

18 February 2013

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By email

Dear Mark

Submission on the technical consultation on the Initial Default Price-Quality Paths for Gas Pipeline Services

1. Following the October 2012 consultation on the “Revised Draft Decision on the Initial Default Price-Quality Paths for Gas Pipeline Services”, (the Revised Draft Decision), the Commerce Commission (the Commission) has now published a technical update paper and accompanying draft determination for further consultation: “How we propose to implement the Default Price-Quality Paths for Gas Pipeline Services, 8 February 2013” (the Update Paper) and “Gas Distribution Services Default Price Path Determination 2013, Technical Consultation Draft, 8 February 2013” (the Technical Consultation Draft).
2. This submission forms GasNet’s response to the issues raised in the Update Paper and Technical Consultation Draft. It addresses the matters most relevant to our business. In particular, the proposed approach to applying claw-back under section 55F(2) of the Commerce Act 1986 (the Act).
3. Before addressing these matters, we would like to thank the Commission for resolving a number of the issues raised in our previous submission on the Revised Draft Decision. In particular, we note and support:
 - the extended compliance time-frame of 50 business days
 - the Commission’s consideration of the supplementary information we provided under the section 53ZD information notice regarding the incremental regulatory costs GasNet will face under Part 4 regulation
 - expression of the Maximum Allowable Revenue (MAR) in millions to 3 decimal places.

Claw-back

4. Section 55F(2) of the Act sets out that claw-back may be applied to a Gas Pipeline Business (GPB) where weighted average prices have increased by more than CPI between 1 January 2008 and the date when a DPP Determination comes into force:

... if a supplier has increased its weighted average prices by more than the movement, or forecast movement, in the all groups index number of the New Zealand Consumer Price Index in the period beginning 1 January 2008 and ending with the date that the determination is made, the Commission may apply claw-back to the extent of requiring the supplier to lower its prices in order to compensate consumers for some or all of any over-recovery of revenues that occurred during that period

5. In its Revised Draft Decision the Commission proposed that claw-back be applied to GasNet over the period 1 October 2008 to 30 September 2012. This was to be recovered in equal instalments over the four remaining DPP assessment periods, commencing 1 July 2013. The Technical Consultation Draft revises the original claw-back proposal by amending the formula as follows¹:
 - The assessed claw-back period is extended five months to 28 February 2013 based on the expected date that a DPP determination will be made
 - A new Regulated Revenue (RR_t) term is introduced which is derived by escalating 2007/08 net revenue (i.e. representing base year prices) by annual movements in CPI and weighted quantity growth. This is compared with GasNet's historical net revenue (NR_t) in order to assess the extent of claw-back over the claw-back assessment period.

Full recovery of claw-back is retrospective and inconsistent with the purpose of Part 4

6. GasNet maintains that the imposition of the proposed claw-back approach is unduly retrospective. As we previously submitted the majority of the proposed claw-back amount relates to price increases that took effect on 1 October 2008, 12 working days after the Commerce Amendment Act 2008 (the Amendment) gained assent into Parliament on 16 September 2008. GasNet's decision to increase prices on 1 October 2008 was committed to prior to the date of assent given we had to notify retailers two months prior to the price change (i.e. by 31 July). Our decision was made at a time when it was not clear whether or how we would be regulated under the then proposed regulations. Similarly, revenue attributed to this price increase was earned prior to the 1 April 2009 commencement date for the Amendment.
7. The claw-back approach proposed in the Technical Consultation Draft is therefore being assessed against pricing decisions made prior to the legislation being enacted and prior to GasNet having full knowledge of the new requirements. This is unfairly retrospective in our view.
8. Pricing decisions which we have made since the Amendment came into force have been made broadly consistent with the intent of section 55F(2). We understand this intent was to incentivise GPBs to hold prices constant in real terms to avoid excessive profits being made prior to an initial DPP determination. GasNet's pricing decisions are consistent with this purpose in that we have tried to maintain prices in real terms since the Amendment came into force.
9. Further, as we have previously submitted, there has been no assessment as to whether the decision to apply claw-back is consistent with subparts b), c) and d) of the Part 4 Purpose Statement. We consider that claw-back should not be applied where it is inconsistent with the purpose of Part 4. In this respect, it appears incongruous that the Revised Draft Decision found GasNet's 2013 prices to be broadly consistent with an assessed Maximum Allowable Revenue (MAR)² (which the Commission considers to be calculated consistent with the purpose statement), yet claw-back was proposed on historical prices that are materially similar to this MAR (in real terms after accounting for growth).

¹ Schedule 6 of the Technical Consultation Draft

² subject to a relatively small minus 2% price adjustment

10. To illustrate this inconsistency, we adjusted GasNet's revised draft 2013 MAR figure of \$4.4m by backing out annual movements in CPI and GasNet's revenue weighted growth. This produced a real, growth adjusted 2013 MAR estimate for each pricing period between 1 October 2008 to 28 February 2013. The present value of this adjusted MAR series was then compared with that of our estimated Regulated Revenue ($RR_{2009}-RR_{2013}$) and Net Revenue ($NR_{2009}-NR_{2013}$) over the same period and calculated consistent with schedule 6 of the Technical Consultation Draft. This analysis shows that the adjusted MAR series was over 5% higher than the assessed Regulated Revenue but just over half a percent lower than Net Revenue³. This suggests that the proposed claw-back approach is materially inconsistent with the adjusted 2013 MAR and is therefore potentially inconsistent with the purpose of Part 4 to the detriment of GasNet.
11. Interestingly, if prices that were effective 1 April 2009 (i.e. the Amendment commencement date) are adopted as base year prices for the calculation of RR_t (i.e. $RR_{2009} = NR_{2009}$), then the difference between the present value of the adjusted MAR and RR becomes immaterial (i.e. less than half a percent difference). This suggests that the adoption of NR_{2009} as the base year is more consistent with the 2013 assessed MAR and potentially with the purpose of Part 4.
12. As we have previously submitted, the Commission has discretion under section 55F(2) to partially apply claw-back or not apply it at all⁴. An alternative approach could therefore be adopted which partially recoups claw-back in order to address the retrospective nature of the current proposal and which better gives effect to the purpose of Part 4 regulation.
13. Accordingly, we do not support the current proposal to seek recovery of claw-back from GasNet prior to the Amendment commencement date. Instead, we recommend that claw-back be assessed against base-year prices that applied at 1 April 2009 (the date the Amendment came into force), rather than those applying at 1 January 2008 under the current proposal. Practically, this will mean the formula proposed in the Technical Consultation Draft would need to be amended to make $NetRev_{2009}$ the base year instead of $NetRev_{2008}$ (i.e. $RR_{2009} = NR_{2009}$). Claw-back would then be assessed over a period of 3 years and 5 months (i.e. between 1 October 2009 and 28 February 2013).
14. We would be happy to provide further information to assist the Commission in making its decision on this matter.

Discounting timing factors

15. Despite the changes made to the claw-back formula in the Technical Consultation Draft, we maintain that the formula is flawed in that it does not resolve the discount rate timing factor issues identified in our previous submission⁵, including that:
 - The proposed timing factors for calculation of CR_t incorrectly assumes revenue is received prior to the start of the pricing year
 - the calculation of claw-back is inconsistent with the mid-period discounting assumption used for the calculation of the MAR, which adjusts the discount timing factors to better reflect the typical billing cycle in which revenue is received 20 days after the end of each month.

³ Assuming zero growth between 1 October 2012 and 28 February 2013

⁴ In particular, we note the wording "...the Commission *may* apply claw-back...for *some or all* of any over-recovery of revenue"

⁵ GasNet Submission on the Revised Draft Decision, 7 December 2012, paragraphs 18-24

16. Our preliminary analysis shows that these timing factor errors over-estimate claw-back. We therefore submit that the Commission reconsider the claw-back formulas to address these issues.

CPI

17. The definition of CPI used in the proposed schedule 6 claw-back calculation is now based on the IM definition of CPI, which makes an adjustment to the standard 'CPI All Groups Index SE9A' for the 2010 GST increase. We do not support this adjustment being made for the purpose of calculating claw-back. This is because it is inconsistent with a plain reading of section 55F(2), which only refers to the unadjusted "all groups index number of the New Zealand Consumer Price Index". We propose that the definition of CPI used in the definition of claw-back refer to the "CPI All Groups Index SE9A", consistent with section 55F(2) of the Act.

Net Revenue

18. The Technical Consultation Draft redefines net revenue ($NetRev_t$) to exclude 'other regulatory income'. We welcome this change. However, upon further consideration we believe it may be more appropriate to define net revenue with direct reference to 'price' as already defined under the IMs. We see this as preferable as the definition of price:
- already excludes 'other regulatory income'
 - excludes other cash-flows and considerations including investment income, capital contributions, and vested assets
 - aligns more closely with the intent of section 55F(2) which refers specifically to 'weighted average prices' for gas distribution services
 - aligns the calculation of claw-back with the DPP mechanism in which claw-back is returned to consumers through 'prices' as a recoverable costs.

19. Accordingly we propose the following definition for $NetRev_t$:

*"...the actual revenue from **prices** paid or payable less actual **pass-through costs** and **recoverable costs**"*

Closing Remarks

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

Yours sincerely



Geoff Evans
General Manager