



COMMERCE COMMISSION

## **DECISION NUMBER 650A**

Final determination pursuant to the Commerce Act 1986 in the matter of an Application for authorisation of a restrictive trade practice. The Application is made by:

**TODD PETROLEUM MINING COMPANY LTD**

**and**

**TODD TARANAKI LTD**

- The Commission:** P R Rebstock, Chair  
P J M Taylor  
D Bates QC
- Summary of Application:** The Applicants applied for authorisation of certain provisions (the relevant provisions) in the Maui pipeline Operating Code that are compulsorily imported into the contracts, between users of the Maui pipeline and its owner MDL Ltd, that govern open access to the Maui pipeline.
- Final Determination:** The Commerce Commission determined that because MDL Ltd has independent status in dealing with parties in relation to open access and the application of the relevant provisions, Todd Petroleum Mining did not have standing to apply for authorisation either as a shareholder of MDL or in its own stead. Todd Taranaki Ltd, as a potential user of the Maui pipeline, required to enter into contracts containing the relevant provisions, did have standing to apply for authorisation.
- Further, the relevant provisions did not lessen competition in comparison to a regulatory counterfactual and, therefore, the Commission did not have jurisdiction to make a determination granting authorisation. The Commission determined to decline to grant authorisation.
- Date:** 17 September 2008

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## INTRODUCTION

1. On 26 August 2005, Todd Petroleum Mining and Todd Taranaki applied under section 58 of the Act 1986 (the Act), for authorisation of certain provisions in the Maui Pipeline Operating Code (the Code). The Code is a set of rules that regulates open access to the Maui pipeline by producers of gas in Taranaki,<sup>1</sup> shippers of gas and downstream pipeline owners. Provisions in the code are imported into the contracts between the owner and users of the Maui pipeline, that govern open access to the facility.
2. Todd did not apply for authorisation of the whole Code, rather a relatively small number of provisions in the Code, which in this Determination are generically termed “the relevant provisions.”
3. The Maui pipeline transmits gas from Taranaki to Rotowaro near Huntly and is owned by MDL Ltd (MDL). Four wholly-owned Shell subsidiaries, OMV and Todd Petroleum Mining are the shareholders of MDL. Pipeline users must contractually commit to the relevant provisions of the Code in their contracts with MDL.
4. Vector’s gas pipelines network, which transmits gas to Northland, Auckland, the Waikato, the Bay of Plenty and Gisborne connects to the Maui pipeline at Rotowaro. Vector also owns the Kapuni North pipeline that transmits gas from Taranaki to Auckland but which is of a lower capacity than the Maui pipeline.
5. The diagram attached to these reasons shows the North Island gas transmission pipework network.<sup>2</sup>
6. Todd Taranaki is a producer of gas in Taranaki and (together with seven other gas traders), uses the Maui and Vector pipelines to ship gas to the consumers that are its customers.
7. The Maui Mining Companies, the owners of the Maui gas field,<sup>3</sup> sell gas to the Crown under the Maui Gas Contract. The Crown on-sold the gas to Vector, Contact Energy and Methanex under contracts that are back-to-back with the Maui Gas Contract.
8. The last tranche of gas to be sold under the Maui Gas Contract is now known as “legacy gas.” Its quantity was fixed at 367 petajoules in early 2003 under an Agreement between Vector, Contact Energy and Methanex (together the “legacy gas users”), the Crown and the Maui Mining Companies. The agreement has been called “Strawman”. Legacy gas has been consumed since the time of the Strawman agreement and is now almost exhausted with only Contact Energy owning rights to about [ ] petajoules.<sup>4</sup>

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<sup>1</sup> Who may own pipelines connecting their gas fields to the Maui pipeline.

<sup>2</sup> The permission of Vector to use this map is acknowledged by the Commission.

<sup>3</sup> Currently Shell, OMV and Todd.

<sup>4</sup> Contact Energy has informed the Commission that it anticipates legacy gas being completely exhausted by [ ].

9. The Maui field has in fact been able to produce gas additional to legacy gas. The additional gas is known as “right of first refusal gas” (ROFR). That name developed because under the Strawman Agreement, Contact Energy and Vector have a right of first refusal of ROFR gas at the price offered by the Maui Mining Companies. If both parties decline to purchase an amount offered for sale at Mining Companies’ price, the gas may be sold to other purchasers who are prepared to pay the required price.
10. Therefore, the gas pipelines that run out of Taranaki may transmit a mixture of legacy gas, ROFR gas and gas produced from other Taranaki gas fields by other parties (including Todd Taranaki). However, the gas owned by one shipper of gas in a pipeline system is physically indistinguishable from the gas owned by the other shippers of gas using that pipeline. Thus, procedures are required whereby each gas shipper’s input into the pipeline system is compared with its off-take and appropriate financial or gas quantity adjustments are made to balance each individual shipper’s inputs and off-takes.
11. On the face of it, the Maui pipeline faces some competition from Vector’s Kapuni North pipeline for the business of gas shippers from Taranaki northwards. However, given their relative capacities, competition between the two pipelines may not be vigorous, particularly for large loads. In addition, according to Vector, it is the proximity of a particular gas field to the route of one or other of the pipelines, that is more important than price competition between the two, in determining which pipeline is lowest cost for an individual gas shipper.
12. The Commission released its draft determination of the application on 14 April 2008. Four submissions and one cross-submission were received. Todd at first requested the Commission to hold a conference on its draft determination but later withdrew that request. The Commission decided not to hold a conference of its own motion.

## **GOVERNMENT POLICY STATEMENT**

13. In its 2004 Government Policy Statement (GPS), the Government invited MDL and legacy gas users to present it with a proposal to allow open access to the Maui pipeline. The Government’s key requirement was that the open access regime should provide non-discriminatory access to all producers and shippers of gas. MDL was a party to the negotiations that followed, as the owner of the Maui pipeline. The legacy gas users were parties because, under the Maui Gas Contract and their back-to-back contracts with the Crown, they were granted exclusive use of the Maui pipeline for the life of the legacy gas in the Maui field. Given that the field was anticipated to produce legacy gas until about 2009, the exclusive use provisions were clearly a barrier to the early open access required by the Government.
14. Under the “Strawman” Agreement, the legacy gas users (and the Crown) agreed to give up exclusive use of the Maui pipeline until legacy gas was exhausted, provided their other contractual rights under the Maui Gas Contract for 367 petajoules of Maui gas (the reserves of the Maui gas field as predicted at that time) were essentially preserved. Vector and Contact Energy were given right of first refusal to additional gas produced from the Maui field (and Methanex was sold a certain quantity of gas by the Maui joint venture to enable its methanol plants to continue operating for a short time). Todd was provided with early open access to the Maui pipeline for its own gas from the

Mangahewa and McKee fields as part of the Strawman agreement. These factors allowed a Code for open access to the Maui pipeline to be negotiated.

## **THE CODE**

15. Open access under the Code began on 1 October 2005. The Code was developed following Strawman during two years of negotiations between MDL, the Crown, the legacy gas users and other potential users of the Maui pipeline. It is a set of rules regulating access to the Maui pipeline for the transport of legacy and other gas. Implementation of the Code occurs by way of bilateral contracts between MDL and parties with pipelines connected to the pipeline and/or those who ship gas along the pipeline. Each connected party and gas shipper is required to enter into an “agreement for the transportation of gas through the Maui pipeline” with MDL under which agreement, the parties accept the rules in the Code.
16. One set of provisions in the Code provides for a different treatment of legacy gas to other gas. Another set of provisions requires gas shippers, who wish to use the Maui pipeline to enter into a Transmission Services Agreement (TSA) with Vector. It was these two specific matters about which Todd had competition concerns, stating that if it was required to enter into contracts containing the relevant provisions, it might be exposed to liability under the Act. It, therefore, applied to have the relevant provisions authorised under Part 5 of the Act. In its application, Todd suggested amendments to the Code that would alleviate the risks it considered it faced under the Act.
17. The Commission understands that while open access has occurred under the Code for almost three years, there have been some technical difficulties with the balancing regime envisaged by the Code. The Gas Industry Company is currently facilitating various proposals to improve the position, one of which is that the legacy gas provisions will be removed. Contact Energy, the only party with remaining rights to legacy gas, has accepted that the provisions in the Code giving a special treatment to that gas should be modified.
18. [

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## **TODD’S CONCERNS**

19. Todd stated in its application that it considered that the Code provides a preferential treatment to the treatment of legacy gas vis a vis other gas and that potentially breaches sections 27 and 28 of the Act. It was also concerned that the provisions in the Code that require a shipper of gas along the Maui pipeline to enter into a transmission services agreement (TSA) with Vector, the pipeline network owner

downstream of the Maui pipeline, potentially breached sections 27, 28 and 29 of the Act.

20. Todd Petroleum Mining considered that it was a party to the provisions of the Code because it was a shareholder of MDL, the owner of the Maui pipeline, and because, under the Code, MDL would be required to enter into contracts containing the provisions, about which Todd Petroleum Mining had competition concerns.
21. Likewise, if Todd Taranaki wished to use the Maui pipeline to transmit gas, it would also be required to enter into contracts with MDL that contained the relevant provisions.
22. The two Todd companies' specific competition concerns about the treatment given to legacy gas in the Code, were:
  - the obligation of a transmitter of non-legacy gas to settle operational imbalances between gas injected into the Maui pipeline and gas consumed by the customers of the gas shipper, by selling or buying gas did not apply to legacy gas (which was to be balanced, as it always had been under the Maui Gas Contract), by the Maui Mining Companies; and
  - the penalty regime which has the purpose of incentivising non-legacy gas shippers to as closely as possible match their nominated off-take quantities with their actual quantities of gas injected into the pipeline, again did not apply to legacy gas.<sup>5</sup>
23. The Todd companies were concerned that these provisions gave legacy gas a significant advantage in the wholesale gas market over ROFR gas or gas from other fields. As a result, the two Todd companies were concerned that they would be required under the Code to enter into arrangements that breached sections 27 and 28 of the Act.
24. Todd's concerns over the Code's requirement that gas shippers must enter into a TSA with Vector, were related to the potential competition between Vector's Kapuni North pipeline and the Maui pipeline. Todd was concerned that gas shippers would be required to negotiate gas transmission prices for the Kapuni North pipeline with Vector from a position of disadvantage. That would occur as a result of Vector's knowledge that, without a TSA under the Code the gas shipper could not use the Maui pipeline. Todd was concerned that as a result, the competitive tension between the two pipelines would be removed. Todd was concerned that by entering into the TSA in terms of the Code, it would potentially be exposed to liability under sections 27, 28 and 29 of the Act.

## **PRELIMINARY ISSUES**

25. Section 59A of the Act states:

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<sup>5</sup> This penalty regime was not part of the original Maui Gas Contract that applied to the Crown and the legacy gas users.

### **When Commission may grant authorisation**

(1) The Commission may grant an authorisation to a person—

(a) to enter into a contract or arrangement, or to arrive at an understanding, even though the contract or arrangement has been entered into, or the understanding has been arrived at, before the Commission makes a determination in respect of the application for that authorisation; or

(b) to give effect to a provision of a contract or arrangement entered into, or an understanding arrived at, even though the applicant has already given, or is already giving, effect to the provision before the Commission makes a determination in respect of the application for that authorisation; or

(c) ...

(d) ...

(2) Subject to subsection (3), all of the parties to the contract, arrangement, or understanding must, unless and until authorisation is granted, discontinue—

(a) giving effect to the provision of the contract, arrangement, or understanding:

(b) ...

(3) The parties to the contract, arrangement, or understanding may do any of the things set out in subsection (2) as long as any of the parties establishes to the satisfaction of the Commission that discontinuing any of those things would, or would be likely to, result in exceptional hardship to any of the parties.

26. Todd's application raised the following preliminary issues of its standing to apply for authorisation and of the operation of section 59A of the Act, in particular:

- whether Todd Petroleum Mining was entitled to apply for authorisation as a shareholder of MDL, the company that would enter into various contracts with parties connected to and/or using the Maui pipeline;
- whether Todd Taranaki was entitled to apply for authorisation as a party that would enter into various contracts with MDL;
- whether, section 59A(2) of the Act requires the parties to provisions in an agreement, that are the subject of an application for authorisation, to discontinue giving effect to the provisions while the Commission makes a decision on the application;
- if section 59A(2) requires such discontinuance, what factors would trigger the exception hardship exception in section 59A(3) of the Act and would those factors apply under the facts of Todd's applications; and

- whether a failure to discontinue giving effect, by all parties to the agreement containing the relevant provisions would bar the Commission from any further consideration of the application.
27. After taking advice on these matters, the Commission advised interested parties of the reasons for the following decisions on the preliminary matters on 21 September 2005:
- Todd Petroleum Mining did not have standing to apply for authorisation either as a shareholder of MDL or in its own stead. That was because MDL has independent status in dealing with parties in relation to open access and the application of the relevant provisions. The Commission would not consider its application for authorisation;
  - Todd Taranaki did have standing to make an application for authorisation in respect of contracts it would enter into as a connected party and as a gas shipper that would contain the relevant provision, and the Commission would go on to consider its application for authorisation;
  - section 59A(2) requires parties to an existing contract, arrangement or understanding (CAU), that is the subject of an authorisation application, to cease to give effect to the CAU while the authorisation application is determined by the Commission. If they do not, the Commission nevertheless must continue to consider the application. However, the provisions of section 59B of the Act would mean that the parties to the CAU would not be protected from future liability under the Act by the fact of the application for authorisation;
  - under section 59 of the Act, if Todd, subsequent to the application, entered into contracts containing the relevant provisions, in order for Todd to be protected from potential future liability the contracts would be required to be subject to a condition that the relevant provisions did not come into force unless and until authorisation was granted;
  - if MDL and other parties to potential contracts containing the relevant provisions did not consider that the provisions were likely to breach the Act, they would not be constrained from entering into those contracts by section 59A(2);
  - exceptional hardship could only apply if *existing* contracts had to be suspended – then the hardship could be evaluated by comparing the positions of the applicant if the relevant contracts continued or were suspended; and
  - as there were no existing contracts, no exceptional hardship would exist in this case and section 59A(3) would not apply.
28. Other than the two Todd companies, the interested parties generally accepted these rulings which were broadly consistent with their own views. As a result, open access to the Maui pipeline was able to begin almost immediately after the Commission's decisions were circulated. Gas producers and gas shippers were able to enter into contracts with MDL and Vector. It is noteworthy that Todd Taranaki also entered into contracts with MDL to become a party connected to the Maui pipeline and a party transmitting gas through the pipeline.



## COMMISSION PROCEDURES

### Framework for Consideration

29. If a person wishes to enter into, or give effect to, provisions in a contract but considers that sections 27, 28, 29, 37 or 38 of the Act might apply to the provisions, that person may apply under section 58 of the Act, to the Commission for authorisation. The Commission must determine whether the relevant provisions in an arrangement would result in a lessening of competition in the market when compared to a counterfactual, and if so, whether the detriments flowing from such a lessening of competition are outweighed by the public benefits that result or would be likely to result from the provisions. The Commission considers that a public benefit is any gain, and a detriment is any loss, to the public of New Zealand, with an emphasis on gains and losses being measured in terms of economic efficiency. If the Commission is satisfied that the public benefits outweigh the detriments, it will authorise the arrangement.

### The Factual and Counterfactual

30. In order to assess the competition effects, as well as the detriments and benefits, the Commission compares the factual to the counterfactual, or what would likely happen in the absence of the provisions in an arrangement. The factual is what would happen if the provisions in the arrangement are proceeded with. A counterfactual will not necessarily be a continuation of the status quo, but rather encapsulates a pragmatic and commercial assessment of what is likely to happen in the absence of the factual.

31. The factual and counterfactual may give rise to different states of competition in the relevant market. A comparison between them allows a judgment to be made as to whether competition in the factual is likely to be lessened relative to the counterfactual.

### Jurisdiction to Authorise

32. Sections 61(6) and 61(6A) of the Act states:

61(6) The Commission shall not make a determination granting an authorisation pursuant to an application under section 58(1) to (4) of this Act unless it is satisfied that—

- (a) The entering into of the contract or arrangement or the arriving at the understanding; or
- (b) The giving effect to the provision of the contract, arrangement or understanding; or
- (c) ...

as the case may be, to which the application relates, will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result ....

(6A) For the purposes of subsection (6) of this section, a lessening in competition includes a lessening in competition that is not substantial.

33. The Commission considers that if the state of competition in the factual is the same as that in the counterfactual, there is no lessening of competition resulting from the “entering into” or “giving effect to” the relevant provisions and the Commission does not, therefore, have jurisdiction to make a determination granting authorisation.

### **Timeline of the Application**

34. Todd’s application was received on 25 August 2005. The Commission’s initial focus was on determining the preliminary issues and decisions were advised to interested parties on 21 September 2005. As a result, open access was able to begin as scheduled on 1 October 2005. After a period of operation of open access under the Code, the Commission contacted Todd and noted that, as no person had commenced court action under the Act against Todd or any other person in relation to the relevant provisions, unnecessary further expenditure of resources by all parties would be avoided if Todd withdrew its application. The Commission also advised Todd that Todd that on the basis of information to hand the relevant provisions of the Code were unlikely to substantially lessen competition in comparison with any practical and realistic counterfactual. In the absence of a response from Todd, the Commission, after updating itself on the industry’s experience of the operations of the open access regime,<sup>6</sup> issued its draft determination. The Commission’s preliminary view was that the factual would be the same as a regulatory counterfactual and there would be no lessening of competition. As a result, the Commission would not have jurisdiction to authorise the relevant provisions.
35. Submissions on the draft determination were received from Todd Energy, Mighty River Power, Vector and Shell and OMV (combined). A cross-submission on Todd’s submission was received from Shell and OMV.

### **SUBMISSIONS RECEIVED ON DRAFT DETERMINATION**

36. Todd Energy submitted on behalf of Todd Taranaki that:
- in response to the Commission’s point that no complaints to the Commission have been made nor proceeding brought under the Act in the three years of operation of open access under the Code, there have in fact been complaints within industry fora in relation to the favouritism granted to legacy gas in the Code and deficiencies in the pipeline balancing arrangements – this has resulted in a Gas Industry Company review;
  - there is no basis to assume that the Crown would not have adopted a regulatory solution (and counterfactual) that preserved the value of the legacy gas contracts

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<sup>6</sup> The Commission has noted that no proceedings under the Act have been brought by any party in the almost three years that open access has been available under the rules in the Code, Further, no complaint been made to the Commission alleging that the relevant provisions in the Code contravene Part 2 of the Act.

while providing an even playing field for legacy and non-legacy gas as suggested by Todd; and

- a delay of one year in the Commission's counterfactual, while the Government implemented a regulatory solution, is not supported by evidence.

37. Shell and OMV submitted that:

- they agreed with the Commission's construction of the counterfactual;
- they agreed with the Commission's view that Todd's suggested construction of the counterfactual (with the relevant provisions revised or removed) would involve significant delay to open access causing material detriments. They submitted that, as such a counterfactual would inevitably involve commercial or regulatory compromise, any competition uplift from Todd's ideas would be likely to be negated by the harmful impact arising from that compromise (whatever it might be) that would be required to secure acceptance of Todd's ideas; and
- the debate should be deeper than the mere provisions of the Code. Open access to the Maui pipeline was a key plank of the Strawman agreement to which the Government was a party. Thus any apparently anti-competitive features were balanced by the pro-competitive compromise whereby the legacy gas owners gave up their exclusive rights to the Maui pipeline capacity to allow non Maui gas to be transported;
- The fact that the Crown was a signatory to the Maui Gas Contract and Strawman indicates explains the Crowns reluctance to interfere with legacy gas owners property rights in the manner in which the Todd counterfactual would require;
- the position of the Government, as the potential regulator of open access in the counterfactual, on whether it would have removed the features of the Code to which Todd objects without compensating in some way for the loss of value to the legacy gas users is clear, it would not have happened; and
- Operational balancing regimes (OBA, of the kind contemplated by the Code, are good practice and for an OBA regime to work in the context of interconnection between the Maui pipeline and Vector's gas transmission network, the existence of a TSA between each shipper of gas and Vector is a must.

38. Mighty River Power submitted that:

- parties such as Todd who wish to change the Maui pipeline access regime can use the change process procedure in the Code, rather than applications to the Commission for authorisation, to address their concerns;
- the absence of allegations of anti-competitive conduct during the period of the open access regime suggests that it is working as intended;
- regulation in the form of the existing Code by the Crown is the appropriate counterfactual;
- absent a TSA between shippers and Vector the stand-alone balancing required would be a less efficient outcome than the existing system; and

- the benefits of the Code in terms of an early open access regime, even if that regime is not perfect, outweighs the public detriments.

39. Vector submitted that:

- it supported the Commission's conclusion in its draft determination that the factual and the counterfactual would in all material respects be identical and that the Commission has no jurisdiction to grant authorisation in this case;
- had the counterfactual been as Todd contended, where legacy gas owners had the property rights interfered with, there would have been significant long term detriments by such an interference with the sanctity of long term gas supply contracts; and
- under the Code the protection of the property rights of the legacy gas users whilst allowing the Maui pipeline to bring alternative gas supplies to market has been unambiguously pro-competitive.

### **MARKET DEFINITION**

40. The Commission considers that the market relevant to its consideration of Todd's Application is that for the provision of gas transmission services between North Taranaki and Huntly.

41. A discussion of the principles used to arrive at this market definition is included in the Commission's "Gas Control Inquiry – Final Report" of 29 September 2004.

### **THE COUNTERFACTUAL**

42. The interested parties, the Ministry of Economic Development and the Treasury advised the Commission that in their view, in the absence of agreement to the provisions of the Code by the negotiating parties, the Government would have promulgated regulations to obtain open access to the Maui pipeline. The Government in its Policy Statement of October 2004, stated that:

The Government expects that efficient industry arrangements for amongst other matters, open access to the Maui pipeline will be in place by December 2004.

If progress ... is unsatisfactory, the Government will consider regulatory solutions.

43. If the regulatory counterfactual to the Code would have contained the relevant provisions that Todd had applied to be authorised, the factual and the counterfactual would be the same. In that case there would be no lessening of competition when the effects of the factual and counterfactual were compared.

### **The Position in Respect to Legacy Gas**

44. The Treasury, acting for the Crown as the buyer under the Maui Gas Contract, advised the Commission that:

- the Crown's agreement to the Code was required under the Maui Gas Contract;

- the Code preserved the existing contractual arrangements with respect to delivery and purchase of Maui gas, while permitting other parties to access the Maui pipeline;
- it had taken two years for the Code to be negotiated and agreed to by MDL, the Crown and the “back-to-back” legacy gas users;
- any amendments to the existing provisions of the Code (as suggested by Todd) would not be agreed by the legacy gas users and, therefore, the Crown would not agree to amendments. In this respect, the Crown would not agree to compromise what it also perceives to be the existing (back to back) contractual rights of the legacy gas users as that would expose it to risk of liability under its contracts with the legacy gas users; and
- if the Code could not be implemented perhaps as a result of disagreement between the parties, it would then be up to the Minister of Energy to consider regulations for open access under Part 4A of the Gas Act 1992. Such regulations would necessarily have regard to the contractual rights of the legacy gas owners.

45. The GPS states:

The Government ... seeks to maintain the value of its existing contractual rights; and

The Government will not accept any increase in the risk it faces as a party to the Maui contracts as a result of the move to open access....

46. Given this aversion to risk by the Government (which the Commission has been advised was one main reasons that negotiations to arrive at the Code took so long), it does not appear that the regulated counterfactual described by the Government in its GPS and by the Treasury in its written submission to the Commission, would or could contain anything other than the provisions protecting the legacy gas owners rights that the parties had already agreed should be included as part of the Code.
47. As discussed in paragraphs 17 and 18 the Gas Industry Company has received a change request from MDL which, if adopted, would have the effect of removing the legacy gas provisions from the code. The Gas Industry Company has informed the Commission that the change request has the support of the industry including Contact Energy and The Crown and is designed to overcome difficulties that have arisen with the process for balancing gas shippers Maui pipeline inputs and outputs.
48. These difficulties arise from the requirement in the Code under the legacy gas provisions that, in effect, out of balances are reconciled monthly whereas experience has shown that needs to be carried out daily.
49. This proposed change to the Code does not alter the Commission’s view of the counterfactual. At the time of the application and during the three years of subsequent application of the Code the favoured position given to legacy gas under the Code was applied. It is only now, when legacy gas is almost exhausted and other commercial considerations relating to the transmission of large quantities of ROFA (and other) gas have become pre-eminent, that Contact Energy (and The Crown) has

agreed to a diminution of its legacy gas rights. There is no evidence that this agreement would have been likely to occur during the previous operation of open access when Contact Energy and Vector had rights to substantial quantities of legacy gas.

50. So in summary, the Commission considers that the evidence strongly supports the conclusion that the counterfactual to the implementation of the Code, and the inclusion of its rules in contracts between MDL and users of the Maui pipeline, would be regulations promulgating the same provisions in respect of legacy gas, as exist in the Code. The conclusion, therefore, is that the relevant legacy gas provisions of the Code would not lessen competition in comparison with the counterfactual because they would be identical.
51. That means that the Commission's view is that it does not have jurisdiction to authorise the legacy gas provisions as the provisions do not lessen competition in a market.

### **The Position in Respect to the Vector TSA**

52. All gas pipeline systems which have multiple parties both inputting gas into the pipeline and off-taking gas from the pipeline require a procedure to balance each gas shipper's inputs and outputs. Imbalances occur because it is never possible for a gas shipper to determine the exact quantity of gas that will be consumed by its customers over a certain period of time. While a gas consumer might indicate in advance to its shipper supplier that it expects to use a certain quantity of gas over a certain length of time (and as a consequence the its shipper arranges for that amount of gas to be injected into the pipeline system to which the consumers is connected) there are many reasons why the consumer might actually take more or less gas. Once example is a gas fired electricity generator whose demand for gas will vary, to a certain extent unpredictably, with weather conditions. Another example is a manufacturing plant in which a plant breakdown occurs.
53. Therefore, a regime to balance inputs and outputs of gas shippers is required.
54. As stated, Vector's pipework network, downstream of the Maui pipeline, transmits gas from its connection point with the Maui pipeline at Rotowaro to Northland, Auckland, the Waikato, the Bay of Plenty and Gisborne, It is necessary for the gas balancing described in the preceding paragraph to be applied to both the Maui pipeline and Vector's pipelines. There are two possible systems for balancing (or reconciling ownership) of gas within the two pipelines. Open access could occur either by:
- the Maui and Vector pipelines each being balanced individually on a "stand - alone" basis; and
  - an OBA type open access regime, of the kind contemplated in the Code, whereby the person (Vector) that controls the valves through which gas exits the combined Maui/Vector pipeline systems to consumers accounts for the difference between

- the scheduled (or nominated) gas flows of shippers and the actual metered gas flows to their customers. Balancing is done by shippers either taking more or less gas in subsequent time periods, or if this cannot be achieved by cashing up the value of the differences. To enforce this system, the balancer, in this case Vector, needs a contractual relationship with shippers.
55. Open access by stand-alone balancing of the Maui pipeline would result in a range of less-than-optimal consequences, including:
- the necessity for a double reconciliation within each of the Maui and Vector pipeline systems. In particular, under that arrangement gas transmitters would not be able to aggregate their positions across both pipelines but instead would need to be “in balance” independently within each pipeline; and
  - it would negate the ability for MDL and Vector to aggregate their respective tolerances to operational swing, providing a less flexible system to pipeline users.
56. An analysis by a group of economic consultants, commissioned by the Ministry of Economic Development on behalf of Government, established that the stand alone individual reconciliation process would result in a higher overall cost to the industry and consumers than would the OBA process. There are, therefore, significant efficiency advantages of the OBA system that were at the heart of the reasons why the Government and the industry preferred the OBA model for open access on the Maui pipeline.
57. Once the system of single seamless balancing (or reconciliation) by Vector was adopted by the parties and enshrined in the Code, it was necessary for parties using the Maui pipeline to have a contractual relationships with Vector in order that a mechanism, for the enforcement of any necessary payments resulting from the balancing process, was available. The two concepts go hand-in-hand.
58. It seems unlikely that in contemplating a regulatory counterfactual (if the Code was not implemented) the Government would choose a less efficient reconciliation system to that which it had already agreed as part of the negotiations surrounding the Code. Indeed as noted above the GPS emphasised the need for efficient open access to be implemented:
- The Government expects that *efficient* industry arrangements will be in place by December 2004 (emphasis added).
59. As stated, once the decision was made to implement a regulatory open access counterfactual using the OBA balancing system, that decision automatically requires a mandatory TSA with Vector for those parties requiring open access to the Maui pipeline. It is, therefore, concluded again that in respect of the TSA provisions, about which Todd had concerns, the factual and the regulated counterfactual would be identical. The relevant provisions in the Code would not lessen competition in comparison with the counterfactual. As before, the Commission’s view is that, as a result, it does not have jurisdiction to authorise the Vector TSA provisions.

## **PUBLIC BENEFITS AND DETRIMENTS WITH THE TODD COUNTERFACTUAL**

60. The Commission has chosen a counterfactual which comprises regulated access arrangements which mirror the Code. Thus, it is axiomatic that the provisions, about which Todd has concerns, do not lessen competition when compared with the counterfactual, and the Commission does not have jurisdiction to authorise the arrangement. In these circumstances any public benefit/detriment analysis is redundant, but it is reasonable to assume that the benefits and detriments would be the same in the factual and regulated counterfactual.
61. Notwithstanding this, and having an abundance of caution, the Commission has briefly considered what the public benefit/detriment situation might be:
- if the Commission was incorrect in its choice of counterfactual;
  - Todd’s preferred outcome (the “Todd counterfactual”) was used as its replacement; and
  - the Todd counterfactual was more competitive than the Code.
62. The principal difference between the Code and the Todd counterfactual would be that in the Todd counterfactual:
- legacy gas would be dealt with in the same manner as other gas; and
  - there would be no requirement for users of the pipeline to enter into a TSA with Vector.
63. Todd has argued that, under the Todd counterfactual, shippers of legacy gas would not have an unreasonable cost advantage over other gas, and that Vector would not have the same ability (arising from the compulsion on users to negotiate a TSA with Vector) to deny pipeline users the ability to play off the Maui pipeline against Vector’s Kapuni North Pipeline.
64. The Commission recognises that during negotiations surrounding the formation of the Code, there was considerable debate as to what were the optimal Maui open access arrangements. All the parties had their particular interests to protect. Each was required to make trade-offs. There was pressure from the Government on the industry to ensure the earliest possible open access. After a considerable period the various parties each compromised sufficiently to allow the general adoption of the Code as it now stands. While the Code may represent an outcome which is not ideal (although the provisions are subject to on-going changes), it has provided an open access regime which has allowed parties to transport their gas to the important Auckland, Waikato and Bay of Plenty markets (and elsewhere). Thus the Code had previously proved difficult as there was no general access to the Maui pipeline available. This has greatly increased competition in the gas wholesale market in these regions. Any delay in implementing the Code would have delayed this increased competition.



65. Todd has suggested that this competition would have been further enhanced had the Todd counterfactual been in place. This is possible, but not certain. On the other hand, the extent of any enhanced competition which could arise from the Todd counterfactual appears likely to be limited given:
- the limited amount of legacy gas remaining in the Maui field;
  - the absence of concerns expressed to the Commission by major gas consumers and gas shippers, other than Todd, about the open access regime under the Code.
66. In any event, the provisions in the Todd counterfactual were not part of the negotiated agreement. That is, the majority of parties with existing contractual and other property rights associated with the Maui pipeline were not prepared to trade-off those rights for the arrangements favoured by Todd under its proposed counterfactual. It is possible that in time (and with continuing Government pressure) these arrangements may have been agreed to, notwithstanding the concerns held about them by virtually all the parties other than Todd. Nevertheless, the Commission considers it very likely that the time necessary to reach any such agreement would have delayed open access (and the public benefits they have brought in the form of a more competitive gas wholesale market) by at least one year.
67. The Commission considers that it is likely that any benefit from the Todd counterfactual would be more than offset by the detriment arising from this delay.
68. Consequently, if the Commission had altered its view and adopted the counterfactual favoured by Todd, it is likely that it would have concluded that the public benefit from open access under the Code (compared with the Todd counterfactual) would outweigh any lessening in competition that would result, by a large amount.

## **CONCLUSION**

69. The Commission therefore confirms its view that in this case there is no lessening of competition when the factual is compared to the counterfactual. The Commission considers that the weight of the evidence quoted above obtained by the Commission points strongly towards the Code being regulated by the Government in the absence of agreement between the industry parties. In this regard the Commission has taken particular note of the submission of The Treasury which acted as The Crown's adviser on these matters and its representative in the negotiations that led to the Strawman agreement and the collateral agreement on the Code.
70. Therefore the Commission concludes that it does not have jurisdiction to make a determination granting authorisation.
71. Given this conclusion, other than the limited discussion in paragraphs 60 to 68 which the Commission provides for the sake of completeness, there is no need in this case to go further and consider in detail the benefits and detriments of the relevant provisions.

**DETERMINATION**

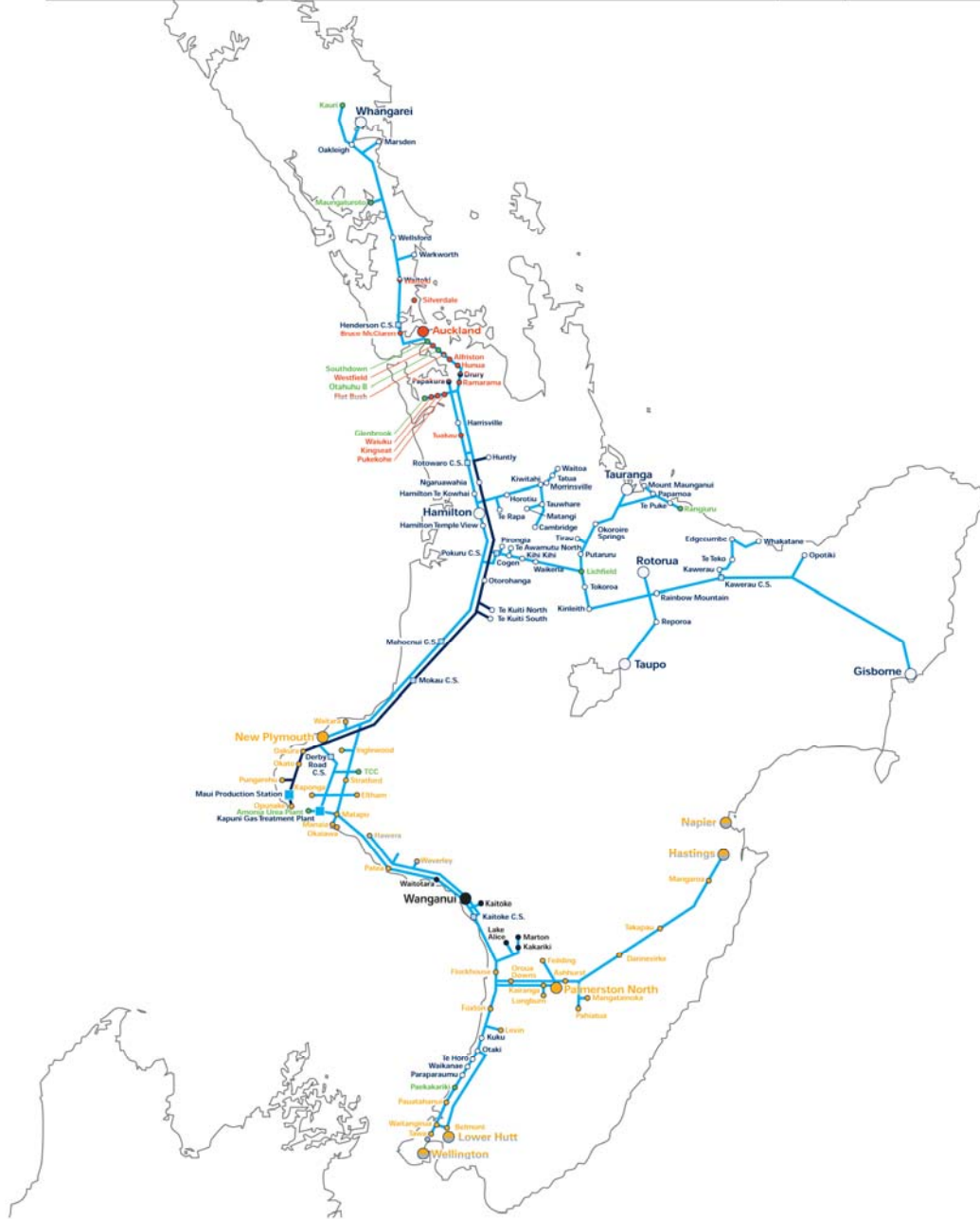
72. On the basis of the information available to it, the Commission has determined that it cannot be satisfied that the relevant provisions in the Code, when imported into contracts between users of the Maui pipeline and MDL, would lessen competition in any market.
73. Therefore, the Commission considers that authorisation of the relevant provisions is neither required by the Act, nor is within the jurisdiction of the Commission and, pursuant to s61(1)(b) of the Act, the Commission determines to decline to grant authorisation of the relevant provisions.

Dated at Wellington this        day of September 2008

Paula Rebstock  
Chair

# High Pressure Transmission Pipelines and Distribution Owners

- Legend
- - PRODUCTION STATION
  - - COMPRESSOR STATION
  - - VECTOR GAS TRANSMISSION
  - - MAUI DEVELOPMENT LIMITED
  - - POWER-CO DELIVERY POINT
  - - VECTOR DELIVERY POINT
  - - VECTOR (WAS NGC) DELIVERY PT
  - - NOVA FEED DELIVERY POINT
  - - WANGANUI GAS DELIVERY POINT
  - - DIRECT FEED DELIVERY POINT



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 April 2007

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