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Dear Ian

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide comments to the Gas Industry Company on the discussion paper entitled 'Access to Gas Processing Facilities' dated August 2006. Genesis Energy has reviewed the discussion paper and is pleased to have the opportunity to respond to the issues raised in it.

Comments on the Proposals

Genesis Energy's responses to the Gas Industry Company's specific questions are attached to this letter as Appendix One. In general, Genesis Energy welcomes the approach set out in the discussion paper – the relatively detailed technical and economic analysis and the qualitative assessment. Genesis Energy whole-heartedly concurs with the statement, set out in the section entitled 'Needs Assessment Framework' that says:

"The design of access protocols will depend on the extent to which they are needed to address any economic efficiency issues..."¹

It is appropriate for the Gas Industry Company to assess the economic characteristics of the gas processing facility market to determine the design of access protocols. It follows that a lack of economic efficiency issues would

¹ Gas Industry Company discussion paper entitled 'Access to Gas Processing Facilities', dated August 2006, page 13, paragraph 5.1.

suggest that no case exists for an intervention (voluntary or otherwise) in the gas market.

Genesis Energy's Approach to this Issue

Ultimately, any analysis of this issue must be underpinned by a 'competition story' – whether access to a gas processing or 'essential facility' is being, or can be restricted to limit competition in either the upstream or downstream markets. In other words, whether an owner of an essential facility can prevent a competitor from processing, and selling gas, and in doing so deter incentives to explore.

Market participants (new or existing) require access to the essential facility in order to compete in other parts of the market. Theoretically, this enables the owner of the essential facility to restrict competition in the following ways:

1. outright refusal to provide access (blatantly anti-competitive behaviour);
2. delaying reaching agreement;
3. designing their facilities in ways that make their use unnecessarily costly;
4. providing access terms and conditions that disadvantage access seekers – for example, by charging access seekers more than they (implicitly or explicitly) charge themselves; and
5. imposing unreasonable technical requirements on access seekers.

In essence, if the level of competition is low, this will temper the external pressure that owner's of essential facilities face to operate efficiently. This in turn means that they would be able to charge excessive prices (extracting excessive profits) and/or recover excessive costs. If these concerns are evident, a regulatory solution is likely to be required to overcome them.

The counterfactual is stated reasonably clearly by the Gas Industry Company:

"It is also necessary to examine whether there is any evidence of inefficiency in this segment of the gas market and, if so, consider whether more proactive protocols could be used to rectify this. If, however, there is no evidence of systemic inefficiency and any issues experienced are of a purely commercial nature, Gas Industry Co does not believe it should intervene in such matters."²

² Op cit, page 7, paragraph 3.14.

The Gas Industry Company's own thorough analysis combined with the views received from industry participants seems to disprove the case for regulatory intervention. For example, the discussion paper demonstrates that the very circumstances that could be expected to be present and therefore demonstrative of the potential to use market power are muted, at best. The discussion paper reaches the following conclusions:

"Although some economies of scale appear to be present, they are significantly less than for "natural monopoly" assets, such as gas transmission pipelines, which are typically regulated."³

"In conclusion, while there are some economies of scale for gas processing, other factors can also be expected to influence gas processing decisions."⁴

"The findings in this section are not a strong indicator that efficiency problems will exist."⁵

"Most companies consider that:

- where an arrangement would benefit both parties commercially, it should be possible to negotiate access to gas processing facilities without being constrained by mandatory access protocols;....."⁶

"Qualitative feedback supported the view that whilst there are some economies of scale associated with gas processing plants these effects are likely to be dominated by other factors (such as pipeline costs and specific technical processing requirements)."⁷

"Most companies indicated they are happy to seek/offer spare processing capacity and to negotiate access agreements on commercial terms without the need for either prescriptive access protocols or regulatory interventions."⁸

³ Op cit, page 20 paragraph 6.13.

⁴ Op cit, page 21, paragraph 6.18.

⁵ Op cit, page 22, paragraph 6.24.

⁶ Op cit, page 26, paragraph 7.9.

⁷ Op cit, page 27, paragraph 7.16.

⁸ Op cit, page 30, paragraph 7.26.

“However, discussions also support the Gas Industry Co’s technical/economic analysis that it is unlikely that these factors are of sufficient magnitude as to introduce inefficiencies. A number of smaller plants have been built indicating that it is economic to do so. Most companies believe that they will be able to negotiate commercial arrangements without the assistance of prescriptive access protocols.

Stakeholder interviews have not identified any systematic problems relating specifically to gas processing facilities.”⁹

“Without evidence of systematic gas processing access problems and substantial inefficiencies it is difficult to justify access protocols that would intervene in existing ownership and commercial transactions in any substantial way.

All but relatively benign interventions carry the risk of deterring E&P investment and compromising a number of the GPS objectives.

It would also be difficult to justify expending significant effort and cost to develop complex access protocols or to impose substantial compliance or regulatory costs on the sector when no efficiency benefits have been identified.”¹⁰

The Gas Industry Company’s own analysis takes Genesis Energy back to the adequacy, or otherwise of the status quo. In other words whether:

1. the current regulatory regime is adequate to address abuses of market power by the owners of essential facilities and therefore if there is a clearly identified need to be able to detect such abuses; and
2. an information disclosure regime (of whatever form) is required as the mechanism via which such abuses would be detected.

But no causal link is drawn by the Gas Industry Company between the inadequacy of the current competition policy legislative framework and the need for some form of protocol to address the potential for the owners of essential facilities to abuse market power. Neither is there any discussion (based on the presumption that the Gas Industry Company *is* seeking to address a market power issue) as to who the most appropriate agency would be to implement an information disclosure regime for essential facilities or be best placed to interpret the information in the context of the operation of competition policy.

⁹ Op cit, page 31, paragraphs 7.32 and 7.33.

¹⁰ Op cit, page 32, paragraphs 8.1 to 8.3.

While there is a clear role for the Gas Industry Company in terms of maintaining a watching brief on gas processing arrangements, the collection and interpretation of information required for the detection of abuses of market power is generally a role reserved for New Zealand's competition policy agency the Commerce Commission.

Despite this, the Gas Industry Company seeks to deliver on the expectation, set out in the Government Policy Statement, of:

“.....the industry body to develop and submit to the Minister of Energy for approval proposed arrangements, including regulations and rules where appropriate, providing for effective industry arrangements in the following areas.

Wholesale Markets and Processing

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- Protocols that set reasonable terms and conditions for access to gas processing facilities.”¹¹

The Gas Industry Company's analysis correctly concludes that a protocol that sets reasonable terms and conditions for access to gas processing facilities would not be appropriate. However, the Gas Industry Company then sets out its proposed regulatory solution of an information disclosure regime which the Gas Industry Company is generously inclined to offer on a voluntary basis (but with the clear threat that if industry participants do not support a voluntary regime the ability to enforce the information disclosure regime via rules and/or regulation remains an option).¹²

Given the above analysis Genesis Energy questions the need for regulatory intervention *of any kind* based on the potential of the owners of essential facilities to abuse market power, and considers that it is a significant leap from “neither the quantitative or qualitative analysis undertaken suggests any

¹¹ Government Policy Statement on Gas Governance, paragraph 9.

¹² Genesis Energy considers it ingenious in saying in paragraph 10.2 that “it may be that facility owners will be incentivised to support an opt-in arrangement as a means of demonstrating support for an industry-led solution in this area.” While demonstrating support for an industry-led solution is undoubtedly worthwhile, it (a voluntary arrangement) is clearly a means and not an end in itself. The end in this instance is the information disclosure protocol and whether a satisfactory case has been made by the Gas Industry Company for one irrespective of the means by which it may be implemented. The Gas Industry Company should not confuse industry participants' support or otherwise of the proposed protocol as any signal whatsoever regarding support or not for voluntary, or industry-led arrangements.

substantive policy intervention is required”¹³ to a conclusion of “The preferred option is the development of an information disclosure regime.”¹⁴ This view would even appear to be supported by the Gas Industry Company’s own analysis regarding the absence of market power by the owners of essential facilities.

Moving this Issue Forward

Despite the absence of a market power rationale, it is still possible that some form of information disclosure for essential facilities that, if fashioned appropriately, could be helpful. More specifically, the Gas Industry Company could seek information to:

1. enable it to determine whether or not a regulatory problem exists at all that needs to be subsequently addressed by an information disclosure regime; or
2. providing an information base that is available to prospective gas explorers.

While the net effect may possibly be the same as that proposed by the Gas Industry Company – the voluntary disclosure of information – its purpose would in both cases be quite different. Its purpose would not be as a solution for an ill-defined regulatory problem but rather to gather information that would assist the Gas Industry Company in fulfilling its role and industry participants in reducing information-gathering transaction costs. The information may or may not be the same for the various purposes.

If, instead, the Gas Industry Company remains convinced that its analysis points to the need for a regulatory intervention in addition to the status quo to address some sort of market problem, the intervention proposed must be fit for purpose.¹⁵ Genesis Energy notes in this regard, that the description of the information to be disclosed is presented almost as if a *fait accompli* (“This option *would* involve:.....”) whereas there are clearly a number of options that are, in the absence of a clearly evident market failure, likely to be as if not more appropriate than the proposed approach. Two of these are set out in Appendix II to the discussion paper, for example:

1. A statement of best practice principles as issued by the Australian Petroleum Production and Exploration Association for the commercial negotiation of third party access to upstream facilities; and

¹³ Ibid, page 39, paragraph 11.2.

¹⁴ Op cit, page 39, paragraph 11.3.

¹⁵ In the absence of a clear market failure, an approach based around, for example, the Jumping Pound methodology would be grossly inappropriate and impose costs on the industry with no commensurate benefits.

2. The publication, in the United Kingdom, of key commercial conditions.¹⁶

A further alternative, in the absence of any evidence of a market failure that a protocol (even a light-handed one) would address is for a non-intrusive 'back-office' process which would be triggered on the basis of specific complaints. Such a proposal would operate where the Gas Industry Company (or even better the Commerce Commission), would directly address specific complaints by industry participants regarding alleged non-legitimate restriction of access to essential facilities against an agreed set of criteria (such as those referred to in 1. above or contained in the Commerce Act).

All three of these options are likely to be lower cost, better fit-for-purpose, less intrusive than an information disclosure regime and likely to be more indicative of case-specific, rather than generic market problems.

Finally, if the Gas Industry Company insists on the appropriateness of an information disclosure regime, Genesis Energy would clearly support a voluntary information disclosure regime over a mandatory one. However, the Gas Industry Company would need to be more transparent regarding the specific market failure such a regime would address such as the abuse of market power, and clearly indicate the relevance of the specific items to be disclosed to the problem identified. Consideration must also be given by the Gas Industry Company as to which agency is best qualified to interpret the information disclosed and detect such abuses.

Conclusion

In light of the analysis contained in this submission, Genesis Energy strongly urges the Gas Industry Company to reconsider its proposed approach. Genesis Energy does not see any failings of the market with respect to accessing essential facilities and does not believe that information disclosure protocols – even voluntary ones - are required at this stage. On the other hand, information to determine whether or not a regulatory problem exists that needs to be subsequently addressed by an information disclosure regime or to provide an information base may be appropriate.

If the Gas Industry Company continues to hold the view that there is sufficient evidence of a problem that warrants a regulatory intervention, Genesis Energy has put three alternative approaches forward for greater consideration. If an information disclosure regime in addition to the status quo is preferred instead, Genesis Energy considers that the Gas Industry Company must ensure that the information disclosure regime is appropriate to detect abuses of market power.

¹⁶ Op cit, Appendix II: Access Protocols in Other Jurisdictions, pages 1 and 3.

Genesis Energy is happy to discuss further any aspect of this submission with the Gas Industry Company.

Yours sincerely

A handwritten signature in black ink, appearing to read "J Carnegie". The signature is fluid and cursive, with a large initial "J" and a stylized "C" for Carnegie.

John A Carnegie
Regulatory Affairs Manager

Appendix One: Responses to Specific Consultation Questions

Questions	Comments
<p>Q1. Do you agree that the overall objective of any protocols should be to facilitate access to gas processing facilities where that is both economically efficient and contributes to better achievement of Government's overall policy objective, taking account of the specific outcomes it expects of the sector? If not, what should the objective be?</p>	<p>Yes.</p>
<p>Q2. Do you agree with the proposed definition of gas processing facilities for the purpose of considering access protocols?</p>	<p>Genesis Energy agrees with the definition of gas processing facility given in section 4.13 of the discussion paper. Genesis Energy also agrees with the Gas Industry Company's view that liquid storage facilities, gas fired power stations and petrochemicals manufacturing facilities do not fall within the meaning of gas processing facilities.</p>
<p>Q3. Do you agree that the framework outlined in section 5 is suitable for identifying whether there are substantial inefficiencies arising from current arrangements for access to gas processing facilities? If not, what alternative framework would provide a superior assessment?</p>	<p>Genesis Energy agrees with the framework set out in section 5 of the discussion paper.</p>
<p>Q4. Do you agree with the technical/economic assessment presented in section 6?</p>	<p>Genesis Energy agrees with the technical/economic assessment presented in section 6. Genesis Energy also agrees with the conclusion that depending on several factors including well stream composition and field location, use of an existing processing facility may not be the most economic way to bring gas from a field to market.</p>

Questions	Comments
<p>Q5. Do you agree with the conclusion that there do not appear to be substantial inefficiency problems with access to gas processing facilities?</p>	<p>Genesis Energy agrees that there are not any substantial market inefficiencies with respect to access to gas processing facilities.</p>
<p>Q6. Do you agree that alternatives to the status quo that may meet the objective are limited to low cost, light-handed measures?</p>	<p>See Genesis Energy's cover letter.</p> <p>Genesis Energy agrees that alternatives to the status quo that may meet the objective are limited to low cost, light-handed measures. However, while Genesis Energy strongly supports the seeking of outcomes which facilitate and promote the ongoing supply of gas to meet New Zealand's energy needs, it does not believe that a sufficiently robust case has been made around the actual or potential abuse market power by owner's of essential facilities for information disclosure protocols (voluntary or otherwise) to be warranted in addition to the status quo. In particular, Genesis Energy is strongly of the view that there is no clearly defined market failure in respect of access to gas processing facilities.</p> <p>Genesis Energy believes that where it is economically, technically and operationally feasible for gas from different fields to utilise in-place infrastructure that this will occur through commercial negotiations.</p>

Questions	Comments
<p>Q7. Do you agree with the assessment and that information disclosure is the preferred means of meeting the objective? If not, why not?</p>	<p>No. This response is based, in part, on the Gas Industry Company's own analysis regarding the absence of any substantial market inefficiencies. In addition, consistent with Genesis Energy's response to Q6 above, it is unclear what market failure an information disclosure regime would address. No real evidence of the actual or potential abuse market power by the owner's of essential facilities has been presented. This is critical as information disclosure regimes are generally imposed to address evidence of a clear regulatory problem. It is Genesis Energy's preference that the Gas Industry Company draw, more directly, the causal link between the inadequacy of the current competition policy legislative framework (that is, the Commerce Act) and the need for some form of regulatory intervention (voluntary or otherwise) that specifically addresses the potential for the owners of essential facilities to abuse market power.</p> <p>In the absence of such evidence, Genesis Energy has presented three alternative options that it considers are likely to be:</p> <ol style="list-style-type: none"> 1. lower cost; 2. better fit-for-purpose; and 3. less intrusive <p>than an information disclosure regime and more indicative of case-specific, rather than generic market problems.</p> <p>Alternatively, as noted in the cover letter, information disclosure may be appropriate, but not as a means to address market power. It may be useful to assist the Gas Industry Company to understand whether a regulatory problem exists, or to lower information-gathering transaction costs for assess seekers. If this is the case, the nature of the information to be disclosed needs to be specifically targeted at these purposes, and not some ill-defined market failure.</p>
<p>Q8. Do you concur with Gas Industry Co's assessment that the industry be invited to adopt a voluntary information disclosure regime? If not, please give your reasons.</p>	<p>No. See Genesis Energy's responses to Q6 and 7 above. It is unclear that an information disclosure regime per se, or one in the form proposed – whether voluntary or not - is warranted.</p> <p>However, having said that, if the Gas Industry Company remains convinced that its analysis points to the need for an information disclosure protocol in addition to the status quo to address a market power (or some other) issue, Genesis Energy would clearly support a voluntary information disclosure regime over any other approach.</p>