Southern Cross Hospitals

Treating you well

Commerce Commission
PO Box 2351
Wellington

Attention Anthony Stewart: Senior Investigator

Dear Mr Stewart,

Vector's proposed acquisition of Contact Energy's natural gas metering business

Southern Cross Hospitals Ltd would like to make this submission on the proposed sale of Contact Energy gas metering business to Vector Limited. We do not support their proposed purchase of Contact Energy's natural gas metering business on the grounds stated by Vector Limited in the public version of *Section 66: Vector – notice seeking clearance, Commerce Act 1986: Business Acquisition.*

The main causes of concern are as follows;

1. The exiting of Contact Energy from the market will create a virtual monopoly situation resulting in end consumers not having any choice in metering or pricing selection.
2. The *Notice Seeking Clearance* does not identify nor acknowledge the differences between the commercial and residential markets.
3. There is a current lack of transparency within the industry and this will further enshrine this situation with the effect of price fixing and on-charging. This seems contrary to that which has happened within the electricity market.

The reasons for believing that it will substantially lessen competition and have a significant impact on commercial customers are as follows;

1. The Vector notice fails to explain how a "meter" is defined, or what components make up a meter set. The meter set, or GMS for commercial / industrial customers, is intrinsically built into the installation and consists of a manifold which includes fabricated rises, uniquely sized flanges, selected regulator(s) and valves etc and of course the "meter" itself (please see photographs attached). The argument about easy entry to the market, low cost etc, we believe, is incorrect for commercial and industrial customers as practically it is significant works, in terms of both time & cost to install or replace a meter.
2. The Notice makes no distinction between residential customers and commercial / industrial customers, when in reality there is a significant difference.
3. The effects of the acquisition seem to contradict that which has occurred within the electricity market with New Zealand and will further diverge the industries from a

Southern Cross Hospitals Limited
Level 10, AMP Centre, 29 Customs Street West, Auckland 1010. PO Box 5341, Wellesley Street, Auckland 1141
Phone 09 925 5300 Fax 09 925 5301 www.southerncrosshospitals.co.nz

transparency and cost perspective. The electricity industry has gone through copious reforms and deregulation over the last 15 years including significant changes in 1998 and 2001 to promote competition and control prices. This ethos is still evident with the recently the Electricity Authority and the Ministry of Consumer Affairs promotional campaign 'What's my Number". In comparison the gas industry has had little reform, relying on the Gas Act of 1992 / 94. The other significant document from a consumer's point of view was the Gas Information Disclosure Regulations 1997, however we believed the "co-regulation" approach that was taken has failed because 'industry helps industry'. We draw to the commission's attention the Government Policy Statement on Gas Governance April 2008, and although this does not specifically cover gas meters, it is clear the intent of the document was to give consumers transparency and protection. We submit the gas industry has not followed this mandate and the acquisition will make this increasingly difficult.

4. The metering providers currently only disclose prices to the gas retailers because unfortunately the Gas Disclosure Regulations focused on "network charges" and perhaps naively the Crown regulators didn't understand the impact and cost of the meter itself. The important point to note here is, that the gas retailer passes on the cost of the meter rental to the consumer as "fixed charges" (please see attached invoice example). Therefore they have no mandate, nor reason, financial or otherwise to question the meter rental costs. The gas retailer is called the customer, when in reality as metering is a "pass through fixed cost". Therefore this acquisition proposal will directly, and in some respects only, effect the consumer.

There appears to be a number of inaccuracies throughout Vectors notice. Listed below are some of these in point-form:

C) ***"[ ] the key constraint for gas metering is threat of entry [ ]".***

We do not agree with this statement. The key constraint is the physical size and cost of the whole meter set. Unlike electricity meters which have current transformers that 'clip' around the mains cables the gas meters are physically installed inline as an integral part of the gas system.

"[ ] gas retailers typically exercise strong countervailing market power because they: are metering customers and accordingly have a strong incentive to drive low input prices for retail gas services".

We do not agree with this statement. As explained above, currently there is no incentive for gas retailers to drive low prices as metering is a pass through cost to the consumer.

9) ***"[ ] Vector considers that incorporating contacts natural gas metering business into Vectors existing operations will generate significant additional scale and accordingly greater scope to provide a compelling proposition to customers".***

As mentioned above. It is misleading as to who the "customer" is. As an example; for all Southern Cross Hospitals within our network, currently Vector has the network distribution, and a Vector subsidiary has the retail (On Gas) and another Vector subsidiary has the metering (Advanced Metering Services). Should Vector obtain the market share of New Zealand's gas metering business, it will certainly benefit their other entities AMS and On Gas, but it will have no benefit what so ever for the consumer. As this will effectively create a monopoly in some areas, it will disadvantage the consumer as it will remove the choice they have at present.

15 A natural gas metering business [ ] involves:

15.1 "ownership of gas meters"

This seems to be over-simplified information to suit Vector's proposal. Metering, for commercial and industrial consumers includes the entire manifold (GMS) as mentioned previously. It is understood that it is one of the significant barriers to entry.

18 "The industries affected by this acquisition are:"

18.1 "the natural gas metering industry"

18.2 "the natural gas retail industry"

Vector has not acknowledged the commercial and industrial industry (i.e. the consumer). Nowhere in the application is the residential consumer acknowledged either. After all, the meter set is physically located, in most cases, on their land or within their building. As mentioned above, as gas metering is a 'pass through fixed price' from gas retailers the consumer is directly affected.

19.3 "Gas remains a discretionary fuel, with most consumers continuing to choose only electricity."

We do not fully agree with this statement. Sites like ours that have boilers which rely on natural gas (Gas-fired boilers) are, and will continue to be, the most efficient and reliable form of heating hot water and for steam generation for sterilisation. In the residential consumer market, we acknowledge Vector's statement would be more accurate.

25.5 "Specific regional contracts or pricing are not a feature of natural gas metering"

26 "[ ] Vectors natural gas metering prices are uniform throughout the county [ ]".

We do not agree with this statement. As an example; Southern Cross Hospitals has 11 sites in the North Island with gas connections that have either Vector or Contact metering. The daily metering charge varies from $2.16/day to $21.22/day (please see attached invoices).

Of direct comparison and confirmation that the above statement is incorrect is Auckland Private Laundry which has a 7 kpa NGC (Vector) meter and pays $4.24/day whereas Auckland Surgical Centre also has a 7 kpa NGC (Vector) meter and pays $2.16/day.

Another comparison of relevance is Southern Cross North Harbour Hospital which presently has a Contact meter costing $3.91/day compared to Southern Cross Hamilton Hospital that has a AMS (Vector) meter costing $17.54. Irrespective of the subtle technical differences in the GMS's at each site that AMS metering may argue they have, the fact of the matter remains both sites use a very similar amount of gas (In Sept, 583 GJ verses 647 GJ). The gas usage has a 10% difference, yet the meter charges are 350% different. If this acquisition by

Vector is permitted to go ahead Southern Cross Hospitals could expect Vector to align the current Contact customers with the Vector pricing schedule. That being the case, on this site we could anticipate a 350% increase. Therefore we, the consumer, will definitely be negatively affected.

As mentioned previously, the gas industry keeps a very closed shop and the fee schedule is not published or available to consumers, so fair pricing is difficult to guarantee, especially if you are a single site business. It is also important to understand that the fee schedule that the meter company state is available to retailers is effectively only useful for residential connections. The majority of commercial and industrial connections are considered "special" or "non-standard" and so are priced on application.

47. "[ ] barriers to entry for gas metering are low"

This statement is inaccurate. It could be argued barriers to the residential market are low, however that's not where the profit is. Entry to the commercial and industrial sector would be medium to high, in that as mentioned previously there is significant infrastructure and cost that goes into the installation of a GMS (manifold and metering set).

47.2 "The cost of an installed natural gas meter is low"

From our recent experiences this statement is also inaccurate. A pertinent example is Southern Cross Hamilton which upgraded its boiler earlier this year. This increased demand triggered the need to upgrade the meter set and pipework as well. To replace the pipe from the meter set on the road side to the building was in excess of $25,000 which we, the consumer, had to pay (as it is not considered part of the 'network'). On Gas's metering provider (naturally, AMS) installed the meter set, however they would not sell it outright, instead our only option was to lease it at $17.54/day. This equates to $6400 per year indefinitely. After a 10 year period this will amount to $64000! It is offensive to call this "low cost", irrespective what size a company you are and especially given we are a non for profit medical facility. Southern Cross Hospitals has completed other projects recently with similar costs.

Also of note and relevance is the metering charges are indefinite. We can appreciate that the metering company needs to recover their costs for the GMS, however it is nothing short of price gouging when the consumer has no choice but to pay $64000 over a ten year period for an item worth a fifth of that.

48 In decision 540, the commission found that there were low barriers to entry in the TOU electricity metering market"

There is a big difference to these two utility markets. Besides the reforms and deregulation of the electricity market which ensured competition (as discussed previously), the TOU metering is not fixed and can be changed very quickly. In addition, once set up, the meters can be read remotely. Hence for example it was conceivable a South Island based company would fit meters in the North Island. History has shown this actually happens. Due to the high cost and the fact presently electronic gas meters are not yet viable, the same competition will not naturally happen in the gas industry.

49 “The most likely potential entrants are gas retailers. This is evidenced by Contact currently being one of the major providers of these services”

Gas retailers are currently the major providers because of the closed regulated industry they work within. The cost of the acquisition, which is I understand is around $63M, is not mentioned as a barrier, yet would exclude all but a few of NZ largest companies.

51.2(b) “[ ] ultimately, the retailer determines the terms on which it will deal with a metering provider”

This appears one of the few sentences that Southern Cross Hospitals is able to completely agree with. This is largely the reason why Southern Cross Hospitals believes that this acquisition should not proceed. The consumer has no control of the process, has practically little/no choice, yet pays the entire cost.

52.3(a) “The costs associated with providing natural gas metering are largely transparent”

We do not agree with this statement. The metering provider will not release this information stating “confidentiality with the gas retailer” and the gas retailer will not release this information stating “confidentiality with the metering provider”. The important factor here for the commission, is although Vector networks publish the charges, Vector metering (AMS) does not.

55.2 “no history of collusive behaviour”

We do not agree with this statement. As above, there is no proof of this as the figures are not publically published.

It would be reasonable to assume that collusive behaviour already exists to some extent within the Vector subsidiaries, in that it is understood Vector networks, Vector retail (On Gas) and Vector metering (AMS) all share the same floor at their offices in Carlton Core Road, Auckland. We have proven that for all On Gas customers there is presently no control or ‘push back’ on the metering fees charged by their colleagues at AMS. The gas retailer’s role, focus and subsequent agreement with consumers is on the unit price of gas. They have no concern about metering as it is a pass through cost. If the consumer did request that comparative metering quotes be provided, given the close physical proximity of the staff working for all these entities, it would be fair to question the confidentially and how impartial the RFP was in any event. If Vector is granted permission to acquire Contact’s portfolio that would bring their dominance to, we understand, 76 per cent nationwide. Of particular relevance though is that their dominance in Auckland would be much higher than that – to the point whereby it is effectively a ‘monopoly’.

55.4 “High transparency of costs by customers”

The author is playing on words and interpretation to suit his application. As mentioned previously; technically the gas retailer is the customer but practically it is the consumer who is the ‘customer’ as they pay the costs.

55.5 "Meters have non-static technology, enabling a new entrant to differentiate its service offering"

We do not agree with this statement. As mentioned previously there is a big difference in the residential and commercial metering applications. The residential market should be considered static as it will be many years before smart metering is affordable enough to be used. Even once it becomes affordable it is questionable whether it would be of any benefit. A comparative example is that most residential electrical meters throughout New Zealand are still analogue and not time of use TOU for that same reason.

In summary the Vector Notice Seeking Clearance of 19th October is very misleading. It seems to have over-simplified what a gas meter is in order to portray that there are low barriers for entry to the market. We trust that our specific examples above have proven there are significant barriers and this acquisition would substantially lessen any chance of competition. Without competition there will be no control mechanism on the costs of metering for both residential and businesses at large. Regardless of the claims made within the Vector application, standard financial acumen would suggest that Vector would not be prepared to pay, what we understand to be in excess or $63M, for a business that will not afford Vector secure market dominance in a captured market. Inadvertently it appears full transparency and justification of the cost of meters and metering sets (GMS's) was not specifically mandated in the Gas Act or Gas Information Disclosure Regulations, we submit to the Commerce Commission to ensure that, as this is an essential utility, competition remains in order to protect the consumer.

I would be happy to present to the Commission in person if required.

Yours faithfully

Brendon Clifford
Technical Services Manager
Southern Cross Hospitals