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Matthew Lewer
Regulation Branch
Commerce Commission
P.O. Box 2351
Wellington



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

Dear Matthew,

Submission on the Initial default price-quality for gas pipeline services – deferral of commencement date

Introduction

1. Vector welcomes the opportunity to make a submission on the Commerce Commission's (Commission) Draft Decision "Initial default price-quality path for gas pipeline businesses – deferral of commencement date", 3 February 2012.
2. No part of Vector's submission is confidential and we are happy for it to be publicly released.

Deferring the commencement of the initial default price-quality paths

3. Vector **notes** that we support the Commission's Draft Decision to defer the commencement date for gas pipeline businesses (GPBs) from 1 July 2012 until the Starting Price Adjustment Input Methodology (SPA IM), and any other additional IMs (if any) have been determined, but no later than 1 October 2013.
4. A consequence of the deferment is that the Commission will not undertake a mid-regulatory period reset or claw-back for GPBs. Vector's concerns about mid-regulatory period resets and claw-back are documented in our Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper, 19 December 2011 (19 December 2011 submission), and so are not repeated here.¹
5. We agree with the Commission that section 55F(2) can be relied on to deal with any gap between the previous regulatory regime and the implementation of Default Price Paths (DPPs) under the new Part 4 of the Commerce Act 1986.

Section 53P(3)

6. Vector also welcomes the Commission's acknowledgement that requiring GPBs to reduce prices to remove the effect of CPI increases since 1 July 2010 would be undesirable. Vector's previous submission to the Commission on this matter explained why we also consider that it would be contrary to the requirements of the Commerce Act.²

¹ Refer to paragraphs 61 to 94 of Vector, *Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper*, 19 December 2011, for details of Vector's concerns about mid-regulatory period reset and claw-back.

² Paragraphs 34 to 60, Vector, *Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper*, 19 December 2011.

7. The inflation issue only goes away if the Commission decides to adopt section 53P(3)(b) rather than (3)(a). Vector considers that the Commission:
 - a. determine whether section 53P(3)(a) or (b) is adopted as part of the SPA IM;³
 - b. not determine whether starting prices should be set under section 53P(3)(a) or (b) of the Commerce Act 1986 at this stage;⁴ and
 - c. accordingly, decide whether to set prices under section 53P(3)(a) or (b) should be made after the SPA IM is determined.
8. In previous submissions Vector has argued the Commission should delay any reset of GPB prices based on future and projected profitability until the next regulatory period. This was primarily because of the poor quality information currently available for GPBs. Vector also set out additional concerns regarding the Commission's approach to efficiency incentives more generally (concerns that would be exacerbated by a section 55F(4) mid-period reset or claw-back but which will arise in relation to any reset).

In Vector's submission these issues remain highly relevant to the question of whether to set prices under section 53P(3)(a) or (b).

9. Vector urges the Commission to undertake a full analysis of the pros and cons of a reset under (a) or (b) so that informed responses can be made. While consultation could commence as part of the SPA consultation (including in relation to the criteria or method to be applied when making this decision), final decisions should not be made until after the SPA IM is determined.
10. Vector accordingly does not believe that the Commission should simply assume the inflation issue will disappear because the Commission will adopt section 53P(3)(b). The Commission should, therefore, consider Vector's 19 December 2011 submission,⁵ and our arguments why the correct application of section 53P(3)(a) would be to set prices the levels that immediately preceded the regulatory period, rather than July 2010 levels.
11. Vector **notes** that the Commission has not responded to the legal analysis set out in Vector's 19 December 2011 submission regarding the correct interpretation of section 53P(11) and other related provisions. If the Commission has doubts about Vector's analysis, Vector urges the Commission to seek clarification from the Court under section 100 of the Act (noting that the Commission agrees its own interpretation results in undesirable outcomes). Vector does not consider it appropriate to prematurely rule out section 53P(3)(a) as an option and/or adopt section 53P(3)(b) as a way of getting around concerns about the treatment of inflation. That is, this issue requires resolution in advance of the Commission deciding whether to set prices under section 53P(a) or (b).

³ Refer, for example, to paragraphs 144 and 146 of Vector, Submission to Commerce Commission on Additional DPP IMs Process and Issues Paper, 27 January 2012.

⁴ The Draft Decision states that the Commission considers application of section 53P(3)(a) would better promote the purpose in Part 4 of the Commerce Act, than section 53P(3)(b). Refer to paragraph 9.1 of Commerce Commission, Draft Decision "Initial default price-quality path for gas pipeline businesses – deferral of commencement date", 3 February 2012.

⁵ Paragraphs 34 to 60, Vector, *Submission to the Commerce Commission on Initial DPP for GPBs Draft Reasons Paper*, 19 December 2011.

First regulatory period for GPBs

12. If the Commission adopts 1 October 2013 as the start of the regulatory period, the Commission will avoid the transition issues that had previously resulted in the Commission concluding the initial regulatory year should be the 15 months from 1 July 2012 to 30 September 2013. This should result in lower regulatory compliance costs.
13. It would also mean the Commission would be able to adopt a full five year regulatory period, rather than the 4 year 3 month period proposed to manage the transition from a July commencement date. Adoption of a full 5 year regulatory period would have the advantage of offering GPBs a slightly bigger incentive to improve efficiency.

Information Disclosure and transition

14. Vector **recommends** the Commission consider whether the decision to defer the start of the regulatory period should also result in deferral of the new Information Disclosure Requirements for Gas, in part or in whole.
15. Vector will be addressing this issue in more detail in our submission in response to the Draft Reasons Paper "Information Disclosure Requirements for Electricity Distribution Businesses and Gas Pipeline Businesses", 16 January 2012. However, Vector has concerns the Commission is proposing disclosure requirements that will, effectively, be retrospective in the first regulatory year that they are introduced.
16. This is particularly concerning given:
 - a. the Commission has only really provided partial draft Determinations for Information Disclosure, absent spreadsheet templates with the formulae and without a full set of definitions; and
 - b. the timeline for completion of the Information Disclosure Determinations has been pushed further and further back (closer to the end of the regulatory period that they are applicable to). Vector considers that the Commission should consider whether the new disclosure requirements should be deferred. This could tie in with the deferral of the start of the regulatory period and price resets
17. This is particularly relevant for the services that have not been required to produce disclosures in the form required by the Commission, previously. The Draft determinations, in such circumstances, are the first time for these businesses to evaluate a full set of draft requirements and to begin planning the systems and processes necessary for the production of the data required to an acceptable level of robustness.
18. In some cases, this can involve multiple processes for the provision of input data and quality systems and processes for integrating multiple data sets to enable the disclosure detail to be in the form requested. This is not a straight forward exercise. Rather, the system and process design will involve much complexity, new degrees of integration with IT and other systems. The data being produced will need to meet external scrutiny, often to a level not previously required. Lead times adequately allowing for transition from previous requirements should be an essential aspect of the Commission's considerations when making the information disclosure determinations. This has been contemplated with respect to information disclosure requirements for electricity businesses. Gas businesses that have not previously been subject to Commission requirements will require the opportunity

to put in place the necessary systems and processes to enable delivery of the information sought.

19. The risk of not accommodating these needs is that sub-standard and inaccurate data will be disclosed that may require subsequent remediation. This risk can be largely eliminated by the Commission's provision of reasonable lead times, that do not have any element of retrospectivity, for getting systems and processes into place at the outset.
20. The deferral provides a very good opportunity for the Commission to ensure that these risks are properly identified and managed.

Application of section 55F(4)

21. Finally, while Vector welcomes the Commission's draft decision to defer the initial GPB DPP, Vector does not agree with the Commission's suggestion that the extent to which section 55F(4) will apply is unclear following the decision in *Vector v Commerce Commission*. In Vector's view a clear finding was made by the High Court that the Commission is entitled to reset starting prices under section 54K(3) (and 55F(4)) if (and only if) it determines a SPA IM reflecting the SPA methodology to be applied.⁶

Concluding remarks

22. Vector considers that the Commission's Draft Decision to defer starting price adjustments is sensible. However, in our view this should not predetermine whether starting price adjustments should be set under section 53P(3)(a) or (b), and should still address the matter of how inflation from 1 July 2010 would be treated under a section 53P(3)(a) reset.
23. If the Commission has any queries regarding Vector's submission or would like further information please contact Robert Allen, Senior Regulatory Advisor, 09 978 8288 or robert.allen@vector.co.nz.

Kind regards



Bruce Girdwood
Manager Regulatory Affairs

⁶ See, for example, *Vector v Commerce Commission* HC Wellington, 26 September 2011, Clifford J, CIV-2011-485-536 at [151].