



3 July 2007

Rebecca Cottrell
Gas Industry Company
PO Box 10 646
Wellington

Dear Rebecca,

Nova Gas Submission Regarding Mechanisms for Implementing a Central Registry

Please find attached our response to the specific questions raised in the discussion paper regarding mechanisms for implementation of a central registry.

Facilitation of voluntary contractual arrangements

Nova Gas supports the working group process adopted by the Gas Industry Company to date. Currently the industry is considering changes to existing contractual arrangements in several areas including switching and reconciliation.

The facilitation of these working groups by the Gas Industry Company has played a key part in overcoming the inertia that has existed in the industry and in some areas we can see the prospects for process improvements occurring for the first time in several years.

We would like to see this process given a chance to deliver improvements in several areas such as switching and central registry arrangements within a contractual framework.

We believe a contractual framework is more likely to deliver dynamic and cost effective governance arrangements than regulation, especially in areas such as switching and reconciliation. Such processes can be given effect through network company Distribution Service Agreements as has been the case historically.

Issues identified by the GIC with respect to existing contractual framework

Concerns regarding failure to reach agreement and “hold out” behaviour by network companies or other industry participants in relation to switching

arrangements do not appear to be based on fact or evidence. While there is the opportunity for such behaviour to occur, we believe that the facilitation efforts of the GIC backed up by threat of regulation are a better way to manage this risk in the first instance. We believe there is significant incentives for all participants to reach agreement in order to realise cost savings and efficiencies identified.

Nova Gas does not share the view of the GIC that contractual arrangements, such as those that exist currently, potentially breach the Commerce Act. Switching and reconciliation arrangements exist to facilitate competition rather than prevent it and there is not the price fixing elements that existed in the New Zealand Electricity Market rules that the Commerce Commission required to be authorised.

It would be appreciated if the GIC could release the legal opinion that supports the GIC's assertion in this matter to the industry for comment.

If you have any questions regarding our submission, please contact me on (04) 917 8851

Yours Sincerely

Charles Teichert
Downstream Trading Manager

QUESTION	COMMENT
<p><i>Q 1: Do you agree that mechanisms to implement a central registry must be mandatory? If not, please explain.</i></p>	<p>Yes.</p> <p>However, we note that where switching and registry arrangements may cover most, but not necessarily all, possible customer connections significant benefits due to economies of scale, standardisation, etc are still possible.</p> <p>The higher the level of participation in a voluntary registry, the higher the degree of cost sharing and standardisation of customer switching and information exchange protocols. Often such voluntary arrangements gain a critical mass and achieve comprehensive coverage without having to resort to regulation requiring mandatory participation.</p> <p>A major advantage of a voluntary arrangement over a mandatory central arrangement is the benefits of tension between competing service providers. With a mandatory central arrangement this competitive tension is weakened significantly and the only mechanism available is contestability of service provider contracts, often at infrequent intervals. In practice, the competitive tension is weak with the incumbent service provider having a significant advantage over competitors. This usually leads to the incumbent service provider pricing up to a level that reflects a new entrant's investment entry price.</p> <p>In order to retain the competitive tension associated with the potential for multiple service providers, Nova Gas prefers that switching arrangements be developed on a voluntary basis.</p> <p>Provided that the benefits of a central registry outweigh the costs, then there are incentives for industry participants to agree agreements voluntarily.</p> <p>Should there be future developments that provide for further efficiencies and cost savings then industry participants are not locked into the one mandatory regime.</p>

QUESTION	COMMENT
	<p>We note that the Government Policy Statement “invites the industry body to recommend arrangements.....in the following areas:</p> <ul style="list-style-type: none"> • The standardisation and upgrading of protocols relating to customer switching, so that barriers to customer switching are minimised...” <p>Nova Gas is not aware of any complaints about existing switching arrangements other than that the process is inefficient and relatively costly compared to what participants believe should be the case. We do not believe that “barriers to customer switching” exist per se and if they did, then the provisions of the Commerce Act protect parties detrimentally affected.</p> <p>We understand that an analysis of costs and benefits suggests that the case for a central registry system is good and on that basis the industry should have appropriate incentives to modify switching arrangements voluntarily.</p> <p>As incentives for such developments are often weak in the gas industry, facilitation by the Gas Industry Company of development of suitable contractual arrangements with a regulatory backstop should be sufficient to overcome this inertia and deliver the costs savings of more efficient customer switching arrangements.</p>
<p><i>Q 2: Do you agree Gas Industry Co has identified the most likely alternatives for mechanisms to implement a central registry? If not, please provide details of any other likely alternative mechanisms.</i></p>	<p>Yes.</p>

QUESTION	COMMENT
<i>Q 3: Do you agree with Gas Industry Co's analysis of a Pan-Industry Agreement as a mechanism to implement a central registry? If not, please explain.</i>	Yes
<i>Q 4: Do you agree with Gas Industry Co's analysis of Pan-Industry Agreement with a Rules fallback as a mechanism to implement a central registry? If not, please explain.</i>	Yes

QUESTION	COMMENT
<p><i>Q 5: Do you agree with Gas Industry Co's analysis of Rules as a mechanism to implement a central registry? If not, please explain.</i></p>	<p>No.</p> <p>1) Risk of Failure to agree overstated The GIC analysis appears to overstate the risk that industry participants are unable to reach agreement on switching and central registry arrangements.</p> <p>With several participants familiar with the switching and registry arrangements in the electricity industry, we would expect that arrangements in the gas industry would be similar in most respects. Those arrangements were developed voluntarily by the industry participants and have been in operation now for several years.</p> <p>Given that contractual arrangements that were developed voluntarily by the industry have been in place for several years we do not believe that there is any evidence to suggest that such arrangements cannot be successful in the future.</p> <p>We note that it has not been clearly established that there are “barriers to customer switching” that require addressing as required under the Government Policy Statement.</p> <p>The risk that distribution companies may exert their dominance in development of contractual arrangements is also overstated given that:</p> <ol style="list-style-type: none"> 1) Distribution companies stand to benefits from reduced costs and efficiencies that should result from upgraded switching arrangements. 2) Facilitation by the GIC of the development of those arrangements should ensure that distribution companies do not engage in “hold-out” behaviour given the threat of regulation.

QUESTION	COMMENT
Q5 (Cont)	<p>2) Risk that contractual arrangements breach the Commerce Act are overstated</p> <p>The GIC analysis also overstates the risks associated with voluntary contractual arrangements breach the Commerce Act. Industry arrangements for switching have been implemented through contracts, notably the network distribution agreements and Vector Transmission Agreements, for several years and no Commerce Commission related issues have arisen that we are aware of.</p> <p>Switching and registry arrangements facilitate competition and do not involve rules pertaining to pricing. Commerce Commission authorisation of the electricity industry rules was required mainly due to elements relating to pricing and clearing and settlement.</p> <p>If the GIC has obtained legal advice supporting the view that current industry arrangements may breach the Commerce Act then we believe that advice should be released to industry participants for comment.</p> <p>Nova Gas does agree that the current arrangements are inefficient and that change is likely to yield cost savings for industry participants. Such benefits have been driven by:</p> <ul style="list-style-type: none"> a) Changes in gas supply arrangements b) Technology changes making central registry options cost effective c) Effective facilitation by the GIC <p>Upgrading existing contractual arrangements should deliver more cost effective and dynamic arrangements than would be possible through regulation.</p>

QUESTION	COMMENT
<p>Q 6: <i>Do you agree with Gas Industry Co's preferred approach? If not, please explain what is your preferred approach and why.</i></p>	<p>No</p> <ol style="list-style-type: none"> 1) Voluntary contractual arrangements for switching are more likely to deliver long term lower cost arrangements 2) Mandatory arrangements would reduce competitive tension in the provision of services as noted in our response to question 1. Wherever possible we believe that the benefits of competition should be retained so that there is continuing pressure for the provision of cost effective arrangements and innovation. 3) Governance arrangements through Rules and Regulations approved by order in Council are inflexible and more costly to change. <p>Nova Gas prefers:</p> <ol style="list-style-type: none"> a) Facilitation by the GIC in the upgrading of switching arrangements that may incorporate a central registry (provided there is net benefit of implementing a central registry), b) Incorporating those improved arrangements in a "Switching Code" with rule change provisions, c) The Code should be referred to in Distribution Service Agreements of network companies that retailers must execute if they wish to trade on a particular network. The provisions of the code would be enforceable through the courts. This is the current framework for switching arrangements, d) Application of the "Switching code" in Distribution agreements should be encouraged in order to obtain the full benefits of economies of scale and standardisation but should stop short of being mandatory, <p>Retailers and customers are protected from anti-competitive behaviour through the Commerce Act and also oversight of the Gas Industry Company.</p>