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Review of submissions

For AECT's cross-submission on the Commerce Commission's Issues Paper on the Initial Default Price-Quality Path for Gas Pipeline Businesses

Report to Auckland Energy Consumer Trust

28 May 2010

About NZIER

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NZIER was established in 1958.

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Executive summary

Purpose

On 12 April 2010, the Commerce Commission (the Commission) released an issues paper setting out its preliminary views on how the initial default price-quality path (DPP) for gas pipeline businesses (GPBs) should be determined (the Issues Paper). The Commission invited submissions from interested parties on the form of control by 30 April 2010 and on all other sections of the Issues Paper by 14 May 2010.

The Commission is now inviting cross-submissions by 31 May 2010 on matters raised in these submissions, to ensure that it is aware of points of agreement and disagreement between submitters.

The Auckland Energy Consumer Trust (AECT), as a majority shareholder in Vector, which owns electricity and gas distribution assets and gas transmission assets, will be affected by the initial DPP. To assist AECT in preparing its cross-submission, AECT has asked NZIER to review the submissions made by other submitters and to identify points of agreement and disagreement with AECT's submissions. This report presents our review.

Conclusions and recommendations

This comparison of submissions indicates general agreement on:

- Section 2: Nature of gas pipeline services, subject to recognition that this differentiation between gas distribution services and gas transmission services does not necessarily extend to a need for different forms of control.
- Section 8: Data requirements, subject to these being relevant and least cost.

The main points of disagreement between submitters are:

- Section 3: Structure of the initial DPP:
  - AECT considers an integrated price-quality path feasible and in the interests of consumers, GPBs and investors, given the link between price and quality.
  - AECT recommends that the Commission investigate including an S-factor quality incentive in the DPP.
  - AECT accepts the setting of separate standards to the extent that it is not practical, feasible or consistent with the low-cost regulatory option to integrate price and quality in the initial DPP.
- Section 4: Form of price control:
  - AECT supports application of a weighted average price cap for gas distribution businesses (GDBs).
  - AECT considers that the appropriate form of control will differ between the two gas transmission businesses (GTBs) due to their very different systems.

  - AECT recommends application of a total revenue cap for gas transmission services where the cost structure is largely fixed and the revenue driver is variable (as typically occurs with common carriage, as on MDL's system) and a weighted average price cap for gas transmission services where the cost structure (including investment in connections and capacity) is variable and the revenue driver is manageable (as typically occurs with contract carriage, as on Vector Transmission's system).
  - If it is not possible for the two GTBs to have different forms of control, AECT favours a weighted average price path for both, for greater compliance with the regulatory objectives.
- Section 5: Pricing arrangements prior to initial DPP:
  - AECT does not consider claw-back to be needed or in the interests of achieving competitive market outcomes.
  - AECT considers the proposed assessment methodology to undermine regulatory and investor certainty, given that the Commission is still determining how asset valuation and cost of capital will be applied in determining whether or not revenue has been over-recovered.
  - AECT recommends that claw-back not apply in the case of technical breaches or where price increases can be justified in terms of incremental investment or providing an adequate return.
- Section 6: Productivity analysis:
  - AECT supports use of New Zealand gas sector data, in the first instance.
  - AECT suggests that the Commission seek to corroborate and/or adjust New Zealand gas sector productivity trends with reference to productivity trends for New Zealand electricity distribution businesses.
  - AECT recommends that the Commission use the B-factor approach to estimating total factor productivity (TFP) in both cases.
  - AECT supports a non-mechanistic, pragmatic approach to using the results of TFP analysis in determining the X-factor, due to data limitations and methodological difficulties.
- Section 7: Quality standards:
  - AECT accepts the setting of separate quality standards to the extent that it is not practical, feasible or consistent with the low-cost regulatory option to integrate price and quality in the initial DPP.
  - AECT recommends that these quality standards be limited to indicators of reliability, more suited to gas than are SAIDI and SAIFI, and allow for variation to avoid causing technical breaches.
- Section 9: Annual assessment and regulatory periods:
  - AECT recommends an assessment period of 1 October to 30 September, to align with the pricing year for GDBs and Vector's GTB.

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1. Purpose

The Commerce Amendment Act 2008 introduced the requirement to set default price-quality paths (DPPs) for both electricity distribution businesses (EDBs) and gas pipeline businesses (GPBs). For GPBs, the legislation requires an initial DPP to be set from 1 July 2010 or as soon as practicable thereafter. The initial view of the Commerce Commission (the Commission) is that 1 July 2012 is the appropriate date to commence this DPP.

On 12 April 2010, the Commission released an issues paper setting out its preliminary views on how the initial DPP for GPBs should be determined[1] (the Issues Paper). The Commission invited submissions from interested parties on the form of control by 30 April 2010 and on all other sections of the Issues Paper by 14 May 2010.

The Commission is now inviting cross-submissions by 31 May 2010 on matters raised in these submissions. The purpose of cross-submissions is to ensure that the Commission is aware of points of agreement and disagreement on matters raised in submissions.

The Auckland Energy Consumer Trust (AECT), as a majority shareholder in Vector, which owns electricity and gas distribution assets and gas transmission assets, will be affected by the initial DPP. To assist it in preparing its cross-submission, AECT has asked NZIER to review the submissions made by other submitters and to identify points of agreement and disagreement with AECT's submissions. This report presents our review.

2. Regulatory objectives

Businesses operating in markets where there is little or no competition face less, if any, competitive pressure on their costs and prices. They may therefore be able to operate less efficiently and/or to charge more than they would if these markets were competitive and to exploit their position of market power to earn "excess returns", to the detriment of consumers.

To address these concerns, Part 4 of the Commerce Act "provides for the regulation of the price and quality of goods and services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition".[2]

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[1] Commerce Commission (2010) *Initial Default Price-Quality Path for Gas Pipeline Businesses*, Issues Paper, 12 April 2010. The Issues Paper and subsequent submissions are available at: www.comcom.govt.nz/default-price-quality-path-regulation-process/

[2] Section 52.

Amongst the changes introduced by the Commerce Amendment Act 2008 was a new purpose statement for Part 4 of the Commerce Act. Section 52A provides that:

> *(1) The purpose of this Part is to promote the long-term benefit of consumers in markets where there is little or no competition and no likelihood of a substantial increase in competition by promoting outcomes that are consistent with outcomes produced in competitive markets so 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 all or any regulated goods or services, including through lower prices; and*
>
> *(d) are limited in their ability to extract excessive profits.*

In other words, a proposed regulatory intervention must promote the long-term benefit to consumers by promoting outcomes that incentivise suppliers to invest, to improve efficiency, to meet the quality demands of consumers[3] and to share efficiency gains with consumers, whilst limiting the ability of suppliers to extract excessive profits. As the purpose statement highlights, these regulatory outcomes have been adopted specifically to be consistent with the outcomes expected to be produced by competitive markets.

Provided that the measure of consistency with promoting competitive markets reflects workable rather than perfect competition, AECT considers it critical that the Commission ensure that this new statutory purpose be carried through in the development and implementation of the new regulatory regime, including the DPP.[4]

3. AECT's submissions

Table 1 summarises AECT's responses, as expressed in its submissions of 30 April and 14 May 2010, to the initial views expressed by the Commission in the Issues Paper. For further details of AECT's concerns and recommendations, please see these previous submissions.

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[3] The three dimensions of economic efficiency – dynamic, productive and allocative.

[4] AECT (2009) *Submission to Commerce Commission on the Regulatory Provisions of the Commerce Act 1986*, 16 February 2009.

Table 1 AECT's responses to Commission's initial views

Commission's initial view	AECT's response
Section 2: Nature of gas pipeline services	
Gas distribution services and gas transmission services are sufficiently different that they will have separate initial DPP determinations	Supports; but does not support the Commission extending this differentiation to the form of control
Gas transmission services will be defined with reference to the definition of "transmission system" specified in the Gas Governance (Critical Contingency Management) Regulations 2008	Supports
Gas distribution services will be defined by inclusion in the definition of gas pipeline services and exclusion from the definition of gas transmission services	Supports
Section 3: Structure of the initial DPP	
The initial DPP will consist of separately specified and assessed price path and quality standards	Does not support; considers it in the interests of consumers, GPBs and investors for price and quality to be integrated within an incentives framework; notes that an integrated approach is consistent with workably competitive markets and the statutory framework; prefers that the DPP provide an S-factor quality incentive in the price path (i.e. the price path is of the form CPI – X + S); considers that the Commission has time to develop options for integrating price and quality; recommends that the Commission undertake analysis to identify an S-factor type incentive to integrate price and quality within the DPP
Section 4: Form of price control	
A weighted average price cap will be applied to gas distribution services	Supports
A total revenue cap will be applied to gas transmission services	Does not support; has concerns about adopting generic revenue cap control for gas transmission services, given that gas transmission is not a generic service to which a generic form of control should apply and compliance with regulatory objectives would tend to favour price control over revenue control; recommends application of a total revenue cap for gas transmission services where the cost structure (including investment) is largely fixed and the revenue driver is variable (as typically occurs with common carriage) and a weighted average price cap for gas transmission services where the cost structure (including investment in connections and capacity) is variable and the revenue driver is manageable (as typically occurs with contract carriage); recommends, as second preference, application of a weighted average price cap for all GPBs
The Commission seeks views on implementation considerations	No comment
Section 5: Pricing arrangements prior to initial DPP	
An assessment methodology will be used to assess whether or not a GPB has increased its weighted average prices by more than the movement in the CPI over the period 1 January 2008 to the determination date	Does not support; considers that this assessment methodology would undermine regulatory and investor certainty, given that the Commission is still determining how asset valuation and cost of capital will be applied in determining whether or not revenue has been over-recovered; considers that having four assessment periods increases the likelihood of a technical breach
A GPB may propose an amendment to the assessment methodology where the GPB can demonstrate that the assessment methodology is not practicable in its particular circumstances and the amended methodology has an equivalent effect	Agrees that, if claw-back is applied, assessment should consider individual circumstances
If a GPB is shown to have increased its weighted average prices by more than the movement in the CPI, the Commission will assess whether the GPB has over-recovered any revenue and, if so, the extent of any over-recovery	Does not support; does not consider claw-back to be needed or in the interests of achieving competitive market outcomes; considers that this pricing arrangement will undermine regulatory and investor certainty, given that the Commission is still determining how asset valuation and cost of capital will be applied in determining whether or not revenue has been over-

	recovered; considers that any assessment of over-recovered revenue must have regard to contemporaneous asset valuations and the cost of capital appropriate for current conditions in global financial markets, to avoid technical breaches, otherwise may deter investment over the period to commencement of the initial DPP; recommends that claw-back not apply in the case of technical breaches or where price increases can be justified in terms of incremental investment or providing an adequate return in prevailing conditions on contemporaneous investment values
Claw-back of over-recovered revenue will be applied through adjusting starting prices at the outset of the initial DPP	Considers that any decision on whether to effect claw-back as part of adjustments to starting prices or price adjustments over the course of the regulatory period should have full regard to the desirability of avoiding both positive and negative price shocks
Services controlled under the Commerce (Control of Natural Gas Services) Order 2005 for which pricing complies with the Authorisation should not have to demonstrate whether or not the CPI criterion has been met for those services	Supports
Section 6: Productivity analysis	
The value of the X-factor will be based on total factor productivity (TFP) analysis of the New Zealand gas sector	Supports use of New Zealand gas sector data in first instance, if sufficient; has concerns about uncertainty in the determination of TFP and considers that undue complexity in determining the X-factor will hide any underlying signal for productivity improvement; recommends that the Commission use the previous B-factor approach for identifying the long-run rate of productivity improvement
Other indirect approaches (gas sectors overseas, other sectors in New Zealand) will be used if data problems cannot be resolved and/or as a cross-check	Broadly supports; suggests that the Commission seek to corroborate and/or adjust New Zealand gas sector productivity trends with reference to productivity trends for New Zealand EDBs (first preference), using the more traditional B-factor TFP approach, and overseas productivity trends
The results of any productivity analysis will not be applied mechanistically, but used with other relevant considerations to inform the Commission's view on the appropriate value of the X-factor	Supports use of non-mechanistic, pragmatic approach to setting X-factor
Section 7: Quality standards	
Quality standards will comprise defined and measurable indicators of reliability (SAIDI and SAIFI) and system integrity (PRE)	Broadly supports, to the extent that it is not practical, feasible or consistent with the low-cost regulatory option to integrate price and quality in the initial DPP; suggests that the Commission may need to identify other indicators of reliability, as SAIDI and SAIFI are less useful for gas than electricity; cautions against use of hard limits based on average reliability performance; considers that indicators must be thoroughly tested (including statistically) to avoid causing technical breaches; agrees that appropriate to adopt different DPP parameters for gas transmission and gas distribution; agrees that additional quality indicators, such as customer service, gas quality and system integrity, may be monitored outside the DPP
Section 8: Data requirements	
The Commission will need to seek further data from GPBs to set the initial DPP	Supports
Section 9: Annual assessment and regulatory periods	
The Commission seeks views on the annual assessment period and presents two options: Option 1 – July to June assessment period (involving two sets of prices over an assessment period); Option 2 – October to September assessment period (aligned with GDBs' and Vector Transmission's pricing years and requiring a three month commencement period)	Does not support Option 1, given that will result in Vector's compliance reporting being non-aligned with its pricing year and increase Vector's compliance costs; supports Option 2

Source: NZIER, taken from AECT submissions of 30 April and 14 May 2010

4. Comparison with other submissions

In Table 2, we identify the points of agreement and disagreement between AECT and other submitters, as reflected in their submissions on the Commission's Issues Paper.

Table 2 Comparison with other submissions

Commission's initial view	Responses of other submitters	Comparison with AECT's response
Section 2: Nature of gas pipeline services		
Gas distribution services and gas transmission services are sufficiently different that they will have separate initial DPP determinations	All support Vector supports, but does not believe the differences are so great as to require different forms of control; considers the relationship between fixed and variable cost structures is not materially different between Vector's transmission and distribution businesses GasNet supports, but considers that GDBs and GTBs have similar cost structures, disagrees that GDBs have a relatively high degree of variable costs and considers the ability of GDBs to influence demand is minimal	Agrees Agrees Agrees that GDBs and Vector Transmission have similar cost structures, but disagrees that MDL has similar cost structure; disagrees that GDBs have a relatively low degree of variable costs and minimal ability to influence demand
Gas transmission services will be defined with reference to the definition of "transmission system" specified in the Gas Governance (Critical Contingency Management) Regulations 2008	All support	Agrees
Gas distribution services will be defined by inclusion in the definition of gas pipeline services and exclusion from the definition of gas transmission services	All support	Agrees
Section 3: Structure of the initial DPP		
The initial DPP will consist of separately specified and assessed price path and quality standards	GasNet supports in the interim, but considers that an integrated price-quality path is more appropriate in the medium run; notes that price and quality are inextricably linked in consumer preferences and willingness to pay for quality; recommends that the Commission investigate the introduction of an S-factor mechanism for GDBs, which would allow a GDB's pricing to adjust to reflect changes in quality performance; considers the setting of one price constraint and one quality constraint sufficient for the initial DPP Maui Development Limited (MDL) supports, given that it would be very difficult to quantify the relationship between the marginal cost and benefit of quality on the Maui Pipeline and for gas transmission there is limited ability to manipulate quality – the pipeline is either safe or not Powerco supports, given current data quality and availability hinders using an integrated price-quality path	Agrees that an integrated price-quality path is more appropriate; agrees that the Commission investigate including an S-factor mechanism in the DPP Disagrees; considers it feasible and in the interests of consumers, GPBs and investors for price and quality to be integrated within an incentives framework Disagrees

	Vector does not support; considers a combined price-quality path, which links price to quality through the S-factor approach, is optimal for driving improvements in quality and providing greater certainty, as GPBs could make explicit price-quality tradeoffs rather than be subject to an uncertain penalty-based regime; recommends that the Commission use the time available until the start of the DPP in 2012 to develop an S-factor mechanism for GPBs	Agrees
Section 4: Form of price control		
A weighted average price cap will be applied to gas distribution services	GasNet supports Powerco supports Vector recommends that GPBs have the option of choosing whether to be subject to a weighted average price cap or a revenue cap; needs more details on how weighted average price cap or revenue cap would be implemented before can choose one approach over the other; initial view is that a weighted average price cap is likely to be appropriate for both GDBs and Vector's GTB; does not believe the differences between gas distribution services and gas transmission services are so great as to require different forms of control	Agrees Agrees Disagrees with allowing GPBs to choose; considers weighted average price cap appropriate for GDBs
A total revenue cap will be applied to gas transmission services	Contact Energy expresses no preference, but prefers whichever control method best incentivises investment MDL does not support; considers that, due to differences in business structure, there could not be a single GTB DPP that was suitable for both MDL and Vector, but could be one that was suitable for one of them; requests a revenue cap for MDL, partly due to MDL's common carriage regime, which makes its revenue volatile and dependent on demand outside its control, whilst Vector Transmission operates a firm carriage regime, which provides more stable revenue Vector does not support; recommends that GPBs should have the option of choosing whether to be subject to a weighted average price cap or a revenue cap; needs more details on how weighted average price cap or a revenue cap would be implemented before can choose one approach over the other; initial view is that a weighted average price cap is likely to be appropriate for both GDBs and Vector's GTB; does not believe the differences between gas distribution services and gas transmission services are so great as to require different forms of control; does not agree that the lumpy and infrequent nature of transmission investment means that a revenue cap is necessarily appropriate for Vector's gas transmission system, given that Vector faces sufficiently frequent connection requests necessitating new investments that a revenue cap would be costly to operate under; disagrees that the form of control for gas transmission services must necessarily be the same for both Vector and MDL, which have quite different systems – MDL does not as frequently make capital investments that would otherwise need to be accommodated under a revenue cap and, due to a more variable tariff structure, faces more acute volume risks outside of its control	Agrees on need to incentivise investment Agrees that the most appropriate form of control is likely to differ for MDL and Vector Transmission; agrees that a revenue cap is likely to be more appropriate for MDL Disagrees with allowing GPBs to choose; agrees that the form of control need not be the same for both Vector and MDL, which have quite different systems; considers a weighted average price cap likely to be most appropriate for Vector Transmission and a revenue cap likely to be most appropriate for MDL
Section 5: Pricing arrangements prior to initial DPP		
An assessment methodology will be used to assess whether or not a GPB has increased its weighted average prices by more than the movement in the CPI over the period 1 January 2008 to the determination date	GasNet supports the timing for submission and completion of assessments (the third quarter of 2011); notes that enactment of the Commerce Amendment Act in September 2008, after prices had been published for the next pricing period (commencing 1 October 2008), means that applying the CPI criterion from 1 January 2008 will impose a retrospective ceiling on gas distribution prices that could not be accommodated within the first assessment period (2008); recommends that the Commission consider such circumstances in	Disagrees that this assessment methodology can be applied without undermining regulatory and investor certainty, given that the Commission is still determining how asset valuation and cost of capital will be applied in

	any assessment; considers that should assess weighted average price over entire period, rather than making an annual assessment for each pricing period; agrees with comparing change in weighted average prices with change in CPI using actual CPI data; agrees with using reference quantities, but any need to accommodate seasonal influences in partial first year MDL recommends pooling of tariffs where there are multiple tariffs, applying the CPI criteria to actual revenue rather than price and calculating over/under recovery of revenue over the total period 1 January 2008 to 1 October 2011 rather than each pricing period Vector does not support; disagrees with applying claw-back on the basis of an assessment methodology that was not notified to suppliers before the revenue was earned and that differs from the Gas Authorisation approach so will require suppliers to change method half-way through the period, which adds to uncertainty and risk of technical breaches due to methodology; does not support assessment in four distinct periods, with a breach in any one period grounds for claw-back; considers the relevant consideration to be the total price increase compared with the total CPI increase over the total time period; considers that use of quantities from 1 January 2010 for all pricing periods from 1 January 2008 increases risk of technical breaches	determining whether or not revenue has been over-recovered; agrees that having four assessment periods increases the likelihood of a technical breach Agrees that having four assessment periods increases the likelihood of a technical breach Agrees
A GPB may propose an amendment to the assessment methodology where the GPB can demonstrate that the assessment methodology is not practicable in its particular circumstances and the amended methodology has an equivalent effect	GasNet supports Vector supports, but recommends that the Commission undertake to accept alternative methodologies that have equivalent effect without the need to demonstrate that it is not practical to apply the assessment methodology	Agrees that, if claw-back is applied, assessment should consider individual circumstances Agrees that, if claw-back is applied, assessment should consider individual circumstances
If a GPB is shown to have increased its weighted average prices by more than the movement in the CPI, the Commission will assess whether the GPB has over-recovered any revenue and, if so, the extent of any over-recovery	GasNet cautions against mechanistic application of any claw-back assessment formula and considers that any analysis by the Commission of whether to apply claw-back should consider actions taken by GDBs to mitigate the effects of or compensate for any perceived over-recovery of revenue; considers that the Commission should also consider any potential under-recovery of revenue MDL recommends that the Commission consider the unique circumstances in each case in determining whether claw-back is necessary	Disagrees that claw-back is needed or in the interests of achieving competitive market outcomes; agrees that, if applied, should not be applied mechanistically and should consider individual circumstances and actions of GPBs; agrees that the Commission should offset any under-recovered revenue in some pricing periods against over-recovered revenue in other pricing periods over the total period 1 January 2008 to 1 October 2011 Agrees
Claw-back of over-recovered revenue will be applied through adjusting starting prices at the outset of the initial DPP	GasNet is unable to comment until it is clear what approach will be used to make such an adjustment, but notes the need to consider and smooth the financial and price impacts of any claw-back; considers that any potential claw-back could be factored into either opening prices or rates of change in the DPP	Agrees
Services controlled under the Commerce (Control of Natural Gas Services) Order 2005 for which pricing complies with the	Powerco supports Vector supports	Agrees Agrees

Authorisation should not have to demonstrate whether or not the CPI criterion has been met for those services		
Section 6: Productivity analysis		
The value of the X-factor will be based on total factor productivity (TFP) analysis in the New Zealand gas sector	GasNet broadly supports, but notes significant risk to businesses if X-factor is calculated incorrectly; has serious concerns about replicating the TFP approach adopted for EDBs; notes that past performance is not necessarily an indicator of future productivity gains; questions whether there is a dataset of sufficient longevity and quality for GDBs for a TFP study; suggests that the Commission give serious consideration to setting the X-factor equal to 0 for the initial DPP MDL requests further information on the method that will be used to calculate TFP and how this will be used in setting the X-factor; supports using a New Zealand gas sector based productivity analysis Powerco supports Vector broadly supports, but notes that the small size of the sector and lack of robust data may prevent all approaches from producing robust results; suggests alternative of setting rate of change equivalent to that used for EDB DPP for first regulatory period and gathering information for robust productivity analysis to inform next regulatory period; recommends using B-factor approach	Agrees with use of New Zealand gas sector productivity analysis; agrees with concerns about risks around methodology and data; disagrees with setting X-factor equal to 0 for the initial DPP – needs to be sufficiently demanding to provide incentive to pursue productivity improvement Agrees Agrees Agrees, subject to using B-factor TFP approach
Other indirect approaches (gas sectors overseas, other sectors in New Zealand) will be used if data problems cannot be resolved and/or as a cross-check	GasNet does not support; does not believe the use of overseas gas sector productivity growth estimates is relevant for New Zealand GDBs Powerco supports, but agrees that it is very important to understand the limitations of any technique or dataset Vector supports; suggests that an indirect approach use the Commission's productivity analysis for New Zealand EDBs	Disagrees Agrees Agrees, subject to using B-factor TFP approach
The results of any productivity analysis will not be applied mechanistically, but used with other relevant considerations to inform the Commission's view on the appropriate value of the X-factor	All support, given data and methodological difficulties Powerco adds that this should not provide the Commission with extensive discretion – the process for setting the X-factor must have transparency and credibility to maintain investor confidence; considers that the X-factor should be set in a conservative manner to ensure a "do no harm" approach	Agrees Agrees with the need for transparent and credible process; disagrees with conservative "do no harm" approach to setting X-factor – needs to be sufficiently demanding to provide incentive to pursue productivity improvement
Section 7: Quality standards		
Quality standards will comprise defined and measurable indicators of reliability (SAIDI and SAIFI) and system integrity (PRE)	GasNet suggests that there should be only one quality measure in the DPP, reflecting reliability; considers SAIDI the most appropriate measure, but requires allowance for external events that affect SAIDI performance; does not support adoption of system integrity, quality of gas or customer service measures of quality for GPBs; agrees that standard be numeric and readily defined and calculated; considers that standard should be based on historical performance, with a benchmark of no material deterioration, allowing for the impact of extreme external events and year-on-year variations in performance	Broadly supports quality standards if not practical, feasible or low-cost to integrate price and quality; agrees with limiting quality standards to reliability; disagrees that SAIDI is appropriate for GPBs; agrees that standard should allow for variation to avoid technical breaches; agrees with a benchmark of no material deterioration

	MDL supports quality standards for system integrity and reliability; considers these should recognise that most interruptions that occur on the Maui Pipeline arise from actions outside MDL's direct control; considers SAIDI and SAIFI inappropriate for a transmission pipeline; considers UFG an appropriate measure; considers that safety is thoroughly and adequately addressed through other regulations; considers gas quality the responsibility of injecting parties; considers that customer service should not be used, as customer interfaces vary considerably; suggests that the Commission consider the value of reliability of service when determining whether it will allow balancing gas costs to be passed through Powerco does not support; considers there to be data and operational difficulties in providing a robust quality path from 2012 using SAIDI and SAIFI; considers that public reported escapes (PRE) and unaccounted for gas (UFG) also have limitations as indicators of quality; considers that compliance with the safety management system provides a useful quality path until data problems are resolved; considers that there should be a maximum of two measures, consistent with the EDB DPP, subject to statistical analysis to test the impact of normalising data on extreme events Vector recommends a maximum of two quality standards each for GTBs and GDBs, focused on the most important quality measures; recommends PRE and responses to emergencies as quality standards for gas distribution; does not consider SAIDI and SAIFI particularly useful measures for GDBs, but, if used, recommends that they be limited to unplanned events only and incorporate an extreme event criterion; recommends that remaining quality performance indicators created for the Gas Authorisation should not be used to set quality standards, but instead reported under information disclosure or removed from any reporting obligation; recommends compressor uptime and failure to meet pressure thresholds as quality standards for gas transmission; recommends some form of buffer or dead zone rather than hard limit, given relatively poor data available, to avoid technical breaches	Disagrees with setting quality standards for system integrity (including UFG); agrees that SAIDI and SAIFI are inappropriate; agrees with excluding gas quality and customer service Agrees that SAIDI and SAIFI are inappropriate; agrees with excluding PRE and UFG (system integrity); disagrees with including safety in quality standards; agrees with statistical testing of indicators and allowing for variation to avoid technical breaches Agrees that SAIDI and SAIFI are inappropriate; disagrees with setting quality standards for system integrity and customer service (including PRE and response to emergencies); agrees with using reliability indicators for GTBs (compressor uptime and failure to meet pressure thresholds); agrees with some from of buffer instead of hard limits to avoid technical breaches
Section 8: Data requirements		
The Commission will need to seek further data from GPBs to set the initial DPP	GasNet agrees that any information required of GDBs would have to be robust, accurate and consistent across the gas distribution sector; considers that any additional data requirements must be directly relevant to GPBs and considered from a least-cost perspective; has a full disclosure dataset available from 1997 onwards, but includes data relevant to unregulated services and includes some step changes due to restructuring, revaluing and improving data over time MDL supports, but does not consider detailed data requirements are necessary; has concerns about providing detailed disclosure information in category allocations that it considers arbitrary; does not currently provide building blocks detail to the Commission, but sees no problem in providing this information in future Vector recommends a pragmatic approach for this reset to setting a rate of change and quality standards due to incomplete data; recommends that the Commission focus on developing good information disclosure requirements for GPBs so that the next reset can be based on good quality information; recommends that the Commission consult with suppliers on the nature of information requests before made and allow plenty of	Agrees Agrees Agrees

	time to respond	
Section 9: Annual assessment and regulatory periods		
The Commission seeks views on the annual assessment period and presents two options: Option 1 – July to June assessment period (involving two sets of prices over an assessment period); Option 2 – October to September assessment period (aligned with GDBs' and Vector Transmission's pricing years and requiring a three month commencement period)	GasNet prefers Option 1, because aligns with its financial year; considers that annual assessment formula could be designed to accommodate a change in prices part way through an assessment period; could also accommodate Option 2, if necessary; does not support an approach that would require it to change its pricing year	Disagrees; Option 1 would result in Vector's compliance reporting being non-aligned with its pricing year and increase Vector's compliance costs; supports Option 2
	MDL prefers Option 1, because aligns with its tariff year and would involve minimal disruption to its business operation, but could change its tariff year to align with 1 October if sufficient reason	Disagrees
	Powerco does not support either option; does not support changing prices in July, when winter and peak gas consumption; considers assessing compliance over two pricing periods is not practical or efficient; suggests an Option 3 – start the DPP on 1 July 2012, but introduce price changes on 1 October 2012 or start the DPP on 1 October 2012, with starting prices adjusted to provide same present value revenue as if price changes had occurred on 1 July 2012	Agrees with introducing price changes on 1 October
	Vector does not support either option; suggests alternative option of setting regulatory period of 1 October 2012 to 30 September 2017, to inconvenience fewest GPBs; second preference is Option 2, with shortened regulatory period of four years and three months; currently avoids mid-year price changes, which would add to administrative costs and complexities	Agrees with aligning assessment period and pricing year to a 1 October start date; agrees that Vector's alternative option would promote certainty by providing maximum length five year regulatory period

Source: NZIER, taken from submissions of 30 April and 14 May 2010

5. Conclusions and recommendations

The above comparison of submissions indicates general agreement on:

- Section 2: Nature of gas pipeline services, subject to recognition that this differentiation between gas distribution services and gas transmission services does not necessarily extend to a need for different forms of control.
- Section 8: Data requirements, subject to these being relevant and least cost.

The main points of disagreement between submitters are:

- Section 3: Structure of the initial DPP – AECT considers an integrated price-quality path feasible and in the interests of consumers, GPBs and investors, given the link between price and quality. AECT recommends that the Commission investigate including an S-factor quality incentive in the DPP, but accepts the setting of separate standards to the extent that it is not practical, feasible or consistent with the low-cost regulatory option to integrate price and quality in the initial DPP.
- Section 4: Form of price control – AECT supports application of a weighted average price cap for GDBs, but considers that the appropriate form of control will differ between the two GTBs due to their very different systems. AECT recommends application of a total revenue cap for gas transmission services where the cost structure (including investment) is largely fixed and the revenue driver is variable (as typically occurs with common carriage, as on MDL's system) and a weighted average price cap for gas transmission services where the cost structure (including investment in connections and capacity) is variable and the revenue driver is manageable (as typically occurs with contract carriage, as on Vector Transmission's system). If it is not possible for the two GTBs to have different forms of control, AECT favours a weighted average price path for both, for greater compliance with the regulatory objectives.
- Section 5: Pricing arrangements prior to initial DPP – AECT does not consider claw-back to be needed or in the interests of achieving competitive market outcomes and considers the proposed assessment methodology to undermine regulatory and investor certainty, given that the Commission is still determining how asset valuation and cost of capital will be applied in determining whether or not revenue has been over-recovered. AECT recommends that claw-back not apply in the case of technical breaches or where price increases can be justified in terms of incremental investment or providing an adequate return.
- Section 6: Productivity analysis – AECT supports use of New Zealand gas sector data and suggests that the Commission seek to corroborate and/or adjust New Zealand gas sector productivity trends with reference to productivity trends for New Zealand EDBs. AECT recommends that the Commission use the B-factor approach to estimating TFP in both cases and not apply the results mechanistically in determining the X-factor, due to data limitations and methodological difficulties.
- Section 7: Quality standards – AECT accepts the setting of separate quality standards to the extent that it is not practical, feasible or consistent with the low-

cost regulatory option to integrate price and quality in the initial DPP. AECT recommends that these quality standards be limited to indicators of reliability, more suited to gas than are SAIDI and SAIFI, and allow for variation to avoid causing technical breaches.

- Section 9: Annual assessment and regulatory periods – AECT recommends an assessment period of 1 October to 30 September, to align with the pricing year for GDBs and Vector's GTB.