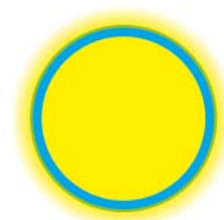


14 May 2010

Matthew Lewer  
Regulation Branch  
Commerce Commission  
PO Box 2351  
Wellington

[By email: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)]



Dear Matthew,

### **Powerco Submission on the Issues Paper: Initial Default Price-Quality Path for Gas Pipeline Businesses**

1. Powerco welcomes the opportunity to comment on the Issues Paper: Initial Default Price-Quality Path for Gas Pipeline Businesses (Issues Paper), published by the Commerce Commission (the Commission) on 12 April 2010. Powerco has only commented on the issues affecting gas distribution businesses (GDBs).

#### **Executive Summary**

2. Table One provides a summary of Powerco's response to the Commission's initial views. Powerco is broadly supportive of the approach the Commission has adopted. The areas where changes are recommended are below:
  - **Productivity Analysis:** Data and methodology issues will make it difficult to mechanistically apply a TFP figure to the X-factor. However, this should not provide the Commission with extensive discretion. The process must have credibility to maintain investor confidence. Given that the new Part 4 requires that the Commission set a generic X-factor, the X should be set in a conservative manner to ensure a "do no harm" approach for all GDBs.
  - **Quality Path:** Powerco recommends that while SAIDI and SAIFI provide a measure reflecting customer service, there are data and operational issues with providing a robust quality path from 2012. Compliance with the safety management system provides a useful quality path until data issues are resolved.
  - **Assessment Period:** Assessing compliance over two pricing periods is not practical or efficient, and Powerco does not support changing prices in July, when we are contractually unable to do so, and when it is winter and gas consumption is peaking. Powerco proposes a third option of beginning the DPP on 1 July 2012, but price changes occur on 1 October 2012. The initial starting price adjustment can be changed to provide the same revenue in NPV terms, as if price changes had occurred on 1 July 2012.

**Table One: Summary of Powerco’s Response to Initial Views**

<b>Initial View</b>	<b>Powerco’s Response</b>
<b>Nature of Gas Pipeline Services</b>	
Gas distribution and gas transmission will have separate DPP determinations.	Powerco supports this; it allows the DPP to be tailored to gas distribution circumstances and is consistent with the approach of overseas regulation.
The transmission system will be defined using the definition in the Gas Governance (Critical Contingency Management) Regulations 2008.	Powerco supports this definition. The alternative options suggested by the Commission have a number of issues.
<b>Structure of Initial DPP</b>	
The gas distribution DPP will have separate price and quality paths.	Powerco supports this; the current quality and availability of data hinders using an integrated price-quality path.
<b>X-factor</b>	
The X-factor will be determined using a productivity analysis of the New Zealand gas sector to the extent practicable. If the data is limited the Commission will use other indirect approaches. The results of any analysis will not be applied mechanistically.	Data and methodology issues will make it difficult to mechanistically apply a TFP figure to the X-factor. However, this should not provide the Commission with extensive discretion. The process must have credibility to maintain investor confidence. Given that under the new Part 4 the Commission must set a generic X-factor, the X should be set in a conservative manner to ensure a “do no harm” approach for all lines businesses.
<b>Quality Path</b>	
The quality path will be monitored using measurable indicators. At this stage, the Commission prefers indicators such as SAIDI, SAIFI and Publicly Reported Escapes of Gas.	Powerco recommends that while SAIDI and SAIFI provide a measure reflecting customer service, there are data and operational issues with providing a robust quality path from 2012. Compliance with the safety management system provides a useful quality path until data issues are resolved.
<b>Requirements for further data</b>	
The Commission will need to seek further data from gas distribution businesses and is consulting on the scope and quality information available	Please see table two for detail on the information Powerco is able to provide.
<b>Clawback under section 55F(2)</b>	
The Commission’s initial view is that services controlled under the Commerce (Control of Natural Gas Services) Order 2005 for which the pricing complies with the Authorisation should not have to demonstrate whether the CPI criterion has been met with respect to those services. <sup>1</sup>	Powerco supports this as the Authorisation has controlled Powerco’s revenue on a CPI-0 price path and this analysis is not required.

<sup>1</sup> Section 55F(2) of the Commerce Act 1986 states that, “[...], if a supplier has increased its weighted average prices by more than the movement, or forecast movement, in the all groups index number of the New Zealand Consumer Price Index in the period beginning 1 January 2008 and ending with the date that the determination is made, the Commission may apply claw-back to the extent of requiring the supplier to lower its prices in order to compensate consumers for some or all of any over-recovery of revenues that occurred during that period”.

Annual Assessment and Regulatory Periods	
The Commission is seeking views on the regulatory period due to the disjoint between the start of regulation provided in the Commerce Act (1 July) and the current date for annual price changes across the gas sector (1 October).	Assessing compliance over two pricing periods is not practical or efficient, and Powerco does not support changing prices in July, when it is winter and gas consumption is peaking. Powerco proposes a third option of beginning the DPP on 1 July 2012, but price changes occur on 1 October 2012. The initial starting price adjustment can be changed to provide the same revenue in NPV terms, as if price changes had occurred on 1 July 2012.

## Definition of Transmission System

*Powerco supports the Commission's definition*

3. The Commission's initial view is that gas distribution and transmission will be distinguished with reference to the definition of "transmission system" as set out in the Gas Governance (Critical Contingency Management) Regulations 2008.<sup>2</sup> This defines the gas transmission system as,
  - transmission system means the system—
    - (a) comprising those high pressure transmission pipelines from the point where the gas leaves a gas processing facility to an interconnection point for distribution or, where the gas does not enter a distribution system, to a consumer; and
    - (b) as depicted in the map published by the industry body in accordance with regulation 10.
4. Powerco supports this definition if the Commission is satisfied that it has considered the proposed definition in light of existing regulation.

*Problems with other definitions*

5. Paragraphs five to eight provide more technical detail on why Powerco does not support the alternative proposed by the Commission.
6. The Commission rules out using the definition of Gas Transmission in the Gas Act 1992 as the Commission considers that distribution pipelines can potentially operate at pressures greater than 2,000 kPa. Powerco notes that the reverse situation can also occur, for example, the 'transmission' pipeline from Waitangarua to feed the Wellington networks is operated at less than 2000 kPa. There have also been cases in the industry where large sites have been considered directly fed from the transmission system, but the relatively short lengths of pipe work between the gate station and installation have been on distribution networks asset registers and fit within the definition of distribution system in the Gas Act 1992.
7. The use of the term ICP to define the distribution network is not appropriate as:
  - ICPs are defined in the Gas (Switching Arrangements) Rules and Gas (Downstream Reconciliation) Rules and these are not interconnection points.

<sup>2</sup> Commerce Commission, Gas Default Price Quality Path: Issues paper, April 2010, paragraph 2.14.

- Section 55A of the Commerce Act limits pipelines “to the point of supply to a consumer” not to the ICP; and it also excludes meters. The point of supply is defined in the Gas (Safety and Measurement) Regulations 2010 and is typically the outlet of the gas measurement system. The issue is the scope of the term ‘pipelines’, and not confusing it with the term distribution system.
  - There are no interconnection agreements between transmission and distribution service providers, and so no inter-connection point is recognised; other than that defined in the Gas Act 1992 (i.e. fittings under the control of a gas distributor from the outlet flange of the gate station).
  - Similarly no interconnection point, other than change of ownership, is typically defined where there are different asset owners in a distribution system i.e. connections between networks, GMSs and ‘embedded’ networks owned by different parties..
8. Under the definition of a point of supply in the Gas (Safety and Measurement) Regulations 2010, the point of supply can be varied from the outlet of the GMS and it can be changed without the distributor’s knowledge in some cases. This means that the scope of gas pipeline services can vary, and a distributor may not be aware of this variation and its interaction with distribution assets.

### **Productivity Analysis**

9. The Commission’s initial view is to undertake a New Zealand gas sector productivity analysis to inform the setting of the X-factor. The Commission proposes to use indirect approaches if issues with data cannot be resolved. The Commission does not intend to apply the results of a productivity analysis mechanistically.
10. Powerco supports the use of total factor productivity (“TFP”) analysis to determine the rate of change for the gas distribution DPP. This is consistent with the approach taken in determining the X factor in the electricity distribution DPP and has been used in New Zealand a number of times.

### *Data Availability*

11. The Commission recognises the issues with data availability and robustness for the New Zealand gas distribution sector. The Commission “considers that the most robust historical dataset for the gas sector is likely to relate to the period prior to Vector’s acquisition of NGC Limited”.<sup>3</sup>
12. Powerco can not comment on NGC data, but from our experience of merging companies, we do recognise the issues of providing an accurate historical dataset to meet the requirements of the Commission.
13. Powerco notes that Meyrick and Associates produced a report on productivity growth in New Zealand gas distribution networks, compiled on behalf of the Commerce Commission in 2004. This reviewed NGC Distribution’s TFP between 1997 and 2003. As many submitters highlighted, and Meyrick acknowledged at the time, there are a number of caveats in the report. The Pacific Economics Group (PEG), submitting on behalf of Vector, commented,

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<sup>3</sup> Commerce Commission, Gas Default Price Quality Path: Issues paper, April 2010, page 26.

I also have some concerns with the Meyrick TFP growth study. Most importantly, the data limitations for TFP trend analysis are even more pronounced than those for TFP level analysis. Meyrick was only able to estimate TFP growth for NGC, which it says accounts for about 25% of the NZ industry in terms of customers served. Number of customers served is the main cost driver in the gas distribution industry, so Meyrick is only capturing about ¼ of the industry in terms of one of the main drivers of cost (and productivity) growth. I do not believe that this is sufficient to reflect the industry TFP trend, since a single company's TFP growth can be highly volatile from year to year and the productivity trend associated with serving ¾ of the industry's customers is not accounted for.<sup>4</sup>

14. This comment is still relevant today. For example, Powerco notes that the majority of NGC gas distribution networks were created as new, to a uniform design and standard; rather than individually converted using ad hoc design processes from locally owned town gas networks, as was the case in many large towns and cities. This means that the NGC networks typically operate to a higher pressure, and have fewer constraints or choke points, than non-NGC networks. Consequently, a much smaller capital investment would be required to deliver a specific increase in capacity in an NGC network than in a non-NGC network.

#### *International Data*

15. Acknowledging the data issues, the Commission states that “the inclusion of overseas data is considered by the Commission to be appropriate, but can be problematic given the need to source appropriate, comparable information and the likely need to normalise data”<sup>5</sup>. Powerco recognises that international studies or data can offer insights, but agrees with the Commission that it is very important to understand the limitations of any technique or data set:
  - The regulatory regime in Australia sets different limits for the maximum operating pressure of gas distribution networks to those in New Zealand. This will affect the cost structure of investments and consequent gas throughputs (i.e. cost and productivity in this regime are affected by this decision), making comparisons difficult. This may also apply to other regulatory regimes that the Commission intends to use for comparison.
  - TFP indexes do not generally control as well as econometric techniques for differences in the scale of output on expected costs.<sup>6</sup> If scale economies exist for a supplier, then cost rises less rapidly than output. One firm can be judged as more efficient than another simply because it has greater output and therefore lower unit cost. New Zealand gas distributors are generally quite small by international and Australian standards. Therefore the TFP of Australian, United Kingdom or American gas companies is likely to be higher than NZ companies.

#### *Economic Insights TFP Methodology*

16. There is also a dispute between the appropriate TFP methodology for utilities with sunk assets. Since the Commission published the Economic Insights (EI)

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<sup>4</sup> Pacific Economics Group, Comments on Meyrick and Associates Reports Prepared for the Commerce Commission's Inquiry into New Zealand Gas Transmission and Distribution Sectors, June 2004, page 9.

<sup>5</sup> Supra n3, page 25.

<sup>6</sup> Supra n5.

approach to calculating TFP for infrastructure assets in 2009, the debate between PEG and EI has continued in Australia.

17. Powerco continues to dispute the EI methodology. The purpose of the Commission's exercise is to set a path for prices, and not to obtain the best estimate of TFP per se. At this stage, the scope for price reductions only exists where revenue grows at a faster rate than costs. The growth of output used by EI is an abstract measure of output that does not translate into revenue growth. It is irrelevant to the price path, irrespective of whether affects a technical measure of TFP growth.

#### *Translating TFP Information into X Factor*

18. There are a number of factors that should be considered in translating the TFP results into the Gas Distribution DPP X factor:
  - productivity driven by consolidation and high growth has ended;
  - increasing costs, for example traffic management costs; and
  - the impact of the recession on data.
19. Some of the growth in TFP in the New Zealand businesses has been achieved through one-off managerial efficiency measures. For example, Powerco's gas business is the result of seven gas business merging since the early 1990s. It has also leveraged-off efficiencies associated with Powerco's electricity business. It is unlikely that the same scope for one-off efficiency gains will exist in the future, and as a consequence more modest future rates of TFP growth should be expected.
20. Powerco also notes that the 1980s and 1990s were marked by high growth as gas distribution networks quickly expanded in greenfield areas. Growth has now slowed and the benefits of economies of scale have declined.
21. Powerco reiterates its point on the impact of the recent recession on TFP. Much of the growth in TFP for utility firms derives from the fact that growth permits a greater realisation of the economies of scale, scope, density and capacity utilisation that may be present in the relevant networks – these factors imply that the technology permits outputs to grow at a faster rate than inputs, which is the definition of TFP growth. This means in turn that the rate of output growth has a material effect on the prospects for TFP growth. The Commission should expect that the rate of productivity growth that was realised before the recession – which was characterised by a period of high economic growth – would overstate the reasonable prospects for productivity growth in the period ahead. In contrast to the utility sector, most of the economy is not characterised by technology that has material economies of scale, scope, density and capacity utilisation, and so the slowdown in economic growth would not be expected to have as large an impact on economy wide TFP growth.

#### *Importance of a "Do No Harm" Approach*

22. In conclusion, data and methodology issues will make it difficult to mechanistically apply a TFP figure to the X-factor. However, this should not provide the Commission with extensive discretion. It is important that several methods are used and the Commission is highly transparent in how it analyses the data. The process must have credibility to maintain investor confidence.

23. Given that under the new Part 4 the Commission must set a generic X-factor, the X should be set in a conservative manner to ensure a “do no harm” approach for all lines businesses – including those that due to their physical characteristics cannot deliver the average productivity gain.

### **Quality Standards**

24. The Commission’s initial view is that, to the extent practicable, the regime will put in place objective quality standards with defined and measurable indicators. The Commission states that “this will ensure that requisite quality can be identified and monitored easily, and DPBs have certainty around performance”.
25. The Commission’s aims seem to be:
- indicator(s) that measure if there is a material degradation in performance;
  - objective and measurable statistic(s); and
  - measure(s) reflecting the level of service customers receive.
26. Powerco would add the aims of simplicity and cost-effectiveness to this list (which were aims of the electricity DPP quality path).

### *Maximum of Two Measures, Consistent with the Electricity DPP*

27. It is important that the quality path consists of only one or two measures. For example, in electricity, the DPP quality path consists of SAIDI and SAIFI. A breach is a serious matter and creates great uncertainty for suppliers and their investors. The quality path should be designed so that a breach only occurs if there is a material degradation in quality. If a large number of measures are used, a breach is more likely to be “technical” or “false”.

### *Safety Regulations Set a High Minimum Standard*

28. The Commission indicates its preference for using the following indicators to set the quality path: SAIDI, SAIFI, Publicly Reported Escapes of Gas (PRE) and Unaccounted for Gas (UFG). It is worth noting that industry does not assess investment or network quality using these indicators.
29. Powerco’s gas network is driven by safety considerations to a greater extent than its electricity network due to the more hazardous nature of gas. Gas safety regulations set a very high standard of quality. For example, the new Gas (Safety and Measurement) Regulations will require gas networks to have an audited Safety Management System in 2013. The Safety Management System depends on Standards requiring risks to supply to be kept as low as reasonably practicable (the ALARP principle). This provides a very high baseline of quality for all consumers.

### *SAIDI and SAIFI*

30. There is a weak relationship between the amount of investment in the gas network and SAIDI and SAIFI. However, SAIDI and SAIFI are useful measures for reflecting the level of service that customers receive.

31. Setting the quality threshold is very important. Under the electricity thresholds regime, many reliability breaches occurred as a result of events and circumstances that were subsequently found to be beyond the direct control of electricity distribution businesses. The Commission sought to mitigate the occurrence of such breaches when specifying quality standards under the Reset DPP, in order to provide greater regulatory certainty.
32. This approach is even more important in gas distribution, where there are many more issues with data. We would also note the changes in definition of SAIDI and SAIFI that have occurred in recent times as Powerco has reported under different regimes – some including the impact of meters and some not.

Accounting for Extreme Events and Sampling Variability

33. The base levels of SAIDI and SAIFI on gas networks are very low and most customers do not experience supply interruptions. This means a relatively small outage can have a large impact on the indicator; the volatility will be much higher. As the Commission recognises in paragraph 7.13, these issues must be accounted for statistically in any analysis of data.
34. For example, electricity and gas have different outage patterns. An electricity event is likely to affect a large number of consumers, but a fault can be quickly cleared (perhaps without anyone visiting site) and supply is restored. A gas event is likely to affect a smaller number of consumers, but it is a serious safety issue and the physical process of making safe and re-commissioning the pipes takes significantly longer. The length of time to restore an interruption is driven by the need to mitigate the risk involved and cannot be compromised according to gas safety legislation.
35. The graph below shows trends in unplanned SAIDI for outages affecting more than five customers for gas distribution networks in Victoria, Australia. The high figure for Allgas Energy in 2006/07 was occasioned by a single outage involving 600 customers for 9 hours due to a third party hit. It shows events, of which GDBs have no control, can have large impacts on SAIDI.

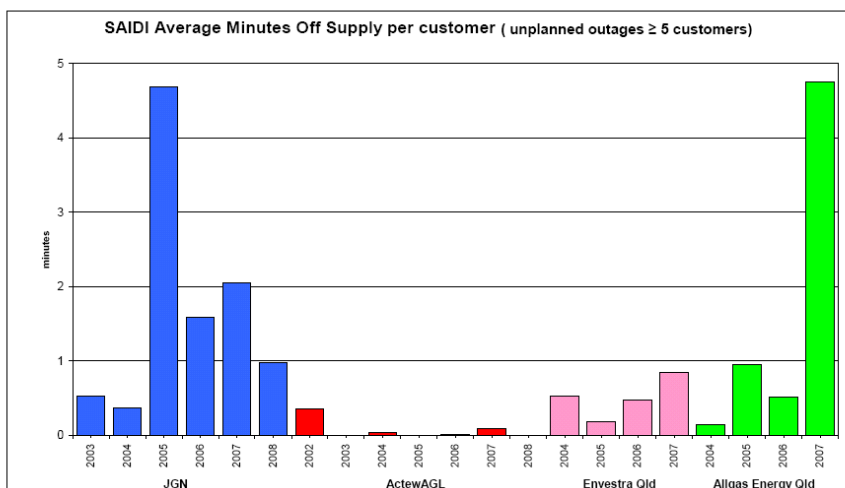


Figure 27. SAIDI unplanned outages for ≥ 5 customers

36. Powerco’s experience and the graph above illustrates the importance of normalising extreme events on gas distribution networks. The electricity approach should not be rolled over, but statistical analysis specific to gas undertaken to test its impact.

37. The availability and robustness of historical information will also make it difficult to set statistically robust targets. For example, Powerco improved and changed its reporting of SAIDI and SAIFI from 1 July 2009 to meet the requirements of the Gas Authorisation. If the quality path is set in February 2012, the Commission will have two years of data, which is not an adequate dataset to set a quality path.
38. The new information disclosure regime for GDBs will provide much more robust and detailed information to the Commission and allow it to monitor a range of measures for the gas networks and how they vary across different suppliers. This would help the Commission set its quality path from 2017.

#### Control over Unplanned SAIDI

39. A leak or interruption in the gas network is a very serious safety issue and operations and investment are focused on preventing this occurring. This means that unplanned SAIDI is driven much more by third party incidents compared with electricity, and GDBs have limited options to invest in the network to reduce unplanned SAIDI. In contrast, electricity networks can invest in activities such as vegetation control and/or devices to automatically clear faults to reduce unplanned SAIDI. Investing in duplicating existing pipelines could reduce GDB SAIDI and SAIFI, but these investments are unlikely to be cost effective.
40. In specifying the electricity DPP quality path the Commission normalised data to reduce the impact of extreme events. If SAIDI/ SAIFI are adopted, this should also occur for gas distribution.

#### *Publicly Reported Escapes of Gas*

41. Powerco has considered other measures suggested by the Commission. Using PRE in the quality path also has limitations. PRE is a safety number, rather than indicating the level of service to customers as many leaks have no effect on a consumer. It also depends on the number of people willing to report incidents, so is not objective, is transient, dependent on climatic conditions, often cannot be verified, and could be affected by pipe and equipment not in the Commission's remit (i.e. gas leaks on GMS and installation pipework) or on uncontrolled networks. For example a report of a gas escape in Featherston Street, Wellington, could come from the Nova network in the area, a Contact meter attached to a building (both of which are uncontrolled) or Powerco's controlled gas network.

#### *Unaccounted for Gas (UFG)*

42. UFG can be a complex issue, resulting from system leaks, theft, inaccurate meters, differences in times meters are read, accounting error, pressure, gas compressibility factor, temperature or heating value discrepancies, line pack differences and losses in commissioning of new or replacement pipes.
43. An investigation by the Gas Industry Company found that UFG in New Zealand is predominantly caused by billing and metering errors, meaning that retailers account for most of the UFG.

Gas leakage from the distribution networks is estimated to be small in New Zealand, as the networks use modern materials and jointing techniques. We estimate that leakage is below 0.2%. Losses for operational purposes are by our estimate also very small and mainly occur when gas has to be vented for maintenance reasons or new connections.

Theft has been investigated in the past and was found to be low in New Zealand. We therefore believe that the responsibility for UFG should not exclusively be allocated to network companies, as leakage and operational losses are estimated to be below 0.5%. This is similar as in the UK, where “shrinkage” as disclosed per distribution network is typically below 1%.

UFG as defined in New Zealand is the sum of the billing errors, including metering and data processing. We therefore believe that the Retailers should account for most of the UFG (currently 2.5%).<sup>7</sup>

44. This clearly demonstrates that the UFG figure Powerco provides to the Commission has little correlation with the quality of Powerco’s gas network.

#### *Customer Service Measures*

45. The Commission has not proposed measuring quality using customer service measures, such as time taken to answer telephone calls. Powerco supports this as, due to the interposed delivery model, Powerco does not have a direct relationship with the customer. For example, consumers will have a greater interest in the time taken for retailers to answer their phone called.

#### *Recommendation*

46. Powerco recommends that while SAIDI and SAIFI provide a measure reflecting customer service, there are data issues and operational issues with providing a robust quality path. Compliance with the safety management system provides a useful quality path until data issues are resolved.<sup>8</sup>

#### **Data Requirements**

47. The Commission is seeking GDBs views on if:
- requiring information on SAIDI, SAIFI, PRE and UFG is appropriate for setting the quality standards;
  - requiring statistical, financial and asset valuation information is appropriate for setting the rate(s) of change; and
  - time period and extent to which the information in Table 4 is available.
48. The earlier parts of the submission provide comment on the methods to set the quality path and rates of change. It is difficult to comment on the appropriateness of the information required, as this depends on the final decisions on the quality path and TFP methodology.
49. The table below provides information on the time period and extent of information available. It is assumed that all the information is required at a Powerco level, rather than a network level. Some historical information may not be to auditable standard.

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<sup>7</sup> Maunsell Limited (on behalf of Gas Industry Co), Allocation of Unaccounted for Gas, June 2007.

<sup>8</sup> Powerco notes that the Safety Management System has to be in place in 2013.

<b>Indicator description</b>	<b>Data availability</b>
<b>Statistics</b>	
Throughput (GJ)	Disclosed under the Gas (Information Disclosure) Regulations 1997 and straightforward to provide a Powerco figure.
System length	Disclosed under the Gas (Information Disclosure) Regulations 1997 and straightforward to provide a Powerco figure.
Maximum monthly flow	Disclosed under the Gas (Information Disclosure) Regulations 1997 and straightforward to provide a Powerco figure.
Total customer numbers	Total customers is disclosed under the Gas (Information Disclosure) Regulations 1997 and straightforward to provide this figure.
Pipeline length broken down by material, diameter and pressure class	Powerco provided this information for the ODV calculation in 2005. Updated figures can be provided.
District regulating stations (DRS) (number)	The number of DRS depends on the original network basis (new or town gas) and the original design and operating philosophy. Powerco estimates it can provide around five years of historical data.
<b>Performance Indicators</b>	
SAIDI	Powerco can provide robust information on these measures for the period beginning 1 July 2009. The Gas Authorisation changed the definitions of these indicators, meaning data collected before this is not comparable.
SAIFI	
Public reported escapes	
Unaccounted for gas ratio	
<b>Financial</b>	
Revenue	This data is collected by Powerco as part of financial reporting. This information could be disclosed at a Powerco level (assuming Powerco's current definitions are used).
Operating expenditure	
Capital expenditure	
Direct line costs per km	
<b>Asset Values</b>	
Regulatory asset base	Powerco does not consider the 2003 ODV valuation to be accurate. There are significant issues with the valuation and whether it could be broken down (meaningfully) into the asset classes likely to be required for a TFP analysis. The 2005 ODV is a more valid figure.
Regulatory depreciation	
Revaluations	
Acquisitions and disposals	

## Annual Assessment and Regulatory Periods

### *Issues with the Two Options*

50. The initial Gas Distribution DPP is due to come into effect on 1 July 2012, however the annual pricing year of GDBs commences on 1 October. The

Issues Paper suggests two options for addressing the disjoint between the regulatory assessment period and the current GDB pricing period:

- Option 1: July to June Assessment Period, with two sets of prices over the assessment period; or
- Option 2: October to September Assessment Period, with a three month commencement period.

51. A main reason Powerco changes gas prices on 1 October is due to the seasonal nature of gas consumption. From a consumer perspective, the worst time to receive a price increase is when gas consumption is at its highest. Changing prices in October helps to smooth consumers' gas bills over the year.<sup>9</sup>
52. An October pricing year is standard gas industry practice and Powerco's use of system contracts only allow us to make one price change in each twelve month period – generally on 1 October. This has a number of other advantages, for example, aligning Powerco's Unaccounted for Gas (UFG) factor calculation as per the Gas Downstream Rules. Powerco recommends that prices continue to be changed on 1 October.
53. Powerco also does not support a 1 July – 30 June assessment period due to the difficulty of designing prices and assessing compliance. We agree with the Commission that there is the potential for increased complexity, raising the likelihood of a technical breach. This rules-out both of the Commission's options.

#### *A Third Option*

54. A third option is for price changes in the DPP to begin on 1 October, either as if the DPP had started on 1 July (ie in NPV terms Powerco's revenue would be the same) or commence the DPP from 1 October. The Commerce Act does not seem to restrict either approach:
- While section 55D states that gas pipeline services are subject to default/ customised regulation on and after 1 July 2010, the Commission has decided that the inconsistency in the Act allows it to set the DPP later than this date;
  - Section 55H states that, "the expiry of the Order must be treated as if it were the expiry of a customised price-quality path, and section 53X applied accordingly". Section 53X(1) states that, "when the customised price-quality path of a supplier of goods or services ends, the supplier is subject to the default price-quality path that is generally applicable to other suppliers of those goods or services". Section 53X(1) does not require a gas distribution DPP to be underway on 1 July 2012. The section only states what must happen if there is a default price-quality path applicable to gas distribution services at this time.
55. Powerco recognises that the Commission may interpret the intent of the Act as ensuring gas distribution services are regulated throughout this period and be unwilling to have a three month period where no regulation is applied. If this is the case, the Commission is still able to start the DPP on 1 July, but make the starting price adjustment and price path take effect from 1 October.

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<sup>9</sup> Powerco notes that the price impact on customers is dependent on when retailers change gas prices.

56. For example, section 53X(2) states that, “the starting prices that apply at the beginning of the default price-quality path are those that applied at the end of the customised price-quality path unless, at least 4 months before the end of the customised price-quality path, the Commission advises the supplier that different starting prices must apply.” Consistent with the approach of the electricity DPP, the Commission does not have to make a starting price adjustment at the beginning of the regulatory period.
57. In the Gas Authorisation Powerco was required to make an 11.1% price reduction to “reflect the fact that excess revenues have been made during which the Provisional Authorisation has been in effect.”<sup>10</sup> This is an example of where the price path has been adjusted to ensure the NPV is the same across the entire regulatory period.
58. Powerco recommends the Commission adopt a third option of beginning the DPP on 1 July 2012, but price changes occur on 1 October 2012. The initial starting price adjustment can be changed to provide the same revenue in NPV terms, as if price changes had occurred on 1 July 2012.

### Contact Details

59. Thank you for considering the points raised in this submission and please contact me on 06 759 6216 if you wish to discuss any of the issues Powerco has raised in more detail.

Yours sincerely

A handwritten signature in blue ink that reads "Goodeve". The signature is written in a cursive, flowing style.

Paul Goodeve  
Regulatory and Business Manager

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<sup>10</sup> Commerce Commission, Gas Authorisation Decisions Paper, 30 October 2008, page 232.