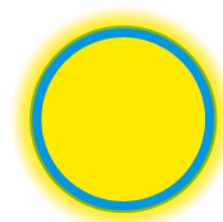


21 December 2012

John McLaren
Chief Adviser
Regulation Branch
Commerce Commission
Wellington 6140

[Sent by email to: Regulation.branch@comcom.govt.nz]



Dear John,

Cross submission on submissions to the *Draft Decision on Initial DPPs for Gas Pipeline Businesses*

Powerco welcomes the opportunity to provide a cross submission on responses to the Commerce Commission's (Commission) consultation document *Draft Decision on Initial DPPs for Gas Pipeline Businesses* (Draft Decision). This submission:

- notes Contact Energy's and Genesis Energy's comments on the value of including reliability measures in the quality path, restates why Powerco disagrees with this, and notes that we look forward to discussing with retailers and the Commission the merits of different quality path metrics for the 2017 reset;
- disagrees with Contact Energy's criticism of the restrictions applying to comparative benchmarking in the DPP, given the differing roles of the DPP and CPP in the regulatory regime;
- notes the Major Gas Users Group's concerns about the possible ways in which price changes might be allocated between different categories of consumers, and our own view that the current regulatory mechanisms which require transparent pricing methodologies and pricing principles are sufficient to deal with these concerns;
- disagrees with Vector Limited's (Vector) recommendation to update the operating expenditure forecast base year to 2012 information as the Commission has just issued a s53ZD notice with a challenging timeframe and Powerco has very limited capacity to provide more information before the default price-quality path (DPP) final decision on 28 February 2012; and
- notes that the publication of the final *Gas Supply and Demand Scenarios 2012-2027* report by Concept Consulting does not provide any material additional information to the draft report, and that the arguments in our submission of 7 December 2012 are still applicable.

Support for reliability measures in the quality path by Genesis Energy and Contact Energy

Genesis Energy and Contact Energy both comment on the value of including reliability measures in the gas DPP quality path. Genesis Energy also mentions the attractiveness of having an integrated price-quality path in the future.

Powerco agrees that reliability is one potential metric that could be included in the quality path, but in our submission on the Draft Decision we outlined a number of concerns we have about using this measure (e.g. weak linkage to investment, volatility and normalising difficulties, and the level of importance to consumers)¹. We recognise, however, that there will need to be a detailed discussion on gas quality metrics for the reset in 2017 and we are encouraged that retailers have shown an interest in this matter, as they provide an additional customer's perspective. We look forward to working with the Commission and retailers in the future to refine the DPP quality path in 2017.

Comparative benchmarking restriction

Contact Energy has suggested that the Commission request the removal of the prohibition contained in s53P(10) of the Act on the use of comparative benchmarking of efficiency in order to set starting prices, rates of change, quality standards or incentives to improve quality of supply. The restriction on comparative benchmarking however, is an integral aspect of the balancing act in the DPP/ CPP regulatory package between a low-cost DPP with lighter information demands and a higher cost, information intensive CPP.

Before the restriction on comparative benchmarking was inserted into the Commerce Amendment Bill, the Bill restricted the Commission from using its statutory powers to obtain information for the purpose of setting default paths for electricity lines and gas pipelines. This restriction was in the Bill because of concerns the Commission would make extensive use of its powers to require businesses to provide large volumes of information and this would be inconsistent with the low-cost nature of the DPP. Once the restriction on the use of comparative benchmarking was added to the Bill, the Commerce Committee no longer saw the need to restrict the Commission from using its statutory powers to obtain information for setting DPPs, as it is the exercise of benchmarking that is especially information intensive. To now remove that restriction would be to disrupt the carefully considered and deliberate balance between the DPP and CPP, which is a major structural part of the price control provisions in Part 4.

Powerco also notes that the difficulty of properly correcting for the different circumstances of EDBs/GPBs ('normalising'), and the substantial informational needs required for that exercise, was another key reason for restricting the use of benchmarking. There have been no significant changes in the industry or benchmarking methods that undermine that legitimate concern.

Price changes for groups of consumers

The Major Gas Users Group raised a concern about how the overall starting price change could be split between different user groups, specifically that residential and commercial customers might receive discounts at the expense of industrial users.

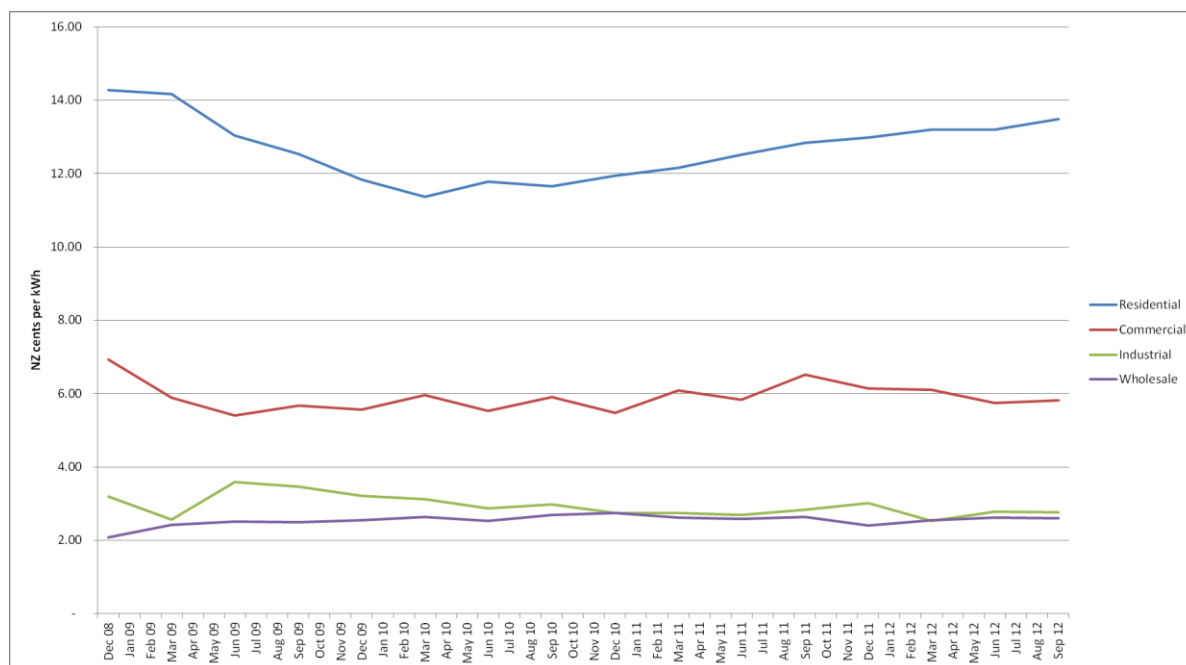
Figure 1 provides the nominal quarterly average price of natural gas for the main classes of consumers from December 2008 to September 2012. This diagram shows that residential and commercial prices have not reduced at the expense of industrial users – in fact, the relative prices applying to the different customer classes have not changed significantly over the period as a whole.

Powerco notes that the Commission requires pricing principles to be adhered to and pricing methodologies to be disclosed, and that this makes the pricing function transparent. The new information disclosure requirements will provide extensive information on the allocation of charges between the main classes of gas consumers. The Commission's current approach achieves an appropriate balance between

¹ Powerco Limited, *Submission on Initial DPPs for Gas Pipeline Businesses*, 7 December 2012, p18.

retaining the ability of pipeline operators to develop pricing arrangements that are suitable to their own and their customers particular circumstances, and the right of customers to be able to confirm that their prices are being determined fairly. The full disclosure of both charges and the pricing methodology being applied provides customers and the Commission with the ability to confirm that suppliers' pricing arrangements are efficient and fair.

Figure 1: Nominal average price for natural gas (December 2008 – September 2012)



Source: Ministry of Business, Innovation and Employment, *Data tables for prices, September 2012* available at: <http://www.med.govt.nz/sectors-industries/energy/energy-modelling/data/prices>.

Late entry into the process by Contact Energy

We note that Contact Energy's submission has repeated a number of comments made in its submission of 2 October 2012 on the electricity DPP starting price adjustment draft decision. Powerco's response of 16 October 2016 addressed many of the points Contact made. For ease of reference, the relevant section of our cross submission is provided below:

Contact Energy's claim that there is a bias in the process does not hold true to us. In fact, we believe the position to be quite the opposite – the Commission has been more than even-handed throughout the process. Part 4 requires the Commission to steer a regulatory course which ensures suppliers have incentives to invest in their business while limiting suppliers' ability to extract excessive profits. While Powerco does not always agree that the Commission's decisions plot that course correctly, there is no suggestion that the Commission does not have paramount in its mind the long term interests of consumers.

Powerco does, however, understand Contact Energy's concern to ensure that consumers are appropriately engaged with the process. We agree that consumer engagement is important in a regime that is focused on promoting their interests.

Although it is probably too late for this reset, Powerco would welcome the Commission looking at ways it can engage with consumers for the next reset. This doesn't necessarily mean funding a consumer advocate or requiring consumer groups to hire experts and duplicate the work of the Commission (or companies), but rather working with consumers to articulate the regulatory choices in terms that consumers can engage with. The price-quality trade off is a good example of a choice that consumers can

readily understand and contribute their views to. The timing of recovery is another area that consumers will no doubt be interested in.²

Operating expenditure forecast

We first note that there are several areas where Powerco's recommendations on the operating expenditure forecast align with those of other submitters. For example, Vector also supports using a single base year rather than an average, and Gasnet has raised concerns about how step changes in opex due to increased regulatory requirements (which are not linked to scale) will be accommodated.

There are also some areas where our recommendations diverge, for example, Vector has proposed updating the opex forecast base year to 2012 information. Powerco is comfortable with using the 2011 year, and, given that the Commission has just issued a s53ZD information request with a very challenging timeframe, Powerco has very limited capacity to provide further information by 1 February 2013. While in most circumstances we would support the use of the latest information, any further demands on our resources would be difficult to meet. Accordingly, we strongly recommend the 2011 base year be retained.

Publication of Concept final report

Since Powerco made its submission on the Draft Decision, the Gas Industry Co has published Concept Consulting's final report, *Gas Supply and Demand Scenarios 2012 - 2027*. Our review of section 3.4 on demand forecasts for industrial, commercial and residential users finds no material changes between the draft report and the final report. Consequently, the arguments in our submission of 7 December 2012 are still applicable to the final report. We also note that Vector's historical gas growth is also more consistent with the "tight" Concept Consulting scenarios, adding further evidence that this is a better forecast of volume growth than the "moderate" scenario.

Yours sincerely



Richard Fletcher
General Manager, Government Relations and Regulation

² Powerco Limited, *Cross Submission to Revised Draft DPP Reset*, 17 October 2012.