

Initial default price-quality path for gas pipeline services – deferral of commencement date

Draft decision

Date: 03 February 2012

Introduction

1. We now consider it appropriate to defer the commencement of the initial default price-quality paths for gas distribution businesses and gas transmission businesses. We have reached this draft decision after reflecting on responses from interested parties to our draft determinations and supporting reasons paper. We identify in this paper factors in favour of a deferral and potential downsides.
2. We seek your views on deferring the commencement. Responses to this paper are due by **13 February 2012**.

Deferring the commencement of the initial default price-quality paths

3. In our recent draft determinations and supporting reasons paper we proposed 1 July 2012 as the commencement date for the initial DPP.¹ In addition, the draft reasons paper stated:

“We remain of the view that prices based on current and future profitability of each supplier are likely to better promote the Part 4 Purpose...

We are nonetheless electing to proceed with the Initial DPPs with starting prices rolled-over from the previous regulatory period as this crystallises two aspects of the regime that are important to ensuring the Part 4 Purpose is met:

- the right of a regulated supplier to seek a CPP
- our ability to apply claw-back if starting prices are reset under s 55F(4) [of the Commerce Act 1986 (the Act)].²

4. We noted that s 55F(2) of the Act requires the Commission to set the initial DPPs as if 30 June 2010 was the end of the previous regulatory period. We therefore proposed that starting prices for gas transmission businesses and those gas distribution businesses not currently subject to the gas authorisations would be their prices as at 30 June 2010.
5. In responses to our draft determinations and supporting reasons paper, interested parties voiced their concern with the proposed adoption of 30 June 2010 as the end of the previous regulatory period, since this requirement results in the affected businesses having to remove the CPI adjustments they have made to prices over the past two years.

¹ Therefore we intended to publish a final determination by 29 February 2012. Commerce Commission, *Draft Commerce Act (Gas Distribution Default Price-Quality Path) Determination 2012*, 21 November 2011; Commerce Commission, *Draft Commerce Act (Gas Transmission Default Price-Quality Path) Determination 2012*, 21 November 2011; and Commerce Commission, *Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 21 November 2011.

² Commerce Commission, *Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 21 November 2011, p. 29.

6. We have had the opportunity to reflect on these responses.³ We accept that requiring businesses to reduce prices to remove the CPI increases that have occurred in the period between 30 June 2010 and the commencement of the initial DPPs would be undesirable.
7. One of the options proposed by submitters to address this problem is for the Commission to defer the commencement of the initial DPPs until we can set starting prices for each supplier based on their current and projected profitability.^{4,5} The ability to set starting prices in this manner is dependent on the additional input methodologies that the High Court has directed us to determine.⁶ Therefore the initial DPPs would commence as soon as practicable after these additional input methodologies have been determined taking effect on a relevant quarter, but no later than 1 October 2013.⁷
8. Should we proceed with setting starting prices under s 53P(3)(a), however, we would need to decide whether the starting prices for the currently uncontrolled gas pipeline services should be CPI-adjusted from 30 June 2010, and, if so, how this should be given effect in the price path compliance formula. This is likely to delay the publication of the determinations until after 29 February 2012, and also affect a 1 July 2012 commencement date. In the instance of such a delay, the next most obvious commencement date would be 1 October 2012. The length of a regulatory period would also need to be reconsidered in the event of such a delay.

³ Submissions and cross-submissions on our draft determinations and supporting reasons paper are published on our website <http://www.comcom.govt.nz/2012-default-price-quality-path/>.

⁴ GasNet recommended that we defer the commencement, "Our submission is that the implementation of the Initial DPP for [gas distribution businesses] until the Input Methodology and reset decisions have been made." This position was also supported by MDL. Vector, on the other hand, recommended that no mid-regulatory period reset be made under s 55F(4) of the Act. Refer to: GasNet Limited, *Submission on Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 19 December 2011, paragraph 25; Maui Development Limited, letter to Regulation Branch: cross-submission on the initial default price-quality paths for gas pipeline businesses draft reasons paper, 20 January 2012, paragraph 10; and Vector Limited, *Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper*, 19 December 2011, paragraph 60.

⁵ As provided for under s 53P(3)(b) of the Act.

⁶ The High Court has directed us to determine additional input methodologies that describe the way that starting prices could be adjusted when default price-quality paths are reset. For further information on the additional matters that we are now determining as input methodologies, the timeframes that we must meet, and the process that we propose to follow, refer to: Commerce Commission, *Additional Input Methodologies for Default Price-Quality Paths, Process and Issues Paper*, 9 December 2011.

⁷ We are required to determine additional input methodologies by 30 September 2012 (unless the High Court grants an extension).

Factors in favour of deferring the commencement

9. Set out below are factors that we have identified in favour of deferring the commencement of the initial DPPs.
 - 9.1 We can set starting prices based on each supplier's current and projected profitability from the outset of the initial regulatory period, our preferred option, rather than 'rolling-over' the prices that applied at the end of the previous regulatory period.⁸ This is likely to better promote the Part 4 Purpose and ensures that the initial DPPs are aligned with the input methodologies that we have determined.
 - 9.2 The deferral provides certainty to suppliers that the starting prices apply for the regulatory period, as it avoids the potential for mid-regulatory period resets after we publish the additional input methodologies.⁹ Further, we note that the extent to which we will be able to apply the provision in the Act allowing a mid-regulatory period reset (s 55F(4)) is at this point unclear. One party has already questioned the application of the equivalent provision for electricity distribution businesses in the High Court.¹⁰ If the initial DPPs are set from 1 July 2012 but cannot be reset using s 55F(4) then starting prices will not be able to be reset until 1 October 2016—ie, a delay of four years and three months. This means that any supplier that would otherwise have been able to increase prices as at 1 July 2012 will not be able to do so until the beginning of the next regulatory period.
 - 9.3 Issues concerning the 'rolling-over' of the prices that applied at the end of the previous regulatory period for suppliers of services not currently subject to the gas authorisations are no longer relevant. GasNet, Vector and MDL submitted concerns on our proposed approach.¹¹
 - 9.4 As set out in our draft reasons paper, one of the reasons for proposing to set the initial DPPs from 1 July 2012 was to allow suppliers to make a customised

⁸ These are the two options for setting starting prices under s 53P(3) of the Act. We have consistently expressed our preference for setting starting prices under s 53P(3)(b). Refer to: Commerce Commission, *Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 21 November 2011, paragraph 7.13; Commerce Commission, *Setting of Starting Prices for Gas Pipeline Businesses under the Initial Default Price-Quality Path*, 22 August 2011, paragraph X.5; and Commerce Commission, *Initial Default Price-Quality Path for Gas Pipeline Businesses, Discussion Paper*, 1 April 2011, p. 27.

⁹ We may set the initial DPPs even if all or any of the relevant input methodologies have not been determined (s 55F(3) of the Act). However, we may reset the initial DPPs if an input methodology is published after the initial DPPs are determined and it would have resulted in a materially different path being set (s 55F(4) of the Act).

¹⁰ *Vector Limited v Commerce Commission* HC Wellington, 26 September 2011, Clifford J, CIV-2011-485-536.

¹¹ GasNet Limited, *Submission on Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 19 December 2011, pp. 2-10; Vector Limited, *Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper*, 19 December 2011, pp. 11-17; and Maui Development Limited, letter to Regulation Branch: cross-submission on the initial default price-quality paths for gas pipeline businesses draft reasons paper, 20 January 2012, paragraphs 2-10.

price-quality path proposal. Submitters have expressed the view that the option of making a customised price-quality path proposal in advance of the additional input methodologies being published is 'severely compromised' by 'the uncertainty regarding the potential for a reset'.¹² Therefore such proposals are unlikely before starting prices have been determined based on each supplier's current and projected profitability.¹³

- 9.5 Despite a default price-quality path not being determined, all suppliers have an incentive not to increase their weighted average prices by more than CPI.¹⁴ We have previously expressed concern about a lack of continuity in regulation for those suppliers currently subject to the gas authorisations. However, we consider that s 55F(2) applies to those suppliers and is a sufficient constraint in these circumstances in the same way that it has been for those services not subject to the gas authorisations since 1 July 2010.
- 9.6 Information disclosure requirements (as currently proposed) will seek information on response times to emergencies that is consistent with the quality standards proposed in our draft determinations.

Downsides of deferring the commencement

10. We have previously deferred setting the initial DPPs,¹⁵ and no supplier has previously raised any concerns about a delay to the commencement of the initial DPPs. We acknowledge, however, that there may be some potential downsides to a deferral beyond 1 July 2012, including that:
- 10.1 for the short period until the initial DPPs commence, some suppliers may continue to have the opportunity to earn above normal returns, while others may not be able to earn normal returns
- 10.2 claw-back under s 55F(4) of the Act is no longer an option, and therefore we would not be able to allow suppliers to recover some or all of any shortfalls in their revenues or consumers for any over-recovery for the period prior to the initial DPPs.¹⁶ However, as is noted above in paragraph 9.2, should it eventuate that the s55F(4) provisions are not met despite additional input methodologies having been set, the reset or any claw-back could not be implemented in any event.

¹² GasNet Limited, *Submission on Initial Default Price-Quality Paths for Gas Pipeline Businesses, Draft Reasons Paper*, 19 December 2011, p. 8.

¹³ See also Vector Limited, *Cross-submission on the Initial DPP for GPBs Draft Reasons Paper*, 20 January 2012, paragraphs 7-9.

¹⁴ As set out s 55F(2) of the Act.

¹⁵ See Commerce Commission, *Default/Customised Price-Quality Regulation, Setting of the Default Price-Quality Path for Suppliers of Gas Pipeline Services, Updated Process Paper*, 9 October 2009.

¹⁶ We would still be able to consider whether to apply claw-back under s 55F(2), if applicable.

What happens next

11. We will decide whether to confirm our draft decision to defer the commencement of the initial DPPs, after considering responses to this paper. We will then inform interested parties of our decision.

How you can respond to this paper

12. This paper is intended to seek your views on the proposal to defer commencement of the initial DPPs as set out in this paper. Submissions on this paper should be received by **5pm Monday, 13 February 2012**.
13. You should address these responses to:

Matthew Lewer (Chief Adviser, Regulation Branch)
c/o regulation.branch@comcom.govt.nz

Requests for confidentiality¹⁷

14. We intend to publish all submissions on our website. We therefore request that submitters provide 'unlocked' electronic copies of their submissions. Submitters should also provide a clearly labelled 'public version' of their submissions, if submissions contain confidential information or if submitters wish for the published electronic copies to be 'locked'.
15. We discourage requests for non-disclosure of submissions, as it is desirable to test all information in a fully public way. However, we recognise that there may be cases where parties in making submissions may wish to provide confidential information to us.
 - If it is necessary to include confidential material in a submission, the information should be clearly marked.
 - Both confidential and public versions of the submission should be provided.
 - The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

¹⁷ Parties can also request that we make orders under s 100 of the Act in respect of information that should not be made public. Any request for a s 100 order must be made when the relevant information is supplied to us, and must identify the reasons why the relevant information should not be made public. We will provide further information on s 100 orders if requested by parties. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any s 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.