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Keston Ruxton
Manager, Input Methodologies Review
Commerce Commission
P O Box 2351
Wellington

[By email]

Dear Keston

**Submission on Input Methodologies Review Draft Decisions Papers**

1. GasNet welcomes the opportunity to make a submission on the Commerce Commission's (Commission) Input Methodology (IM) review draft decisions consultation papers. This submission is not confidential.

**Principles for Regulatory Change**

2. GasNet is a relatively small gas distribution business (GDB). In order to comply with the current set of IMs, information disclosure (ID) requirements and price-quality regulation we have had to make significant investments in systems and processes. The costs of these investments have been borne by our consumers.
3. GasNet generally supports stability within the IMs as this promotes certainty and minimises costs for everyone. However, we are supportive of changes that reduce costs or make material improvements in terms of how the regulations are implemented (for example, the introduction of the 'pass-through balance – discussed below).

**Form of Control**

4. The IM draft decision proposes to retain the current weighted average price cap for gas distribution services. GasNet supports this decision. A price cap already applies to GasNet and we understand it and have the necessary systems and processes in place. A price cap is also useful for businesses pursuing growth as it helps to promote new connections on the network.

**Pass-Through Balance**

5. The IM draft decision proposes to apply the 'pass-through balance' to gas distribution businesses. GasNet supports this proposal. This will overcome the problems with the current 'ascertainable' approach to recovering pass-through and recoverable costs (i.e. the ascertainable approach delays the recovery of pass-through costs that are unknown at the time prices are set).
6. Most importantly, the pass-through balance will ensure that, over time, gas distribution businesses earn enough revenues to exactly cover their pass-through and

recoverable costs, and they do not under-recover or over-charge consumers in relation to these costs.

7. The default price-quality path (DPP) determination will need to address the transition between the ascertainable approach and the pass-through balance to ensure any unrecovered costs from the current regulatory period can be recovered. The most straightforward option might be to include the unrecovered costs within the pass-through balance.

**Capex Wash-Up**

8. The IM draft decision proposes to apply the 'capex wash-up' to GDBs. It already applies to electricity distribution businesses (EDBs) and makes sure that the DPP price reset decision reflects the value of the opening regulatory asset base (RAB) of each regulated business. It does this by washing up the difference between the Commission's forecast and the actual value of commissioned assets in the year before the price reset. The wash-up value is then recovered across years 2-5 of the regulatory period.

9. GasNet supports applying the capex wash-up for GDBs. It is appropriate that the DPP reflects the actual opening RAB, rather than a forecast.

**Cost of Capital**

10. The current IMs provide for an increase in the gas asset beta by 0.1 above the electricity asset beta. The IM draft decision is to remove this uplift. GasNet considers that the uplift should remain in place as it reflects the different natures and risk profiles of GDBs compared to EDBs.

11. The current IMs and the IM draft decision calculate a single asset beta for both gas and electricity. If the 0.1 uplift to the gas asset beta is removed, we support calculating separate asset betas for gas pipeline services and electricity lines services as this would more closely reflect the actual cost of capital for the relevant services. The risk profiles of the two sectors are not the same and this should be reflected in the cost of capital.

**Cost Allocation**

12. The draft decisions propose two changes to the cost allocation IM:

    a. To reduce the revenue materiality threshold for applying the avoidable cost allocation methodology (ACAM). At present ACAM can be applied if a GDB's unregulated revenues are less than 20% of its total revenues. The proposal is to reduce this threshold to 10%.

    b. To tighten the rules on using proxy allocators by requiring the Chief Financial Officer (CFO) to certify that, where proxy allocators are used, no causal allocators were available and the proxy allocator chosen is the best option.

13. GasNet currently applies ACAM to asset values only and uses the accounting based allocation approach (ABAA) with proxy allocators for opex. We consider that the current cost allocation IM works well and we have developed our approach to be consistent with the current IM. We do not support changes that would increase our costs or require additional disclosure burdens.

14. GasNet does not support reducing the ACAM materiality threshold. The Commission's analysis justifying this change is based on information relating to EDBs only and has not considered GDBs. We also question whether the analysis is plausible as it assumes that businesses that apply ABAA use an industry average proportion of unregulated revenue to regulated revenue as the allocator. GasNet, in contrast, uses company specific revenue and asset information to allocate its operating costs.
15. GasNet is comfortable with disclosing some additional information regarding why it chooses a particular cost allocator. This would be a straightforward statement to make that would reflect the reasons for a business decision. However, we do not support this statement being made by way of a CFO declaration. This is an additional compliance task that is not necessary. Directors will certify the overall disclosures and there is no need for additional management declarations relating to particular disclosed information.

**CPP Requirements**

16. The draft decisions include a series of proposed changes to the customised price-quality path (CPP) application requirements that apply to EDBs. The Commission has not yet reached draft decisions on the CPP application requirements for gas pipeline businesses.
17. GasNet notes that even if the gas CPP requirements are changed in a similar manner to the electricity CPP requirements, the cost, time and resource needs of a CPP application would still be excessive for GasNet. We do not expect that a CPP will be affordable for us at any foreseeable time in the future. It is essential that the DPP is sufficiently flexible to provide for our expenditure requirements and we look forward to working with the Commission on this during the DPP reset process.

**Closing Remarks**

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

Yours sincerely,

**Geoff Evans**
General Manager