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Input methodologies review

Gas pipeline default price-quality path reset 2017

Gas stakeholder meeting – 8 December 2015

Summary of views

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Purpose

1. This paper gives an overview of the meeting the Commission held with stakeholders in the gas pipeline sector on 8 December 2015, at the offices of the Gas Industry Company. The paper summarises the issues Commission staff and stakeholder representatives discussed, and the views attendees expressed on them.

2. We have published this paper to assist stakeholders – both those who attended and those who did not – with preparing submissions on gas pipeline sector-specific issues.

Meeting purpose

3. The purpose of the meeting was to:

   3.1. continue engagement with the gas pipeline sector on the Input Methodologies (IM) Review;

   3.2. begin engagement on the Default Price-Quality Path (DPP) Reset for the gas pipeline sector; and

   3.3. seek stakeholder views on gas pipeline-specific issues for the IM review, issues for the DPP reset.

4. The meeting was intended to encourage open discussion and exchange of information between all parties. As such, the views Commission staff expressed represented only preliminary views for the purpose of promoting discussion, rather than a formal Commission position.

Summary of views

5. This section summarises the views attendees expressed in relation to each of the issues on the agenda. It (largely) follows the course of the meeting. However, because of the interrelated nature of the topics and the open structure of the meeting, some of the views may have been raised in different parts of the meeting.

6. The topics covered were:

   6.1. opportunities for future engagement with sector stakeholders;

   6.2. quality of service and security of supply;

   6.3. the treatment of major capital projects;

   6.4. form of control, pricing, and risk sharing; and

   6.5. the incremental rolling incentive scheme (IRIS).

7. The agenda did not include other cross-sectoral topics that the Commission is considering as part of the IM review, as they are more generic in nature rather than gas-specific.

Engagement with stakeholders

8. The Commission said that identifying opportunities for future engagement with industry was a key goal for this meeting. They pointed to the example of the Electricity Networks Association (ENA) working groups in advance of the 2015 electricity distribution reset as an example of the type of workshop considered.

9. Powerco commented that the ENA working groups had worked well for problem definition, and that it was useful having the Commission present as observers. Powerco suggested that the Gas Association of New Zealand (GANZ) may be able to fulfil this role for the gas pipeline sector.

10. MEUG said that the quality of service working group had worked well. They also pointed to the consumer engagement Transpower does for their major capex projects, and suggested that this approach might be one option for gas transmission. The importance of engagement with end users was highlighted.

11. Maui Development Limited (MDL) suggested that for some issues the Gas Industry Company (GIC) may work as a forum for discussion. Coordination between the different regulators in the sector (the Commission, GIC, and MBIE) was critical. Vector echoed this sentiment.

12. MGUG commented that they were interested in being involved in any work on the security of supply.

Quality of service and security of supply

13. The Commission provided an overview of the current measures used to assess quality in the gas sector, commenting that the response time to emergencies (RTE) measure was somewhat “bland”.

14. The Commission asked what if any changes needed to be made to the quality standards (or the information disclosure requirements) to provide the right incentives for suppliers. In particular for:

    14.1. reliability and security of supply for consumers;

    14.2. incentivising the right investments in the future; and

    14.3. for addressing high-impact, low-probability events.

15. The Commission also identified five considerations that had been used previously when looking at the electricity distribution sector:

    15.1. what consumers care about;

    15.2. what metrics can be used to measure quality of service and security of supply;

    15.3. what it is appropriate to regulate;

    15.4. what data exists; and

    15.5. what you can attach financial incentives to.

16. Powerco highlighted the need to focus on the differences between distribution and transmission. RTE was a coarse measure, but it does work as a measure for distribution, as it focuses on safety at a consumer level.

17. In terms of other performance indicators, Powerco indicated that from their customer surveys there did not appear to be a strong desire for change. However, measures such as connection times, response to complaints, and response to faults were mentioned.

18. Powerco suggested the use of GANZ as a forum for discussion of these issues, and that if the Commission were looking to implement new measures, then it should work with all stakeholders to do so. They also stressed the need for any changes to the quality regime to be incremental, and that the focus should be on working towards measures for the 2022 reset.

19. Vector said that there is a significant difference between distribution and transmission when it comes to quality. They also said that there is a cost to creating systems that capture the data necessary for quality disclosures, and so measures need to focus on what consumers care about.

20. MGUG said that security of supply was one of their keys issues (along with pricing and form of control). They did not believe that RTE was a good quality of service measure from a consumer perspective. They said that there are large differences between the distribution and transmission sectors on this issue.

21. MGUG drew attention to the need, with regards to transmission, to focus on understanding high-impact low-probability events like the 2011 outage on the Maui pipeline. In particular, issues including:

    21.1. risk management and mitigation;

    21.2. what consumers can do in response to an outage in terms of business contingency; and

    21.3. whether the economic impact of such events could be reduced with “short term” repairs.

22. MGUG also highlighted the benefit of the duplication created by the Vector and MDL systems where they run in parallel, noting that it kept some gas flowing during the 2011 MDL outage.

23. MGUG expressed a desire to understand the quality measures, and what businesses plans are. They said they would like to have input into any working group on this issue.

24. MDL said that from their perspective the RTE measure is limited. In their view one outage is one too many, and that a response or repair-based measure is too late in the failure chain to work for transmission. The focus should be on prevention of the outage.

25. MDL said that while there may be useful measures, additional costs should not be imposed, noting that these will be passed onto consumers. They suggested a focus on the other (non-Commission) existing incentives for security of supply, and the use of information that is already available. MDL echoed Powerco’s comment that any new incentives would need to be phased in.

Treatment of major capital projects

26. The Commission introduced this topic by seeking views on the kind of involvement it should ideally be seeking from industry. This was in terms of what consultation on major projects was needed and the kind of information necessary to drive that. The Commission also made it clear that any solution needs to work for a range of major capex projects, not just MDLs Whitecliffs project.

27. In response, MDL noted that where suppliers and consumers agree a project is necessary, allowance for it should be made. Projects like Whitecliffs were driven from a technical perspective, and that they did not want to see investments like this blocked because of willingness to pay issues.

28. MDL said that capex in the transmission sector is lumpy, and that MDL does not have the benefit of a constant spend across a network. They commented that a DPP's five-year time horizon causes problems, but that a customised path's 'whole of business' approach is also not suitable. Alternatives of either a streamlined customised price-quality path, or some kind of listed project mechanism under a default path, were suggested.

29. Oji Pulp and Paper asked about the investment test that these projects are subjected to, and highlighted the importance of the link to quality standards. They said that consumer consultation on a proposal was important, and that where consumers see benefit, they will be willing to pay. They noted that producers, not just consumers, are beneficiaries of investments.

30. Fonterra added that consumers like them did not have the choice not to pay.

31. MDL said that the definition of 'consumers' in this context was important, but that no matter where in the production chain a cost is added, it will eventually pass on to consumers.

32. Speaking specifically about the Whitecliffs, MDL noted that from their point of view the project is not optional, but that for the Vector transmission pipeline it is. They noted that if Vector asked to connect to the Maui pipeline and met the criteria, MDL could not refuse the connection.

33. The Commission asked for a distribution perspective on the major capex issue, to which Colonial First State responded that the natural incentive that exists to control costs should not be underestimated, and that as a fuel of choice, there is an incentive to invest to build volume.

34. Finally, MDL raised the issue that not all projects need a capex solution, and that there should not be an unnatural incentive to favour opex over capex. The Commission noted that this issue is important to the discussion around the IRIS.

Form of control and pricing

35. The Commission introduced this topic noting that it is a generic issue across the IM review, affecting both gas and electricity. They said that here the focus was on gas-specific factors, and also on the differences between distribution and transmission.

36. The Commission framed the topic in terms of three "buckets" of issues:

    36.1. form of control, or the total revenue allowance;

    36.2. pricing, or how that total revenue is split between customers; and

    36.3. implementation and compliance.

37. The IM review is focused on form of control issues. Responsibility for pricing issues is shared by the Commission and the GIC. From the Commission's point of view, it is important that the form of control does not create barriers to efficient pricing. The Commission commented that any barriers seem more related to how compliance is assessed than with the form of control itself.

38. Castalia said that it is important that the compliance approach not undermine the form of control decision and that if businesses should not face demand risk, the compliance approach should not undermine that outcome.

39. Vector said that it is important to be clear about the problem that you are trying to solve, and that you need to consider the differences (in distribution) between the electricity and gas sectors. They also noted that there are issues created by the retailer wash-up process.

40. Powerco had earlier raised the differences between electricity and gas. Gas is a fuel of choice, giving suppliers an incentive to drive volumes and a revenue cap for gas distribution businesses may disincentivise this.

41. By contrast, MDL said that the Commission's previous decision that transmission businesses had limited ability to control demand remained sound.

42. Oji Pulp and Paper drew attention to the differences between the way MDL and Vector transmission set their prices, noting that from their perspective MDL bears more risk than Vector. This issue was connected to the WACC the businesses earn.

43. Oji Pulp and Paper noted that from their point of view, the "big bucket" of total revenue is less important than how that revenue is divided up under the pricing methodology.

44. MGUG highlighted the price volatility in the transmission system, noting that the 2013 reset had seen a substantial drop in prices, but that since then prices had increased, and at more than CPI. They said that the effect of these prices has been different for different users.

45. In terms of risk allocation, they also noted the difference between Vector and MDL's pricing, and how these differences transfer risk to consumers in different ways. Vector's approach puts more risk on end consumers, and that this may create unintended consequences.

46. In terms of pricing methodologies, they said that transmission businesses had a lot of latitude in how they price, and that there was a lack of consistency between how gas and electricity are regulated. In the electricity sector, the Electricity Authority and the Commission have responsibility for setting pricing methodologies, but the same is not true for gas.

47. MGUG considered that the effects of pricing across user groups were uneven, highlighting the difference between standard and non-standard tariffs. They noted the problems caused by the use of two-year lagged quantities. While all these issues may be within the rules as they are currently written, you need to ask whether this is helpful for industry, and for New Zealand as a whole.

48. MDL highlighted the work that the GIC is currently undertaking on allocation of capacity, and that the Commission's IMs currently contradict the goals of this work. They pointed to the possible move to auction based pricing as being incompatible with the Commission's current approach.

49. Vector also pointed to the progress that the GIC forum is making on pricing, and that there is conflict between this work and the Commission's. They noted that this work imposes costs in terms of updating IT systems, and that the IM review completion date at the end of next year imposes time pressure.

50. The Commission asked what specifically in the IMs is creating a barrier to the kinds of changes being mentioned in the GIC's pricing work. MDL responded that the problem is in the notional revenue approach which uses a two-year lagged quantity, and the ability to deal with auction periods that cover less than one year.

51. In terms of a solution to this problem, MDL suggested a pure revenue cap that allows for unders and overs. This would smooth revenue, and therefore smooth pricing. They pointed to Transpower's revenue cap as an example of this. Vector commented that a similar approach is taken in Australia.

Incremental rolling incentive scheme (IRIS)

52. The Commission introduced this topic stating that there is now an IRIS in place for electricity distribution, and that an IRIS for gas pipelines was progressed to the draft decision stage in 2014. The issue of whether to introduce an IRIS for gas is now part of the IM review, and the Commission is focusing on gas sector-specific factors that may lead to a different approach.

53. Powerco said that there is no evidence that the timing incentives an IRIS is designed to address are occurring. They said that in the electricity distribution sector, there is an acceptance that an opex IRIS is regulatory best practice and that there is no real distinction between electricity and gas distribution.

54. However Powerco said that for capex there are distinctions noting that new connections drive much of their capex, and that this should be excluded from any IRIS mechanism. Their support for any capex IRIS is conditional on how capex is forecasted, and that if it is based on businesses' Asset Management Plans, they would be more supportive.

55. Vector commented that the need for neutrality is important, and that opportunities for arbitrage should not be created.

56. MDL said that for a transmission business IRIS poses particular issues. In particular, where large investments like the Whitecliffs project are treated as an ‘overspend’ relative to forecasts, this would expose them to a substantial loss. In those conditions they would be strongly opposed to a capex IRIS.

Attendees

Name	**Representing**
Ben Gerritsen	Castalia (on behalf of Colonial First State)
Gavin Kerr	Colonial First State
Andrew Stevenson	Commerce Commission
Calum Gunn	Commerce Commission
Grant Weston	Commerce Commission
James Marshall	Commerce Commission
James Mulrennan	Commerce Commission
Matt Lewer	Commerce Commission
Nick Russ	Commerce Commission
Nicola Mitchell	Commerce Commission
Linda Thompson	Fonterra
Ian Wilson	Gas Industry Company (GIC)
Patrick Wilson	Gas Industry Company (GIC)
Paul Cruz	Gas Industry Company (GIC)
Steve Bielby	Gas Industry Company (GIC)
Greg O’Malley	Gasnet
Ralph Matthes	Major Electricity Users Group (MEUG)
Len Houwers	Major Gas Users Group (MGUG)
Richard Hale	Major Gas Users Group (MGUG)
Claire Graeme	Maui Development Limited (MDL)
Jelle Sjoerdsma	Maui Development Limited (MDL)
Matt Wilson	Maui Development Limited (MDL)
Gareth Wilson	Ministry of Business, Innovation, and Employment (MBIE)
Lyndon Haugh	Oji Pulp and Paper
Nico Vessiot	Powerco
Oliver Vincent	Powerco
Richard Fletcher	Powerco
Anna Casey	Vector
Luz Rose	Vector
Richard Sharp	Vector