

6 July 2007

Commerce Act Review
Minister of Economic Development
PO Box 1473
WELLINGTON

Dear Sir/Madam

Submission on the Review of Regulatory Control Provisions under the Commerce Act 1986

Introduction

Gas Industry Company Limited (Gas Industry Co) would like to take the opportunity provided by the Ministry of Economic Development in its discussion document entitled "*Review of Regulatory Control Provisions under the Commerce Act 1986*" to make a submission on two aspects of the proposals which relate to Gas Industry Co's role in making recommendations to the Minister of Energy on governance of the gas sector.

Our main submission relates to the entity which should make the final decision on whether to impose control. We also suggest that, if amendments are to be made to the Commerce Act as a result of this review, consideration be given to clarifying the ability of controlled entities to pass through all costs imposed on them by an industry specific regime such as that under the Gas Act, including costs which arise from non-regulatory as well as regulatory solutions.

Background

The Minister has wide powers to regulate gas utilities under the Gas Act. These powers include prescribing reasonable terms and conditions for access to transmission and distribution pipelines, providing for minimum terms in contracts between consumers and gas distributors, and requiring expansions, upgrades or service quality improvements to gas transmission pipelines. The ultimate goal in exercising these powers is to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable and environmentally sustainable manner. Gas Industry Co was formed to make recommendations to the Minister of Energy about the exercise of these powers, and to advise the Minister on the performance and present state of the gas industry.

Under the Commerce Act, the Minister of Energy can also recommend regulatory control for gas utilities. This involves imposing controls which set or influence the prices companies can charge and the quality of goods and services they supply. The ultimate goal is to protect the long term benefit of consumers in markets where there is little or minimal scope for competition. As a result, where market failure in the gas industry is demonstrated through either the prices charged or the nature of services offered (access or quality), the Minister of Energy has a choice between the Commerce Act and the Gas Act as to how to intervene.

Imposition of Regulatory Control

Paragraph 105 of the discussion paper notes that there are several options as to who should make the decision on whether or not to impose regulation on a particular firm/industry. The discussion paper proposes that the current decision-making powers should be retained, that is, the Minister should continue to make the decision on whether or not regulation should be imposed on a particular firm/sector. Gas Industry Co believes this is the only practicable option as it is important that this decision takes into account the governance arrangements of industry specific regulators.

This is highlighted in the case of gas transmission. Gas Industry Co is currently developing principles of access which relate to such matters as ring-fencing, new-entrant access, pipeline balancing and outage and contingency management. As these arrangements will affect the risks and costs of pipeline companies, it seems desirable to have clarity about the form of these arrangements before making further decisions about the nature of any increased economic regulation of the affected utilities.

In Gas Industry Co's view, the Minister of Energy, as the Minister to whom both the Commerce Commission and Gas Industry Co report on their respective activities in relation to gas, is best placed to determine when policy issues relate primarily to price and levels of profitability or to other terms and conditions of access. We also consider before making a decision on whether to impose control, that it may be desirable for the Minister to seek advice, from both the Commerce Commission, and any other regulatory agencies with responsibility for regulation of that particular firm/sector.

Input Methodologies

Section 8.1 of the discussion paper recommends that input methodologies such as the calculation of WACC, the valuation of assets, the allocation of common costs and pass through costs be set in advance of any regulatory inquiry and following a transparent consultation process. Gas Industry Co is firmly supportive of this recommendation. Certainty surrounding how specific issues will be treated under the regulatory control provisions of the Commerce Act is important to enable companies to make investment decisions and to give support to new industry arrangements.

In order to get industry agreement on some matters the consent of both the competitive and the non-contestable segments of the supply chain are required. We have already had

experience of pipeline owners being reluctant to support industry arrangements due to the uncertainty surrounding whether the costs of implementing such arrangements will be recoverable.

Section 57CA(2) of the Commerce Act provides that before exercising any of its powers under Part 4A or section 70 – 72 of the Commerce Act that the Commerce Commission must take into account, , any gas governance regulation or rule under Part 4A of the Gas Act, or any decision under that regulation or rule that relates to or affects the quality standards or pricing methodologies applicable to a gas pipeline owner.

This section does not, however, apply to industry agreements which have been recommended to, and accepted by, the Minister of Energy pursuant to the Government Policy Statement. This is inconsistent with our understanding of the co-regulatory model which allows the industry to adopt non-regulatory solutions such as contractual arrangements and/or voluntary codes in addition to regulatory solutions for its gas governance.

Accordingly, we invite further changes to those proposed to the Commerce Act to ensure that, in addition to costs imposed by regulation, costs of industry arrangements (contractual or voluntary) that have been recommended to, and accepted by, the Minister under an industry specific regime such as that under the Gas Act are able to be “passed through”. This would require a minor change to section 57CA(2).

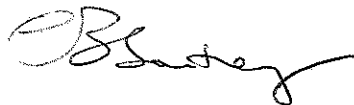
Concluding Remarks

Gas Industry Co would like to congratulate the authors of the discussion document for a well presented and comprehensive analysis of the current issues affecting regulatory control. Gas Industry Co supports the development of a set of arrangements which provide incentives for infrastructure investment whilst mitigating market power issues. We also support a wide range of tools being available for economic regulation as the constraints faced by entities with market power vary significantly across and within different industries. Market circumstances and the nature of these constraints should be taken into account when deciding the form of regulatory control.

In addition to the decision on the form of control, important decisions need to be made about when control is imposed and its scope. We think that if the Minister of Energy continues to be involved in this decision there will be an opportunity for wider policy factors such as the current state of industry specific regulatory reforms to be taken into account. This ultimately will lead to a more efficient regulatory process.

We would be happy to discuss any of our comments with your staff and we would like to be kept informed of the outcomes of the review.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Christine Southey', with a stylized, flowing script.

Christine Southey
Chief Executive