

Wanganui Gas Limited

Submission to The Commerce Commission

In response to its

Gas Control Inquiry Draft Report 21 May 2004

PUBLIC VERSION

2 July 2004

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Introduction

1. Wanganui Gas Limited (WGL) wishes to thank the Commerce Commission (Commission) for the opportunity to provide this submission in response to the Gas Control Inquiry Draft Report – Public Version (DR), relating to the current Gas Pipeline Inquiry.
2. WGL acknowledges the significant consideration and analysis provided by the Commission through a suite of released documents available from the Commission's website and as separately provided to WGL. WGL identifies at Attachment One and Two full listings of documents to which it has had access in forming its comments.
3. To assist with confidentiality matters, WGL has chosen to respond in two parts:
 - Part 1 relates to public versions of the various documents and is structured under headings relating to General and WGL Specific considerations.
 - Part 2 contains comments in relation to WGL Version information which the Commission has retained as confidential. WGL wishes this information to be treated by the Commission as confidential under the existing section 100 Order.
4. On this basis WGL requests that its comments contained in Part 2 are considered as covered by the existing s 100 Order, and thus access to this information is restricted. Should the Commission view this matter differently, WGL requests consultation and the opportunity to consider the Commission's position, prior to public release of any information currently deemed confidential by WGL.
5. If there is a need to provide further clarification or any general queries please contact

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6. WGL wishes to appear at the public conference on the Draft Report, scheduled for 22-28 July 2004.
7. To assist the Commission, WGL has provided a list of abbreviations used in this submission.
8. On this basis WGL provides the following for the Commission's consideration.

List of Abbreviations

Abbreviation	Intended meaning
CB-ANZ	Comparative Benchmarking of Gas Networks in Australia and New Zealand report.
Commission	Commerce Commission
CR-ODV	Consistency Review of ODV Network Asset Valuations report.
DR	Commerce Commission Draft Report – Public Version
EMC ^a	energy market consulting associates
EV	Economic Value
<i>GasNet</i>	The network and metering Division of WGL.
Inquiry	Commerce Commission’s Natural Gas Control Inquiry
NAB	Net Acquirer Benefit
NGCD	Distribution business of NGC Holdings Limited
NPB	Net Public Benefit
ODRC	Optimised Depreciated Replacement Cost
ODV	Optimised Deprival Value
TFP	Total Factor Productivity
WACC	Weighted Average Cost of Capital
WGL	The gas network and metering division of Wanganui Gas Ltd which trades as <i>GasNet</i> .

Executive Summary

9. The key points of WGL’s submission, lifted from Part 1 Commentary on Public Information, section 1.1 General Considerations, are:
 - 9.1 *WGL considers that the Commission has shown a lack of consistent treatment of what is confidential information. Refer to section 1.1 a.*
 - 9.2 *WGL urges the Commission to provide the “thrust” of the blanked out material. Refer to section 1.1 a.*
 - 9.3 *WGL urges the Commission to reconsider the asset base used for analysis of network business performance. Refer to section 1.1 b.*
 - 9.4 *WGL believes that the Commission should reconsider the basis upon which analysis of network business performance is undertaken. Refer to section 1.1 c.*
 - 9.5 *WGL considers that the Commission’s model has a number of limitations which need to be reviewed. Refer to section 1.1 d.*
 - 9.6 *WGL considers that it operates separate energy transport and metering markets and that a separate metering market should be considered. Refer to section 1.1 e.*
 - 9.7 *WGL considers that all network businesses should be subject to a minimum level of disclosure. Refer to section 1.1 f.*
 - 9.8 *WGL considers that there is no simple pass-through mechanism for costs associated with control to acquirers. Refer to section 1.1 g.*
 - 9.9 *WGL considers that dynamic inefficiency needs to be quantified as a possible disbenefit of control. Refer to section 1.1 h.*
 - 9.10 *WGL considers that the Commission needs to provide clear direction as to the intended period between review points. Refer to section 1.1 i.*
 - 9.11 *WGL suggests that the Commission should reconsider its distribution market definition. Refer to section 1.1 j.*
 - 9.12 *WGL considers that the Commission should not rely on the now historical draft 2000 ODV Handbook for Gas for current valuation analysis. Refer to section 1.1 k.*
10. In addition, WGL makes observations and responses to a number of comments regarding its network activities raised within the Draft Report - Public Version in Part 1, section 1.2 WGL Specific Considerations, and finally responds to a number of comments regarding its network activities raised within confidential versions of the Draft Report and supporting documents.

Part 1: Commentary on Public Information

11. Please refer to Attachment One, Section A for a listing of public version documents from which the following comments have been referenced. To assist the reader, any referencing to a specific document and point therein will follow a convention: [Name of Document (abbreviated)], [page number], and [section or subsection identifier or paragraph identifier on that page].

1.1 General Considerations

a) Public/Confidential Information Consistency

Key Points:

- a1 WGL considers that the Commission has shown a lack of consistent treatment of what is confidential information.*
- a2 WGL urges the Commission to provide the “thrust” of the blanked out material.*
12. WGL has engaged actively with the Commission to identify what it considered public and confidential information as evidenced by its letters of 14 and 30 April 2004 on this matter – refer to Attachment Two for details. WGL observes that the Commission has gone to considerable lengths to preserve confidential information for all companies. However it is concerned at the apparent inconsistent application of this practice on an inter-company basis.
13. WGL’s view is that the Commission is in possession of all the information and associated confidentiality requests by parties and is thus ideally placed to apply consistency as to what is and is not confidential for all parties. There are numerous examples of where the Commission apparently has abided with the request of one company while failing to apply, in a consistent fashion, the same level of confidentiality to another company regarding the same information. The result of this treatment for readers of the public version of documents released by the Commission is reduced analytical value and potential inconsistent conclusions being drawn.
14. Further WGL considers that while the Commission has blanked out many sections of the DR on confidential information grounds, it has not applied the requirement it places on others at DR, 1.7, clause 1.36 to “... provide a “public version” of confidential material, which at least conveys the thrust of the material (or argument) ...” in releasing public version documents. In some cases the lack of information is so great as to render the section or document to at best, of limited value for consideration or analysis.
15. WGL views the spate of applications for Deed of Undertaking in regard to confidential or restricted information with some concern. While DR, page 1.7 paragraph 1.35 is extremely clear that legal advisors and experts, through signing the Deed cannot disclose this information to third parties including the

parties they represent, the wording of the Deed of Undertaking is perhaps less obvious on this matter.

16. Further as the use of the information is limited to these proceedings (and possible subsequent judicial proceedings), the question remains as to how this information can be represented to the Commission without at least “greying” further the boundary between confidential and public information.

b) Treatment of Metering Assets

Key Point:

b1 WGL urges the Commission to reconsider the asset base used for analysis of network business performance.

17. Given the level of specific detail requested by the Commission in its December 2003 section 70 E Notice, WGL had an expectation that the Commission would be undertaking analysis based on gas network business assets considered to collectively represent monopoly or non-contestable business activity. WGL is therefore both surprised and concerned that the Commission has chosen not to undertake analysis of pipeline performance, but rather to “gross up” the respective business activities and to use this “apples with pears” position for building block modelling and comparative performance studies.
18. WGL’s concern goes to the core of this Inquiry. To consider the question of whether gas services offered by gas transmission and/or distribution systems should be controlled, one needs to have adopted a clear and consistent definition of what constitutes both transmission and distribution systems and thus gas services that are able to be offered. Simply put: like for like entities should be used as the basis for comparison.
19. It is the apparent lack of recognition by the Commission that a transmission or distribution business can exist without requirement for its own metering services business activity and vice versa which is fundamentally concerning. By undertaking financial modelling and comparative benchmarking analysis on the basis that the Commission has, implies conditionality which does not exist. The flow on effects of this treatment are to colour the methodologies, bias results and distort conclusions about inter-company financial, economic and operational performance.
20. In consideration of this matter, WGL urges the Commission to reconsider this basis of analysis for network business performance.

c) Comparative Benchmarking

Key Point:

c1 WGL believes that the Commission should reconsider the basis upon which analysis of network business performance is undertaken.

21. WGL has previously advised the Commission that it was in favour of comparative benchmarking analysis as an evaluation framework, in preference to the building block approach. WGL maintains its position on this matter, notwithstanding the data limitations experienced by the Commission's expert Meyrick and Associates.
22. WGL is particularly surprised that the benchmarking exercise was undertaken with full acknowledgement that the sample included businesses which had dissimilar business functions most notably metering services (CB-ANZ, page 17) and inclusion of "non regulated activities" for Australian business (CB-ANZ, page 17). As WGL understands it, the fundamental tenant of benchmarking is to compare equivalents with the intention of measuring their relative performance attributes. WGL can therefore only conclude that the Commission has deviated from this tenet by allowing its expert to investigate and report on this evaluation approach on this basis.
23. WGL also notes with concern Meyrick and Associates' presentation of their model 3 conclusion drawn in regard to the Total Factor Productivity (TFP) for distribution businesses. Meyrick and Associates conclude that using model 3 "... leads to a productivity gap between the New Zealand and Australian distributors being further reduced to around 21 per cent." (CB-ANZ, page 57), on a throughput weighted average basis. However at CB-ANZ, page 43, it is stated that on "a throughput weighted average basis, the Australian distributors have between 5 and 32 per cent higher TFP than their New Zealand counterparts depending on which distributor's densities are used as the base.". While this later statement puts the performance "gap" in a much needed context, it is disappointing to note that the Commission chose not to provide this context at DR, page xv, paragraph 112.

d) Commission's Model and Sensitivity Analysis

Key Point:

d1 WGL considers that the Commission's model has a number of limitations which need to be reviewed.

24. WGL accepts that in adopting the building block approach, the Commission has provided detailed discussion of a number of its assumptions including WACC and its sensitivity range. Other values for terms such as leverage, productivity and unrecoverable cost benefits; however arrived at are given as absolute values. WGL believes that in taking this action the Commission is suggesting robustness of these parameters where in fact they are judgemental in nature.
25. While WGL offers no expert opinion on discrete parameter setting, it does consider that a sound approach in such situations is to offer an indication of the "certainty" with which the chosen parameter has been given - a confidence level for the parameter(s). On this basis, for example 10%, 50% and 90% confidence levels could be developed, thus deriving a likely value range for each parameter. The Commission would then be in a position to test NAB sensitivity to changes in these parameters.

26. WGL acknowledges that the Commission has undertaken some sensitivity analysis around what it identifies as “key variables”, namely WACC, unrecoverable excess returns by control and common costs (DR, refer to any specific company chapter under the section headed “Sensitivities”). WGL also notes the commentary at DR, pages 5.22-.24, paragraphs 5.118-.125 and in particular Table 5.4 relating to key variables. On the basis, WGL wonders why the Commission chose to apply sensitivity analysis to only 3 of the 8 key variables listed. WGL also notes that there has been no attempt to consider the effects on NAB of combinations of different parameter values or in fact that the tested parameters are indeed independent parameters.
27. At DR, page 5.22, paragraph 5.121 the Commission stated that “Data for control purposes would need to be audited and would require a greater degree of transparency and definition than was available to the Commission in the timeframe for this Inquiry”. WGL considers that this analysis is at the heart of the matter before the Commission and while the Commission states that “The purpose of the analysis was to give the Commission an indication of whether or not control was warranted” (DR, page 5.22, paragraph 5.121), it is WGL’s position that an indication is insufficient justification to warrant a draft recommendation of control of virtually all of the total network industry.
28. WGL questions the appropriateness of treating smoothed annualised revaluations as revenue without recognising a commensurate adjustment to the level of taxation payable by the business. In essence this revenue component then becomes overstated by its level of tax liability that may lead to an incorrect conclusion that excess returns exist.
29. WGL confirms that it has provided “post financing” tax data for all years. On this basis it understands from the Commission’s website that this may have created an over estimate of excess returns earned based on the calculation method used in the Commission’s model. The tax data was listed in the Commission’s template and assumed by WGL to be post financing (interest) costs. Should the Commission concur with WGL, this would have a substantive impact on the assessment of excess returns.
30. WGL also notes that if the revenue values were overstated for the reasons given above (or another reason) then this would impact on the calculated efficient price (P_c) and efficient quantity (Q_c) and drive their respective values back towards actual price (P_m) and actual quantity (Q_m). This would clearly reduce the quantum of allocative inefficiency as discussed by the Commission at DR, pages 5.3-.5, paragraphs 5.13-.25.
31. The Commission has indicated that it wishes to undertake further investigation of data provided by some businesses prior to finalising the Gas Control Inquiry report. WGL considers that given the limitations of the modelling work undertaken by the Commission, effort should be made to resolve consistency matters more rigorously to improve the reliability of the currently inconclusive outcomes as ultimately measured by the Net Acquirers Benefit Test. If the incorporation of useful refinements resulted in a delay in reporting back to the Minister, then WGL believes that this would be an acceptable cost for the improved benefit of more robust calculated outcomes.

e) Market Definition

Key Point:

e1 WGL considers that it operates separate energy transport and metering markets and that a separate metering market should be considered.

32. WGL has stated previously that it faces inter-fuel competition and therefore operates in an energy market. While noting the Commission's findings on this, its position is unchanged. WGL is gratified by the Commission's view that gas is an essential service (DR, page ix, paragraph 61), however in practice apart from recent Emergency Management legislation; WGL is unaware of gas having had this status. In fact, WGL would enthusiastically welcome the adoption of, for example, all local government bodies mandating inclusion of gas reticulation of new subdivisions and property developments on the basis of being an essential service. In the meantime in WGL's opinion, inter-fuel competition is real and a strong dynamic efficiency constraint.
33. In addition, WGL would welcome the consideration of a gas meter services market if this would remove the current distortion to the Commission's analysis as to what constitutes a gas transmission or distribution system business. It would also enable the Commission to introduce metering services providers currently ignored due to the current market definition and hence regulatory analysis.

f) Consistent Treatment of Pipeline Assets

Key Point:

f1 WGL considers that all network businesses should be subject to a minimum level of disclosure.

34. Should information disclosure be warranted and thus specified under regulation, then the first level of information would relate to technical and safety matters as proscribed. A second level would relate to financial and asset valuation matters required for price control monitoring.
35. Where a business does not face control regulation and the Commission has a concern that control related information should be created and maintained by said business, then the regulations could require this. This information would not be published but would be available for future control review points.
36. In this way all businesses, undertaking carriage of specification gas for the reticulated market would be treated consistently, while observing the market based differences in existence from time to time. It is worthwhile to note that all pipelines conveying natural gas have the potential to be open access, thus the collection of information thereon would seem prudent in a long-term sense.
37. WGL believes that all pipelines conveying natural gas for the reticulated market need to be treated in a consistent manner regarding disclosure of

information irrespective of specific terms and conditions associated with transportation of gas.

g) Cost of Control Falling to Acquirer

Key Point:

g1 WGL considers that there is no simple pass-through mechanism for costs associated with control to acquirers.

38. The Commission advises in DR, page 5.9, paragraph 5.46 that it takes the position that all costs will ultimately fall to the acquirer. While conceptually tidy, WGL considers this outcome to be complex due to factors such as:

- i) the pricing constraints of the applied control mechanism,
- ii) threat of by-pass (where applicable),
- iii) interfuel competition (accepted by Commission as a feature of the market but not an endemic feature of the market),
- iv) gas retailer pressure to resist costs increasing both of a generic and specific nature,
- v) practical timing of any pass through possible, and
- vi) applicable operational practices and contractual matters of individual gas network businesses.

WGL would argue that due to the above factors that it is in fact quite debatable as to the amount able to be passed on at any point in time and the timing thereof. WGL accepts the assumption, but wishes to emphasise that translation to practice is unlikely to be achieved.

39. In reaching its conclusion that productive inefficiency of imposing control is in the range of 0 – 0.66%, with an assumed midpoint value of 0.33% or 1% increase in operating costs (DR, page xi, paragraph 77), the Commission has smoothed compliance costs over a review cycle of five years (at least for modelling purposes -see point i below). Clearly gas network businesses will have to face the fluctuating burden of compliance consistent with the specific year within the review cycle concerned. If rate shock for the pricing of services provided is to be avoided, individual businesses will need to apply smoothing to their cost recovery paths no matter what percentage of these costs are finally recovered.

h) Dynamic Inefficiency of Control

Key Point:

h1 WGL considers that dynamic inefficiency needs to be quantified as a possible disbenefit of control.

40. The Commission states at DR, page x, paragraph 78 that dynamic inefficiency may be caused by imposition of control as it may cause under-investment that might result in reduced service quality to existing customers (and delayed availability of services to further customers). WGL agrees with the thrust of the Commission's view and hence was surprised that no "cost" allowance for this inefficiency has been included in the long term financial modelling undertaken.
41. Given that the considerable value of existing infrastructure, then even a modest percentage efficiency cost per year would represent a seven-figure sum. This sum may be a number similar to the combined Net Acquirer Benefit values for all companies calculated by the Commission, using the 75% percentile approach indicated by the Commission.
42. As commented above, the Commission has referred to the gas networks an essential service. Should this be the case rather than a discretionary service, the dynamic inefficiency effect is likely to be significantly greater than discussed above as potential acquirers would be greater in number, may have to forego the benefit of using gas for longer or even, denied access to gas permanently.

i) Period of Control

Key Point:

- il* WGL considers that the Commission needs to provide clear direction as to the intended period between review points.

43. The Commission indicates at DR, page xxiv, paragraph 179 that it considers the appropriate period for expiry of an Order declaring control would be 11 years. The logic supporting this period appears to be one year to bed down the control mechanism followed by two five year cycles each consisting of one review year and four non-review years (DR, page 5.9, paragraph 5.50). At DR, page 7.5, paragraph 7.23 the Commission refers to adoption of a 3 year risk free rate as "this most closely approximates the likely horizon of price setting in the gas pipeline industry".
44. These positions do not appear to be reconcilable and further have quite significant modelling and business activity implications. WGL would appreciate improved clarity as to what review period the Commission actually favours.

j) Scope of Control

Key Point:

- jl* WGL suggests that the Commission should reconsider its distribution market definition.

45. The Commission states at DR, page 2.6, paragraph 2.31 that Section 70(1) of the Commerce Act “empowers the Commission to make an authorisation of all or any component of the prices, revenues, or quality standards relating to the supply of the controlled goods or services”. WGL is on record as stating that in does not consider control is warranted for gas networks or if control is considered necessary due to there being found absence or limited competition in the defined markets, then WGL should be exempt.
46. WGL made these comments specifically in regard to its network pipe assets and at no time has considered gas network assets as intrinsically consisting of pipe and meter assets. Thus WGL firmly believes that, consistent with the draft revised Gas (Information Disclosure) Regulations 2000 and associated draft 2000 ODV Handbook for Gas (both currently in abeyance), metering assets form business activity which is part of a contestable if not workably competitive market distinct from the activities of gas pipeline businesses.
47. For these reasons, WGL urges the Commission to reconsider its current position as espoused at DR, page iv, paragraph 27 and finds that metering assets either are not covered by any Order declaring control, or if covered by an Order declaring control, then this be a separate consideration based on its own market and the market behaviour of participants therein.

k) Premise of Using Draft ODV Handbook for Gas

Key Point:

k1 WGL considers that the Commission should not rely on the now historical draft 2000 ODV Handbook for Gas for current valuation analysis.

48. WGL notes that the Commission expert EMC^a indicates that they have used the draft 2000 ODV Handbook for Gas as “a pragmatic reference point” (CR-ODV, page 3, section 1.1). While WGL can understand the necessity of this action, it has grave concerns about then leaping to conclusions as to what “compliant” valuations of networks would look like (the applied adjustments), especially where a reader without the required background, may reach conclusions regarding current network valuations which are unfounded.
49. While the draft 2000 ODV Handbook for Gas was released in 2000 for consultation with the industry none of the extensive range of suggestions and concerns have been addressed in the four years since as evidenced by comment at CR-ODV, page 9, section 2.4., thus it is simply unrealistic to presume that it is a workable surrogate for 2004 (and beyond) and that its value is anything more than historical. Further EMC^a advise at CR-ODV, page 5, section 1.3 that there are number of issues which need to be addressed prior to consideration of adjustments.

1.2 WGL Specific Considerations

1.2.1 Modelling Treatment

50. While WGL offers no expert opinion on discrete parameters derived by the Commission, it does provide the following comment in regard to specific aspects of the modelling treatment adopted by the Commission.

i) Modelling Treatment - Revaluation Smoothing

51. WGL is concerned about the use of the revaluation smoothing technique, noting that as it is a central parameter in the Commission's analysis, its calculation is material to the resultant calculation of NAB test. WGL believes that there are a number of modelling simplifications applied that need to be clarified to ensure that the Commission has fully considered their implications.

52. The Commission has determined that a revaluation point can be evenly spread over the preceding three years. Concerns about this approach relate to

i) the revaluation is a forward looking mechanism, thus the revaluation benefit assumed as revenue is simply not available to be taken by the company in a previous year(s), and

ii) secondly this simplification suggests that a full ODV valuation was undertaken each year which would impact on the investment behaviour of the business as investment in the whole network would be recognised each year not just the actual capital investment for that year.

53. For the reasons identified above, while WGL recognises that the deconstruction of supplied data undertaken by the Commission facilitates in turn creation of a view about the provided data, WGL is not convinced that such modelling should necessarily be equated with the actual published financial performance of network businesses.

ii) Modelling Treatment - 1996 Data

54. WGL is concerned that the Commission has used constructed 1996 asset data for its analysis especially as this year is the anchor point for the Commission's model. WGL did not provide 1996 data as it undertook an ODV valuation for the first time in 1997, thus it was in a position to offer only robust historical cost information for 1996. WGL has previously advised the Commission of the Company's position in regard to 1996 data as this has been articulated both verbally and in writing (refer to the Company's letter of 2 March 2004).

55. As the Company does not have robust ODV data for 1996, it will not challenge the Commission's constructed data, however it does consider that the Commission's assumptions for the value selection should have been made available to the Company, along with a sensitivity analysis of the stated values to check materiality of assumption error.

1.2.2 Productivity Improvement Factor

56. The Commission has identified that it considers that the gas industry can as a whole be 1% per annum more productively efficient than that indicated by the Meyrick and Associates analysis of NGCD which indicated a TFP growth rate of 2.8%. Meyrick and Associates state that the observed trend rate is “relatively high” which does suggest that there is doubt as to the sustainability of this level, let alone addition of a 35% increase as a base assumption.
57. Further WGL would question on what basis the Commission is certain that the performance as analysed by Meyrick and Associates for NGCD is representative of all businesses operating in the industry. Also WGL is unclear as to whether the base data used for NGCD include or exclude metering services owned by NGC. On the basis of the introductory comments at TFP Growth, Introduction, page 1 it appears that the Commission had an opportunity to gain a second set of TFP data from WGL’s supplied section 70 E data. However it appears that any efforts to resolve apparent WGL data anomalies were dismissed as WGL “only accounts” for a few percent of the New Zealand market.
58. WGL considered that it operates a productively efficient business and is therefore unduly disadvantaged by the Commission’s assumed industry productive efficiency.

1.2.3 Unrecoverable Benefits of Control

59. At page xi, paragraph 75 the Commission advises that it has set unrecoverable benefits of control at 20% and further supports this position at pages 5.14-.15, paragraphs 5.74-.76. The text suggests that this assumption is somewhat speculative given the Commission’s position in previous Inquiries on this point. On this basis WGL expected that there would be a sensitivity analysis offered, thus providing the reader with an understanding of the materiality of this assumption to the resulting NAB and NPB test results.

1.2.4 Common Costs

60. The Commission makes an observation at DR, page viii, paragraph 55 that “... avoidable cost methodology can lead to over-recovery of common costs for gas pipeline businesses that have made no allowance for economies of scope in determining the stand-alone costs of gas pipeline services and other activities ...” and then at DR, page 4.4, paragraph 4.20 that the Commission is concerned that a disproportionate share of common costs have been loaded on “gas” activities.
61. WGL finds these statements somewhat misleading and seeks clarification from the Commission as to what was intended. Specifically, WGL is unclear whether the Commission is referring to common costs for a business that has both electricity and gas (or just energy interests), or common costs within a gas business that has more than one business activity, or both. As currently framed, our construction is that it can be taken that the Commission intends these statements to be directed at WGL (amongst others).

62. On this basis WGL advises the Commission that it undertakes comprehensive cost allocation between its business activities and that inevitably judgement is required where common costs are applicable. WGL has used the 1993 document entitled “Guidelines for Gas Distribution: Procedure to Comply with the Information Disclosure Regime” prepared for guidance in this area. Given WGL’s focus on ensuring that common costs are allocated on a fair and equitable basis and the fact that the allocation methodology is independently audited, WGL considers the Commission’s conclusion to be incorrect in this instance.

1.2.5 Business Compliance Costs

63. WGL notes the Commission’s reliance on WGL’s comment that a significant portion of compliance costs are fixed and thus relatively independent of the “size” of the business. It is therefore somewhat bemused at the apparent arbitrariness of the discrete components of the cost of compliance as applied to WGL in table 5.1, page 5.11 at paragraph 5.59. WGL has calculated these four discrete components, as percentages of the cost stated for any of the other network businesses at 60%, 50%, 48.6%, 48.6% respectively. Whatever logic has been used, WGL questions that the lower end of the percent range is consistent with the idea of “a significant portion” of costs being fixed.
64. WGL notes that the Commission has made no such “size” distinction when determining the level of cost it faces in monitoring compliance at table 5.2, page 5.12, paragraph 5.62.

1.2.6 Superior Performer or Excess Returns

65. WGL acknowledges that the Commission faces analytical difficulties in determining whether the financial performance which delivers returns greater than economic efficiency modelling would determine for a company “normal returns”(DR, page 4.5, paragraph 4.26), is due to superior performance rather than simply extracting excess returns (DR, page 4.6, paragraph 4.28). While it appears attractive to assume that the reason is excess returns, WGL urges the Commission to avoid this temptation on the basis of its analytical framework, empirical evidence and applied assumptions. It is noted that the Commission at DR, page 5.5, paragraph 5.26 acknowledges that “... the level of any excess return has been the key component as to whether net benefits to acquirers are found.”
66. WGL also notes that dynamic efficiency considerations also need to be factored in to the question of returns. As network businesses need to take a very long term investment view due to the very nature of the assets and their sunk cost characteristic, it does follow that they must also capture returns on those investments which may not sit well with the period of smoothed desktop analysis.
67. In regard to WGL specifically, the Company considers that its self imposed business drivers including cost consciousness provide it confidence to suggest to the Commission that its financial performance is defensible as evidence of superior achievement - simply put: delivering more with less.

68. WGL also considers that it has balanced the sharing of benefits between acquirers generally and shareholders specifically which, according to the Commission's current modelling, would suggest that it closely approximates the calculated performance of such a business operating in a competitive market.

1.2.7 Net Public Benefit Test

69. WGL concurs with the Commission's position that the NPB test is not appropriate as outlined at DR, pages 2.14-15, paragraphs 2.73-2.80, due to the treatment of foreign ownership in New Zealand companies. Thus the Company is supportive of the Commission relying on the NAB test as being the measure used as it is neutral on the subject of ownership nationality. WGL would be supportive of the NPB test if it was also neutral in this regard.
70. It perhaps is relevant to assist the Commission to this end, by noting that New Zealand companies having share trading liquidity are prone to having direct or indirect foreign ownership - an example could be a New Zealander living off shore or New Zealand residents having a shareholding in a foreign company such as The Australian Gas Light Company. Such public benefits do not appear to feature in the Commission's analysis as presented at company level.

1.2.8 Quoted Transmission and Distribution Costs

71. WGL noted that the Commission has oft stated in the DR that "on average distribution ... represents perhaps 40% ... of the delivered price of gas (DR, page vi, paragraph 40). This is considered a vague, unsupported statement which is potentially damaging to distribution businesses as the statement is "perhaps" not representative of these transportation costs. WGL has reviewed this statement and concludes that the Commission's comment is too general and thus could be misleading. For the Commission's assistance WGL provides the following view for its consideration.
72. WGL takes the term "delivered price of gas" to mean the price paid by the consumer of the gas. There are five components to this price (wholesale gas, transmission, distribution, metering and retail) and each in turn has a cost and margin component. Also there are different types of consumers – residential, small commercial, large commercial and industrial. Each type of consumer enjoys a tailored relationship with a retailer under accepted terms and conditions.
73. WGL accepts that for low demand residential consumers distribution costs may tend towards the 40% indicated by the Commission. This result however is not representative of an average distribution charge to all types of consumers as the per GJ charge falls as volume taken increases due to the fixed cost nature of a network charge. Hence for high volume consumers this cost is typically less than 10%.
74. Hence it depends on the network volume transported and customer mix as to what a possible "average" distribution cost is. Based on a consumer weighted

average, distribution costs would tend to the higher value and on a throughput weighted average, distribution costs would tend towards a lower value.

75. However given the recent dramatic increase in wholesale gas prices the distribution component is more likely to decrease as a percentage of the delivered price of gas than the 40% that the Commission has suggested.

1.2.9 Correction of WGL Information Errata

76. WGL has identified a number of errors within the DR relating to stated information about the company. The following paragraphs within this subsection provide the Commission with corrections.
77. With reference to DR, Table 1, page ii (and Table 1.3, page 1.4, Table 3.2, page 3.11), and DR, page 13.2, paragraph 13.11 WGL has a small distribution system in South Taranaki.
78. In regard to the Commission's comment that if revaluation gains are being included in depreciation treatment, then smoothing of depreciation may be needed (DR, page 5.6, paragraph 5.30). As this is the case for WGL, and there appears to be no depreciation smoothing applied in the Commission's model, the Company would welcome an indication from the Commission as to whether this was an oversight.
79. At DR, page 6.10, paragraph 6.57, the Commission states that financing costs during construction are included in valuations at replacement cost. WGL does not include financing costs.
80. At DR, page 7.16, paragraph 7.83 the Commission discusses assumed business behaviour related to stranded assets. WGL advises that this approach is inconsistent with its own treatment of such assets which are similar to the draft 2000 ODV Handbook for Gas both in terms of optimisation and economic valuation (write-down) treatments. As such, WGL does not consider itself to be included in the Commission's assumption about business behaviour on this matter.
81. At DR, page 9.2, paragraph 9.9 the Commission indicates that WGL distributes and retails gas throughout the Manawatu, Taranaki and Auckland. WGL has networks in Rangitikei, Wanganui and South Taranaki only.
82. At DR, page 13.3, paragraph 13.21, the Commission states that WGL's nominated balance date was 31 March. Since establishment in 1992, WGL's balance date has been 30 June.
83. At DR, page 13.8, paragraph 13.48, table 13.6, WGL presumes that the Commission has mislabelled the "DHC" and "ODV" columns as the ODV value is inconsistent with that shown at the top of page 13.7 at the continuation of Table 13.3.

Part 2: Commentary on WGL Version and Related Confidential Information

WGL considers Part 2 of its submission to be confidential and seeks to have this information covered by the existing section 100 Order.

PUBLIC VERSION

As material in the following part of this submission is considered confidential by WGL, it seeks consultation with the Commission prior to release of any information in a public version of this submission.

Part 2: Commentary on WGL Version and Related Confidential Information

84. Please refer to Attachment One, Section B for a listing of WGL Version documents from which the following comments have been referenced. To assist the reader, any referencing to a specific document and point therein will follow a convention: [Name of Document (abbreviated)], [page number], and [section or subsection identifier or paragraph identifier on that page].

2.1 [REDACTED]

85. [REDACTED]

86. [REDACTED]

2.2 [REDACTED]

87 WGL has undertaken an examination of the Commission’s model for its business based on [REDACTED]. The results under the Commission’s tests are shown in the following table.

88. Table of Results

Test	Net Acquirers Benefit	Net Public Benefit
DR Result (\$,000 per Annum)	167	-312
WGL Analysis (\$,000 per Annum)	[REDACTED]	[REDACTED]
Change	[REDACTED]	[REDACTED]

89. WGL concludes from this analysis that [REDACTED]

[REDACTED]
[REDACTED] the draft recommendation in regard to WGL.

90. Noting the preliminary view of the Commission regarding WACC range, it is interesting to note that the 75th percentile for WACC equates to a [REDACTED] per Annum NAB test result.
91. WGL acknowledges that in January 2004 in preparing the required section 70 E Notice information, [REDACTED]

2.3 Reconciliation of Information

92. WGL is particularly concerned by the Commission's statement at DR, page 13.5, paragraph 13.33 relating to the Commission's inability to reconcile "WGL's numbers for ODV, depreciation, capital expenditure and revaluations from year to year". WGL is

- a. firstly, aggrieved that the Commission would make such a generic statement available within the public document version of the DR without context or limitation. [REDACTED]

- b. secondly, while the Commission acknowledges that WGL supplied [REDACTED]

[REDACTED]. WGL believes it has demonstrated its preparedness to engage with the Commission on such matters during the course of this Inquiry and therefore feels disappointed by the lack of consultation.

- c. and thirdly, as revaluation is a Commission devised parameter, WGL cannot be held responsible for its "operation" within the Commission's own model and therefore its inclusion in the public version of clause 13.33 is considered unreasonable.

2.4 Historical Cost Approach Report

93. WGL notes that at DR, page 1.8, paragraph 1.37 at Table 1.5 that the Commission had a report prepared by Cranleigh Strategic entitled "Gas

Control Inquiry - Asset Valuation - Historic Cost Approach” and that this document is only available as a confidential version. WGL asks why there has been no public version released [REDACTED]

94. WGL notes that public versions of Meyrick and Associates Productivity Growth report and the Energy Market Consulting Associates Consistency Review of ODV Valuations exist, but each is shown as a “Confidential version only” status in Table 1.5.

2.5 [REDACTED]

95. [REDACTED]

96. [REDACTED]

2.6 Investment - Subdivisions

97. At DR, page 5.20, paragraph 5.110 the Commission states that some network expansion such as rollout of new subdivisions are undertaken by developers. In regard to subdivisions specifically, [REDACTED]

98. On this basis WGL has [REDACTED]

2.7 [REDACTED]

99. [REDACTED]

[REDACTED]

100. There are a number of points that WGL wishes to make in regard to these comments:

i) [REDACTED]

ii) [REDACTED]

iii) [REDACTED]

iv) [REDACTED]

2.8 Discussion on [REDACTED] and WACC

101. [REDACTED]

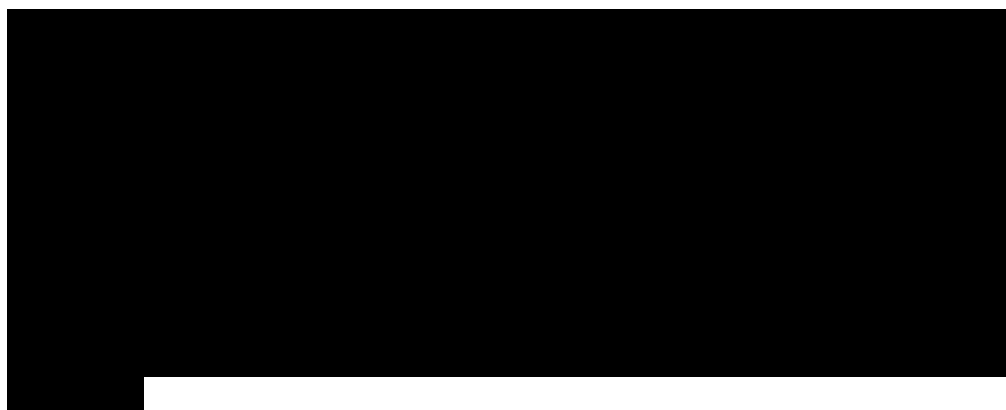
102. WGL has chosen to limit its discussion of WACC as the Company wished to utilise its resource on other aspects of the Commission's report. WGL remains very interested in the calculation of WACC and thus its resultant value range. WGL does note the discussion provided by the Commission at chapter 7, and as WGL has touched on a number of the parameters involved

within this submission, it remains unconvinced that the Commission's value range is reasonable.

2.9 Further Comment on Productivity Growth in NZ Gas Distribution Networks

103. At page 1, Introduction, paragraph 2 Meyrick and Associates refer to "apparent anomalies mainly related to reported operating expenditure". WGL has looked at the specific confidential comment and considers that even a cursory glance at the supplied data would have provided the Commission's expert with a number of answers to the so-called anomalies. For further assistance the Company was merely an email or phone call away.

104.



105. WGL is not pleased at providing detailed information and it being handled with scant regard. Nor does it wish the Commission to form a view that data provided to it lacks foundation in fact, subject to any human error or misunderstanding.

2.10 Further Comment on Benchmarking Study (Public Version only)

106. WGL notes that Meyrick and Associates comment at pages 5-6, Previous Benchmark Studies under the IPART (1999) and Pacific Economics Group (2001) studies that Multinet was found to be the best performing network. On models 1 and 2 of this study, Multinet out performed all other networks, however under Model 3 the performance of Multinet, Envestra Albury and Wanganui were almost indistinguishable.

107.



108. WGL also considers that, notwithstanding the limitations of this desktop study, it provides robust confirmation of WGL's view that this approach is a viable method for evaluation of the relative performance of disparate network businesses. With greater attention to comparison of like for like businesses and access to a greater range of consistent comparable data, WGL is confident that this method can provide a workable framework for the Commission's analysis relating to this Inquiry.

109.

[REDACTED]

110. WGL notes at page 21, paragraph 1 that its 2003 throughput is “estimated” at 1,108 terajoules. WGL would accept “rounded to 1,108 terajoules”, but as the figure to the last gigajoule was provided to the Commission and is consistent with gazetted disclosure estimated it is not.

2.11 Further Comment on ODV Valuation Study

111. At page 8, section 2.3.3, WGL notes that EMC^a believes that in most cases simulated flow analysis is required to support the optimisation.

[REDACTED]

112. At page 10, section 2.6, WGL notes a comment regarding some lack of consistency of disclosed value and ODV report values for network assets.

[REDACTED]

a)

[REDACTED]

b)

[REDACTED]

b)

[REDACTED]

113. WGL has considered the comment at

[REDACTED]

[REDACTED]

114. WGL wishes to convey to the Commission that [REDACTED]

115. [REDACTED]

116. WGL advises that at page 30, section 3.4.1, paragraph 1 the reference to “GasNet” being formed in 1992 is incorrect. WGL was formed in 1992 and GasNet, the independent operating division of WGL was branded as such as of 1 July 2001.

117. [REDACTED]

118. [REDACTED]

Concluding Comments

119. WGL acknowledges the significant amount of analysis of company and market information undertaken by the Commission. The documentation made available by the Commission assisted WGL to better understand conclusions reached and hence the draft recommendations given.
120. WGL has approached its review and analysis with a desire to ensure that its position on issues, and information provided by it in relation to these issues, is correctly stated. In instances where the Company has identified matters that are, in its opinion, in need of clarification, correction or comment it has attempted to provide this constructively and professionally.
121. WGL has to date met the Commission's requirements for the provision of information and submissions on the various aspects of the Inquiry. WGL also remains fully prepared to engage with the Commission prior to publication of its report to ensure the accuracy of the information upon which the report is based.
122. WGL has noted and commented on a wide range of topics that it believes it is well placed to provide. In Part One, Section One it identifies a number of general points that it urges the Commission to consider and act on. In Part One, Section Two WGL switches focus to issues of direct importance to it, while noting that they may also be applicable to other businesses. Finally in Part Two, WGL examines points relating to its own confidential material on which it seeks revision.

Attachment One: Listing of Source Documents

Section A Public Version Documents

1. Commerce Commission Gas Control Inquiry Draft Report, 21 May 2004
2. Comparative Benchmarking of Gas Networks in Australia and New Zealand, produced by Meyrick and Associates, 14 May 2004.
3. Commerce Commission Gas Control Inquiry: Consistency Review of ODV Network Asset Valuations, produced by EMC^a (energy market consulting associates), May 2004.
4. Productivity Growth in New Zealand Gas Distribution Networks, produced by Meyrick and Associates, 14 May 2004.

Section B WGL Version Documents

5. Chapter 13 Wanganui Gas Limited, Commerce Commission Gas Control Inquiry Draft Report, 21 May 2004
6. Commerce Commission Gas Control Inquiry: Consistency Review of ODV Network Asset Valuations, produced by EMC^a (energy market consulting associates), May 2004.
7. Productivity Growth in New Zealand Gas Distribution Networks, produced by Meyrick and Associates, 14 May 2004.
8. Commerce Commission section 70 E Notice dated 11 December 2003.

Attachment Two: Other Reference Documents

1. [REDACTED]
2. [REDACTED]
3. [REDACTED]
4. [REDACTED]