GREYMOUTH GAS

31 May 2010

Matthew Lewer
Regulation Branch
Commerce Commission
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By email: regulation.branch@comcom.govt.nz

Dear Matthew,

Greymouth Gas New Zealand Limited (**Greymouth Gas**) is pleased to have this opportunity to make a cross-submission on the submissions various parties have made on the Commerce Commission's (the **Commission**) issues paper relating to the *Initial Default Price-Quality Path for Gas Pipeline Businesses* published on 12th April 2010.

Form of control

Greymouth Gas agrees with many of the submitters that the choice between a revenue cap and a weighted average price cap form of incentive regulation is not clear cut. Each form of control gives rise to its own incentives and these also depend on the costs and pricing structures of the regulated enterprise and the nature of any decisions it has to make about increasing supply. For instance, a gas pipeline business (**GPB**) operating under common carriage and a revenue cap will have no incentive to encourage an increase in volume beyond that implicit in its revenue cap. On the other hand, a GPB operating under firm carriage terms and a weighted average price cap will have incentives to sell more firm capacity for an existing pipeline, and this may lead it to discourage utilisation by those who have paid for firm capacity, although, in practice, it may be limited in its ability to do this.

Greymouth Gas agrees with the submitters that argue the most appropriate form of control will depend on the circumstances. However, it disagrees with the assumption these submitters generally make that it is the interests of the GPB which should determine the choice in each circumstance. Vector is most explicit about this by arguing that the choice of form should ideally be left to the GPB to decide for itself, but other submitters also considered the issue from a supplier's perspective.

Greymouth Gas notes the purpose of Part 4 of the Commerce Act 1986 (the **Act**) is "to promote the long-term benefit of consumers". It submits that this should be the basis on which the Commission decides on the form of control implemented in the default price-quality path (**DPP**)

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in each specific circumstance. To allow a GPB to choose its own form of control is very unlikely to result in all decisions being consistent with the purpose statement of Part 4 of the Act.

In its Emerging Views Paper of December 2009 the Commission expressed the preliminary view that "suppliers will not be required to apply a pricing methodology input methodology under the DPP, as the Commission considers that the net benefits of doing so might not be sufficient".[1] GasNet, Powerco and Vector all support this preliminary view in their submission on the DPP Issues Paper. Greymouth Gas continues to hold the contrary view that it put forward in an earlier submission. Specifically:

Greymouth Gas submits that it will be of long-term benefit to consumers for:

- *all GPBs, whether subject to a default or customised price-quality path, to be required to implement a pricing methodology consistent with robust pricing principles that will ensure prices are efficient and promote, rather than hinder, competition among the providers of gas to consumers*
- *the information disclosure requirements on all GPBs should be sufficient to allow any interested party to determine whether a GPB is complying with the pricing methodology and*
- *all GPBs should be subject to audit and verification to ensure they are complying with the pricing methodology.*

Greymouth Gas notes that although Vector supports the Commission's preliminary view on this matter, it considers "that it is reasonable for GPBs to disclose information on how prices have been derived and continue to support a principle-based approach to these matters." (Vector, Form of Control Submission, p.8) Greymouth Gas supports Vector's call for a principle=based approach but is of the opinion that it would be in consumers' interests if the principles used are laid down by the Commission and consumers have the reassurance of audit and verification that the principles have been used.

Structure of the Initial DPP

Several submitters have argued that the Commission should set a price path with an integrated price and quality criterion either now (Vector and AECT) or sometime in the future (GasNet). They propose this be done by incorporating an S-factor "quality" incentive in the price path. Some other submitters question whether the data available would support such a development (Maui Development Ltd and Powerco).

Greymouth Gas shares the scepticism about the available data. Moreover, it is not convinced by the arguments so far advanced that an integrated criterion is best, if practicable. An integrated criterion would allow GPBs to trade-off prices and quality in the manner set out in the criterion. There is no mechanism to ensure that the rate of trade-off in the criterion will lead GPBs to "have incentives to ... provide services at a quality that reflects consumer demands" at the prices set by the GPB. But this is what is required by the purpose statement of Part 4 of the Act, however.

[1] Commerce Commission, Input Methodologies (Gas Pipeline Services): emerging Views paper, December 2009, p.54.

In other words, with an integrated criterion, GPBs will choose how they trade-off higher quality and lower price and vice versa. They will do this in a manner which allows them to best fulfil their own objectives and not necessarily in a manner consistent with how consumers would prefer to trade-off price and quality. Greymouth Gas would prefer separate criteria for price and quality and submits that this is more consistent with the purpose statement in section 52A of the Act than an integrated criterion.

Claw-back under Section 55F (2)

The Commission's initial view is that if a GPB has increased its weighted average prices in any year from 1 January 2008 by more than the movement in the consumer price index (CPI) over the year it will assess if the GPB has over-recovered any revenue, and the extent of any over-recovery, so it can claw it back.

Greymouth Gas notes that a number of submitters have argued that instead of a series of annual assessments covering 2008, 2009, etc the Commission should conduct only one assessment covering the period from 1 January 2008 until the date that a determination is made. Greymouth Gas would like to point out to the Commission that, should it adopt the approach urged on it by these submitters, it will encourage any GPB that has not raised its weighted average price each year since 2008 by the movement in CPI to do a catch-up adjustment to its prices, even if this means it makes excessive returns in that year (and future years). A late flurry of catch-up price rises at the outset of the new regime made by GPBs to ensure their overall price increases between 2008 and the start of the new regime are at the maximum permitted level is likely to undermine the credibility and stability of the regime. In Greymouth Gas's opinion, providing GPBs with an incentive to do this would not be of long-term benefit to consumers.

Vector has more generally complained that it would be a breach of natural justice for the Commission to undertake a claw-back on the basis of an assessment methodology that was not notified to suppliers before the revenue was earned. (Vector, Issues Paper Submission, p.5) Parliament knew that the assessment methodology would take some time to notify when it provided for claw-back to the start of 2008 (but not beyond) in the legislation. Moreover, all GPBs have been aware of claw-back since the legislation was passed. This occurred prior to the 1 October price reset date in 2008. In Greymouth Gas's opinion, Vector's complaint is without merit and should be disregarded by the Commission.

Quality standards

Greymouth Gas notes that the views of submitters differ greatly on what quality standards should be set for GPBs as part of the default price-quality path. The difference between a quality standard included in the default price-quality path and one included in the information disclosure requirements is enforceability. Greymouth Gas notes that from a consumers' perspective enforceability can be a two edged sword.

On the one hand, if a quality standard is enforceable, consumers can be reasonably sure of receiving services that meet it in the medium term. On the other hand, since regulators are naturally reluctant to take enforcement action, except when it is really necessary to protect the interest of consumers, they have an incentive to set enforceable standards at a relatively low level to avoid unnecessary enforcement actions. A low standard set for this reason can become

viewed as an acceptable standard; enforcement can have the perverse effect of lowering the quality consumers actually achieve below the quality that reflects consumer demands.

Greymouth Gas urges the Commission to ensure that the quality standards it sets as part of the DPP will help promote the long term benefit of consumers by ensuring GPBs "have incentives to improve efficiency and provide services at a quality that reflects consumer demands" as required by the Act. In this regard, quality standards related to reliability (which are set at a level consumers want), responsiveness to consumer requests and complaints and the provision of opportunities to provide informed feedback to the GPB would seem to Greymouth Gas to be appropriate for inclusion in a quality criterion.

Yours sincerely,

Lara Walker