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Potential amendments to input methodologies for gas pipeline services for February 2013

Consultation paper

Amendments proposed to be made under s 52X of the Commerce Act 1986 to the input methodologies for default price-quality paths and customised price-quality paths for gas distribution and gas transmission services.

Date: 21 December 2012

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Purpose of this paper

1. This paper proposes amendments to the input methodologies applying to suppliers of gas transmission and gas distribution services. Any amended input methodologies will apply to the initial default price-quality paths for gas pipeline businesses scheduled to be determined by 28 February 2013.
2. We invite your views on the proposed amendments—submissions are due 1 February 2013.

Overview of the proposed amendments

3. We propose to amend a limited number of input methodologies applying to suppliers of gas pipeline services to:¹
 - 3.1 update the definition of balancing gas set out in clause 3.1.3(1)(c) to include balancing costs from welded parties;
 - 3.2 adjust the relevant definitions of notional deductible interest for the treatment of taxation to reflect a mid-year cash flow timing assumption;
 - 3.3 include Electricity and Gas Complaints Commission levies for gas transmission services as pass through costs under clause 3.1.2(2)(b);
 - 3.4 remove an erroneous tax deduction term for calculating the term credit spread differential allowance in clause 4.3.1(4);
 - 3.5 remove the bold emphasis of controllable opex for customised price-quality paths where relevant; and
 - 3.6 correct references to electricity distribution services in clause 2.2.4(4) to gas distribution services and gas transmission services.
4. The Commission is in the process of determining default price-quality paths for suppliers of gas pipelines services. The amendments proposed above were identified in consultation on the default price-quality paths and require correction or updating before the default price-quality paths are determined. The initial default price-quality paths will therefore apply any amendments determined prior to that date.

Discussion of the proposed amendments

5. This section sets out the amendments proposed including drafting changes to the relevant input methodology determinations where possible.

¹ The input methodologies applying to suppliers of gas pipeline services are set out in *Gas Transmission Services Input Methodologies Determination 2012 NZCC 28*, and *Gas Distribution Services Input Methodologies Determination 2012 NZCC 27*.

Amending the definition of balancing gas

6. We propose that the definition of balancing gas for suppliers of gas transmission services be amended to refer to the recovery of balancing gas costs from welded parties, as well as shippers, on a supplier's network.²
7. The current definition of balancing gas does not reflect that the majority Maui Development Limited's (MDL) balancing gas costs are recovered from welded parties. This is evidenced in MDL's submission on the initial default price-quality paths below.³

MDL does not allocate balancing gas to shippers. (The only theoretical exception would be shipper mismatch under section 11 of the MPOC, but this mechanism is not used in practice.) MDL's balancing regime is set out in the MPOC. It is fairly complex and subject to ongoing change discussions. The outcome of that regime is that balancing costs of MDL are recovered to the extent possible from Welded Parties through a system of cashouts and incentives pool debits and credits. However, there is not necessarily a direct relationship between the balancing actions taken by MDL and the balancing charges assessed against Welded Parties.

8. An amendment is appropriate as MDL already recovers balancing gas costs from welded parties on its network, and these costs should not also be considered a recoverable cost for the default price-quality paths. We are satisfied that including welded parties in the definition of balancing gas is consistent with the reasoning set out in Appendix J, paragraphs J2.31-J2.34 of the input methodologies reasons paper.⁴
9. To include welded parties in the definition of balancing gas we propose clause 3.1.3(1)(c) of the gas transmission input methodologies be amended so that balancing gas is:

A cost or credit arising from the GTB's purchase or sale of balancing gas that has not been:

- (i) allocated to a person shipping gas on the GTB's network; or
- (ii) recovered from or credited to persons having an interconnection agreement with the GTB, subject to the requirement specified in subclause (2);

Amending the definition of notional deductible interest to reflect a mid-year cash flow timing assumption

10. We propose to amend the definition of notional deductible interest used in the treatment of taxation input methodologies to apply a mid-year cash flow timing

² Shippers and welded parties are customers of the Maui's 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.

³ Maui Development Limited, *Submission on Draft Reasons Paper for "Initial Default Price-Quality Paths for Gas Pipeline Businesses"*, 19 December 2011.

⁴ Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons paper*, 23 December 2010.

assumption to the calculation of interest payments. The current input methodologies assume year-end payments rather than payments being made during the year.

11. Mid-year timing assumptions recognise that suppliers will pay interest during the year, and the amount paid will be less than if payment were to be made at year-end. Vector submitted via Competition Economists Group (CEG) that deductible interest payments should be assumed to be made during the year rather than at year-end.⁵ An amendment would also align the timing assumptions for the interest tax deductions with the mid-year timing assumptions adopted for other cash flows within the input methodologies.⁶
12. We propose that the expression for notional deductible interest in the input methodologies be amended to the following:⁷

((opening investment value × leverage × cost of debt) + term credit spread differential allowance) / SQRT(1 + debt rate)
13. The proposed amendment above assumes interest payments are 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 at the debt rate, and the interest payable is then reduced (relative to a year-end amount) by a factor of 1 / SQRT(1 + debt rate).
14. For reference, notional deductible interest is defined in the input methodologies in the following clauses:

	Gas distribution	Gas transmission
Information disclosure	2.3.4(2)	2.3.1(5)
Default price-quality paths	4.3.3(2)	4.3.4
Customised price-quality paths	5.3.16(2)	5.3.13(5)

⁵ CEG, *Default price-quality path reset for gas pipelines November 2012* (on behalf of Vector Limited), 10 December 2012.

⁶ Commerce Commission, *Electricity and Gas Input Methodologies Determination Amendments (No.2) 2012 Reasons Paper*, 16 November 2012.

⁷ Note that this amendment would mean the adjustment factor applies to the term credit spread differential allowance as well as the main interest payment. This is appropriate as the term credit spread differential allowance is an interest amount.

Including Electricity and Gas Complaints Commission levies as a pass through cost for gas transmission services

15. We propose to amend the gas transmission services input methodologies determination to include Electricity and Gas Complaints Commission (EGCC) levies as a pass through cost for suppliers of gas transmission services.
16. The proposed amendment reflects that gas transmission businesses have become members of the EGCC since the input methodologies were first determined. We consider gas transmission businesses should be able to recover the costs of membership similar to gas distribution businesses and electricity distribution businesses that already have EGCC levies as a pass through cost.
17. To allow gas transmission businesses to recover the EGCC levies we propose that clause 3.1.2(2)(b) be amended to read:

For the purpose of subclause (1)(a), the costs are-

(a) rates on system fixed assets paid or payable by a GDB to a local authority under the Local Government (Rating) Act 2002; and

(b) levies payable-

(i) under regulations made under s 53ZE of the Act;

(ii) under regulations made under the Gas Act 1992;

(iii) the Commerce (Levy for Control of Natural Gas Services) Regulations 2005;
or

(iv) by all members of the Electricity and Gas Complaints Commissioner Scheme by virtue of their membership.

Correcting the treatment of taxation so the term credit spread differential allowance is only deducted once

18. We propose to correct the treatment of taxation in each relevant input methodologies determination to remove an error which allows the term credit spread differential allowance to be deducted twice. An explanation of the error is provided below.
19. Clause 4.3.3(2) of the input methodologies defines 'notional deductible interest' as including term credit spread differential allowance. Notional deductible interest is then used as a negative term in the definition of 'Regulatory Tax Adjustments' in Clause 4.3.3(1). There is therefore an implicit negative term credit spread differential allowance within the regulatory tax adjustment. The regulatory tax adjustment is then used as a component of the regulatory taxable income at Clause 4.3.1(3). There is therefore an implicit negative term credit spread differential allowance within the regulatory taxable income.

20. The other component of the regulatory taxable income is the 'regulatory profit / (loss)', and this component contains a negative term credit spread differential allowance term within it. There are therefore two negative term credit spread differential allowance amounts with the regulatory taxable income, with the result that the tax deductibility of term credit spread differential allowance is counted twice, whereas it should be counted only once.
21. To give effect to the amendment we propose to delete the reference to the term credit spread differential in the expressions of 'regulatory profit / (loss) before tax' in clause 4.3.1(4).

Removing the bold emphasis for controllable opex

22. We propose to remove the bold emphasis of controllable opex in clause 5.3.1(1)(a), and D16(a) and (b), for each relevant methodology determination. Controllable opex is not a defined term and the bold emphasis is in error.

Correcting references to electricity distribution services

23. We propose to correct an error for RAB roll forward in clause 2.2.4(4) that refers to electricity distribution services. This is intended to refer to the regulated services that the RAB roll forward relates to. The error correction will replace electricity distribution services with gas transmission services and gas distribution services in each relevant input methodology determination.

How you can provide your views

24. Submissions on the proposed drafting are due by 5pm, Friday 1 February 2013. We stress that there is unlikely to be time to take into account any submissions that are made after this deadline has passed.

Address for responses

25. You should address your responses to:

Dane Gunnell (Senior Analyst, Regulation Branch)

c/o regulation.branch@comcom.govt.nz

26. Responses should be provided in both MS Word and PDF file formats.

Requests for confidentiality

27. While we discourage requests for non-disclosure of submissions, we recognise that there may be cases where parties that make submissions wish to provide information in confidence. We offer the following guidance.
 - 27.1 If it is necessary to include confidential material in a submission, the information should be clearly marked.
 - 27.2 Both confidential and public versions of the submission should be provided.

- 27.3 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
28. We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions and cross submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.

Next steps

29. We intend to make final decisions on the proposed amendment by 28 February 2013 in time for the amended input methodologies to apply to the initial default price-quality paths for suppliers of gas pipeline services.
30. At this stage, we don't intend to hold a technical consultation prior to our final decisions. We will review this position after considering submissions, and notify parties of any change.