

## Media Release

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### **Commerce Commission proposes default price-quality paths for gas pipeline services**

The Commerce Commission has today released its revised draft decision proposing the first default price-quality paths for gas pipeline services. Once finalised, these paths will set the maximum prices that gas pipeline businesses are allowed to charge customers for their services from 1 July 2013.

The affected gas transmission businesses are Vector Limited and Maui Development Limited. The affected gas distribution businesses are Vector Limited, Powerco Limited and Gasnet Limited.

Under the proposal, some businesses will be required to charge less for their services while some will be able to charge more. The proposed adjustments to average prices for individual businesses at the start of the regulatory period in 2013 vary in size from a reduction of 25% for Vector's transmission business to an increase of 5% for Powerco's distribution business. Following the initial price adjustment, the Commission proposes limiting price increases to no more than the rate of inflation for the remainder of the regulatory period to 2017. An estimate of the potential effect of the proposal on residential customers' gas bills is attached.

"This is the first time that some of these businesses have been subject to price-quality regulation. We are now bringing the prices these businesses can charge their customers more into line with the costs of providing those services," said Sue Begg, Commerce Commission Deputy Chair.

The default price-quality path must be set in a relatively low cost way. Most of the cost estimates for the regulatory period, including the cost of capital, are based on the input methodologies that the Commission set following more than two years of consultation with interested parties. To set the path in a low cost way, the Commission does not scrutinise the proposed investments or operating expenditure of the businesses in detail.

Where a business expects a significant increase in investment or operating expenditure during the regulatory period compared to what they have spent in the past (as is the case for Maui Development Limited and Vector Limited) then the business is able to apply for a customised price-quality path.

“Although substantial price reductions are necessary for Vector, we do not expect this to limit its ability to invest in or maintain its network. All of the gas businesses have the option of applying for a different price-quality path that is customised to the needs of their business,” said Ms Begg. “For the default paths we have provided for increases in proposed investments of up to 20% above what a business has spent historically. We have set a cap at a 20% increase because the investments are not subject to scrutiny. However, even if we used Vector’s own investment forecast for transmission, the proposed price reduction would still be 23%.”

Parties are able to make submissions on the revised draft decision until 7 December 2012, and cross-submissions are due 21 December 2012. Submissions can be emailed to:

[regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

The Commission expects to reach a final decision on the default price-quality paths by 28 February 2013. Changes resulting from the default price-quality path would apply to suppliers of gas pipeline services from 1 July 2013.

## **Background**

### *What are price-quality paths?*

Price-quality paths are a form of regulation applied to certain businesses that are regulated under Part 4 of the Commerce Act. They are intended to influence the behaviour of those businesses by setting the maximum average price or total allowable revenue that the businesses can charge. They also set standards for the quality of services that each business must meet. This ensures that businesses do not have incentives to reduce quality to maximise profits under their price-quality path.

For gas pipeline services, there are two types of price-quality paths that suppliers can have. All businesses start off on a ‘default’ path which is generic in nature to provide a low cost form of regulation. If the default path does not suit their particular circumstances however, a business can apply for a ‘customised’ price-quality path. Customised price-quality paths use more business specific information, and rely on more in-depth audit, verification, and evaluation processes.

### *What’s the difference between transmission and distribution?*

Gas transmission services provided by Maui Development Limited and Vector Transmission meet the demand from large users which are often directly connected to the gas transmission network,

such as electricity generation and large industrial users. The Vector and Maui pipelines also transport gas which is further distributed via gas distribution networks.

A majority of the gas transported in the Vector pipeline, is first transported by the Maui pipeline. The Vector Transmission pipeline provides gas to large users directly connected to the network, and provides gas to the GasNet, Powerco and Vector distribution networks.

### *What are input methodologies?*

Input methodologies are the upfront rules and processes of regulation set by the Commission which underpin Part 4 regulation. For example, input methodologies concern things such as the valuation of assets, the treatment of taxation, the allocation of costs, and the cost of capital.

To set price-quality paths (or any other form of Part 4 regulation), we are required to apply input methodologies where relevant. We first published input methodologies for gas pipeline businesses in December 2010. Since then we have re-determined these input methodologies in September 2012 to specify the existing methodologies for asset valuation, tax, and cost allocation as also applicable to default price-quality paths.

For more information on input methodologies, including our reasons, visit <http://www.comcom.govt.nz/input-methodologies-2/>.

### *How have prices and quality been regulated previously?*

Once finalised, the initial default price-quality paths will be the first time that gas pipeline businesses have been subject to price-quality regulation under Part 4.

For Maui Development Limited and GasNet, it will be the first time they have been subject to any regulatory controls on their prices or quality. Powerco and Vector (certain services only) have been previously regulated under the 2008 Gas Authorisations. These Authorisations were the result of the 2004 Gas Control Inquiry and expired July 2012.

For more information on the Gas Authorisations visit:

<http://www.comcom.govt.nz/vector-powerco-authorisation/>

### *Why have we published a revised draft decision?*

We began work on the initial gas default price-quality paths in April 2010, and anticipated making a final decision in 2011. This timing was to allow the Commission to apply the input methodologies published in December 2010 in making our final decision. However, in September 2011 the High Court found that further input methodologies needed to be specified for default price-quality paths.

In the absence of these input methodologies, we contemplated setting the initial default price-quality paths for gas pipeline services by rolling over the current prices for the gas businesses. This led to our November 2011 draft decision.

However, after further consideration, we decided instead—with the agreement of all interested parties—to defer setting the initial default price-quality paths until after the input methodologies were specified.

One of the key considerations in the decision to defer setting the initial default price-quality paths was our ability to 'claw-back' any price increases above CPI for the period from 1 January 2008

until we set the default price-quality paths. This claw-back effectively provides a price-cap at CPI from 2008 until the default price-quality paths are set.

Media contact:	Allanah Kalafatelis, Communications Manager Phone work (04) 924 3708, mobile 021 225 4417
	Victoria Rogers, Senior Communications Adviser Phone work (04) 924 3709, mobile 021 225 4454

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## Attachment to media release No. 34

**Table 1: The proposed price adjustments for gas distribution and transmission businesses and previous form of price-quality regulation (if any)**

Business	Proposed adjustment to charges	Previous price-quality regulation
GasNet Limited (Distribution)	-2%	None
Powerco Limited (Distribution)	+ 5%	Subject to price-control under Commerce Act (2005-2012)
Vector Limited (Distribution)	-16%	Auckland network only: subject to price-control under Commerce Act (2005-2012)
Vector Limited (Transmission)	-25%	None
Maui Development Limited (Transmission)	+2%	None

**Table 2: The potential effect on an average residential gas consumer's monthly bill**

Distributor	Estimated monthly bill effect on residential gas user in 2013/14 from proposed adjustments to line charges <sup>1</sup>	Regions served by supplier	Number of residential customers
GasNet Limited	\$-1.10	Wanganui and surrounding district	10,167
Powerco Limited	\$ 0.60	Napier, Hastings, Southern Hawkes Bay, Taranaki, Manawatu, Levin, Foxton, Hutt/Mana, Wellington	101,651
Vector Limited (Distribution)	\$-4.60	Northland, Greater Auckland, Waikato, Bay of Plenty, Rotorua, Taupo, Gisborne, Kapiti	143,602

### Notes and assumptions:

1. The calculation assumes that the changes is evenly spread across the year and excludes inflation.

We propose to adjust the price of gas distribution and gas transmission services.

Gas retailers purchase gas and arrange the transmission and distribution of gas for residential consumers. We therefore had to estimate the effect of proposed changes in charges on residential consumers.

For gas distribution we have assumed that all types of consumer (residential, commercial and industrial) receive a percentage adjustment to their bill equal to our proposed adjustment to the line charge.

For gas transmission, we have assumed that the proposed reduction to line charges for Vector Limited (Transmission) of around 25%, and the 2% proposed increase for Maui Development Limited are spread equally among all consumers (residential, commercial and industrial) based on their gas usage.

For a typical residential gas consumer we assumed a gas usage of 6415kWh per year, at a cost of around \$70 per month.

**Source:**

The Commerce Commission developed the monthly bill estimates using information provided by gas distributors and gas transmission businesses, and information on the average residential gas bill from the Ministry of Business, Innovation & Employment Energy Data File 2012.