

2 July 2004

Gas Pipelines Inquiry
Commerce Commission
PO Box 2351
Wellington
New Zealand

Dear Sirs

Commerce Commission Gas Control Inquiry Draft Report

AGL has reviewed the Commission's draft report with interest. The report deals with numerous complex matters which our subsidiary, NGC Holdings Ltd (NGC), will take up directly with the Commission. There is one matter, however, which is of particular importance to AGL, namely that of foreign ownership.

The thrust of the Commission's inquiry is to assess the relative weight of benefits and costs of imposing control on the natural gas transmission and distribution sectors. Under the test defined in the Commerce Act, this assessment is to be made on the benefits and costs to acquirers of the relevant services. The Minister's terms of reference to the Commission also require it to make an assessment of the public benefits and costs.

While the Commission has urged caution in assessing its draft view, it has clearly stated that the test of net public benefit will differ for firms with foreign ownership. It is important to note that the Commission only considers foreign ownership relevant where a pipeline company earns "excess returns", and that the Commission has concluded in its draft report that NGC is in that category. AGL understands that NGC will be making a submission strongly refuting the Commission's assessment.

The Commission has stated that it is much more likely to recommend to the Minister that price control be imposed on foreign-owned firms where excess returns are found. In its draft report the Commission finds that Vector, PowerCo and NGC are earning excess returns, but states that on a public benefits test only NGC should be subject to price control and only because of its significant foreign shareholding.

This will obviously have detrimental impacts outside the Commission's relatively narrow framework. Such a conclusion will inevitably be interpreted as discriminating against foreign investment. While the Commission attempts to distinguish between normal and excess returns, the practical effect is that foreign investors in New Zealand will be at risk of the Commission forming a view that returns are excessive, whereas domestic investors will not.



In part, this is a function of the two-step process provided by the Commerce Act. The Commission carries out a relatively constrained calculation, and may conclude forecast returns exceed some calculated “normal” level. Factors such as whether these reflect short run movements in the market, the need to provide incentives for investment, particularly in the current energy environment, the wider benefits of foreign investment, and other policy considerations are left for Ministerial decision.

For example, the Commission does not consider the fact that NGC’s current strength is to a large extent a result of the support that AGL has provided over the past twelve years, and its very existence today is directly attributable to the additional \$134 million invested by AGL in 2001 when the company suffered substantial losses in its wholesale electricity portfolio. This is a good example of the benefits that can flow from international linkages and a powerful argument in support of foreign investment. The Commission places no value on these benefits in its draft report.

The Commission also does not consider whether its conclusion is appropriate within the recent and very positive moves toward a single trans-Tasman marketplace. In fact, the Commission’s draft report illustrates some of the distortions that exist and AGL is encouraged by its understanding that a significant amount of policy development is occurring in this area.

The Commission’s proposed solution to these difficulties is to recommend that the Minister base his decision on whether regulation will benefit purchasers of pipeline services alone, rather than whether there is a net benefit to New Zealand overall. On this basis the Commission would recommend that price control be imposed on Vector, PowerCo and NGC. In AGL’s view this would simply be bad economics. Further, it would be a departure from the established policy framework and from the way the Ministerial decision was made in response to the Commission’s report on Airport services.

AGL urges the Commission to give more explicit recognition to these matters in reaching conclusions on net public benefit than it appears to have done in its draft report.

Yours sincerely

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