Vector Limited
101 Carlton Gore Road
PO Box 99882, Newmarket
Auckland 1149, New Zealand
www.vector.co.nz
Corporate Telephone
+64-9-978 7788
Corporate Facsimile
+64-9-978 7799

21 December 2012

John McLaren
Chief Advisor
Regulation Branch
Commerce Commission
WELLINGTON

Dear John,

Draft Decision on the Initial Default Price-Quality Path for Gas Pipeline Services

1. Vector welcomes the opportunity to cross-submit to the Commerce Commission (Commission) on the consultation paper "Revised Draft Decision on the Initial Default Price-Quality Path for Gas Pipeline Services", dated 24 October 2012.
2. Please find attached a report from Castalia "Revenue Forecasting Approach: Cross-submission on Reset of Gas Default Price-quality Path", 20 December 2012.
3. No part of this cross-submission or Castalia's Report is confidential.
4. Vector's contact person for this submission is:

   Robert Allen
   Senior Regulatory Advisor
   robert.allen@vector.co.nz
   09 978 8288

5. The views expressed in Vector's submission are unaffected by the content of any of the other submissions.

Table: Vector responses to selected comments in the other submissions

Topic	Submitter	Comments
Material bias	Contact Energy	Contact Energy's claim that there is "a material bias in favour of the suppliers of gas pipeline services" is without foundation.[1] Submissions that the Commission has consistently received throughout its consultation on the operation of Part 4 clearly indicate the opposite is the case. No part of Contact Energy's submission addresses or invalidates the concerns raised by other submitters or demonstrates there is a material bias in favour of suppliers. The major gentailers, as well as MEUG and MGUG (measured in terms of their constituency) are

[1] Contact's submission contains a number of unsubstantiated assertions. For example, Contact state that they support the Commission's position that regulated suppliers have overstated the risks associated with a CPP without explaining how they believe regulated suppliers have overstated the risks.

Topic	Submitter	Comments
		substantially larger and better resourced than the vast majority of EDBs and GPBs. It is not credible to suggest that they are unable to vigorously engage in Commission consultation processes. It is worth observing that there is substantial engagement by both access providers and access seekers in Commission consultation processes for regulation under the Telecommunications Act 2001 and also in relation to airport regulation under Part 4 of the Commerce Act. It is difficult to see why airlines and entrant telecommunications services providers are able to substantially engage in Commission consultation processes, but that Contact does not feel it is able to.
Capex cap	Contact Energy	Contact's concern about inflated capex (etc) forecasts would be best addressed by adopting Castalia's recommendation for a sliding scale incentive mechanism for capex, rather than an arbitrary cap on capex.
CPPs	Contact Energy	Contact states they support a regulatory setting that encourages the application of a CPP. It is not clear what Contact means by this. If Contact means the Commission should mitigate any potential barriers to regulated suppliers applying for a CPP (e.g. the risk of a worse outcome than the DPP) Vector supports this position. If, instead, Contact means that it would prefer regulated suppliers to operate under CPPs rather than DPPs, this would be contrary to the intent of Part 4 where "[t]he purpose of default/customised price-quality regulation is to provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances" (s 53K, Commerce Act 1986).
Service quality measures	Contact and Genesis Energy	Contact and Genesis both intimate that only having an emergency response time service quality measure may not be sufficient to ensure regulated suppliers do not cut costs by compromising on quality. We refer to Contact's own subsequent observation that GPBs "are subject to a number of regulatory mechanisms that contribute to the safe and reliable supply of gas. We do not wish the Commission to duplicate or create different standards." Health and Safety regulation effectively means that GPBs are subject to substantial service quality constraints, not just one, and are subject to strong requirements

Topic	Submitter	Comments
		to maintain a safe network.
Adoption of an S-Fact	Genesis	Genesis Energy “encourage the Commission to re-evaluate the cost-effectiveness and practicality of an integrated price and quality DPP once more comprehensive standards are in place.” Vector agrees that “an integrated approach will give regulated suppliers better incentives to innovate and invest to improve service quality”,.
Efficiency incentives	MGUG	MGUG states that while incentive mechanisms may be able “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.” Vector would welcome consideration of incentive mechanisms for future regulatory resets.
Implementation of prices	MGUG	MGUG expresses concern about “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”. Vector doesn’t regard any gas consumer, let alone an entire “market segment” as “captured”. There is a high degree of fuel substitutability with gas being a discretionary fuel for many consumers.
Use of market power	MGUG	MGUG claims that “pipeline owners can use their market power to bolster demand for pipeline services from market services (such as residential and commercial customers), where there are low barriers to switch ...” We do not understand why MGUG would make this claim: • It would be entirely “consistent with outcomes in a competitive market” for a pipeline owner to tailor its pricing to both retain and attract customers with the greatest ability to switch. • It is a normal workably competitive market practice to price discriminate in favour of customers with more elastic demand. As price discrimination is behaviour that is observed in workably competitive markets it cannot be “use” of “market power”. • Vector is not sure why MGUG is concerned about GPBs boosting demand. MGUG expressed the opposite concern in relation to use of a revenue or weighted average price cap for gas transmission services. Vector should be encouraged to “boost demand” as both a measure to protect its assets by preventing load loss from increasing average prices and by

Topic	Submitter	Comments
		reducing average prices (by spreading fixed costs over a larger load base). It should also be noted that gas distribution and transmission are subject to Input Methodology pricing principles which constrain the way GPBs can set their prices.
Ban on price differentiation	MGUG	MGUG argues that "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". There are any number of reasons why tariff rebalancing may be adopted, which impacts on how overall price reductions are spread amongst different customer groups. If one group already faces low or insufficient prices, it is not necessarily reasonable to expect that they would receive the same price reductions as other customer groups. Where an MGUG member's transmission "price" has been increased by more than CPI, that indicates such price(s) are non-standard i.e. discounted to standard prices. By definition, non-standard prices are set (and periodically re-determined) based on the circumstances of the individual consumer. MGUG is ill-informed if it is suggesting that the Commission's proposed SPA adjustments for Vector's distribution and transmission networks "indicat[e] significant past revenue over recovery including from our members". The Commission has provided no assessment of the distribution of alleged over-recovery.
Claw-back	MGUG	MGUG's claw-back proposals would, if implemented, breach the Commerce Act.
IRIS	Powerco	For the avoidance of doubt, Vector supports Powerco's views on adoption of an Incremental Rolling Incentive Scheme (IRIS) and an incentive scheme for capex. In respect of the latter we refer the Commission to Castalia's recommendation for a sliding scale incentive mechanism for capex, rather than an arbitrary cap on capex.

Concept Report

6. The GIC has now released the final version of Concept Consulting's Report, Gas Supply and Demand Scenarios 2012 - 2027, December 2012. To the extent that the Commission relies on the Concept Report in its final pricing determination we assume it will use the finalised version of the Report rather than the draft.[2]

7. In our submission we noted that Concept had emphasised that its price scenarios were not intended as forecasts. Our submission to the GIC raised this as a

[2] http://gasindustry.co.nz/sites/default/files/consultations/254/gas_supply_and_demand_study_v2.pdf

concern and suggested that further work be undertaken such that the report could be used for forecasting purposes. Unfortunately this recommendation was not adopted, and Concept has retained the following qualification:[3]

> It is important to emphasise that these price scenarios are not forecasts. Rather, they represent alternative 'futures' that could unfold over the 2012-2027 period. They are deliberately structured to span the broad range of outcomes that could plausibly emerge in this timeframe.

Exemptions for circumstances outside of suppliers' control

8. In Vector's submission we recommended that the Commission define circumstances in which an exemption would be granted from the 180 minute requirement. Vector has given this recommendation further consideration and now provides the following specific drafting suggestions (track changed) for inclusion in the Gas Transmission [Distribution] Default Price-Quality Path Determination 2013:

> *Exemption for approved emergencies*
>
> 9.3 If it was not practicable for a **GTB [GDB]** to respond in the required timeframe to an **emergency** a **GTB** may apply to the **Commission** for an exemption from including this **emergency** in the annual quality assessment.
>
> 9.3a For the purposes of clause 9.3, the **Commission** will grant an exemption from including an **emergency** in the annual quality assessment if:
>
> (a) the **emergency** occurs in an area that in the Commission's reasonable opinion is too remote or otherwise too difficult for a **GTB [GDB]** to reasonably respond in the required timeframe; and/or
>
> (b) it was not practicable for the **GTB [GDB]** to respond in the required timeframe due to an event or circumstance beyond the reasonable control of the **GTB [GDB]** including, but not limited to:
>
> (i) acts of God;
>
> (ii) fire, landslide, earthquake, lightning, storm, flood, volcanic eruption, tsunami or tempest;
>
> (iii) acts of terrorism, sabotage, acts of war, blockades, insurrections, riots, civil disturbances or epidemics;
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> (iv) strikes, lock-outs or labour disputes of any kind;
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> (v) failure of an IT or telephone system; and
>
> (vi) a requirement of any Crown entity, or any governmental authority or agency, court or tribunal, or other person having authorisation to exercise functions or powers under any statute.
>
> 9.4 An exemption request, as provided for under clause 9.3, must include appropriate supporting evidence and be provided to the **Commission** within 30 days of the **emergency**.
>
> 9.5 An **emergency** may only be removed from the calculation of the annual quality assessment formulas for an **assessment period** where the **Commission** has granted an exemption.

Kind regards

Bruce Girdwood
Regulatory Affairs Manager

[3] Page 29, Concept Consulting, Gas Supply and Demand Scenarios 2012 - 2027, draft and final versions.