

Amendments to input methodologies for gas distribution and transmission services

Reasons paper

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Section One: Introduction

Purpose of this paper

1. This paper sets out the reasons for amendments to the input methodologies applying to suppliers of gas distribution and gas transmission services.

Overview of amendments

2. We have amended the input methodologies to make changes to provisions that will apply to the default price-quality paths for suppliers of gas pipeline services.¹ We have also taken this opportunity to correct for some errors in the input methodologies.
3. The amendments are given effect to by the Gas Pipeline Services Input Methodologies Determination Amendment (No. 1) 2013, [2013] NZCC 3 (“the Amendment”).
4. A summary of the amendments provided by this decision are set out below.
 - 4.1 The definition of recoverable costs for gas transmission services is revised to include a reference to ‘welded’ parties for the recovery of balancing gas costs.
 - 4.2 The definition of notional deductible interest is revised to apply a mid-year cash flow timing assumption in respect of notional interest expenditure when calculating the tax allowance for gas distribution and gas transmission services.
 - 4.3 The definition of pass-through costs for gas transmission services is revised to allow the pass-through of Electricity and Gas Complaints Commission levies.
 - 4.4 The taxation input methodologies for gas distribution and gas transmission services are corrected to prevent the term credit spread differential allowance being deducted twice in the calculation of the regulatory tax allowance.
 - 4.5 The bold emphasis of controllable opex for customised price-quality paths is removed, as it is not a defined term.
 - 4.6 References to electricity distribution services in the gas distribution services input methodologies are corrected to refer to gas distribution services.
5. The reasons for each amendment are set out in Section Two of this paper.

¹ The default-price quality paths are expected to have effect from 1 July 2013.

Determinations affected by these amendments

6. The Amendment takes effect immediately and updates input methodologies contained in the principal determinations below:
 - 6.1 Gas Distribution Services Input Methodologies Determination, [2012] NZCC 27
 - 6.2 Gas Transmission Services Input Methodologies Determination, [2012] NZCC 28

Section Two: Reasons for amending input methodologies

7. This section provides reasons for the decision to amend the input methodologies. In making these decisions, we have considered submissions provided to us on our consultation draft published 21 December 2012.^{2 3}

Revised definition for recovering balancing gas costs for gas transmission services

8. The definition of recoverable costs is amended to refer to the recovery of balancing gas costs or credits from welded parties, as well as shippers, on a supplier's network.⁴ Welded parties are defined as those entities having an interconnection agreement with the gas transmission business.
9. The previous definition did not recognise that the majority of Maui Development Limited's (MDL) balancing gas costs are recovered from welded parties, and not shippers.⁵ Without an amendment:
- 9.1 MDL would have been potentially able to recover its balancing costs twice—via recoverable costs as well as the prices it charges its consumers—if it was owed amounts allocated to welded parties; or
- 9.2 MDL would not be able to recover other legitimate recoverable costs if it owed amounts to welded parties. These would produce a negative recoverable cost amount for balancing gas, reducing the overall recoverable cost amount.
10. We consider the amended definition appropriately reflects that suppliers should be able to recover balancing costs on their network where these are unallocated (and would otherwise be unable to be recovered under the default price-quality path), and where these costs are allocated, these costs do not need to be considered as a recoverable cost.
11. The amendment takes into account drafting suggestions proposed by MDL in its submission of 1 February 2013, including removing "gas balancing" from the definition of "system management and operations opex" in schedule D, clause D1.⁶

² Commerce Commission, *Potential amendments to input methodologies for gas pipeline services for February 2013 Consultation Paper*, 21 December 2012.

³ We received submissions on the consultation draft from MDL, Vector, Powerco, GasNet and ENA. These submissions are available at <http://www.comcom.govt.nz/amendments-and-clarifications/> under "Submissions on potential amendments to input methodologies for gas pipeline services – 13/02/2013".

⁴ Shippers and welded parties are customers of the Maui pipeline. A shipper is a party that transports gas through the pipeline and a welded party is a party responsible for the physical transfer of gas into, or out of, the pipeline.

⁵ Maui Development Limited, *Submission on Draft Reasons Paper for "Initial Default Price-Quality Paths for Gas Pipeline Businesses"*, 19 December 2011.

⁶ Maui Development Limited, *Submission on proposed amendments to input methodologies for gas pipeline services*, 1 February 2013.

Mid-year cash flow timing assumptions for notional deductible interest payments

12. The definition of notional deductible interest used in the treatment of taxation input methodologies is amended to apply a mid-year cash flow timing assumption to the calculation of notional interest amounts.
13. Mid-year timing assumptions more accurately reflect when suppliers would typically receive and make payments over time. For notional deductible interest, the amendment recognises that suppliers pay interest during the year, and the amount paid will be less than if payment were to be made at year-end.⁷ The amendment also aligns the timing assumptions for the interest tax deductions with the mid-year timing assumptions adopted for some other cash flows within the input methodologies.
14. To give effect to the mid-year timing assumptions, we have revised the formula for the calculation of interest payments in the input methodologies applying to information disclosure, default price-quality paths, and customised price-quality paths for both gas distribution and gas transmission services. Table 1 below sets out these revisions below.

Table 1: Revised formula for calculating notional deductible interest amounts

Information disclosure clause 2.3.4(2) for gas distribution clause 2.3.1(5) for gas transmission	$\frac{((\text{regulatory investment value} \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance})}{\sqrt{1 + \text{cost of debt}}}$
Default price-quality paths clause 4.3.3(2) for gas distribution clause 4.3.4(1) for gas transmission	$\frac{((\text{opening investment value} \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance})}{\sqrt{1 + \text{cost of debt}}}$
Customised price-quality paths clause 5.3.16(2) for gas distribution clause 5.3.13(5) for gas transmission	$\frac{(((\text{regulatory investment value} + \text{RAB proportionate investment}) \times \text{leverage} \times \text{cost of debt}) + \text{term credit spread differential allowance})}{\sqrt{1 + \text{cost of debt}}}$

15. Notional interest payments in the above formulae are assumed to be made continuously through the year at a constant rate (which would be closely equivalent to a single interest payment being made at mid-year). The interest payment is then discounted for half a year using the debt rate as a discount factor.

⁷ This position is supported by Vector in its submission on the October 2012 Revised draft decision for the gas default price-quality paths. See: CEG, *Default price-quality path reset for gas pipelines November 2012* (on behalf of Vector Limited), 10 December 2012.

16. The amendment takes into account suggestions by ENA in its submission of 1 February 2013.⁸

Gas transmission businesses may now pass-through Electricity and Gas Complaints Commission levies

17. The definition of pass-through costs for gas transmission services is amended to allow for the recovery of Electricity and Gas Complaints Commission (EGCC) levies.
18. Gas transmission businesses have become members of the EGCC since the input methodologies were first determined. The amendment allows gas transmission businesses to recover the costs of EGCC membership the same as gas distribution businesses and electricity distribution businesses that already have EGCC levies as a pass through cost.

Correction of errors in the determinations

19. The input methodologies for gas distribution and gas transmission services have also been amended to make the error corrections set out below.

Correcting the calculation of the regulatory tax allowance

20. The taxation input methodologies for gas distribution and gas transmission services are amended to correct an error which effectively allowed the term credit spread differential allowance to be treated as a tax deduction twice in the calculation of the regulatory tax allowance.
21. The input methodologies had previously been drafted so that the term credit spread differential was included in both the definition of notional deductible interest, and the definition of regulatory profit / (loss) before tax.⁹ This was in error as the calculation of the regulatory tax allowance should only incorporate a tax deduction for the term credit spread differential allowances once.
22. We have removed the reference to the term credit spread differential in the expressions of 'regulatory profit / (loss) before tax' to correct this error.

Removing the bold emphasis for controllable opex

23. The bold emphasis of controllable opex in clause 5.3.1(1)(a), and D16(a) and (b), for each relevant methodology determination has been removed. Controllable opex is not a defined term and the bold emphasis is in error.

⁸ ENA, *Submission on proposed amendments to input methodologies for gas pipeline services*, 1 February 2013.

⁹ Notional deductible interest is set out in clause 4.3.3(2) for gas distribution services, and clause 4.3.4 for gas transmission services. Regulatory profit / (loss) before tax is set out in clause 4.3.1.(4) for both services.

Correcting references to electricity distribution services

24. References to electricity distribution services in clause 2.2.4(4) in the input methodologies for gas distribution services have been amended to correctly refer to gas distribution services.