think differently

nova energy

20 October 2010

Ian Wilson
Gas Industry Company
Wellington

Dear Ian,

Gas Governance Issues in Distribution

We have reviewed the consultation paper regarding the current status of governance of the monopoly low pressure distribution networks.

Nova believes that there is some value in the industry pursuing improvements to monopoly distribution agreements from not only an economic efficiency perspective but also from the perspective of improving consumer outcomes.

In particular we believe that with the GIC's decision to put in place a regime for monitoring and benchmarking retail contracts that there is a need to ensure that upstream distribution agreements are consistent with retailers being able to deliver on those outcomes. On that basis we believe that an appropriate approach would be to develop benchmarks for distribution contracts followed by a process and timeframe for monitoring and reporting on those agreements.

We would also like to take the opportunity to comment on one or two apparent inaccuracies we noted in the consultation paper:

1) Nova Gas Limited (and not Todd Energy Limited), owns private pipelines that compete directly with Powerco and Vector pipelines in the same locations;

2) Nova Gas has approximately 200 customers connected to its private pipelines as previously disclosed to the GIC;

3) Nova Gas supplies metering services to other retailers nationally although the numbers of meters that it owns is not large comparatively;

Please find below specific responses to the questions posed in the consultation paper below.

Yours sincerely

Charles Teichert

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Question 1: Do you agree with the proposed regulatory objective? If you disagree please explain why and/or provide an alternative.

The objective should include the requirement for distribution agreements to be consistent with, or to not conflict with the benchmarks for retail contracts that have been established by the GIC.

In 2009, the GIC consulted on and proposed a regime for the monitoring and benchmarking of retail contracts for residential and small commercial consumers. The proposal which was adopted included a number of minimum terms and conditions that the GIC expected all retailers to include in their standard contracts.

It is recognised in the consultation paper that retailer contracts represent a bundle of wholesale, transmission, distribution, metering retail service elements.

It is important that the monopoly distribution and transmission arrangements are consistent with expectations that the GIC has for retailers and their terms of supply to consumers. Failure to minimise mismatch results in unnecessary risks and costs being passed on to consumers by retailers.

It is somewhat ironic that it was due to the perceived lack of competitive tension and consumer bargaining power that led the GIC believe that retail contracts of several competitors should be subject to benchmarking and yet there is no linkage to ensure that monopoly distribution terms are not also consistent with those same. Retailers have little if any bargaining power individually or collectively as has been demonstrated previously in several areas such as disconnections, UFG management and scaling of volumes and credit support to name a few.

Question 2: Have we identified all relevant characteristics of distribution? If not, please suggest what other features you believe to be relevant, and explain why they are relevant.

A key characteristic not included in the analysis is the inclusion of certain obligations under distribution contracts in retail contracts with consumers. As there is limited opportunity for retailers to negotiate distribution terms and no competitive tension, then obligations placed on retailers are generally included in consumer retail contracts.

The terms and conditions in distribution contracts that tend to be identified as issues related to retail contracts include (but are not limited to):

- Disconnection/reconnection;
- Faults information and notification;
- Access to network assets and interconnection points;
- Responsibility for assets;
- Credit support.

These areas are also the subject of the benchmarks for standard retail contracts that are being monitored and assessed by the GIC and we believe there is a growing disparity between what is expected of retailers in their contracts and what is in distribution agreements.

In the circumstances where there is competition between distribution networks (such as in areas where Nova has competing pipelines) then retailers and their customers have access to improved negotiated terms and conditions compared to standard terms. This reflects the benefits of competitive tension.

Question 3: Have we identified all regulatory arrangements that are relevant to the analysis of gas distribution? If not, please suggest what other regulatory arrangements are relevant, and explain why they are relevant.

We agree with the GIC's assessment that non price aspects of distribution contracts are an issue that is not covered adequately by the Commerce Commissions price control regime especially when at the level of detail identified in the consumer outcomes the GIC seeks to achieve through retail contract benchmarks.

Nova believes that a direct outcome of the Commerce Commissions price control regime has been the incentive for distribution companies to pass risk to retailers that is better or more appropriately managed by distributors. Evidence of this includes onerous credit support requirements on retailers that cannot be passed through to consumers and the lack of relief from fixed term pipeline charges when customers default. In addition, retailers must deal with terms that they would not have to in competitive markets such as:

- payment of lines charges after customer disconnection or premise vacancy;
- UFG risk and scaling of customer usage volumes;

Question 4: Have we identified all issues relevant to the analysis of gas distribution? If not, please suggest what other issues are relevant, and explain why they are relevant.

As noted above, Nova believes that some of the key issues to be addressed in new distributor arrangements include:

- credit support requirements need to align with consumer outcomes as per the retail contracts framework put in place by the GIC;

- UFG management. Currently, distributors scale retailer volumes to eliminate UFG risk and there is no incentive to undertake activities that prevent or minimise UFG. The fact that one retailer have been identified as understating volumes most likely deliberately affects all retailers and competition between them and should have been identified much earlier than it has been.

- Lines charges following ICP vacancy. Nova' view is that distributors should not be able to charge retailers for ICP's that are vacant. This issue manifests itself in the disconnection/reconnection fiasco that continues unabated.

- Information requirements regarding faults and interruptions need to align with consumer outcomes as per the retail contracts framework put in place by the GIC

These are areas that currently represent misalignment of interests and result in inefficient outcomes for consumers. This is born of the lack of competitive tension as distribution is for the most part a natural monopoly. If distribution was competitive, then the current treatment of the issues identified above would likely be different and more aligned with retail and consumer interests.

Question 5: Do you agree Gas Industry Co should do no further work on the safety and reliability aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.

We agree, that the GIC should not do any further work related to safety of networks as these issues we believe are comprehensively covered by existing legislation for all pipeline owners, distributors and gas installation owners.

Question 6: Do you agree with the options identified for dealing with slow progress on updating standard distribution agreements? Which option do you think is most appropriate?

Yes.

Nova prefers that the GIC develop minimum benchmarks for distributor arrangements and set a timetable for compliance with those benchmarks. We suggest a similar timeframe as used for retail contracts should be sufficient.

Question 7: Do you agree Gas Industry Co should do no further work on the other efficiency aspects of distribution services? If you think Gas Industry Co should do further work on this topic, please explain why.

Nova believes that any other issues relating to efficiency can be addressed during development of benchmarks.

Question 8: Do you consider the high level benchmarks for distribution contracts proposed in Appendix A are appropriate? If not, please suggest what alternatives should be considered.

The high level benchmarks described in Appendix A were referred to as preliminary ideas only and Nova agrees that the style of the benchmarks should be a useful starting point for development.