

7 December 2012

John McLaren
Chief Advisor
Regulation Branch
Commerce Commission
P O Box 2351
Wellington

Dear John

Re: Revised Draft Decision on the Initial Default Price Quality Paths for Gas Pipeline Services

1. This following submission is being made on the Commerce Commission Discussion Paper dated 24 October 2012 by Hale and Twomey Ltd/Aretê Consulting Ltd on behalf of the Major Gas Users Group (MGUG):
 - a. Fonterra Co-operative Group Ltd
 - b. Carter Holt Harvey Ltd
 - c. New Zealand Steel Ltd
 - d. Refining NZ
 - e. Ballance Agri-Nutrients Ltd
 - f. New Zealand Sugar Company Ltd
2. MGUG was established in 2010 and has as one of its aims the promotion of effective/efficient market arrangements for delivery of natural gas. As such we welcome the opportunity to comment on the revised draft decision as members of the group are substantial users of gas and will be directly impacted by the regulatory instruments being developed by the Commission for suppliers of gas pipeline businesses. While these views are expressed to be on behalf of the group we note that members may have individual views on matters contained within this submission which they may choose to provide to the Commission directly.
3. Our main submission point is that we support the Commission's draft decision and also its reasoning with respect to starting price adjustments, rate of change, and quality standards. We say this in an environment where members of the Group, who make up a significant proportion of New Zealand's productive export sector, face continuing cost increases from suppliers of monopoly services able to achieve rates of return that are do not reflect the risks that would typically be faced by private sector firms. We also note the high level of information asymmetry which exists around gas pipeline services including the lack of clarity around access and pricing which undermines confidence in the availability of competitive gas supply.

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4. MGUG however has a number of comments on matters of implementation and detail it wishes to put to the Commission. These include:
 - a. The ability of monopoly suppliers to set prices in a way that prevents or limits captured market segments from being able to access the benefit of the reduction in revenue proposed by the Commission.
 - b. Claw-back provision for excessive overtake of revenue in period 1 January 2008 – 30 September 2012.
 - c. Our comments in relation to incentives based regulation, quality, demand forecasting

5. **Part 4 Purpose**

- a. The Commission refers (1.12) to consistency with s 52A (1) (purpose of Part 4) of the Commerce Act as a guiding principle in setting the initial default price-quality paths. Effectively this means that consumers would expect to see outcomes that are consistent with outcomes in a competitive market.
- b. However, in arriving at its conclusions the Commission appears to accept that benefits (or dis-benefit) might accrue differently in different market segments by tacitly acknowledging the freedom that pipeline owners have to decide how to spread prices across their customer base.
- c. The MGUG concern is that pipeline owners can use their market power to bolster demand for pipeline services from market segments (such as residential and commercial customers), where there are low barriers to switch to alternative energy sources, by reducing pricing whilst holding or boosting pricing in a captive market segment¹.
- d. We would note that some of our member's have already experienced this directly during the period 1 January 2008 to 30 September 2012 when GPB revenue increases were capped at CPI, yet costs to individual sites grew by significantly more than CPI.
- e. If the purpose of the regulation is to give effect to s 52A and the Commission has determined significant downward price adjustments for Vector's distribution and transmission networks, indicating significant past revenue over recovery including from our members, our members expect that the Commission's decision should be providing relief from excessive pricing going forward.

¹ GPBs can do this through discriminatory allocations within load groups to single out large users in the case of distribution pipelines, or the use of supplementary agreements, and/or price discrimination on different parts of the transmission network to isolate charges to industrial customers.

- f. Accordingly, as a matter of principle the MGUG is asking the Commission to ensure that the benefits of lower pricing be distributed equally across the customer base.

6. **Claw-back**

- a. Whilst the MGUG understands that the principles of claw-back are only applicable where GPBs have increased their revenues by more than CPI during the period 1 January 2008 to 30 September 2012 we are concerned that over this period our members (and other consumers) have seen their distribution and transmission costs increase by more than CPI (excluding volume effects). Furthermore the size of the downward adjustment on Vector's systems in particular suggests that the prices applying from 1 January 2008 were already excessive and unjustified i.e. Vector was already over-recovering and continued to do so through the period 2008 to 2012.
- b. To the extent that the GPBs have *engaged in conduct* (Section 2(2)) through contract provisions that have over-recovered revenues through this period (regardless of whether or not price increases over the 2008-12 period were greater than inflation) MGUG asserts that the Commission should (within the intent of s 52D (Meaning and Application of claw-back)) apply claw back over the 2008-2012 period "to compensate consumers for some or all of any over-recovery that occurred under the prices previously charged by the supplier" (s 52D(1)(a)).

7. **Other Matters**

- a. We agree with the Commission's reasoning and decision to base starting prices on s 53P(3)(b) of the Act.
- b. We accept the Commission's reasoning and decision to propose an industry wide X factor, rather than consider it from an individual enterprise perspective. Our submission on the November 2011 paper argued that the number of businesses was sufficiently small, and the environment sufficiently stable, to consider each business separately with respect to determining X factors. However in the context of starting price adjustment being the main objective and the duration of the first regulatory period being relatively short we consider the Commission's decision to apply an industry X factor to be a pragmatic one.
- c. We agree with the Commission's pragmatic approach to setting quality standards for the first regulatory period.
- d. We agree with the Commission's reasoning and decision on the role of customised price-quality paths.
- e. We agree with the Commission's views about alternative incentive mechanisms. Although there may be ways to finesse the regulatory incentives to achieve a better overall outcome these adjustments are better based on experience from the first regulatory period in an actual New Zealand market context.

- f. **C11 – MDL Compressor Fuel.** We are not sure why compressor fuel for MDL is not considered a base opex item. The fact that the Commission is silent on how it treats Vector’s compressor fuel within its base opex determination suggests that it may have accepted that it is a legitimate opex for Vector to include. MDL requires compressor fuel to transport gas along the Maui pipeline in order to provide the service. If MDL can demonstrate that compressor fuel is no longer “free” going forward we suggest that it would be unreasonable to exclude an allowance for this cost. On the second point whether \$1.87 million is appropriate we suggest that the commission reviews MDL’s historical compressor fuel use to determine a reasonable quantity and either use an estimated market price for gas (possibly the MBIE published Energy Data File wholesale gas price) or an actual quoted price for MDL, whichever is lower.
- g. **Attachment E: Reasons for applying revenue cap to transmission services.** The MGUG has submitted twice already that a weighted average price cap should apply to Vector’s transmission business. We remain sceptical of the Commission’s view that a revenue cap is more suitable because it is difficult to forecast demand and hence revenue for Vector’s systems over the first regulatory period. Our reasoning in support of weighted average price cap was laid out to the Commission in our November 2011 submission.

We don’t propose to repeat the points here because they don’t add any more information not already provided to demonstrate the stability of gas conveyed and revenue over the last 10 years including a period of extreme volatility in electricity generation and petrochemical production cited as key reasons against a weighted average price cap. In fact it is our contention that it is just as, and perhaps more, difficult to predict demand on a distribution system (which uses a weighted average price cap) for individual suppliers than a transmission system yet the Commission accepts that distribution systems should be subject to a weighted average price cap.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J. Hale', with a stylized, cursive script.

Hale & Twomey Ltd/Arete Consulting Ltd
For the Major Gas Users Group