 period of the investment, the long-term, normally in the
11 order of up to 70 years, the -- we anticipate to be able
12 to -- to pick up additional connections, i.e. Infill.

13 Wanganui network, for example, is a very mature network
14 by gas standards, with penetration or infill rates in the
15 order of 60 to 65% which is analogous to the situation in
16 the greater Wellington City area. Some of our other
17 networks, like the Marton network, is a much younger network
18 being built from the 80s and has accordingly much lower
19 infill in the order of 20 to 30%.

20 In terms of investment risks associated with gas
21 pipeline businesses versus electricity line businesses, we
22 believe that there are different or greater risks associated
23 with the gas business, purely because, if an electricity
24 lines company is reticulating a street, it has an assumption
25 of almost -- well, normally 100% connection or penetration,
26 and as I've just said, for gas the penetration rates are
27 assumed to be much much longer at on-set of investment.

28 We believe on that basis that returns under the regime,
29 whatever regime is actually used, must be commensurate with
30 those risks, and that we also indicate picking up on some of
31 the comments that have been made at this Conference, we

1 acknowledge that our networks are in fact a set of discrete
2 networks defined by geographic location.

3 **MR STEVENS:** Just -- sorry, picking up on the investment risk
4 issue, do you construct -- we're now talking about the
5 residential customers obviously and not your commercial
6 customers. Do you tailor your pipelines to projected
7 maximum demand or do you tailor it to a lesser demand, or
8 how do you actually tailor the sizing of your pipes for
9 example?

10 **MR COE:** That's a very intriguing question. We take a very
11 long-term view, and on that basis the pipes are sized to the
12 perceived high penetration, ultimate high penetration rates
13 of, say, 60 to 70%. On new subdivisions, ironically,
14 penetration rates of 90 to 95% have been experienced. So,
15 on that basis we would be looking at installing sufficient
16 capacity to meet that sort of long-term projection; a new
17 subdivision, ultimately about 100%.

18 **MR STEVENS:** So, in terms of your investment risks, just so I
19 can get my head around this, are you therefore saying that,
20 in a new subdivision where the take-up rate isn't as high,
21 you haven't factored the cost of your overall network in
22 terms of the charges, so you have -- is that what you're
23 saying why the risk is higher?

24 Because, I presume that when calculating your pipeline
25 charges to all of the users on your network, you simply add
26 up the total cost of your investment and then allocate those
27 fixed and variable costs across the existing users, and the
28 more users you have, therefore, you could possibly lower
29 your marginal cost. So, I'm having a bit of an issue
30 understanding why there is an investment risk.

31 **MR COE:** In part it relates to the valuation methodology that we

1 have. We use ODV, and within ODV we have optimisation
2 rules. In the short-term, a year, 2 years, 3 years, the
3 point you raise is valid, but the rules indicate that if the
4 investment is uneconomic or unsustainable, using ODV rules,
5 it is written down to its economic value.

6 So, there are questions around for how long or the
7 horizon(?) period for investment.

8 **MR STEVENS:** How do you determine whether something is economic
9 or not eventually, and do you have discrete areas that you
10 judge that on, or you judge that across your whole network?

11 **MR COE:** We use as a principal guide the draft 2000 ODV or Gas
12 Handbook and apply that. On that basis we're looking for
13 sustainability versus non-sustainability, and sustainability
14 is where the income stream associated with the tariffs that
15 we are charging create a sustainable asset or NPV.

16 **MR STEVENS:** And do you use that across your whole network, or
17 do you segment your network out or how do you actually judge
18 that?

19 **MR COE:** We are currently using it across the whole network --
20 whole networks.

21 **MR STEVENS:** So, to a certain extent you have cross-
22 subsidisation between areas of high uptake and those areas
23 with low infill uptake.

24 **MR COE:** Yes. But in saying that, the reality that we find is
25 that networks have to be built before they can be utilised
26 and additional connections made to them. It's a chicken and
27 egg scenario that we're faced with.

28 **MR STEVENS:** Obviously, what's your ratio between your
29 residential and your commercial users on your networks, in
30 wide percentage terms?

31 **MR COE:** In percentage terms, about 95% residential to non-

1 residential.

2 **MR STEVENS:** And in terms of income, it would be obviously the
3 flipside of that?

4 **MR COE:** Well, in part it is. A number of the larger -- I mean,
5 because we are a regional economic, or a regional based
6 company, we have some larger end-users and we have a lot of
7 smaller, small commercial users with then predominantly
8 residential. So, with the larger users, if they are sited
9 close to the gate where we take supply from, from NGC, then
10 they may be applicable to a bypass pricing regime. So, it's
11 not absolutely clear-cut in terms of the revenue stream.

12 **MR STEVENS:** I guess where I was getting to is, ultimately if
13 your significant revenue earners on your asset base are your
14 large commercial users and while your residential in terms
15 of numbers may be significant, then for it to be uneconomic
16 you would have had to build out some large distribution
17 networks to some commercial users which weren't economic; is
18 that what you're saying in terms of your overall network?

19 Because it's hard for me to understand how a few
20 consumers not taking an uptake can cause your whole network
21 to be uneconomic when the majority of your income is derived
22 from your commercial users and, and I was just getting my
23 head around your issue on after the 3 year and re-assessment
24 of the ODV.

25 **MR COE:** In terms of the investment process, the way we look at
26 it is, if a new subdivision or reticulation along a street
27 which we haven't previously reticulated is considered, that
28 may be triggered by a retailer or a request via a retailer
29 of an end-user, we attempt to look at the commission of that
30 based on the long-term.

31 In doing that, we tend to run to the average cost of

1 implementing the solution. If I can give you a concrete --
2 sort of a concrete example; if there are six houses in a
3 street and one particular house wishes to have gas, there's
4 no reticulation, the approach we take is, we determine the
5 actual cost of that investment and then determine whether in
6 fact there is a cost to the end-user of that connection from
7 the outset, or under our policy and conditions we assume
8 that the outfill or the infill over time will justify the
9 investment over the long-term.

10 **MR STEVENS:** So, in terms of your capital outlay, what
11 proportion would relate to large commercial users and what
12 proportion of your capital outlay on your network relates to
13 residential customers?

14 **MR COE:** By far the greater would be with residential; by far.

15 **MR STEVENS:** So, you spend significant amounts of capital on the
16 residential users who produce only a smaller amount of your
17 income?

18 **MR COE:** I may have misconstrued or not answered your point
19 completely before. There is -- a large percentage of our
20 income is derived from the mass market or the residential
21 market by way of our daily service charge and our throughput
22 charge.

23 **MR STEVENS:** Okay.

24 **CHAIR:** Can I just follow-up on your experience in applying
25 ODV, and in particular the economic EVA test. How often
26 have you optimised out parts of your network because it
27 failed the economic value assessment?

28 **MR COE:** We have revalued the network assets twice in -- the
29 first time was in 2000, while opening with the company, and
30 we've just completed the exercise a month ago 2003, and in
31 both occasions we have applied economic valuation criteria

1 to either a network or part of a network.

2 **CHAIR:** And how much difference did that make?

3 **MR COE:** Well, in one example, which Mr Goodwin's going to talk
4 to specifically, Flock House gate, it had -- the total
5 investment moved from approximately, under ODV, \$120,000 to
6 \$30,000 in round numbers.

7 **CHAIR:** That's one example, but what was the overall effect of
8 the EVA?

9 **MR COE:** Modest on our networks. The reason for that is the way
10 that we have captured data and the mechanisms we have to
11 capture data historically have not been as sophisticated or
12 as complete as perhaps we would like or other companies
13 currently do. We are currently installing an asset
14 management system to assist in that process, and therefore
15 the optimisation process that we've applied has been related
16 to pressure optimisation and specific optimising out of
17 duplicated asset.

18 **CHAIR:** I just want to go back to the point 3 on the previous
19 slide about the threat of bypass. You've got a bullet point
20 there that says "proactive pricing methodology reflects
21 identified bypass risk candidates". Are you suggesting
22 there you've got different pricing structures depending on
23 the extent to which bypass is a risk?

24 **MR COE:** We have identified rationale for large end-users that
25 may be susceptible to bypass. We have then reviewed, via
26 our published methodology, the appropriate pricing in those
27 circumstances and then priced or provided that pricing
28 information to retailers. On that basis they are treated
29 as -- well, they are contract customers and they are treated
30 as contract customers in the same way as all other contract
31 customers. But the pricing will be reflective of the risks,

1 the bypass risk, yes.

2 **CHAIR:** But you're still earning an economic return on those
3 connections, presumably?

4 **MR COE:** On the basis of the bypass calculation that we do,
5 which is different to the enmeshed infrastructure, our gas
6 infrastructure that is actually in place.

7 **CHAIR:** How much difference does that tend to make when you
8 shift someone from the normal pricing to a contract price?
9 Does it result in a substantial change in the price that is
10 achieved?

11 **MR COE:** On full based -- we look at doing distance pricing in
12 the first instance, and there can be some material downward
13 shift.

14 **CHAIR:** What do you consider material? Just some approximate --
15 [Pause]. If it's confidential, that's fine, you can provide
16 it to us on a confidential basis, but I think it would be
17 very helpful for us to know what the difference is in the
18 price where there is bypass risk and where there isn't.

19 **MR GOODWIN:** Madam Chair, could I make a comment. We picked up
20 on this policy very early in our pricing methodology, so
21 it's not something that we've done in recent years. When we
22 first set up our pricing methodology under the new regime,
23 the open access regime, we identified it as a risk at that
24 time and did the pricing from there. So, to try and
25 determine what the shift was, effectively that's what we did
26 from day one. So, we don't have a direct comparison.

27 **CHAIR:** Right, but you must know what you would have charged if
28 you hadn't identified a bypass risk? There must be some
29 difference, otherwise you wouldn't bother doing the
30 exercise?

31 **MR GOODWIN:** Perhaps we could respond to you, if you wish?

1 **CHAIR:** Okay, thank you.

2 **MR COE:** Just continuing on, gas pipeline businesses require
3 certainty and stability from the regulatory regime. This
4 goes to the point that the pipeline businesses are making
5 very long-term investment and therefore as much certainty
6 and stability in whichever or whatever type of regime is put
7 in place, be it light-handed or otherwise regulation, is
8 very important.

9 The final point there goes to, investment and innovation
10 could suffer. We note that an area of innovation for
11 pipeline systems can relate to the pressure that they
12 operate at. The Wanganui network is a very old network in
13 part because, as Mr Goodwin said, it relates back to the
14 coal gas days. So, parts of the network operate at what is
15 deemed low pressure.

16 Modern equivalent assets would run at medium pressure
17 and the pressure difference is substantial, and to up-rate
18 an existing low pressure system to operate either at the top
19 end of what is defined as low pressure in the distribution
20 standard, 7 kPa gauge, or to run as medium pressure is a
21 capital intensive process, and that is an area that would
22 possibly not occur, depending on the regime which was in
23 place, whether it was proactively supporting investment or
24 not, because the networks actually exist, they are providing
25 a service.

26 This links to an issue Mr Goodwin raised relating to
27 appliances. Very modern appliances, high demand appliances
28 require both higher operating pressure and higher
29 deliverability of gas simultaneously. Low pressure networks
30 were not designed or intended to operate with these
31 appliances, and there can be a mismatch as a result.

1 To give you some indication, approximately 40% of the
2 Wanganui network is what I would call low pressure or what I
3 would define as low pressure. Now, that means there are
4 numerous end-users located on that part of the network who
5 may not be able to utilise high demand appliances versus
6 others on the same geographic area who are operating, or on
7 the medium pressure part of our network who would be able to
8 enjoy those benefits.

9 So, there are a couple of areas that investment is
10 required to essentially do the same job we're doing today
11 but to meet a new specification, end-user specification.

12 **MR STEVENS:** So, is that more termed innovation, or is that
13 investment?

14 **MR COE:** The innovation is the pressure enhancement. The
15 investment is the amount -- I'm referring to the amount of
16 money we require to retro fit or improve the network to
17 handle that innovation, and the reason why that innovation
18 would be required is the high demand appliances. 10 years
19 ago they didn't exist and both in terms of their operating
20 pressure and the energy demand that they have when they
21 operate, they are significantly, significantly higher than
22 was ever envisaged.

23 **MR STEVENS:** Are there other areas of innovation that Wanganui
24 Gas are aware of at the moment in the pipeline distribution
25 or transmission area?

26 **MR COE:** Very little. I think the point I made about pressure
27 is the key one. The only other innovation that's been
28 referred to by others is the use of polyethylene pipe, which
29 is now our mainstay product. But, because of the maturity
30 of our network, it's not across the whole network, so you
31 could possibly argue that as an innovation.

1 Also under the new New Zealand Gas Standard 5258, NZS
2 5258 the pressures at which these polyethylene pipes can
3 operate is being raised, and there's a safety case to be
4 met, which under the preceding standard wasn't possible.

5 **MR STEVENS:** On a related question; do you work cooperatively
6 with other utility providers in roll-outs?

7 **MR COE:** Network roll-outs?

8 **MR STEVENS:** [Nods]

9 **MR COE:** To my knowledge we haven't had that opportunity. We
10 would certainly embrace that if it was appropriate, or
11 offered, or came about.

12 Are you suggesting at some sort of boundary level or.

13 **MR STEVENS:** I'm thinking more of along the lines of what Nova
14 Gas is doing in terms of piggybacking together with a Saturn
15 roll-out, for example.

16 **MR COE:** Sorry, other utilities within our geographic area?

17 **MR STEVENS:** Yes.

18 **MR COE:** Absolutely. One of the things, just linking that
19 thought with some others; the roading corridor is a
20 congested place and there are many comments, and I'm sure
21 familiar to the Commissioners, of various utilities digging
22 up the road and then next week or next month another utility
23 has another go in the same area. We have endeavored,
24 through co-ordination with the Wanganui District Council, to
25 co-ordinate and improve the roll-out of those -- all
26 services. The Wanganui District Council, for example, is
27 doing a major wastewater and water reticulation separation
28 which is over 7 or 8 years, and we are trying to co-ordinate
29 our efforts with theirs as best we can. We're not in
30 control of the process and therefore mismatch still occurs.

31 **MR STEVENS:** Will you see these as significant cost savings?

1 **MR COE:** They can be important cost savings, depending on the
2 work that's been done and who the principal party
3 responsible for initiating the work is.

4 Just to elaborate; water systems are buried very deep in
5 the ground, they're basically a gravity system, and
6 depending where the sump or collection point is, it may be 5
7 to 7 metres below ground level. Now, our network operates
8 at around about, normally about 600 millimetres below ground
9 level, and so to jointly trench share is possible, but needs
10 a lot more co-ordination because the works of the water
11 utility or water function need to be sufficiently or
12 significantly completed before we could join. So, therefore
13 the cost sharing is minimal.

14 In other circumstances, for example telecommunications,
15 it is possible. But we have found, for example with the
16 Saturn roll-out, that the location of the telecommunication
17 cable they were putting in was principally in areas where we
18 already had reticulation so, therefore, we didn't have that
19 opportunity, or we had a conflict about the proximity of
20 pipes or other services. Yes, we definitely try to if we
21 can.

22 Okay, moving on: Is prescriptive control required? The
23 first point we'd like to make is that it is yet to be
24 demonstrated that the benefits of a prescriptive regime will
25 outweigh the costs. Being a small company, this is an issue
26 that we are intensively interested about.

27 Sitting at this table is 60% of the management team of
28 Wanganui Gas, so we're a small company and have small direct
29 resources, and that is something which we would like to be
30 comfortable, that the benefits that are the goals of this
31 Inquiry and any potential recommendations are in fact

1 justifiable, vis-a-vis the cost of their implementation.

2 The second point is, the net benefits of control might
3 not be passed on to end-users by retailers. The point here
4 is that network, as for example was disclosed in the Meritec
5 presentation this morning, that there is in fact five
6 parties in the chain from developing the final end-user
7 cost, and distribution is but one component; and so, if
8 there are net benefits from controlling of networks, or
9 distribution, we have some reservations whether in fact that
10 will be fully reflected at the end-user level.

11 **CHAIR:** If you've got six retailers competing, you'd think that
12 that competition would ensure that those benefits got passed
13 on. I'm not sure I understand why -- what the reason would
14 be for arguing that they be passed on.

15 **MR COE:** Of the six retailers, I think -- I'll limit it to most,
16 are dual fuel or dual energy providers; and they may or may
17 not perceive the pricing to end-users for gas as being most
18 critical to their business and the value creation of that
19 business. So, therefore it may be that part of the savings
20 are retained to offset some of the costs of their operation;
21 that's really as far as that point's meant to go.

22 **CHAIR:** I still don't understand why they would risk -- it seems
23 to me they would risk losing both electricity and gas to
24 another retailer if they let one or the other get out of
25 line, and if somebody else was retaining some of it there'd
26 be an opportunity to take those customers away by passing
27 on -- by the other company just passing those benefits
28 through. So, I'm just not clear how in practise this can
29 happen if you've got that sort of competition occurring.

30 **MR GOODWIN:** Madam Chair, it's relevant that of the six
31 retailers only two of them are active in the mass market.

Wanganui Gas

1 The others tend to work -- one, for instance, has one
2 industrial supplier and one other commercial -- sorry, one
3 industrial commercial and one other commercial customer.
4 Some of these people have come on our network by virtue of
5 picking up a national deal, so they supply -- for instance,
6 in one case they picked up all of the Corrections
7 Department, so they picked up our local prison.

8 That may be the only customer that retailer has on our
9 network. That doesn't preclude them from coming to retail
10 it to the mass market, but they aren't active in the mass
11 market. So there really only two retailers who are active
12 in the mass market.

13 So with a duopoly it could be decided by both the
14 retailers that it was time for them to increase their
15 margins and they could simply pick up those reductions in
16 the network and just keep them for themselves.

17 **CHAIR:** I think we will have to give that some careful thought,
18 but just before I forget; on that previous request that I
19 asked for on the bypass price information, it would be
20 helpful to know how many instances there have been when
21 you've identified candidates as being at bypass risk, what
22 percentage of your network would you say have been
23 identified -- -- has been identified as at risk of bypass?

24 **MR GOODWIN:** We have a somewhat unique situation in Wanganui
25 where the point of delivery off the high pressure
26 transmission network is right bang in the industrial area of
27 Wanganui. So, effectively all of those businesses that were
28 sitting around that gate station, as it's called, were at
29 risk of bypass. So, they were instantly recognised in
30 price, but we will take your point away and come back to
31 you.

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1 **MR COE:** Can I just ask a further point of clarification there;
2 you want the number of end-users affected and the kilometre
3 of pipe?

4 **CHAIR:** I hadn't asked for that, but if you want to provide it,
5 that will be fine.

6 **MR COE:** We believe that Wanganui Gas will bear a
7 disproportionate share of the cost of control. Our point
8 here is that the -- our business has approximately 11,000
9 end-consumers, or our networks, and this is only a small
10 portion of the approximately 230, 235,000 end-users across
11 the country, and that if the control mechanism has a
12 relatively high fixed cost component due to compliance costs
13 then we, on that basis, will see a disproportion -- there
14 will be a disproportionate share of the cost, vis-a-vis
15 other networks.

16 We feel that prescriptive control for Wanganui Gas is
17 not necessary, and that's predicated on the fact that we
18 continue to achieve cost efficiencies which we share with
19 both retailers and owners of the business. This goes to
20 some material we provided in our written submission at page
21 6 and page 7.

22 I appreciate the time; are you happy to continue?

23 **CHAIR:** Yes, please.

24 **MR COE:** Analytical framework: We believe that the benchmarking
25 is preferable, but recognise there are some issues relating
26 to comparability. We would suggest, or just -- [**Pause**]. We
27 would suggest one way that comparability could be enhanced
28 is by looking at the discrete networks owned by Wanganui
29 Gas, and on that basis there are five networks that we own.
30 They could then be potentially looked or compared with other
31 networks, hence increasing the population of networks for

1 comparability.

2 The building blocks approach appears to us to be
3 complex, intrusive and expensive.

4 If it is used, or if it does become the required
5 mechanism to provide a valuation for the network assets,
6 then we believe that ODV is the most appropriate
7 methodology. We believe this because it's currently in use.
8 We believe that it is understood, robust and transparent,
9 and we believe it's further is consistent with dynamic
10 efficiency criteria.

11 **CHAIR:** Have you ever done any benchmarking of your company
12 against other like companies?

13 **MR COE:** Yes, in part, in that we have access, like others, to
14 the information disclosure information, and on that basis we
15 do have some comparability -- comparativity information --
16 comparability, excuse me, information. That's probably the
17 limit of the information available.

18 **MR STEVENS:** Do you have a view on the Powerco submission in the
19 ODV calculation of the inclusion of intangibles and
20 easements, particularly statutory easements and intangible
21 assets such as customer bases etc? We'd be very interested
22 in Wanganui Gas' view of that.

23 **MS TAYLOR:** I think that that's an issue we haven't considered
24 in our submission. It is an issue we'd like to go away and
25 think about and perhaps come back to you on in a cross-
26 submission.

27 **MR STEVENS:** Thank you.

28 **MS BATES QC:** Could I just ask a couple of questions, and one of
29 them, Ms Taylor, might be probably addressed to you. I was
30 just looking at the PricewaterhouseCoopers disclosure
31 compendium and not quite understanding why you can't find

1 any ROI results for gas?

2 **MS TAYLOR:** The disclosure compendium reflects the Information
3 Disclosure Regulations for the gas sector which were
4 promulgated in 1997. And, those regulations include the
5 accounting rate of profit indicator.

6 **MS BATES QC:** Yes, I see that one.

7 **MS TAYLOR:** And historically that was part of the electricity
8 information disclosure requirements as well, but then was
9 amended in the 1999 amended regulations for electricity to
10 become ROI. There are draft new regulations for the gas
11 sector which also -- I think I'm right in recalling --
12 change the ARP to an ROI calc, but that's never been
13 promulgated. So, that's why current disclosure by the gas
14 pipeline businesses reflects an ARP calculation.

15 **MS BATES QC:** And what sort of differences could we expect
16 between an ARP and an ROI?

17 **MS TAYLOR:** I'd have to come back to you on that; I can't
18 remember exactly the specifics of the calculation.

19 Just while we're on that point though, there is one
20 point of clarification I'd like to make about the accounting
21 rate of profit disclosed by Wanganui Gas as reported in the
22 compendium.

23 **MS BATES QC:** 23.1?

24 **MS TAYLOR:** Yeah, it's through these discussions and through
25 work that we've been doing with Wanganui that it's become --
26 I've become aware that the ARP that Wanganui in fact
27 disclosed in both 2002 and 2001 was incorrect. There was an
28 error in the calculation. The ARP in 2002 should have been
29 8.61%, and in 2001 should have been 8.87%.

30 **CHAIR:** Did you feel worse after you made the correction?

31 **MR GOODWIN:** It was -- revaluation of assets has an impact on

1 the ARP in the year in which they occur, but for the
2 subsequent two years the calculation formula picked up the
3 same revaluation, and that's why it was wrong, and yes, it
4 was audited, so we are talking quite sternly to our
5 auditors.

6 **MS TAYLOR:** I just want to say that in fact the compendium does
7 include the formula for the ARP and the formula for the ROI;
8 they are actually published in the compendium. So, in
9 response to your question, it is in here.

10 **MS BATES QC:** I did have a look, I was just sort of thinking of,
11 in numerically simple terms, what difference it would really
12 make.

13 **MS TAYLOR:** I'd like to go away and just run the calculations
14 and see how I think it would be different and come back to
15 you.

16 **MS BATES QC:** Yeah, that would be -- could be helpful.

17 Just on the return on equity, I'm just curious as to
18 why -- have you got these things here?

19 **MS TAYLOR:** Mmmhmm.

20 **MS BATES QC:** I know it doesn't directly bear on Wanganui, but
21 return on equity, page 38, I'm just curious why Powerco has
22 a 0.9 and United has a 172.8, there seems to be --

23 **MS TAYLOR:** I'd have to look at the detailed information in the
24 gazettes to understand that.

25 **MS BATES QC:** It's there too, anyway, I'll drop that at the
26 moment.

27 Just going back to the proposition in one of your slides
28 that returns under the regime must be commensurate with the
29 risks; remember that bit?

30 **MR COE:** [Nods]

31 **MS BATES QC:** What are your actual returns?

- 1 **MR GOODWIN:** Using what formula?
- 2 **MS BATES:** Well, what formula do you use?
- 3 **MR GOODWIN:** For disclosure -- the difficulty we have with the
4 company as a whole is that there are two parts to the
5 business. One's contestable, one's not contestable, and so
6 information disclosure is the only place that you can get
7 that information relating to the non-contestable part of the
8 business, the network distribution operations.
- 9 **MS BATES QC:** The gas pipeline business?
- 10 **MR GOODWIN:** Yes, and that's what's in those disclosure
11 accounts.
- 12 **MS BATES QC:** So, it's the ARP?
- 13 **MR GOODWIN:** There's ARP and also --
- 14 **MS BATES:** What is in the disclosure accounts is the ARP?
- 15 **MR GOODWIN:** Sorry?
- 16 **MS BATES QC:** That's the point, there isn't an ROI in those --
- 17 **MR GOODWIN:** No there isn't, that's right.
- 18 **MS BATES QC:** So do you know what the ROI is?
- 19 **MR GOODWIN:** Not of the top of my head, no.
- 20 **MS BATES QC:** But do you actually know what the ROI is,
21 somewhere in your company information?
- 22 **MR GOODWIN:** I'm sure somewhere in our company we do, yes.
- 23 **CHAIR:** Do you have a target rate of return you price to
24 achieve?
- 25 **MR GOODWIN:** That's an area that we take advice on, but it
26 obviously involves the weighted average cost of capital and
27 things like risk and risk-free rate of return and so on, and
28 we take advice from PricewaterhouseCoopers on an annual
29 basis before we do our tariff setting.
- 30 **CHAIR:** So, do you have a target rate of return that you price
31 to?

1 **MR GOODWIN:** For our network business, yes, we do.

2 **CHAIR:** Can you tell us what that is? Is that confidential?

3 **MR GOODWIN:** I would say at this stage it is confidential, but
4 we would be happy to provide it to you.

5 **MS BATES QC:** And whether the targets have been met in the last
6 years will also be interesting.

7 **MR GOODWIN:** Okay. Well, I can assure that you it wasn't for
8 the last 12 months, and the shareholders were not impressed.

9 **MS BATES QC:** Yes, but where you got to would be interesting.

10 **MR COE:** Moving on, we would also like to see that the allowable
11 return would support superior performance of the network or
12 networks. This goes to the point that, if a network company
13 is able to reduce costs, then they should be in a, we
14 believe, in a position to retain that and share with both
15 the retailers and owners of the business.

16 **CHAIR:** How do you tell the difference between superior
17 performance and performance that isn't superior? How do you
18 tell the difference?

19 **MR COE:** If the -- using the current disclosure regime that we
20 have in the last year, the comparisons were actually done
21 and published by what was Ernst & Young. Wanganui Gas, or
22 GasNet for Wanganui Gas recorded the lowest -- well, better
23 be careful of my words -- the best performance or least cost
24 performance of the networks that information was provided
25 for. And, on that basis, we believe that we have driven our
26 operation to a low cost environment. We believe that it's
27 not necessarily sustainable at that cost level over time,
28 and we would like to think that, if we can do better than we
29 have currently benchmarked ourselves at, that would be an
30 example of going to this point where we've actually then
31 done a superior performance.

1 So, perhaps slightly long-winded, we believe that by
2 demonstration of our performance vis-a-vis other networks by
3 way of published information, at least on that set of
4 information, that's the performance measure. I've got a
5 number of comments to make in regards to the information
6 disclosure on the next slide which may support this sort of
7 comment.

8 **MS BATES QC:** Just before we go there -- sorry, you probably
9 said this, but you use ODV for your own accounting purposes?

10 **MR COE:** For valuation of network assets, yes.

11 **MS BATES QC:** No, but for your reporting to your shareholders?

12 **MR GOODWIN:** Yes.

13 **MS BATES QC:** When did you change to that?

14 **MR GOODWIN:** In 1997.

15 **MS BATES QC:** Okay, thank you.

16 **MR COE:** Just by way of clarification, reporting to shareholders
17 is under FRS3.

18 **MR GOODWIN:** There's a certain amount of conflict between ODV --
19 which is the lower of ODRC, or EV -- and FRS3, because FRS3
20 does not allow ODV.

21 **MS BATES QC:** No, it's historical cost.

22 **MR GOODWIN:** No, it does allow ODRC.

23 **MS BATES QC:** Does it? So you use ODRC?

24 **MR GOODWIN:** The debate between our auditors and our valuers is
25 currently raging. FRS3 is a beast.

26 **CHAIR:** We've heard a lot about it in our hearings.

27 **MS BATES QC:** Sounds awful.

28 **MR COE:** Moving on. Counterfactual: We do not believe that it
29 is appropriate to assume the status quo, the existing
30 regime -- sorry, start again. It is not appropriate to
31 assume the status quo; that is, the existing regime.

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1 In our opinion the counterfactual needs to reflect the
2 impact of other proposed changes. The first point I'd like
3 to go to here is the Gas (Information Disclosure)
4 Regulations. As you're well aware, they're promulgated in
5 1997. In 2000 there were significant draft amendments to
6 the Gas (Information Disclosure) Regulations, which Lynne
7 has referred to, haven't been promulgated. I'd just like to
8 comment or make note of a number of aspects which were
9 included in those draft regulation changes.

10 The first, and very importantly, is the separation of
11 contestable and non-contestable assets, business components,
12 rather, or groupings of assets; and that disclosure was
13 going to relate to non-contestable. A key example of a
14 contestable asset group would be gas measurement systems,
15 the metres, and on that basis we, in cognizance of these
16 draft changes, have made a number of adjustments to the way
17 we report information already.

18 Second point is that the regulations talked to the use
19 of avoidable cost allocation method, and here it's basically
20 identifying the costs necessary to run the network business
21 by itself.

22 Thirdly, and significantly, there were many requirements
23 for disclosure of asset management system information. This
24 goes to the question of the condition of networks, and
25 basically the investment or security or safety associated
26 with the total network. This is an area that is completely
27 omitted from the current regulations.

28 Part of the Gas (Information Disclosure) Regulation
29 changes was to be the inclusion of the Gas ODV Handbook.
30 Now, since the release of the draft handbook in 2000, all
31 matters have been in abeyance, yet we, like I believe other

1 companies, have been utilising the rules and tests within
2 the draft handbook as a mechanism by which we can value the
3 network.

4 There's also an aspect which I think is important to
5 note. There was clear interest in making sure that
6 information could be made available to the widest grouping
7 of stake-holders, and in the Draft Regulations was the
8 provision for a website to be mandated, so therefore
9 information could be provided at least cost to all stake-
10 holders.

11 In addition, we have already drawn some attention to the
12 fact there was comparative information provided by, in the
13 past, Ernst & Young and addition to that the
14 PricewaterhouseCoopers' information provides at least part
15 of that continuing information flow.

16 In addition, as you are aware, the Government has set
17 its objectives for the gas industry this year and part of
18 that is a desire or challenge, or not -- desire for the
19 industry to set itself up in a self-governance way to meet
20 the requirements or objectives of the Government, and I'm
21 specifically referring here to the Gas Industry Steering
22 Group, which is basically the chief executives of gas
23 companies working together to collaboratively work out the
24 best way that self-governance can achieve those Government
25 objectives.

26 **CHAIR:** I just want to ask you a question on that. You probably
27 are aware that we looked at the same issues in the
28 electricity sector, and I believe it took them some 2 to
29 3 years to come up with a proposal that they then brought to
30 the Commission for authorisation, and we did authorise it
31 and in the end the industry did not vote to go with the

1 industry regulation.

2 The Crown now is moving to implement a Crown EGB. I
3 just -- I wonder how much weight can the Commission put on a
4 possible development that, yes, the Government has set some
5 objectives, but it's really over to the industry now and
6 whether it's going to advance it, and it's very unclear what
7 form it might take. I just wonder if there's enough
8 specificity there for the Commission to put a lot of weight
9 on it one way or the other?

10 **MR GOODWIN:** Madam Chair, if I could answer that; I think there
11 is a distinct difference between the electricity industry
12 and the gas industry. The electricity industry has a large
13 number of players, particularly in the distribution aspect,
14 the ELBs, a significant number of them. Whereas in the gas
15 industry there are only four or five network companies and
16 about six or seven energy retail companies retailing gas.

17 I also think that the gas industry has a track record of
18 being able to do things co-operatively. We talked earlier
19 on about the Pipeline Access Code which was developed by Gas
20 House in a cooperative manner. Also there was a
21 reconciliation Code which was developed and adopted by the
22 retailers for the allocation of gas at various delivery
23 points. So, I think it's very clear that the gas industry
24 has demonstrated a willingness to cooperate.

25 The other thing I might bring your attention too is
26 that, in drafting the legislation for the electricity
27 governance regime, the Minister has also included --

28 **CHAIR:** A backstop.

29 **MR GOODWIN:** -- a backstop for gas. So, I think there's a very
30 clear message there to the gas industry that unless we as
31 the industry get those things sorted out -- and we've got

1 till December next year -- then the legislation will be
2 passed, that it won't be an Electricity Governance Board, it
3 will be an Energy Governance Board and we will be included
4 in it.

5 So, I think the arguments you put are entirely valid as
6 for the electricity industry, but I think the situation with
7 gas is somewhat different.

8 **CHAIR:** I guess, you know, one other aspect to this is, it does
9 seem to me that -- I accept the points that you've made, I'd
10 like to hope that the gas industry may learn something from
11 the electricity experience, but it does seem to me that one
12 thing the electricity industry did have, an advantage is, it
13 did have fairly well developed rulebooks in large areas in
14 markets that had been in operation for a long time, and the
15 gas industry seems to be a bit further behind, has much
16 greater ground to cover.

17 **MR GOODWIN:** You're right in that the formal documentation is
18 not there, but you'd have to concede that the industry is
19 working, that switching is occurring, that reconciliation
20 and allocation is occurring; so these things are happening,
21 it just so happens that we don't have rulebooks written
22 down. It's a matter of us agreeing on what those Rulebooks
23 are and adopting them formally, but the industry -- you
24 don't hear a lot about the gas industry having problems in
25 switching, customer complaints, typical of the early days of
26 the deregulation in the electricity market where you heard
27 horror stories about consumers on a regular basis not being
28 billed and then being billed for a long period of time, that
29 sort of thing. Didn't happen in the gas industry.

30 So, I think we've just quietly got on with it.

31 **CHAIR:** How much specificity is there in the draft legislation

1 in terms of the backstop? What would happen if the gas
2 industry did not meet the timeframe? Is it specified in a
3 form that will allow us to actually turn it into a
4 counterfactual?

5 **MR GOODWIN:** I think it is reasonably specific in that I think
6 we would be -- we would have to comply effectively with the
7 same rules that the electricity industry does already.

8 But I would have to say, the Gas Industry Steering Group
9 has already made progress on a number of the issues. The
10 consumer complaints aspect of it has already been progressed
11 significantly; the switching, central registry aspect, there
12 is a proposal being put in a week's time to that group from
13 a body that has such a vehicle. So, progress is certainly
14 happening. Maybe it's valuable for you to receive an update
15 on the progress of the Gas Industry Steering Group.

16 **CHAIR:** That would be helpful. Are you on that?

17 **MR GOODWIN:** Yes, I am.

18 **CHAIR:** Okay, if that's possible, that would be useful. I did
19 meet once with, I think it's Mr Bolter, who's chairing that
20 work, but it was when he was first setting it up, and I
21 haven't heard how it's progressing now.

22 **MR COE:** Just in regard to the information, or the materials
23 that are available in regard to the draft, or year 2000 Gas
24 (Information Disclosure) Regulation documentation that I've
25 been referring to, that should all be readily available from
26 the Ministry of Economic Development, if you wish.
27 Alternatively we're more than happy to supply what we have.

28 I can recall off the top of my head something like a 40
29 or 50 page document which covered the aspects that I've
30 touched on. So, there is quite concrete information in
31 record as to what was proposed. The industry did meet with

1 representatives, Ministry representatives, to discuss those
2 proposals as well.

3 Finally, Wanganui Gas cannot continue, or believes it
4 cannot continue to reduce costs at the same rate as it has
5 achieved under the current regime. We have over time, and
6 we've provided some evidence in our written submission,
7 tried to reduce costs and return that both to retailers and
8 owners. But, if you can perceive of a cost curve, we
9 believe we're pretty much at the bottom of the curve for our
10 business; and we perceive that in any terms of any regime
11 that is put in place, costs will be reflective ultimately to
12 retailers in the short-term and over the longer term through
13 to end-users of any transaction or compliance costs which we
14 face.

15 **CHAIR:** When you've shared your efficiency gains in the past,
16 how did you think about what was shared with retailers and
17 what you kept for your shareholders?

18 **MR COE:** Part of the process we have done each year when we've
19 looked at our tariffs is a balancing of the aspects of
20 the -- the assets and the various components of the asset
21 base we have to recover a return depreciation operating
22 costs on.

23 We have endeavored to provide pricing which is pro-
24 competition and pro use of gas within the markets that we
25 operate, the network geographic market areas.

26 On that basis we strive to both reduce costs to
27 retailers and hopefully through to end-users, while
28 returning an acceptable long-term return to our
29 shareholders. It's a dynamic balance that we go through.

30 In terms of, for example, our supply charge, which is
31 the principal mechanism where we use to recover all the

1 value of the mains we have in the ground, over the period
2 1998/1999 through to 2002/2003 we've had a negative price
3 curve. So, we believe that that is indicative of the
4 benefit sharing that we were talking to here.

5 **MR GOODWIN:** There's some self-interest in it, Madam Chair, in
6 that, if we can lower the prices to the retailers who
7 hopefully will lower the price to the end-users, we will be
8 able to attract more end-users and hopefully we'll get an
9 even better return on our investment.

10 **MR COE:** That concludes the presentation, and I'd like to hand
11 back to Mr Goodwin.

12 **MR GOODWIN:** Madam Chair, I'm aware of the time. Do you wish us
13 to answer the questions that we heard raised earlier on in
14 the presentations?

15 **CHAIR:** I think we should, yes. The Commission has time, if you
16 have time.

17 **MR GOODWIN:** Certainly, yes. Commissioner Bates spent some time
18 asking questions about the ease of switching for business
19 customers. You accepted very readily that domestic,
20 residential consumers could switch easily, but you wanted
21 more evidence of business customers.

22 **MS BATES QC:** That's right.

23 **MR GOODWIN:** I have a couple here that, if you'd like, I can
24 give you some idea.

25 A number of business users, particularly the high-end
26 industrial users, are using natural gas to raise heat by
27 virtue of steam or hot water. Now, as you're obviously
28 aware, you can raise steam and hot water by using gas or by
29 using electricity or by using diesel or coal.

30 I'll give you an example of a freezing works that we
31 have on our network, Affco in Wanganui; they actually have

1 dual fuel boilers. They actually have -- it can be gas
2 fired or it can be diesel fired. Now, the choice for them
3 is simply that they actually fire the diesel on a regular
4 basis just to keep the thing working.

5 **MS BATES QC:** I can see how they could switch.

6 **MR GOODWIN:** So, they can switch readily.

7 As regards -- for instance, we have a metal foundry that
8 has dye casting.

9 **MS BATES QC:** Just go back to your Affco situation. How easily
10 could it switch to electricity?

11 **MR GOODWIN:** Probably not that easily, although I'm sure they
12 could have their boilers -- they could install electricity,
13 but fact that there is one alternative means that gas is
14 kept very honest in regard to pricing, because -- the thing
15 about gas too is that, gas is priced through the
16 transmission line on the basis of maximum daily quantity.
17 So, if a consumer needs say 10 units per day, the retailer
18 has to book those 10 units in the pipeline every day, 365
19 days of the year.

20 So, if the end-user finds that for a downturn in
21 business, or whatever the activity might be, their demand
22 comes down from 10 to 9 or to 8, we are still booking for --
23 booking and paying for that capacity in the line.

24 Something like coal or diesel doesn't have those sort of
25 capacity reservation costs, so if you've got diesel in a
26 tank, you just top it up on a regular basis. Sure, there
27 are some costs in arranging the diesel storage, but it's not
28 like having reserve capacity, which you must pay for.

29 **MS BATES QC:** Yeah, but that client you mentioned has dual
30 capacity, dual fuel capacity?

31 **MR GOODWIN:** Yes, it does. But equally other boilers could be

1 converted to LPG or to diesel as well. So, if you look at
2 the predominance of industry using the energy to raise heat,
3 then there are certainly other forms of raising heat, and
4 some use electricity by choice.

5 Another example is a foundry that we have who raises
6 metal to a point where it's liquid and then uses it for dye
7 casting. They have typically always been a gas both for
8 what they call the melting process and the holding process
9 where they hold it as a liquid; they've recently converted
10 to electricity holders because they actually believe they're
11 more efficient than gas holders. So, the chance for them to
12 switch, that if gas became price d to a higher level or
13 unavailable, they would simply use electricity rather than
14 gas.

15 And the third example is one that we actually have in
16 our submission, our written submission. An example of a
17 training establishment called Flock House near Bulls.

18 **MS BATES QC:** Yeah, I know that establishment.

19 **MR GOODWIN:** They used to have natural gas; in fact, the gate
20 station was put in there to supply Flock House. And it was
21 a very large consumer and the network was there,
22 predominantly to supply them. But while the network was
23 there, it also was taken a little bit further to supply a
24 grain dryer and a dairy farmer.

25 What happened without consultation with the retailer who
26 was supplying them, they decided to convert their whole
27 property to natural gas, they simply arranged for their
28 supply to put a big tank on the property. The cost of
29 converting their appliances was simply the cost of changing
30 an injector from a natural gas injector to an LPG injector
31 and they just rang us up one day and said "we don't want to

1 take natural gas any more". So, effectively that whole
2 network was of no value any further, but we had to maintain
3 it because at the very end of it we had a grain dryer and a
4 farmer, a dairy farmer.

5 Also, I might add that the transmission suffered
6 extensively from that; the transmission operator, because
7 they owned all of the gate station hardware, and they were
8 going to get virtually zero return. So, they are a couple
9 of examples of the ease of ability to switch away from
10 natural gas.

11 Another question that you mentioned --

12 **MS BATES QC:** I accept those examples, I don't accept they
13 necessarily give me a total profile. I mean, I'm not
14 disagreeing with you, I'm just saying you can take examples
15 from wherever you like to try and establish something, but
16 it doesn't give me -- it doesn't give me enough to be able
17 to say, yeah, that's pretty easy, switching is pretty easy
18 for industrial users.

19 **MR GOODWIN:** If I said to you that say 80% of all industrial
20 users use natural gas to raise the water temperature to
21 steam or hot water, then although you may say it's not a big
22 issue, it actually could affect a very large number of
23 consumers. There are some consumers who use the heat to,
24 say, burn the hair off hides. Now, you couldn't use
25 electricity for that, you have to use gas. So, there are
26 those examples, you're quite correct.

27 **MS BATES QC:** Thank you for bringing those to my attention. I
28 wasn't meaning to be rude about that, it's just that, those
29 sorts of processes, some will be easier for conversion than
30 others?

31 **MR GOODWIN:** Yes. Another point you made was the barriers to

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1 growth. I'd like to advise you that recently ECA, the
2 Government Energy Efficiency Agency, the Ministry for the
3 Environment and the Gas Association of New Zealand funded
4 some research into what were the barriers for growth. And,
5 that report is available now. If you wish, I could have a
6 copy of that sent to you.

7 **MS BATES QC:** Yes, we would be most grateful for that, thank you
8 very much.

9 **MR GOODWIN:** We spent a lot of money on it, so we'd like to see
10 it --

11 **MS BATES QC:** Are you going to charge us for it?

12 **MR GOODWIN:** No, no, we won't charge you for it, but we'd like
13 to see it used as widely as possible.

14 **MS BATES QC:** Okay, thank you very much for that.

15 **MR GOODWIN:** Commissioner Stevens talked a little earlier in our
16 presentation about the take-up in new subdivisions. I'm not
17 sure whether we confused you, but the take-up in new
18 subdivisions is extremely high, because it's very easy to,
19 when you're building a new house, to outfit it with gas
20 appliances from day one. So, typically the take-up in
21 subdivisions is somewhere in the 90 to 95%.

22 Unfortunately in Wanganui we don't have a lot of new
23 subdivisions, we don't have residential growth, so although
24 it is an option to us, and we take it up wherever we can,
25 it's not part of a large growth for us.

26 Typically our growth comes from, as Mr Coe said earlier
27 on, infill; so this is where we have a pipeline running down
28 a road and we may have of 100 mains fronters, we may have 30
29 or 40, we try very hard to encourage the retailers to get
30 out there and make new connections.

31 So, that's probably the largest area of growth

1 opportunity for us, and that's a lot more costly than it is
2 in a new subdivision.

3 You talked about us sharing utility trenches, and Mr Coe
4 mentioned that the Wanganui District Council is running a
5 programme of replacing wastewater pipes, and although it's
6 not ideal, we will sometimes take up that opportunity. But
7 quite often it's in an area where we have perhaps, in the
8 last 2 or 3 years, replaced our old metal pipes with a PE
9 pipe; there's absolutely no advantage to it. But certainly,
10 from an economic point of view, if we can, and even if it's
11 not necessarily in our plan to upgrade that part of the
12 network next, if there is a cost saving, a considerable cost
13 saving by sharing a trench, then yes, we certainly take up
14 those opportunities.

15 That's the only extra comments I'd like to make. I'll
16 just perhaps ask Mrs Taylor? **[No comments]**

17 **CHAIR:** I'll just see if there are further questions, if you
18 don't mind.

19 **MS BEGG:** I had a couple. One question was whether you had any
20 view on whether the constraints on a gas distributor, like
21 yourselves, that doesn't own an electricity distribution
22 together; do you think the constraints on you are --
23 competitive constraints are stronger than where the gas and
24 electricity distribution is in common ownership?

25 **MR GOODWIN:** I guess customer loss from one -- from say a gas
26 network wouldn't be so significant to you if you owned the
27 same -- the electricity network in the same area. So, I
28 guess we fight harder to keep our connections as high as
29 they possibly are. But, I wouldn't go any further than
30 that.

31 **MS BEGG:** And just the other question I had was; you said that

1 the net benefits of control might not be passed on to end-
2 users by retailers and, as I understand it, you are
3 retailers. Are you saying that that's -- that you think
4 that you would be able to capture that difference, as
5 retailers?

6 **MR GOODWIN:** To be fair to the retailers, in the last say 3 to 5
7 years there's been a lot of competition, and the margins are
8 very low, so I think that retailers are probably looking to
9 increase their margins, particularly now that gas is less
10 readily available, and certainly there are price signals
11 that gas is going to go up, so I believe that retailers will
12 be looking to make increased margins. That may be one way
13 that they can increase their margin, is by simply absorbing
14 the pass-through from the network operators.

15 **MS BEGG:** And that's your strategy? That would be your strategy
16 as a retailer?

17 **MR GOODWIN:** It wouldn't necessarily be our strategy, but I
18 would think it could be a strategy adopted by a practical
19 retailer.

20 **MR ADAMS:** You mentioned before -- I think Mr Coe mentioned the
21 cost to your company of control being a small company with
22 limited head office staff. Did you ever calculate the cost
23 of controls, quite intrusive price controls in the pre-1994
24 days?

25 **MR COE:** Not to my knowledge. I haven't been with the
26 company -- I joined the company 4 years ago. I'm not aware
27 of any work to that -- which goes to your question.
28 Perhaps, Mr Goodwin...?

29 **MR GOODWIN:** No, I'm sorry, I don't know. It ceased about the
30 time I joined the company, so I couldn't tell you.

31 **MR MELVILLE:** I've just got one question about your bypass

1 pricing regime or methodology. You spoke before that in one
2 situation there's a transmission pipeline or a gate station
3 in the middle of one of your networks, so it affects the
4 group of consumers around that, and I was just wondering
5 whether, if you had some rules or a method that you use to
6 define which consumers would be subject to this bypass
7 pricing in relation to, say, distance from a transmission
8 line or size of consumer, and also whether there was a
9 scaled approach or whether it was just in or out where the
10 consumers were subject to bypass pricing or they weren't
11 subject?

12 **MR COE:** In response we have, as a network, identified a set of
13 guidelines or rules which we believe characterise parties
14 who may be eligible for bypass.

15 **MR MELVILLE:** Is it possible to have a look at or get a copy of
16 those rules?

17 **MR COE:** I don't see why not. We can identify -- take note of
18 that and provide that with other requests.

19 **MR MELVILLE:** Thank you.

20 **CHAIR:** Okay, I think that completes all of our questions,
21 unless you think you have any further comments you would
22 like to make?

23 **MR GOODWIN:** No, thank you, Madam Chair.

24 **CHAIR:** I'd just like to thank you, Wanganui Gas, for your
25 submission. We've found it very useful. I know we've taken
26 up 60% of your management capability for the day, but it's
27 been very useful to us. You've been very forthcoming with
28 answers to questions and offers of additional material, and
29 we're grateful to you for that. So, thank you once again.

30 Before we adjourn for the day, I'd just like to remind
31 parties that we're starting at 8.30 in the morning with NGC,

1 and in the afternoon we'll have Vector, and the plan is to
2 close the hearing tomorrow at 5.30. So, on that basis I
3 will adjourn for the day, thank you.
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6 **Hearing adjourned at 5.20 pm**

7 **Resuming Wednesday, 3 September 2003 at 8.30 am**
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