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[By email]

Dear Sir/Madam

**Submission on technical paper for Consultation: Information Disclosure, Approaches for Understanding EDB and GDB Cost Efficiency**

1. This submission forms our response to the Commerce Commission's (Commission's) Technical Paper for Consultation: Information Disclosure, Approaches for Understanding EDB and GDB Cost Efficiency, dated 7 October 2011, (the Consultation Paper). GasNet welcomes the opportunity to comment on the proposed cost efficiency benchmarking for Gas Distribution Businesses (GDBs). We note the Consultation Paper also includes proposals for Gas Transmission Businesses (GTBs) and Electricity Distribution Businesses (EDBs). These reflect significant overlap and commonality in the approach to be adopted. We have not considered specially the proposals for GTBs or EDBs in this submission, other than where they are relevant for GDBs.

**Regulatory Framework**

2. The Consultation Paper introduces new proposals for an assessment of Opex and Capex efficiency of GDBs. It is proposed that this is to be undertaken as part of the Information Disclosure Requirements (IDR) for regulated suppliers under Part 4 of the Commerce Act. Part 4 also provides for default/customised price-quality control of GDBs. The IDRs for GDBs are currently being reviewed and we understand they are likely to require the disclosure of financial, service quality, price, asset management performance and contractual information pertaining to each regulated supplier. In this context the Consultation Paper provides insight to just one performance component of the proposed IDRs for GDBs.

3. IDR for the gas sector has lagged well behind that for the electricity sector. The current IDRs were implemented in 1997. Although subsequent revisions have been considered and drafted, they have never been implemented. In addition, other than the control authorisations for Vector's Auckland gas distribution and Powerco's gas distribution networks, price-quality regulation as implemented in the electricity sector in 2003 has not been replicated in the gas sector. Accordingly the gas sector is playing catch up to the electricity sector in regulatory terms. This means that that scope and quality of information about the regulated activities of gas sector suppliers today, is much more limited than that of the EDBs.
4. GasNet believes the proposals for assessing cost efficiency for the gas sector are premature. Instead, GasNet submits the Commission should focus its immediate efforts on developing and implementing the Default Price-Quality Path (DPP) as required by Part 4 of the Commerce Act, and reviewing and implementing revised Information Disclosure Requirements (IDRs) for GDBs. In our opinion, these are long overdue.
5. Part 4 of the Commerce Act sets out the purpose for IDR in section 53A as follows:  
*“to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met.”* In this context the ‘purpose of this Part’ refers to the section 52A Purpose Statement:  
  
*“The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—*
  - (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
  - (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
  - (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
  - (d) are limited in their ability to extract excessive profits.”*
6. These purpose statements, taken together, therefore define the scope of information to be included in IDR. In addition, in respect of IDR, section 53B(2) sets out additional requirements on the Commission as follows:

*“If a supplier of goods or services is subject to information disclosure regulation, the Commission—*

*(a) may monitor and analyse all information disclosed in accordance with the information disclosure requirements; and*

*(b) must, as soon as practicable after any information is publicly disclosed, publish a summary and analysis of that information for the purpose of promoting greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time.”*

7. Accordingly GasNet submits that in implementing the IDRs under Part 4 the Commission should:

a) Firstly define the outputs it believes it requires to enable interested persons to assess whether or not regulated suppliers are meeting the objectives of the 52A Purpose Statement;

b) Define and implement the information requirements consistent with this objective; and finally

c) Publish its summary and analysis.

8. As the section 52A Purpose Statement has a number of strands which are interlinked, the outputs required to assess performance need to be viewed as a package. As stated above IDR is likely to encompass the publication of information about financial, price, service and asset management performance. This is likely to include historical and forecast information. In addition, as IDR is not the only regulatory mechanism which applies to regulated suppliers, it should not be viewed in isolation without consideration of impact of price-quality regulation.

9. The Consultation Paper addresses just one component of business performance. This is presented only in the context of IDR, ie: does not consider the influence of price-quality regulation or other aspects of IDR. In addition the Consultation Paper does not consider the outputs the Commission believes it needs to implement for IDR consistent with the 53A purpose of IDR. Accordingly it is extremely difficult to comment on the proposals without this wider view, ie: how the proposals fit into the overall regulatory framework and how the Commission intends to implement its summary and analysis assessments.

10. The proposed approach appears to require a large quantity of detailed data about our regulated business. Accordingly GasNet is very concerned about the cost of

the proposals and is unable to support them without further information and explanation. In the following paragraphs we set out our key concerns.

- a) The purpose of IDR is to provide sufficient information for interested parties to assess performance against the section 52A Purpose Statement. The Consultation Paper however suggests the purpose of the IDR cost efficiency information and monitoring is in itself a regulatory mechanism to promote performance efficiency. Whilst this may be an outcome of IDR, we submit it is not its purpose. We believe this debate is central to the specification of the scope and amount of information that should be disclosed. The Consultation Paper is silent on how the Commission interprets the 53A purpose of IDR and therefore how it has determined its proposed information requirements.
- b) Price-quality regulation provides incentives to improve efficiency and share efficiency benefits with consumers over time. This has significant overlap with the proposals in the Consultation Paper however the role of price-quality regulation is not addressed at all in the Consultation Paper. We submit this is an oversight and, in regard to the Commission's summary and analysis of IDR data, the cost efficiency benchmarking proposals should not be viewed in isolation of the other regulatory incentive mechanisms. Without this consideration we submit it is not possible to define the outputs or inputs required for IDR for the purpose of assessing efficiency.
- c) The Consultation Paper is also silent on the costs of complying with the proposals (for regulated suppliers) and the costs of implementing and managing the information gathering, analysis and monitoring roles to be undertaken by the Commission (but borne by consumers via the Commerce Act Levy). GasNet has previously submitted that it is unlikely to consider applying for a CPP given the expected costs of such a detailed process are significant for a small GDB such as ours. We are seriously concerned that some of the information requirements which were discussed at the Technical Reference Group Workshop were more detailed than those required for a CPP proposal. We cannot understand how the requirements for information disclosure can be more detailed than those required for a CPP given the monitoring objective of IDR versus the objective of CPPs which is to pre-approve a forecast capex/opex/service plan for an individual supplier.

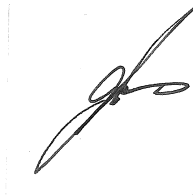
d) We understand the Consultation Paper outlines a proposal which has been informed by the UK electricity distribution price control review. We are concerned that the scope and scale of the businesses in the UK, and the purpose of that review are significantly different to the New Zealand situation. We therefore question whether this is the appropriate reference case, and whether enough consideration of the New Zealand situation has been made, particularly in respect of the gas sector, and specifically the smaller GDBs.

11. Our responses to the specific questions raised in the Consultation Paper are appended to this submission.

### **Closing Remarks**

If you have any queries in relation to this submission, please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Geoff Evans', written over a faint, light-colored signature line.

**Geoff Evans**  
General Manager

## **Appendix A – Responses to Questions for Submitters**

### ***Q.1 How much insight would an assessment of operating expenditure based on NZ comparators alone provide, for EDBs and for GDBs?***

Regarding GDBs specifically, insights are already observable from existing information disclosure data, however as previously submitted the information disclosure requirements (IDRs) are overdue for review. GasNet's position is that the Commission should focus on its review of the IDRs before considering the Opex performance of each GDB. This review should encompass the full scope of IDRs, including price, contract, financial, service performance and asset management information. It is only once these requirements have been consulted on and implemented, that expenditure performance assessments will be possible. This is not possible in the short term as GDBs need to have sufficient time to implement the systems required to comply with the new requirements once they have been determined.

We note that given the control authorisations in place for both Powerco and Vector, the Commission already has detailed operational expenditure information for those businesses.

### ***Q.2 How insightful could international comparators be in assessing EDB and GDB expenditure?***

We do not consider any international comparisons will be meaningful for GasNet. In addition to the complexity of normalising for international differences (input costs, market structure etc) GasNet's scale makes meaningful comparisons within New Zealand difficult enough. Internationally, GDB businesses are typically much larger than those in New Zealand, and in particular GasNet. We do not believe the cost and complexity of such a proposal is justified. The most valid GPB comparator for GasNet is Nova Gas; however this company is exempt from the requirements of Part 4 of the Commerce Act.

### ***Q.3 What companies, countries or datasets should be included in the analysis?***

GasNet questions whether it is possible to achieve meaningful comparisons between our business and other gas networks. We suggest it is more meaningful to consider changes in our own performance over time.

If GasNet is to be compared with other businesses, the comparative companies should be New Zealand based GDBs.

***Q.4 How appropriate are sub-company comparisons of costs?***

GasNet does not consider sub-company comparison for our GDB either relevant or practical to measurement of its cost efficiency for the purpose of undertaking summary analysis of information disclosed under Part 4 of the Commerce Act. Particularly given our small size, any subdivision will create artificial cost allocations which will be immaterial.

***Q.5 How feasible and costly would it be to collect sub-company cost and characteristic data to enable sub-company comparisons?***

This would not be feasible for GasNet given our small overall size.

***Q.6 What factors (outside management control) drive industry wide Opex?***

In regard to GDBs specifically:

- Regulation, including local body requirements and safety management regulations
- The regional, national and international labour markets
- Third party service providers
- Price of delivered natural gas relating to the wholesale price, transmission fees and retailer margin

***Q.7 To what extent does the current information disclosure data capture these factors?***

Regarding GDBs specifically, the current information disclosure regime was established in 1997 with its only revision deferred at the outset of the Gas Inquiry in 2003. Since 1997 many changes have occurred within the sector and across the economy which justify the Commission's review of IDRs. GasNet is unclear how the Commission intends to use factors (outside management control) that drive industry wide Opex to determine GDB cost efficiency for the purpose of undertaking summary analysis of information disclosed under Part 4 of the Commerce Act. The factors listed in response to Q6 above are not currently captured by the IDRs.

***Q.8 What cost drivers, if any, (outside management control) are unique to your EDB or GDB?***

Although the following factors are not unique to GasNet, they reflect characteristics which differ between GDB networks which are relevant to assessing Opex.

- Network operating pressures,

- asset materials and construction,
- asset age profiles,
- ground conditions,
- CBD/non-CBD mix,
- end-user mix,
- local economic factors,
- mains fronting; and
- property penetration ratio.

***Q.9 To what extent does the current information disclosure data capture these factors?***

The current disclosure data for GDBs does not capture information of sufficient detail to be able to determine the relevant characteristics of each network for the factors listed in response to Q8 above.

***Q.10 What factors (other than changes in input prices) influence Opex over time?***

In regard to GDBs specifically:

- Asset age profiles,
- ground conditions,
- asset materials and construction,
- natural events,
- network length,
- network pressure,
- required performance quality, and
- third party activity (and possible damage).

***Q.11 To what extent should quality be taken into account when assessing cost efficiency?***

There has been some consultation on appropriate quality measures for GDBs in the context of the DPP consultation. The outcomes of this consultation are not yet available. However in principle, it is important to consider the quality of the service delivered when assessing cost efficiency – otherwise low cost operators providing lower levels of service may be inappropriately deemed “efficient”, if the service they provide is below that expected by their customers.

It should be noted that the changing safety regulations will require GDB's to determine their own operations and maintenance regime based on their own risk based approach. This will inevitably result in different outcomes which will be difficult to measure. If these outcomes (eg: leak surveys and the number of leaks found during a

survey) are considered to be a measure of quality used to compare GDBs, then they will misrepresent the performance of the business.

***Q.12 What level of Opex should be assessed? Should the current sub-categories of EDB and GDB Opex (e.g. general management, administration and overheads) be separately assessed, should further disaggregated cost data beyond these categories be collected and assessed, or should the analysis focus on total Opex only?***

There are no current sub-categories of Opex for GDBs. The approach taken in the s53ZD information request for DPPs was to allow GDBs to specify their own cost categories. The cost categories used for that purpose by GasNet were:

- Corporate
- Finance and administration
- Engineering
- Supply
- Asset information services
- Other.

We note that the Input Methodology Determination for Customised Price-Quality Paths (CPPs) sets out a limited number of cost categories which were consulted upon last year. We would not support any further disaggregation, and in addition note that if common cost categories are to be implemented for IDR, that GDBs must be able to transition to these. It is not possible to retrospectively assign expenditure into new categories.

As stated earlier until the outputs of the proposed efficiency benchmarking have been determined, it is not possible to determine the inputs.

***Q.13 What components of Opex should be separately benchmarked?***

We believe that it is appropriate to separately consider the same categories as included in the Input Methodologies (as per Schedules B and E). This ensures consistency across the regulatory framework which ultimately will limit compliance costs. Adequate definitions are required to ensure suppliers are able to apply the requirements consistently.

***Q.14 How much insight would external comparisons of common functions provide?***

GasNet does not consider external comparison of common functions to be relevant or practical to measurement of its cost efficiency for the purpose of undertaking summary analysis of information disclosed under Part 4 of the Commerce Act. It is our view that there is considerable work required to review and implement IDRs for GDBs. We believe these should be the priority, implemented and assessed before any consideration of cross sector comparison be made. In principle we do not support comparisons between sectors because the scope of activity undertaken by the businesses in each sector would need to be normalised.

***Q.15 What functions should be benchmarked and how easily available is cost data at a function-level?***

***Q.16 What industries and operators should be included when benchmarking these functions?***

Refer above.

***Q.17 Should nature-of-work comparisons be further considered in assessing EDB and GDB Opex efficiency? If so, what sectors should be included in the analysis?***

For reasons already stated in response to questions listed above, given its metrics GasNet does not consider nature-of-work comparison of common functions to be relevant or practical to measurement of its cost efficiency for the purpose of undertaking summary analysis of information disclosed under Part 4 of the Commerce Act.

***Q.18 To what extent should assessments of historical Capex based on direct comparisons be considered as part of summary and analysis?***

Historical Capex spend is reflective of the business environment and strategic investment appetite at those points in time and the underlying performance management of the assets concerned over time. Historical Capex decisions are reflected in the existing network, its performance, condition and age profile. These factors are relevant for the performance of each individual GDB and accordingly make inter GDB comparisons somewhat meaningless.

***Q.19 What are the material assets and activities that should be included in a Capex assessment?***

***Q.20 What are the drivers of activity on these assets?***

The Consultation Paper proposes that forecast Capex for each supplier will be used to assess Capex efficiency. This discussion assumes a level of forecast information which is currently not included in GDB IDRs. We understand the Commission intends to include requirements for GDBs to publish Asset Management Plans (AMPs) as part of IDR. GasNet submits that GDBs must be given time to implement the Asset Management Plan requirements, and refine them (as EDBs have over time) before any assessment of forecast Capex is made for the purpose of assessing business performance.

GasNet has not published an AMP document to date. This is not because it has previously considered an AMP irrelevant, but due to long term stability of its personnel it has retained a wealth of organisational knowledge across its entire network delivery assets. This is atypical of the gas industry. GasNet is likely to require three - five years to introduce, monitor, revise and streamline asset management data capture and documentation as an integral part of its day to day operational business.

It is our view that the proposal to assess Capex forecasts in order to determine business efficiency is flawed, as they are more likely to measure the efficiency of forecasting than Capex. GasNet's Capex forecasting processes are not technically sophisticated, and they don't need to be. We operate networks with very low growth, and hence our asset management activity is primarily focussed on maintaining service capability.

GasNet is extremely concerned at the proposals to benchmark GDB Capex by forecast activity and unit cost. The allocations required to achieve this for our business would be arbitrary, costly and meaningless. For reasons already stated in response to questions listed above, given its metrics GasNet does not consider detailed asset or activity candidates as either relevant or practical to measurement of cost efficiency for the purpose of undertaking summary analysis of information disclosed under Part 4 of the Commerce Act.

The Consultation Paper appears to draw heavily on the EDB AMP experience with regard to Capex. We submit this has little relevance for our GDB.

***Q.21 How can Capex effectiveness be measured?***

***Q.22 How suitable is the proposed approach for assessing Capex?***

Given the influence of historical evolution and investment in a network, Capex effectiveness is reasonably unique to each network and thus can only be assessed on a network basis. This is likely to be based on qualitative not quantitative analysis, which requires AMPs to be developed and published.

***Q.23 To what extent do suppliers consider the Opex-Capex trade-off could distort an assessment of expenditure that is based on separate reviews of Opex and Capex?***

***Q.24 Which components of expenditure have significant Opex-Capex trade-offs?***

The answer to this is likely to depend on the status of performance attributes for each network, as discussed above. For GasNet, our preferred approach is a review of total network expenditure, ie: not Capex and Opex in isolation.

***Q.25 How should the cost analysis take into account any Opex-Capex trade-offs?***

By considering total cash expenditure on the network, over time.