

17 June 2011

Commerce Commission
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[By email]

Dear Sir/Madam

Submission on DPP Draft Information Requests and Process Update Consultation Paper

1. On 27 May 2011, GasNet submitted its response to the Commerce Commission's (the Commission's) 1 April 2011 Discussion Paper on the "Initial Default Price-Quality Path for Gas Pipeline Businesses". Our submission responded to the proposals for determining Default Price-Quality Paths (DPPs) for Gas Pipeline Businesses (GPBs). The Discussion Paper and associated submission did not address how starting prices for the DPPs were to be determined.
2. On 30 May 2011, GasNet submitted in response to the Commission's 11 April 2011 Update Paper on the "2010-15 Default Price-Quality Path Starting Price Adjustments and Other Amendments" which applies to Electricity Distribution Businesses (EDBs). This paper is relevant to GasNet as in it the Commission indicated that:
 - there are likely to be parallels with setting starting prices for the DPPs to be determined for GPBs;
 - the Commission intends to make information requests for GPBs for this purpose in the near future; and
 - the information requests are likely to be similar to those issued for EDBs.
3. In our 30 May 2011 submission we raised concerns with the Commission's proposed approach for setting starting prices for DPPs for GPBs as it appeared to have been developed with little explicit consideration of the gas pipelines sector. In our submission we stated:

Accordingly, we submit that that Commission must issue a proposal for a SPA [Starting Price Adjustment] method for GPBs for consultation which specifically addresses the circumstances relevant to the gas sector including the regulatory provisions (both current and past) and the information requirements. This must be consulted upon prior to any information request for SPA data. It is not appropriate to assume that EDB consultation is sufficient for GPBs. We must be able to consider a specific proposal for our sector before a determination is made.

4. However, on 3 June 2011 the Commission released a Consultation Paper “Default Price-Quality Path for Gas Pipeline Businesses Draft Information Requests and Process Update”. The Consultation Paper includes a draft section 53ZD Notice information request which we understand is largely based on those which were issued to EDBs in March 2011. We are disappointed at this recent development and again urge the Commission to consider more explicitly the circumstances relevant to GPBs in this respect. We set out our most significant concerns with the draft information requests in the remainder of this submission.

Disclosure Period

5. It is proposed that audited information is to be provided to the Commission by 30 September 2011 and that information will pertain to the period ending 30 June 2011 for GasNet and other gas distribution businesses (GDBs).¹ We submit that this allows insufficient time for the information to be compiled and audited. The information preparation is likely to be complex as it involves:
 - the application of the Input Methodologies (IMs) for the first time (components of which must be established as at the beginning of the 2010 disclosure year and rolled forward); and
 - provides for establishing an adjusted Initial Regulatory Asset Base (RAB) which involves corrections to detailed asset registers.
6. The IMs currently exist as legal determinations only and there is no additional practical guidance as to how they are to be implemented. Their initial implementation is expected to be difficult as it is not possible to access precedents. Equally it is anticipated that engineering and financial auditing processes will be more time consuming than to be expected in the future.

¹ We have not commented on the proposals for gas transmission businesses for the purpose of this submission.

7. However our most significant concern in meeting the September deadline is that the underlying financial information for the period ending 30 June 2011 is not yet available and has to be finalised and audited before it can be used for the information request. It is not possible to apply the IMs to GasNet's revenues, costs, assets and other financial information such as taxation and depreciation until after the end of the financial year. This information then needs to be collated and audited for external financial reporting purposes. These year end processes are resource intensive for our staff and our auditors who will be fully committed to meeting our external reporting deadlines. As the DPP information request relies on audited information for the 2011 year, there is little opportunity for preparing the financial information requested in the draft s53ZD Notice in parallel with the external financial statements.

8. We understand that the EDB s53ZD Notice required financial information for a prior period. This information had been previously disclosed and audited. If the Commission is unable to move its 30 September deadline, then we submit that the information request should be amended to require information pertaining to the 12 months ending 30 June 2010. This will still place considerable pressure on GasNet and its auditors given the overlap with the year end financial reporting processes, however it avoids the scheduling delays associated with the 2011 year end data. Given the Commission has just received information from EDBs pertaining to the March 2010 year end, it seems reasonable that GDBs provide data relevant to the June 2010 year end. If the Commission wishes to confirm or otherwise the trend indicated by the 2010 data, it may wish to supplement it with additional data at a later stage. We believe this initial dataset will allow the Commission to undertake its preliminary analysis on the current profitability component of the DPP starting price assessment. We discuss projected profitability further below.

Proposed Templates

9. GasNet recently attended the Commission's information disclosure (ID) workshop which discussed preliminary draft templates for financial disclosures. The draft templates set out a proposed approach for implementing the IMs where relevant in order to derive regulatory profit and other RAB information necessary to derive the Commission's Return on Investment (ROI) regulatory profit measure.

10. The proposed templates illustrate the practical implementation of the RAB, regulatory tax and cost allocation IMs. A number of suggested improvements to the templates were discussed at the workshop however there was general support for the proposed approach. From GasNet's perspective, the templates greatly assist in our understanding of the IMs in practice.
11. We are somewhat disappointed however that the information request which is intended to gather information relevant to determining 'current profitability' for the purpose of setting starting prices under the DPP, has not drawn on the draft ID templates. The draft information request does not include a complete profit statement or a complete regulatory investment value (RIV) derivation. Similarly, the tax information requested is not sufficient to generate a regulatory tax allowance.
12. It is not clear why this is so. The information included in the draft s53ZD Notice may adequately meet the Commission's needs for its starting price analysis however the proposed templates provide very little assistance for GPBs and their auditors. They cannot be reconciled to previous disclosures or external financial statements and the possibility of error or misunderstanding is increased as a result. In addition we do not believe that it is appropriate that the Commission's analysis of current profitability for the DPP starting prices is based on a dataset which does not include this one key output.
13. Accordingly, GasNet submits that the Commission should make use of the recently published draft ID templates which provide a more transparent, complete and hence a more useful approach to deriving regulatory profit, the regulatory tax allowance (and its various components) and the RIV.
14. We also note that the Commission has provided no guidance in support of the draft information request notice other than that contained in the IM determinations. We find the IMs extremely difficult to follow particularly due to the cross references between their various Parts. We suggest the Commission makes available resources to provide guidance for GPBs and their auditors throughout the data compilation period. We would also find it helpful if the Commission were able to provide a worked example of the key templates.

Specific Comments on Templates

15. We offer the following specific comments on the spreadsheet schedules:

- We do not record our operating costs in the categories presented in Schedule A1 and A2. It is not clear why the Commission would require our operating costs in this form for the profitability assessments for the DPP. If we were required to comply with this format it would create considerable extra work to retrospectively apply the categorisation to 2010 or 2011. GasNet submits we should be able to enter operating costs in the categories which we currently use for our own management accounting purposes.
- We find Schedule A3 particularly confusing as it appears to require a range of variables across the 2010 and 2011 disclosure years, some of which are 'allocated' and others of which are 'unallocated'. The design of the schedule assumes that there will be an entire RAB roll forward created outside the schedule from which selected pieces of information are extracted in order to complete the template. As stated above, it would be more helpful to us if the schedule reflected the RAB roll forward from the date of the Initial RAB, to the end of the period which the Commission is assessing. This should be on an allocated basis. If the Commission wishes transparency over the allocation method, it could also include a roll forward on an unallocated basis but this is of secondary importance to the purpose of the information capture.
- Schedule A4 is to capture information regarding the asset valuation adjustments permitted in the RAB IM. We suggest the schedule is extended to allow for reporting of more than three categories of errors.
- Schedule A6 requires tax related information. Once again this appears to assume that we will prepare a full tax calculation outside of the Schedules, and extract selected pieces of that calculation in order to populate the template. Can we suggest the Commission replaces Schedule A6 with the tax schedules from the draft ID templates. These set out the key components of the regulatory tax calculation (tax asset roll forward, deferred tax balance, tax loss balance, amortisations etc) but most importantly include the regulatory tax allowance calculation. We would find this format more efficient and we are confident our auditors would also.
- Schedule C – the reference to ODV should be changed to refer to the method used in the most recent valuation prepared in accordance with the Gas (Information Disclosure) Regulations 2007 which is more consistent

with the IM. In addition in Table 1 in respect of the valuation of included assets as defined in IM clause 2.2.1(2)(b) we note that this clause is subject to 2.2.1(5) which also allows depreciated carrying value where historic cost records are not available.

Projected Profitability

16. The Consultation Paper indicates that the Commission is yet to determine its approach for assessing projected profitability for GPBs for the purpose of the starting prices under the DPP. It refers to the proposed EDB approach which involves assumptions about future changes in demand, opex and capex and suggests that it is possible that similar information may also be required for GPBs.
17. Our 30 May submission on the proposed EDB process highlighted a number of concerns should this approach be adopted for GPBs, particularly in respect of the availability of the historical datasets for the gas pipelines sector. We also expressed concerns about the use of industry wide datasets for this purpose, given GasNet's small relative size to other GDBs.
18. Given these limitations, we suggest that should the Commission require information regarding the future profitability of each regulated gas supplier, that it seeks such information directly from each business, rather than approximating it through industry-wide assumptions and estimates. This may be as simple as each supplier providing its estimates of volume growth (as relevant to revenue) and capex and opex forecasts. These could be supported by each supplier's comparable data for a historical period, say five years. We understand the Commission's modelling for EDB starting price assessments uses estimates of these three variables, along with the CPI in order to estimate starting prices for the DPP.

Closing Remarks

19. If you have any queries in relation to this submission, please contact me.

Yours sincerely



Geoff Evans
General Manager