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Dear Ian

Application of Gas Governance Arrangements to Private Networks

Introduction

1. Thank you for the opportunity to comment on the Simon Terry Associates paper, prepared for the Gas Industry Company (GIC) by Geoff Bertram, "Application of Gas Governance Arrangements to Private Networks" (the Bertram Paper), February 2009. No part of our submission is confidential and we are happy for it to be publicly released.

Mighty River Power's views

2. Mighty River Power considers the Bertram Paper to be fundamentally sound and well thought through. We applaud the author and consider the Bertram Paper offers a valuable contribution to the issues at hand. We are comfortable with the analysis and conclusions reached in the Bertram Paper. We also have a number of observations and comments we consider relevant regarding the matter of who should be regulated and how.
3. As the GIC will be well aware, our view is that regulation should focus on addressing market failures. We believe economic regulation should focus on controlling natural monopoly businesses (eg access terms and conditions, price levels and service quality), and removing barriers to competition, to the extent they exist, in competitive and potentially competitive parts of the market (which can often require regulation of access terms and conditions, particularly in relation to vertically-integrated natural monopolies).
4. The appropriate tests for determining whether economic regulation should be introduced depend on the nature of the problem being addressed. Price control (including both price levels and service quality) should only be set where competition is limited (and unlikely to develop) and is in the long-term interests of end-users. Regulation to remove barriers to

competition (eg network access regulation and switching rules) should be introduced where it can promote competition for the long-term interests of end-users.

5. There can be instances where firms in competitive markets should be regulated in order to remove barriers to competition. The requirement, under the Telecommunications Act 2001, for telecommunications firms to enable number portability is one such example. Participation in the Gas Registry, as part of the Gas (Switching Arrangement) Rules 2008, is another example. We are firmly of the opinion that the Gas Registry was designed as the database of record for all Gas Installation Control Points including those on the Nova Gas networks. We are therefore firmly of the opinion that the population and maintenance of the Gas Registry within the Gas (Switching Arrangement) Rules 2008 should apply to all gas end users including those on the Nova Gas networks.
6. We accept conceptually, that there can be instances where infrastructure competition or substitutability address concerns about network natural monopoly characteristics. This tends to occur in network markets which are subject to significant technological change eg the telecommunications industry. We are aware, for example, that the ACCC has removed certain access obligations on Telstra in certain CBD areas where there is sufficient infrastructure-based competition. Such circumstances are most unlikely to arise in sectors such as the gas and electricity industries. That said, there are some instances where our generation business has the opportunity to connect new generation to the local electricity lines business or Transpower, and this helps mitigate their substantial market power/market dominance, but it by no means fully addresses natural monopoly problems, and tends to be the exception rather than the rule.
7. We agree with the Bertram Paper that bypass networks (such as that of Nova) can develop as a consequence of market inefficiencies (excess incumbent network operator costs/prices). We are also of the view that where a bypass network operator exists – leveraging off the incumbent’s natural monopoly situation – the ensuing duopoly situation does not necessarily mean there are no network issues (around access, pricing, and service quality) that need addressing. This is a situation that needs to be considered on a case-by-case basis.

Nova Gas

8. We are aware the Commerce Commission concluded, in its Gas Price Control Inquiry, that Nova Gas faced workable competition and therefore should not be price controlled.¹ It is our understanding though that Nova Gas has extended its gas networks in Auckland and Wellington into areas where there is no competing network.
9. Regardless of whether it is accepted that Nova Gas should not be placed under price control, there can still be concerns about the level of competition and whether regulation is needed to promote competition.
10. By way of analogy, Telecom lost its monopoly in the cellular market when BellSouth (now Vodafone) rolled out its own cellular network. Despite having two nationwide networks both Telecom and Vodafone are subject to a number of network access requirements, under the Telecommunications Act, such as an obligation to allow co-location on their cell-sites, and to provide roaming to any new entrant cellular operator (likely to be NZ Communications).
11. Mighty River Power believes Nova Gas' operation as both a closed network and also a closed retail operation on that network gives rise to regulatory concerns. This is a situation that warrants regulatory attention.²

Concluding remarks

12. If you would like to discuss any of our above comments directly with Mighty River Power, then please do not hesitate to me (on 09 308 8259 or robert.allen@mightyriver.co.nz) or Jim Raybould, Mighty River Power's Retail Gas Operations Manager, on 06 348 7926 or jim.raybould@mightyriver.co.nz .

Yours sincerely,

Robert Allen

Regulatory Manager

¹ <http://www.med.govt.nz/upload/15717/chapter18.pdf>

² We are also concerned by Nova Gas' failure to comply with the Gas (Information Disclosure) Regulations 1997, but recognise this is outside of the jurisdiction of the GIC.