



COMMERCE COMMISSION

Authorisation for the Control of Supply of Natural Gas Distribution Services by Vector Ltd and Powerco Ltd Process Paper

24 January 2006

Purpose

This Paper describes the Commerce Commission's (the Commission) proposed approach for issuing the final determination for the authorisation of the supply of gas distribution services by Vector Ltd (Vector) and Powerco Ltd (Powerco).

Background and Legislative Context

On 27 July 2005 the Minister of Energy announced the decision to impose control over the gas distribution services of Powerco and Vector. The Minister made this decision based upon, among other advice, the recommendations of the Commission in its Gas Control Inquiry Final Report¹. Control was implemented by way of an Order in Council², and took effect on and including 25 August 2005.

The Order in Council defined the gas distribution services to be subject to control as being the line function services and metering services (the controlled services).

Sections 70 to 72 of Part 5 of the Commerce Act (the Act) provide for authorisations, provisional authorisations and alternative undertakings, which may be imposed following a declaration of control.

On 24 August 2005, pursuant to section 71 of the Act, the Commission issued a provisional authorisation specifying the control terms for the supply of the controlled services by Vector and Powerco to enable the controlled services to be lawfully supplied on and after 25 August 2005. Section 71 of the Act allows the Commission to issue a provisional authorisation pending the making of a final determination under section 70 of the Act.

Subsection 70(1) of the Act empowers the Commission, using whatever approach it considers appropriate, to make an authorisation regarding all or any component of the prices, revenues, or quality standards that apply to the supply of the controlled services. The approach may include the use of formulae or other methods from which prices or revenues may be determined. The Commission may authorise different prices, revenues and quality standards to meet different circumstances.

¹ Commerce Commission, Gas Control Inquiry Final Report, 29 November 2004.

² Commerce (Control of Natural Gas Services) Amendment Order (Order in Council) 2005, gazetted 28 July 2005.

In exercising its powers in reaching a decision on the final authorisation, s 70A of the Act states that the Commission must have regard to -

- (a) the extent to which competition is limited or likely to be lessened in respect of the controlled goods or services;
- (b) the necessity or desirability of safeguarding the interests of persons who acquire (whether directly or indirectly) or supply the controlled goods or services;
- (c) the promotion of efficiency in the production and supply or acquisition of the controlled goods or services.

Under s 70B, the Commission is also required to follow a particular administrative procedure in reaching decisions about the nature and form of control for the final authorisation. As part of that process, acquirers and suppliers have a right to be heard and the Commission must have regard to any submissions they make. The suppliers of the controlled services are Powerco and Vector. There are many acquirers of the controlled services; these are the relevant gas retailers, the large industrial gas users, small business consumers and residential consumers who are supplied from Powerco's and Vector's gas distribution networks.

Under s 70C (1) the Commission may impose, as part of an authorisation, provisions for remedies and penalties that apply if –

- (a) the prices determined by the Commission in an authorisation are lower than any price charged to any person under a provisional authorisation;
- (b) higher prices are charged, or higher revenues are derived, than those allowed in an authorisation;
- (c) quality standards are breached.

This paper describes the process that the Commission proposes to follow in reaching its decision on the final determination.

Process and Timetable

The following table summarises the steps the Commission will follow to reach its decision on the final determination. The intention is for the final determination to be published by 1 September 2006 to align with the annual price adjustment by gas retailers which occurs by 1 October. In the event of any delay to the process, the Commission will consider issuing an amended provisional authorisation.

Period	Steps
25 October 2005	Commission issues Invitation for Expressions of Interest.
17 November 2005	Commission issues Proposed Process Paper.
25 November 2005	Commission seeks asset valuation information from businesses.
8 December 2005	Comments on Proposed Process Paper due.
20 January 2006 30 January 2006	Commission seeks operating expenditure, capital expenditure and quality information from businesses. Commission issues Asset Valuation Methodology Discussion Paper. Commission publishes adopted process paper.
27 February 2006	Commission releases Form of Control Discussion Paper for consultation. Submissions on Asset Valuation Methodology Discussion Paper due.
27 March 2006	Commission issues letter of instruction to businesses on asset valuation requirements.
24 April 2006	Submissions due on Form of Control Discussion Paper.
1-5 May 2006 14 May 2006 28 May 2006	Conference on Form of Control. Cross submissions required System fixed assets valuation completed.
End of June 2006	Draft Decision Paper issued
End of July 2006	Submissions on Draft Decision Paper. Possible amended Provisional Authorisation issued.
Early August 2006 Mid August 2006	Conference on Draft Decisions. Cross submissions required
1 September 2006	Final Determination issued.

Comment on Process

The Commission considers that the process can be separated into two broad work-streams:

- The development of the form of control framework and methodologies to be applied for the final determination; and
- The identification of the input data (e.g., the costs and forecasts) to be fed into the form of control framework.

This approach is similar to the process followed by the Commission in the Gas Control Inquiry. The Commission does recognise that there is some overlap between these two broad work-streams and there is a need for them to be properly sequenced.

The development of the form of control framework will proceed through the release of a discussion paper, along with the request for submissions and a conference on that paper. The discussion paper is expected to cover:

- The economic and legal framework for the final determination,
- Analysis on the appropriate form of control for Vector's and Powerco's controlled services,
- Analysis on the appropriate pricing structures and the duration of control.

The intention is for this paper to be issued around February 2006.

The formulation of the inputs for the form of control work-stream addresses the determination of the businesses' allowed efficient costs and quality standards to factor into the form of control methodology. This covers:

- establishing appropriate values for the regulatory asset base and asset life/depreciation profiles;
- verifying forecast operating expenditure;
- verifying forecast capital expenditure;
- determining the appropriate cost allocation methodologies for allocating common costs among the businesses' regulated and non-regulated businesses;
- determining appropriate Weighted Average Cost of Capital numbers for the two businesses; and
- determining quality and reliability standards.

The Commission will make use of its information gathering powers in the Act (sections 70E and 98) to assist it in obtaining information relevant to the determination of the authorisation.

The two work-streams will come together towards the end of the process through the release of a draft Decision Paper for consultation. The paper will explain the Commission's proposals for setting the terms of the final authorisation for the controlled services.

Other Considerations

Undertakings

The Commission may, instead of making a final determination, obtain or accept a written undertaking in respect of the controlled services. The Commission must have regard to the considerations outlined in s 70A in accepting an alternative undertaking. An undertaking may include provisions for remedies and penalties for overcharging or for breaches of quality standards.

Amended Provisional Authorisation

The terms of the current provisional authorisation will remain in effect, until it is replaced by the final authorisation. The Commission is committed to meeting its 1 September 2006 target date for the final authorisation. If the process is delayed, however, the Commission may decide to issue an amended provisional authorisation. Progress against the target date therefore will weigh heavily in its consideration of whether to issue an amended provisional authorisation.

Possible Thresholds Regime

The Minister of Energy also announced on 27 July 2005, that a thresholds regime for all gas pipelines businesses would be introduced. This is something the Commission will be mindful of during the final authorisation process.

Proposed Process Paper

On 17 November 2005, the Commission issued its Proposed Process paper outlining the proposed process for issuing the final determination for the authorisation of the supply of gas distribution services by Vector and Powerco.

Submissions on the Proposed Process Paper.

Submissions on the proposed Process Paper were due on 8 December 2005. Two submissions were received, from Vector and Powerco. The submissions have been posted on the Commission's website: www.comcom.govt.nz

The submitters both had concerns with the overall timeframe allowed in the process for determining final authorisations. Powerco raised concerns about the contractual timeframe required to consult with retailers, should a change in tariffs occur.

Powerco's submission raised concerns that the interim timeframes should be more precisely detailed, that there should be an allowance for cross submissions, that the form of control ('how to') work stream needs to be sufficiently advanced before the information requirements can be defined; and that it would be indicative of a predetermined outcome to define the information requirements ahead of the consultation on the form of control. Powerco also stated its overriding concern as "that the proposed process is premature in light of the substantial challenges Powerco has initiated in its Judicial Review".

Vector's submission noted the proposed process does not specifically allow for consultation on the final authorisation.

The Commission agreed that interim timeframes should be more precisely outlined and that a cross submission process should be provided for following consideration of submissions on the form of control and asset valuation methodology. The 1 September 2006 final determination target date is left unaltered as it is considered the process will be completed to align with the annual contract date for distribution service contracts with retailers.

With respect to Powerco's concerns relating to the outcome of the Gas Control Inquiry judicial review the Commission considered its regulatory functions in determining a final authorisation should not be delayed. The Commission considered it was supported in its view by the judgment written by Justice Young in the Unison Court of Appeal case. The view was that regulatory processes could be disrupted if the courts insist that a challenge to one step in a statutory procedure must be fully resolved before any subsequent procedural steps can be completed.