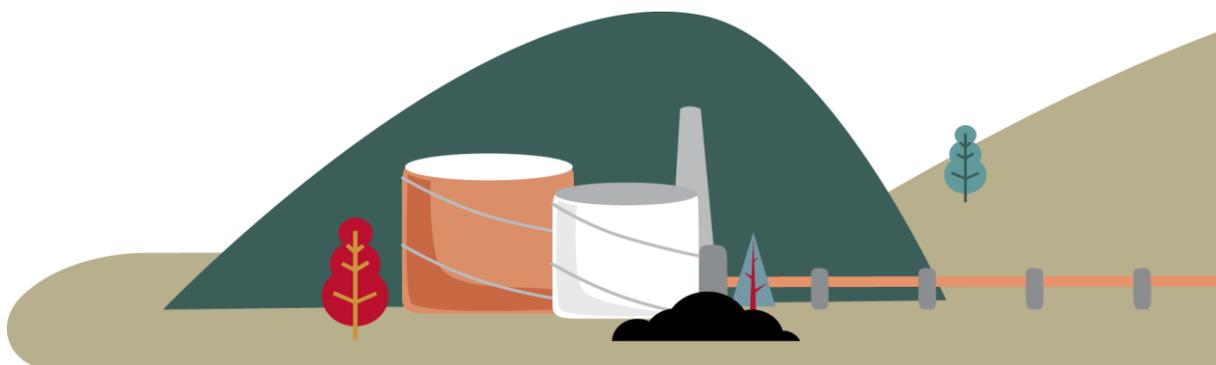


Default price-quality paths for gas pipeline services from 1 October 2017

Process and issues paper

Date of publication: 29 February 2015

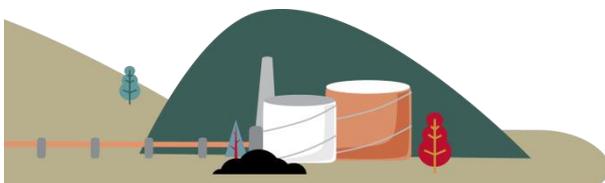


Associated documents

Publication date	Reference	Title
28 February 2013	ISBN 878-1-869452-20-9	Setting default price-quality paths for suppliers of gas pipeline services
28 February 2013	ISBN 978-1-869453-11-4	[2013] NZCC 4 Gas Distribution Services Default Price-Quality Path Determination 2013
27 March 2014	ISBN 978-1-869453-60-2	[2013] NZCC 5 Gas Transmission Services Default Price-Quality Path Determination 2013 (consolidating all amendments as of 26 March 2014)
16 June 2015	ISBN 978-1-869454-55-5	Input methodology review: invitation to contribute to problem definition
21 December 2015	-	Input methodologies review: gas pipeline stakeholder meeting held 8 December 2015 – Summary of views

Regulation Branch, Commerce Commission

Wellington, NEW ZEALAND



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1. Introduction

Purpose of paper

- 1.1 This paper:
- 1.1.1 seeks feedback on issues and initial views we have identified ahead of our draft decision to reset the default price-quality paths (DPP) for gas pipeline services for the 2017-2022 regulatory period;
 - 1.1.2 seeks feedback on issues relating to the DPP that will contribute to the Input Methodologies (IM) Review; and
 - 1.1.3 sets out the process we intend to follow when resetting the DPPs, including indicative timeframes for all publications and events that are planned between now and the publication of our final decision in May 2017.

Our framework for making changes to the DPP

- 1.2 The approach we are taking to this reset is to retain approaches from the 2013 reset where they remain fit-for-purpose.¹ Consistent with the IM review framework, we will consider making changes to the 2013 approaches where they will:
- 1.2.1 better promote the s 52A purpose of Part 4 of the Commerce Act 1986;²
 - 1.2.2 better promote the s 53K purpose of default/customised price-quality path regulation;³ and
 - 1.2.3 reduce complexity and compliance costs.
- 1.3 Key drivers for changes include:
- 1.3.1 implementing changes as a result of the IM review;
 - 1.3.2 responding to changes in the ownership structure in the gas pipeline sector;
 - 1.3.3 where appropriate, carrying across new approaches developed during the last electricity distribution businesses (EDB) DPP reset; and

¹ The approaches taken in the 2013 reset are explained in the final reasons paper for that reset. See: Commerce Commission “Reasons for setting default price-quality paths for suppliers of gas pipeline services” (28 February 2013).

² Commerce Act 1986, s 52A.

³ Commerce Act 1986, s 53K.

- 1.3.4 working to better co-ordinate the regulatory regimes administered by the Commission and the Gas Industry Company (GIC).
- 1.4 The IM review is under way and while it is being progressed in parallel with this work, it is more advanced. We have identified interdependencies to ensure the process is as seamless as possible – paragraphs 2.3 to 2.10 detail more fully the relationship between the two projects. The scope of work for the IM review has been determined following previous consultation.
- 1.5 Before we start work on our draft decision, we are seeking input on our views, and what we have identified as our key issues. Table 1 contains a summary. ‘Emerging’ views represent those views where our thinking has progressed further than that for an ‘initial’ view. In this paper, we discuss emerging views around the form of control and the implementation of an incremental rolling incentive scheme (IRIS).
- 1.6 We invite you to provide your views and suggest any other alternatives you think we should consider as well as any additional issues not yet identified.

Table 1	
Area	Initial and emerging views, key issues and options
Approach to setting starting prices	<ul style="list-style-type: none"> We intend to set starting prices for the DPPs on the basis of current and projected profitability, rather than on a roll-over of current prices.
Forecast opex	<ul style="list-style-type: none"> We would like to actively explore the option of using suppliers' own forecasts as a starting point and scrutinising them. If we retain the step-and-trend approach we will need to reassess the inputs used to set the trend, and any adjustments to the base year.
Forecast capex	<ul style="list-style-type: none"> We would like to actively explore the option of using suppliers' own forecasts as a starting point and scrutinising them. There may be an opportunity to increase the capex cap for suppliers that have demonstrated higher forecast accuracy in past capex allowances. We are also assessing the best way to treat major one-off investments.
Constant price revenue growth (CPRG)	<ul style="list-style-type: none"> We will explore options for refinements to the existing CPRG model.
Productivity	<ul style="list-style-type: none"> We will look at the costs and benefits of retaining the approaches to setting the X-factor and opex partial productivity; as well as any alternative methodologies that may exist.
Form of control	<ul style="list-style-type: none"> Emerging view is that a pure revenue cap is appropriate for gas transmission, but we require further analysis to make a decision for gas distribution. Choice of form of control may reduce the importance of CPRG forecasts. We will need to introduce a wash-up mechanism if a pure revenue cap is applied, which may also be used to help smooth price changes and deal with proceeds from capacity auctions.
IRIS	<ul style="list-style-type: none"> Emerging view is that the benefits from implementing a capex and opex IRIS for gas pipeline services are unlikely to outweigh the costs, at this time. If IRIS is not implemented, the current asymmetric opex IRIS applying to customised price-quality paths (CPPs) should be removed for gas pipeline services.
Company specific issues	<p>Colonial First State Global Asset Management (Colonial)</p> <ul style="list-style-type: none"> Our initial view is to have one price-quality path for transmission. <p>Powerco</p> <ul style="list-style-type: none"> We are considering options as to what base year to use for Powerco due to timing of information disclosures.
Quality of service	<ul style="list-style-type: none"> For gas transmission we will consider whether there are other quality of service standards that could be implemented. For gas distribution we consider that the current quality standard for response time to emergencies (RTE) should remain, but we will consider whether there are other quality of service standards that could be implemented. We will reassess the current information disclosure measures to ensure readiness for any development of standards for the 2022 reset.

How you can provide your views

- 1.7 There are two consultation timelines for this paper. We welcome your views within the timeframes set out below.
- 1.8 For matters related to the IM review, comments are due by **5pm Thursday 24 March 2016**. These are:
 - 1.8.1 form of control; and
 - 1.8.2 IRIS.
- 1.9 For all other matters:
 - 1.9.1 submissions are due by **5pm Wednesday 30 March 2016**; and
 - 1.9.2 cross-submissions are due by **5pm Wednesday 13 April 2016**.

Address for responses

- 1.10 Responses should be addressed to:

Tricia Jennings (Project Manager, Gas DPP reset 2017)
c/o regulation.branch@comcom.govt.nz

- 1.11 Please include 'Gas DPP reset 2017' in the subject line of your email. We prefer submissions in both a format suitable for word processing (such as a Microsoft Word doc), and a 'locked' format (such as a PDF) for publication on our website.

Requests for confidentiality

- 1.12 We encourage full disclosure of submissions so that all information can be tested in an open and transparent manner. However, we offer the following guidance where you wish to provide information in confidence:
 - 1.12.1 If you include confidential material in a submission, both confidential and public versions of the submission should be provided
 - 1.12.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

Question and answer session on process and issues

- 1.13 To help clarify our initial and emerging views expressed in this paper, and to help stakeholders in preparing their submissions, we are intending to hold a question and answer session on Thursday 10 March, 9am, at the Commission's Wellington office. Details regarding the question and answer session were sent in an email on 22 February 2016.

2. Process we propose to follow

Purpose of this section

- 2.1 This section outlines and explains the process we intend to follow to reset the DPP for gas pipeline services. It covers:
- 2.1.1 the relationship between the DPP reset, the Commission's IM review, and work the GIC is undertaking;
 - 2.1.2 the major consultation documents we intend to release and their intended timing; and
 - 2.1.3 the opportunities stakeholders may have to engage during the reset process.

Process that we have followed so far

- 2.2 We held a gas pipeline stakeholder meeting on 8 December 2015 to discuss issues relevant to the DPP reset and the IM review, which are specifically relevant to the gas sector. The submissions we received following this meeting have been considered in developing this paper.

Relationship to other processes

Interrelationship with the review of the IMs

- 2.3 We are preparing for the DPP reset while at the same time reviewing the IMs. The timing of the DPP reset was one of the factors in our decision to complete the IM review by December 2016.⁴ The two processes are interrelated. As a result, we intend:
- 2.3.1 to make it clear to stakeholders where there are connections between decisions being made in each process; and
 - 2.3.2 for the consultation process to be as seamless as possible from a stakeholder perspective.
- 2.4 Despite the interrelationship, there are still necessary boundaries between the two processes. This is because they are separate determinations with different end dates, and different appeal rights attach to them.

⁴ Commerce Commission "Open letter on our proposed scope, timing and focus for the review of input methodologies" (27 February 2015).

Material submitted for the Gas DPP reset also forms part of the record for the IM review

2.5 Section 52ZA of the Act sets out the process for an appeal against an IM determination. This includes a specific provision that the appeal “must be conducted solely on the basis of the documentary information and views that were before the Commission when it made its determination, and no party may introduce any new material during the appeal”.

2.6 As we indicated in our 30 October 2015 Process Update Paper for the IM review:

Any material provided in the course of the IM review (on any topic or sectoral issue), including in any engagement planned on any topic, will form part of the record for the IM review.

The record will therefore include any material provided during Commission workshops or other engagements in the course of the IM review, including any material that may cover matters wider than the IMs.⁵

For instance, the airports profitability topic may also consider changes to the airports ID determination, and the gas pipeline issues topic may cover preparations for the 2017 gas DPP resets.

2.7 Consistent with the above, we consider that any submissions or material provided in relation to the DPP reset that are relevant to the IM review and is received before the final IM review determination is made will also form part of the IM review record.

Timing of decisions made in the IM review and the DPP reset

2.8 Decisions on the IM review will be made before decisions on the DPP reset, at both the draft and final stages. As we need to apply the IMs to certain aspects of the DPP reset process (such as weighted average cost of capital (WACC), treatment of taxation, form of control, and IRIS) these IMs need to be set before the DPP reset can be finalised.

2.9 We intend to publish the draft decision on the IM review in June 2016. Shortly after we publish the IMs draft decision, we will publish a paper explaining how we would expect the draft IMs to be implemented through the DPP reset.

2.10 The IM review is intended to be completed by December 2016, and will be followed by a draft decision on the DPP reset in February 2017. The draft DPP decision will be prepared in line with the updated IMs.

⁵ Commerce Commission “Input methodologies review process update paper” (30 October) at [30-31].

Work by the Gas Industry Company

- 2.11 Stakeholders across the sector have highlighted the importance of coordination between different regulators in the sector, and in particular between the Commission and the GIC. We agree with this view, and so will be taking steps to be aligned where it is practical to do so.⁷

Major publications

- 2.12 Consultation on the DPP reset will run on two tracks during the early phase of the process.
- 2.12.1 Matters closely related to the IMs will be consulted on first, in conjunction with the IM review – see paragraph 1.8.
- 2.12.2 Matters not closely related to the IMs will be consulted on second, and separate from the IM review.
- 2.13 These two tracks will converge with our publication of a draft decision in February 2017. This decision will take into account both the final IM review decision, and submissions in response to our DPP policy paper – see Table 2.
- 2.14 We are proposing this approach to allow both the Commission and stakeholders sufficient time to engage on all issues, and to avoid asking stakeholders to engage with a large volume of consultation material all at once.⁸
- 2.15 Table 2 sets out the major consultation papers we intend to publish that are relevant to the DPP reset. The intended timeframes remain indicative at this stage, and will be confirmed following feedback on this paper. Note that these dates have changed slightly since the 8 December 2015 stakeholder workshop.⁹

⁷ The Commission's relationship to the GIC regarding our respective roles under the Commerce Act 1986 and the Gas Act 1992 are explained in our Memorandum of Understanding see: Commerce Commission/Gas Industry Company "Memorandum of Understanding" (5 August 2011).

⁸ This was identified as a concern by stakeholders in feedback on previous consultation processes. See: Electricity Networks Association "Feedback on the process for resetting default price-quality paths for electricity distributors" (10 April 2015) at [10-13].

⁹ Commerce Commission "Input methodologies review – Gas pipeline stakeholder meeting" (8 December 2015) at slide 10.

Table 2	
Publication/event	Intended timing
Question and answer session on process and issues paper	10 March 2016
IM review draft decision: DPP implementation paper (IM issues)	July 2016
Policy paper for the DPP reset (non-IM issues)	September 2016
Final decision on the IM review	December 2016
Draft DPP decision	February 2017
Technical consultation on the DPP determination	March/April 2017
Final DPP decision	31 May 2017

DPP implementation paper (IM issues)

- 2.16 Shortly after we publish the draft decision on the IM review, we intend to publish a paper explaining how the draft IMs would be implemented in the DPP reset. This paper is intended to give stakeholders a clear picture of how the draft IM review decisions would work in practice.
- 2.17 The paper will cover issues for the DPP reset which are closely related to the IM review, including issues related to form of control, the relationship between DPPs and CPPs, pass-through and recoverable costs, and IRIS.¹⁰
- 2.18 We are interested in views on whether to provide a draft version of the financial model with this paper. Up-to-date information necessary for the model would not be available, so it would need to be populated with 'dummy' data.

Policy paper for the DPP reset

- 2.19 In September 2016, we intend to release a policy paper setting out our approach to issues not directly related to the IM review. We expect this to include matters concerning forecasts of opex and capex, forecasts of CPRG, productivity used in determining the X-factor, quality standards and compliance matters.
- 2.20 We expect this policy paper will be accompanied by any models we use to forecast revenue and expenditure.

¹⁰ This list is not intended to be exhaustive and may expand once decisions from the IM review are known.

Draft decision

- 2.21 A full draft decision, based on the finalised IMs and taking into account submissions on the DPP reset policy paper, will be published in February 2017. This decision will be accompanied by all models used in setting starting prices, which will make use of the information we intend to use in setting the final starting prices. It will also be accompanied by a draft of the DPP determinations.

Technical consultation on determination drafting

- 2.22 If necessary, we will hold a final technical round of consultation on the drafting of the DPP determinations in March or April 2017. This step has been useful in previous DPP resets (both for electricity distribution and gas pipelines) for ensuring the drafting of the determination is clear and achieves the Commission's policy intent.
- 2.23 We will reassess the need for this step closer to the time of the draft decision, and will advise stakeholders whether we intend to proceed with it.

Information requests

- 2.24 We will rely on disclosed information where possible, but dependent on the approaches we take, we may need to ask for more information from regulated suppliers. For example, it is likely we will need information on the effect of changes in ownership as a result of the Colonial First State Global Asset Management (Colonial) transactions.

Opportunities to engage in the process

- 2.25 We will consider using a number of different channels for engagement in addition to the regular submission and cross-submission process. We will consider the use of question and answer sessions following major publications, workshops on specific issues, and bilateral engagement with stakeholders.

Question and answer sessions

- 2.26 Following each major publication, we will consider holding question and answer sessions. This will allow stakeholders to better understand what the Commission is proposing, and provide an opportunity to share initial thoughts with the Commission and other stakeholders. These sessions would be held before submissions on each publication are due.
- 2.27 The first such session will follow the publication of this paper. Depending on whether stakeholders find this process useful, we will reassess whether to continue with it for subsequent publications.

Sector workshops on specific issues

2.28 We are considering holding workshops on specific topics, which might benefit from close engagement with suppliers and other sector stakeholders' proposals. The topics we consider might benefit from this are:

2.28.1 quality of service; and

2.28.2 forecasting revenue and expenditure.

2.29 If there is stakeholder interest in this proposal, we will follow up with information on the timing and location of these workshops. We seek stakeholder feedback on the timing of these potential workshops.

2.30 In addition to workshops organised by the Commission, the GIC may also hold workshops relevant to our work. The Commission proposes to these in an observer capacity.

Bilateral engagement with stakeholders

2.31 Our process may necessitate direct engagement with suppliers. This may be by way of bilateral meetings, or through information gathering requests under s 53ZD of the Act. In particular, we see this approach as being suited to managing issues relating to the sale of Vector Gas Limited (VGL) and Maui Development Limited (MDL) to Colonial. We will endeavour to be transparent about such bilateral engagement.

3. Forecasting of expenditure and revenue

Purpose of section

- 3.1 In this section, we signal our initial views and the forecasting issues we are proposing to focus on as part of the 2017 DPP reset.
- 3.2 The main change from the 2013 DPP reset that is signalled in this section is an intention to consider an approach where we use suppliers' forecasts as a starting point and then scrutinising them in order to set network and non-network opex allowances. For capex we adopted suppliers' forecasts in the 2013 DPP (and applied a forecast capex cap).
- 3.3 In addition to the possibility of using suppliers' forecasts, the other forecasting issues we will be considering as part of this DPP reset are:
- 3.3.1 our approach to starting prices and revenues;
 - 3.3.2 refining and updating the current 'step-and-trend' opex forecasting approach, including setting the base level of opex, and updating the rate of change of the three main drivers of opex (network scale, opex partial productivity and input prices);
 - 3.3.3 a forecast capex wash-up mechanism;
 - 3.3.4 treatment of major capex and forecast capex;
 - 3.3.5 revenue growth – gas demand forecasts and forecasting CPRG; and
 - 3.3.6 productivity – X-factor and opex partial productivity.

The 2013 DPP

Forecasting opex

- 3.4 In the 2013 DPP network and non-network opex allowances were set using a step-and-trend forecasting methodology. This involves adopting a base level of opex (with appropriate 'step' adjustments) that is projected using the rate of change of three main drivers (outlined in 3.3.2) over the future regulatory period (ie, the 'trend').

Forecasting capex

- 3.5 In the 2013 DPP, we adopted suppliers' forecasts of network and non-network capex, subject to a 120% cap based on previous capex variation. If a supplier's capex exceeded the 120% cap they could apply for a CPP or they would likely not recover a return on that capital investment until the next regulatory reset.

- 3.6 We considered this approach to forecasting capex was appropriate because:
- 3.6.1 suppliers have the best information on future demand and how to efficiently meet this demand; and
 - 3.6.2 the impact on consumers of a higher than necessary allowance is lower for capex than for opex in the short term.

Revenue growth

- 3.7 In the 2013 DPP, we modelled CPRG differently for gas distribution and gas transmission businesses. The differences in modelling approaches were:¹¹
- 3.7.1 for gas distribution we modelled constant price revenue separately for residential, industrial, and commercial users. We used information on load groups provided by suppliers under an information request to classify revenue into those three categories, and modelled the impact of changes in forecast quantities a supplier charges for. The three distributors used gas quantities delivered and per connection charges as parts of their tariffs; and
 - 3.7.2 for gas transmission we modelled constant price revenue separately by the billing quantities the businesses used. Both businesses used throughput fees that reflect the quantity of gas transported. MDL used as a second billing basis the quantity of gas transported multiplied by the distance transported. Vector Transmission billed for the amount of reserved capacity.
- 3.8 Revenue from gas quantities was modelled using gas demand forecasts from a study by Concept Consulting Group Limited for the GIC.¹² We modelled the other tariff components by extrapolating historical trends in these components forward, except for Vector’s transmission business where we used a forecast from Concept Consulting Group Limited.

Productivity: The X-factor and opex

- 3.9 For the 2013 DPP, we determined the common rate of change in price or revenue based on the long run total factor productivity improvement rate in the sector.¹³ In particular, we set the X-factor based on the difference between the long run productivity improvement rate in the sector compared with the wider economy.

¹¹ Commerce Commission “Setting Default Price-Quality Paths for Suppliers of Gas Pipeline Services” (28 February 2013) at Attachment E.

¹² Concept Consulting Group Limited, “Gas Supply and Demand Scenarios 2012 – 2027”, (December 2012).

¹³ The X-factor sets the time profile of prices or revenues over the regulatory period.

- 3.10 For the 2013 DPP, we considered there was a benefit to including an opex partial productivity term in our step-and-trend methodology. We considered that making productivity assumptions explicit ensures the theoretical consistency of our approach and may also create incentives.¹⁴

Our initial views

Starting prices and revenues

- 3.11 We have an option of either rolling over starting prices or revenues, or resetting starting prices and revenues based on current and projected profitability.
- 3.12 Our initial view is that we will look to set starting prices and revenues on the basis of current and projected profitability.¹⁵

Forecasting opex and capex

- 3.13 We intend to consider an approach where we use suppliers':
- 3.13.1 opex forecasts as a starting point and scrutinising them in order to set network and non-network opex allowances; and
 - 3.13.2 capex forecasts as a starting point and scrutinising them in more detail than previous resets to set network and non-network capex allowances.
- 3.14 In parallel to this, we will also be updating and considering incremental improvements to our current step-and-trend approach. If the decision is made to proceed with the forecasting method of starting with suppliers' forecasts and scrutinising them, then we may still rely on the step-and-trend method to cross-check any forecasts that result. This cross-check would not require estimates of opex partial productivity.¹⁶

¹⁴ Commerce Commission "Setting the Default Price-Quality Paths for Suppliers of gas Pipeline Services" (28 February 2013) at [C23].

¹⁵ In our view, it is generally not possible to make a decision on the approach to use until we have calculated the starting prices and revenues that would apply if starting prices and revenues are adjusted based on current and projected profitability of each party. By carrying out this calculation, and determining the materiality of differences between the alternative starting prices, we will be able to make an informed decision.

¹⁶ In particular, we may compare the results of our assessment of suppliers' forecasts against an updated step-and-trend approach. Any difference in the two approaches could be reconciled through the implied rate of improved opex partial productivity term in the step-and-trend approach. An unrealistic implied rate of improvement in opex partial productivity may suggest further analysis of suppliers' forecasts is appropriate.

Revenue growth and productivity

- 3.15 We intend to adopt a broadly similar approach to forecasting CPRG to that used in the 2013 DPP. We seek stakeholder views on how our approach to forecasting CPRG can be improved or tailored more closely to an individual supplier's circumstances.
- 3.16 For the productivity assessment methodology used to set the X-factor and opex partial productivity, we intend to look at the costs and benefits of retaining the approaches to setting the X-factor and opex partial productivity; as well as any alternative methodologies that may exist.

Forecasting opex

Improving our forecasts

- 3.17 There are opportunities to improve our forecasts – we can either:
- 3.17.1 improve the existing approach; or
 - 3.17.2 better tailor forecasts to individual suppliers' circumstances.
- 3.18 Such changes could be based on information disclosure, summary and analysis, or other information and remain relatively low cost. As part of our work reviewing the IMs, we are considering a more tailored approach to resetting the DPP where this can be done without significantly increasing cost.
- 3.19 In making potential changes to our opex forecasting methodology we will consider:
- 3.19.1 the relative merits in a forecast's robustness and cost between the approach taken in the 2013 Gas DPP and the alternatives; and
 - 3.19.2 the materiality of any change in forecasting methodology on consumers and suppliers.

Assessment of suppliers' opex forecasts

- 3.20 As there are a limited number of gas transmission businesses and gas distributors it may be possible to assess each supplier's opex forecasts when setting network and non-network opex allowances. Using suppliers' opex forecasts as a starting point and scrutinising them may result in more robust opex forecasts and allowances than the 2013 Gas DPP approach. It may also allow us to develop a stronger understanding of industry drivers.
- 3.21 We have identified a number of things to consider before using this approach:

- 3.21.1 the information on which to base our decision, for example, whether to use forecasts contained in Asset Management Plans (AMPs) or an alternative. Any data source we use is likely to be imperfect for setting allowances and may carry risk of bias;
 - 3.21.2 the expenditure objective to apply to suppliers' forecasts, ie forecast opex should reflect the efficient costs that a prudent supplier would require to meet or manage expected demand for its services, at appropriate service standards;
 - 3.21.3 the depth of assessment into suppliers' forecasts to obtain the appropriate level of scrutiny and assurance;
 - 3.21.4 the method of assessment, eg desktop analysis, information requests, external consultant review, working groups, and interviews.
- 3.22 We may still use the step-and-trend framework to validate the forecasts.

Refining and updating the step-and-trend approach

- 3.23 In parallel to the above alternative approach, we will be updating our estimates of key parameters and considering incremental improvements to our current step-and-trend approach.
- 3.24 The step-and-trend methodology involves adopting a base level of opex (with appropriate 'step' adjustments) projected using the rate of change of three main drivers over the future regulatory period (ie, the 'trend'). We adopted the following three main drivers of opex in 2013: network scale, opex partial productivity and input prices. Below we consider these (except opex partial productivity which is discussed in paragraphs 3.59 to 3.61).

Base opex

- 3.25 The step-and-trend approach relies on a base level of opex from which to project future levels of opex. Step-change adjustments to the base level of opex can be made where appropriate.
- 3.26 We have identified a number of things to consider before setting a base level of opex:¹⁷
- 3.26.1 the base year of opex;
 - 3.26.2 the potential to adopt a multi-year average of opex;¹⁸

¹⁷ In addition to these, there is also the potential implementation of an opex IRIS. Any implementation of an opex IRIS will influence the choice of a base level of opex - see section 5 of this paper.

- 3.26.3 adjustments to the base level of opex. There may be circumstances where supplier-specific base opex adjustments are appropriate – we encourage suppliers to evidence this early in the process so that it can be fully assessed; and
- 3.26.4 the effect of changes in ownership as a result of the Colonial transactions.

Network scale

- 3.27 In the 2013 DPP the step-and-trend approach captured the effect of network scale on opex through observed trends in network length and the number of customers. Trends in network scale were multiplied by the estimated elasticities of opex to network length and the number of customers, respectively.¹⁹
- 3.28 We consider that the network scale elasticities should be updated using the most recent data. Issues with doing this are:
 - 3.28.1 data availability – the 2013 Gas DPP approach was based on limited New Zealand and Australian gas pipeline business data. We would like to explore larger datasets on which to base our analysis; and
 - 3.28.2 alternative methods and approaches to estimating network scale elasticities – we would like to stress test the previous approach in light of updated data and explore other quantitative or qualitative methodologies to estimating network scale elasticities.

Input prices

- 3.29 In the 2013 DPP the step-and-trend approach captured the effect of opex input prices through forecasting all industry price indices. The opex input prices were measured through a weighted average of the forecast of the Producer Price Index and the Labour Cost Index.²⁰ The forecast change in input prices reflects how the annual cost of providing a given level of service is expected to evolve over the next regulatory period.
- 3.30 We have identified opportunities for refinement to this approach:

¹⁸ This concern may receive more weight if an opex IRIS is not put in place for the 2017 Gas DPP reset.

¹⁹ Our adopted elasticities were based on an econometric analysis of Australian and New Zealand data by Castalia. See Castalia “Review of the Draft Decision on the Revised Initial Default Price-Quality Paths for Gas Pipeline Services: Report for Vector Limited” (December 2012).

²⁰ The forecast labour cost index received a 60% weight, while the forecast producers price index received a 40% weight.

- 3.30.1 sub-industry measures of input prices. Instead of using all industry cost indices we can explore using industry specific indices more reflective of the gas pipeline sector. We adopted industry specific sub-industry cost indices in the 2015 Electricity Distribution Business DPP reset;²¹ and
- 3.30.2 the weights applied to the Labour Cost Index and the Producers Price Index. Suppliers may be able to provide information to update the weight applied between the two cost indices used to forecast input prices.

Forecasting capex

There are opportunities to improve our forecasts of capex

- 3.31 There are opportunities to improve our forecasts – we can either:
 - 3.31.1 improve the existing approach; or
 - 3.31.2 better tailor forecasts to individual suppliers' circumstances.
- 3.32 As with forecasting opex, such changes could be based on information disclosure, summary and analysis or other information and remain relatively low cost. As part of our work reviewing the IMs, we are considering a more tailored approach to setting the DPP where this can be done without significantly increasing cost.
- 3.33 It may be possible to remove the explicit capex cap applied to forecasts allowing for a potentially more efficient profile of capex over the next regulatory period. A cap may become implicit and different for each supplier. If a full removal of the forecast capex cap is not appropriate it may still be possible to reassess its level. We encourage stakeholders to provide evidence of inefficiency created by the forecast capex cap. This also links with the discussion on the treatment of major investments in paragraphs 3.43 and 3.46 below.
- 3.34 This alternative approach may also allow the opportunity to develop a stronger understanding of the industry through engagement on suppliers' capex forecasts.
- 3.35 In making changes to the capex forecasting methodology we will consider:
 - 3.35.1 the relative merits in a forecast's robustness and cost between the current 2013 DPP approach and the alternatives; and
 - 3.35.2 the materiality of any change in forecasting methodology on consumers and suppliers.

²¹ Commerce Commission "Default price-quality paths for electricity distributor from 1 April 2015 to 31 March 2020: Low cost forecasting approaches" (28 November 2014).

An assessment of suppliers' capex forecasts

- 3.36 Similar to our initial views on forecasting opex discussed above, as there are a limited number of suppliers it may be feasible to assess each supplier's capex forecasts when setting network and non-network capex allowances.
- 3.37 This may involve starting with the capex forecasts contained in AMPs, and then, dependent on how confident we are in those forecasts, we might need to supplement them with requests for information. Alternatively, we may ask suppliers to disclose alternative capex forecasts.
- 3.38 We have identified a number of things to consider before we more heavily utilise suppliers' forecasts of capex:
- 3.38.1 the considerations we have identified above in 3.21.1 to 3.21.4 for when we assess the proposed approach to use supplier forecasts for opex;
 - 3.38.2 treatment of different suppliers. Different assessment approaches may be applied to different suppliers based on materiality or other factors, such as the recent Colonial transactions and the implications for data availability; and
 - 3.38.3 the potential to remove or increase the forecast capex cap. Provided sufficient assurance is gained in respect of suppliers' capex forecasts, there may be a case to remove or increase the forecast capex cap.
- 3.39 Any potential allowance of major capex under the DPP may have implications for the appropriateness of an increased focus on suppliers' forecasts of capex to set capex allowances and the forecast capex cap. We discuss major investments below.
- 3.40 Any additions made to the DPP to address major capex may act to reduce the appropriate forecast capex cap. Future expenditure variation, once major capex is excluded from the forecast, may be lower. Capex 'lumpiness' is an industry feature to consider when setting the cap and assessing supplier forecasts.

A forecast capex wash-up mechanism

- 3.41 As part of the 2015 EDB DPP reset we introduced a forecast capex wash-up mechanism.
- 3.42 This mechanism accounts for the differences between the forecast value of commissioned assets used for the last year prior to the reset, and the actual values which are not available until after the DPP must be determined.

The treatment of major investments

- 3.43 Our emerging view is that major investments, such as the Whitecliffs project,²³ are best dealt with under a CPP.²⁴
- 3.44 It has been suggested by stakeholders that a targeted mechanism requiring no regime change between a DPP and a CPP is appropriate to accommodate major capital investments. It is suggested that this mechanism apply to projects where need is certain, but timing approach and cost is subject to uncertainty.²⁵
- 3.45 Colonial provided in its submission a high level analytical framework for accommodating major capex under the DPP.²⁶
- 3.46 The high level analysis conducted by Colonial on assessing a major capital project under a DPP suggests that scrutiny of individual major projects is required. Colonial submitted that this should be done under a major projects approval process under a DPP.²⁷ It is our emerging view that a CPP to accommodate such an investment is in consumers' long term interests.

Revenue growth

Gas demand forecasts

- 3.47 Our emerging views within the IM review on the appropriate form of control for gas pipeline services are set out in section 4, and include gas transmission businesses moving to a pure revenue cap.
- 3.48 This means that we may need a forecast for gas distributors but not for gas transmission businesses. Our previous approach to forecasting CPRG in the 2013 Gas DPP relied on a gas demand study commissioned by the GIC.
- 3.49 Given data limitations, we aim to explore the performance of these forecasts and attempt to identify opportunities to improve them.

²³ The Whitecliffs project involves relocating part of the existing pipeline, which is on land subjected to subsidence.

²⁴ Commerce Commission "Input methodologies review: Emerging views on opportunities to improve the way default and customised price-quality paths work together" (29 February 2016).

²⁵ Colonial and MDL support 'listed projects' as part of the DPP. CFS suggests a high level analytical framework. Colonial First State "Submission on the gas pipeline stakeholder meeting" (29 January 2016) at 5-7; Maui Development Limited "Submission on the gas pipeline stakeholder meeting" (28 January 2016) at 5; Powerco "Input methodologies review: gas pipeline default price-quality path reset 2017" (28 January 2016) at [27]. Powerco support the principle of a supplier being able to make an individual case to the Commission for 'single issue' investment drivers.

²⁶ Colonial First State "Submission on the gas pipeline stakeholder meeting" (29 January 2016) at [4].

²⁷ Ibid.

Forecasting CPRG

- 3.50 Our current view is that, subject to assessing forecast performance, we will adopt a similar approach to forecasting CPRG for gas distribution and possibly transmission businesses as in the 2013 Gas DPP reset. However, there may be opportunities for potential improvements.
- 3.51 As part of our work reviewing the IMs, we are considering taking a more tailored approach to setting the DPP where this can be done without significantly increasing cost. There may be a case for tailoring suppliers' CPRG forecasts.
- 3.52 The 2013 Gas DPP approach modelled consumer groups separately (using an information request to understand load groups) as well as modelling suppliers' fixed and variable charges.

Productivity: The X-factor and opex

- 3.53 For this reset we will consider:
- 3.53.1 the productivity assessment methodology used to set the X-factor and opex partial productivity in the last DPP reset;
 - 3.53.2 the options for setting productivity measures; and
 - 3.53.3 the regulatory value in retaining explicit productivity measures in the DPP.
- 3.54 The technical methodology employed in the previous gas DPP reset required judgement to set appropriate forward-looking productivity growth rates.

Setting the rate of change at which revenue is recovered

- 3.55 The rate of change in price or revenues affects the time profile of revenues. We refer to this rate of change as the X-factor.
- 3.56 The Act requires us to set a rate of change based on the long run average productivity improvement rate achieved by suppliers in New Zealand and/or overseas. The Act allows us discretion to adopt a method we think most appropriate.²⁸ This could include:
- 3.56.1 international benchmarking;
 - 3.56.2 an index-numbers total factor productivity analysis (adopted for the 2013 Gas DPP); or
 - 3.56.3 alternative quantitative or qualitative methods.

²⁸ Commerce Act 1986, s 53P(6).

- 3.57 In the 2013 DPP we determined the common rate of change in price or revenue based on the long run total factor productivity improvement rate in the sector. In particular, we set the X-factor based on the difference between the long run productivity improvement rate in the sector compared with the wider economy.
- 3.58 The X-factor only acts to smooth suppliers' price-quality paths. This smoothing does not affect the overall amount of revenue that suppliers can expect to earn over a regulatory period.²⁹

Setting the rate of opex partial productivity

- 3.59 The Act does not require us to set rates of opex partial productivity.
- 3.60 The step-and-trend methodology to forecasting opex includes an adjustment term for the rate of opex partial productivity. In this situation opex partial productivity will impact on the opex allowance and suppliers' starting prices or revenues.
- 3.61 In the 2013 DPP reset we considered there was a benefit to including an opex partial productivity term in our step-and-trend methodology for opex. We considered that making productivity assumptions explicit ensures the theoretical consistency of our approach and may also create incentives.³⁰

There are options in assessing sector productivity growth

- 3.62 We consider the following issues are important in deciding upon a methodology to determine the X-factor or opex partial productivity:
- 3.62.1 alternative methodologies to measuring sector productivity change. This could include alternative empirical approaches, including international benchmarking;
 - 3.62.2 data requirements. There may be data limitations that restrict our potential alternative methodologies. We expect information disclosures to act as the primary source of data potentially supported by supplier information requests; and
 - 3.62.3 transparency. It is appropriate that stakeholders engage with the productivity assessment and its findings. This may influence the choice of methodology, or the degree of engagement through workshops and working groups.

²⁹ This contrasts with a situation in which starting price or revenue is rolled over from a previous period. In that situation, the rate of change in price or revenue would have a direct impact on the amount of revenue that the supplier can expect to earn over the regulatory period.

³⁰ Commerce Commission "Setting the Default Price-Quality Paths for Suppliers of gas Pipeline Services" (28 February 2013) at [C23].

- 3.63 An appropriate productivity analysis will consider these issues and weigh them against the materiality of the findings to consumers and suppliers through the DPP.³¹
- 3.64 We are interested in exploring potential approaches and associated data requirements behind alternative methodologies to appropriately set the X-factor and opex partial productivity where necessary.

³¹ A productivity study into the sector also has value to strengthen our understanding of the industry.

4. Form of control – limiting price or revenue changes

The 2013 DPP

- 4.1 For gas transmission businesses, the 2013 DPP specified maximum prices in terms of a revenue cap. For gas distribution businesses, maximum prices were specified in terms of a weighted average price cap (WAPC).
- 4.2 For both transmission and distribution, compliance with the price path was demonstrated using two-year lagged quantities. We chose to use lagged quantities to provide businesses with a degree of certainty when setting prices.

Purpose of this section

- 4.3 This section summarises our emerging views on the appropriate form of control for gas transmission and gas distribution businesses, as set out in our emerging views on form of control paper, published separately today.³² This paper then discusses how the choice of form of control will impact the setting of the DPP.
- 4.4 Stakeholder comments on the choice of form of control within the IMs should be made by Thursday 24 March 2016. Views on the implications for how we set the DPP should be submitted by Wednesday 30 March 2016.

Emerging views on form of control

- 4.5 Our emerging views on the appropriate form of control for gas pipeline services are:
 - 4.5.1 that gas transmission businesses should remain subject to a revenue cap, but that it should be assessed using current quantities with a wash-up mechanism, rather than on lagged quantities;³³ and
 - 4.5.2 that we need to do further analysis to determine what form of control is appropriate for gas distribution businesses. We envisage choosing between a WAPC using lagged quantities (the form of control in the current DPP), a WAPC using quantities with no lag, and a pure revenue cap.

³² Commerce Commission “Input methodologies review – Emerging views on form of control” (29 February 2016).

³³ We refer to a revenue cap using current quantities as a “pure” revenue cap.

Implications for the DPP

- 4.6 The decisions on the form of control and on quantity lagging are relevant to aspects of how we set the gas pipeline DPP, specifically:
- 4.6.1 the need for forecasts of constant price revenue growth (CPRG);
 - 4.6.2 the need for a wash-up mechanism to deal with under and over recovery and to help mitigate price volatility; and
 - 4.6.3 dealing with the implications of the introduction of auction based pricing.

Implications for forecasting

- 4.7 The decision on form of control and the decision about whether to use lagged or current quantities impacts whether we need to forecast CPRG.³⁴
- 4.8 Under a WAPC, we forecast CPRG for the next regulatory period in order to set starting prices. The requirement to forecast CPRG for the next regulatory period applies whether or not we use lagged quantities.
- 4.9 Under a pure revenue cap, we do not need to forecast CPRG for the next regulatory period.
- 4.10 If we use two-year lagged quantities, under a WAPC or a revenue cap, we must model CPRG for the year immediately before the start of the next regulatory period, and the first year of the next regulatory period, in order to take account of the two-year lag.

Introduction of a revenue wash-up mechanism

- 4.11 The different forms of control we are considering require different price path compliance formulas in the DPP determination. Applying a pure revenue cap or applying a WAPC with quantities with no lag means that, as a matter of best practice, a wash-up mechanism would be necessary. Under a lagged quantities approach, this mechanism would not be necessary.
- 4.12 Under a pure revenue cap, suppliers set prices at the start of the year based on a forecast of quantities for that year. We envisage that this forecast would be made by the supplier. A wash-up mechanism would then reverse out the revenue impact of any difference between these forecast quantities and the actual quantities in the year.³⁵

³⁴ For a more detailed discussion of CPRG forecasting, see paragraphs 3.47-3.49.

³⁵ This mechanism has also been referred to as an “unders and overs” mechanism.

- 4.13 Such a mechanism could also be used to help with smoothing revenue recovery over the regulatory period, and to help with over or under recovery due to proceeds from capacity auctions.
- 4.14 We are interested in stakeholder views on how a wash-up mechanism might be implemented, including:
- 4.14.1 how often the wash-up between forecast and actual revenues should occur;
 - 4.14.2 options for smoothing revenue recovery to deal with price volatility;³⁶
 - 4.14.3 any lessons from the economic value (EV) account mechanism used by Transpower to roll-forward and apply the results of wash-ups of revenues, or from approaches taken by other regulators overseas; and
 - 4.14.4 possible implications of the GIC's work on transmission access pricing.

Table 4.1: Transpower's EV account mechanism

One means of implementing a wash-up mechanism is to apply an EV account concept, similar to what applies to Transpower in the annual update to Transpower's forecast maximum allowable revenue.

The purpose of an EV account is to return to, or recover from, a supplier's customers under or over recoveries of revenue resulting from differences between actual and forecast values (eg for Transpower this includes the difference between actual and forecast transmission revenue). This is to ensure that overall the supplier receives an appropriate return on its actual investment.

An EV account effectively does this by recording amounts that will later be used to increase or decrease a supplier's maximum allowable revenue for the applicable period; annually through an update to the forecast maximum allowable revenue in Transpower's case.

For example, if Transpower over recovers revenues from consumers in one year, that amount enters the EV account, and will later be released from the EV account resulting in the forecast maximum allowable revenue for the next available pricing year being reduced.

Proceeds from capacity auctions

- 4.15 As part of its work on transmission access pricing, the GIC is looking at the use of capacity auctions. Our initial view is that the transmission DPP will need to be set in a way that can deal with the proceeds of capacity auctions.

³⁶ Gas consumers have raised this intra period price volatility as a problem with the current form of control compliance arrangements. Major Gas Users Group "Submission on the gas pipeline stakeholder meeting" (28 January 2016) at [13-18]; Oji Fibre Solutions "Submission on the gas pipeline stakeholder meeting" (28 January 2016) at [2]; Greymouth Gas "Submission on the gas pipeline stakeholder meeting" (28 January 2016) at 1.

- 4.16 Any such mechanism would need to both mitigate the risk of suppliers inadvertently breaching the price path, while at the same time not allowing suppliers to over-recover their allowed revenue. We are interested in stakeholder views on how a mechanism could achieve these outcomes, and on any other considerations we ought to take into account.

5. Incentives for expenditure

Purpose

- 5.1 In this section we signal our approach and seek views on whether there should be an opex and capex IRIS for gas pipeline services.
- 5.2 Stakeholder comments on IRIS should be made by Thursday 24 March 2016.

The 2013 DPP

- 5.3 The 2013 DPP did not contain an opex or capex IRIS mechanism.

Our emerging view

- 5.4 Our emerging view is that the benefits from implementing a capex and opex IRIS for gas pipeline services are unlikely to outweigh the complexity and associated costs, and that fuller consideration of IRIS mechanisms should be deferred until the next DPP reset.

Gas transmission businesses

- 5.5 While capex for gas transmission businesses is typically considered 'lumpy', based on AMP information provided by suppliers, forecast capex over the next DPP regulatory period is generally expected to be relatively small and stable. This suggests that even the upper limit of potential benefits from a capex IRIS is limited. Taking into account the likely magnitude of efficiencies and the sharing of these between suppliers and consumers, any efficiency benefits are likely to be a very small portion of total capex.
- 5.6 One known exception relates to the potential Whitecliffs project, which would likely represent a large proportion of total capex. It is possible that this expenditure may be high in the early years of the next regulatory period. However, in the event that this is the subject of a future CPP and therefore outside of the DPP, this would further reduce the impact of a capex IRIS in the DPP. While not implementing a capex IRIS in the DPP means that the incentive for large capex investments is not consistent over time, we anticipate that this would only have a marginal impact, which would not warrant the complexity associated with its introduction.
- 5.7 The level of opex expenditure for a gas transmission business is typically higher than capex expenditure. This means the upper limit of efficiency benefits of an IRIS would likely be higher than for capex. The Commission's starting point for any IRIS mechanisms for the gas sector is the recently introduced IRIS incentives (both capex and opex) applying to EDBs. However, at this point we consider that it is more prudent to wait until the EDB IRIS mechanisms have settled, and minor problems have been rectified, before implementing similar mechanisms for the gas sector.

- 5.8 Further, there may be additional design complexity involved in developing IRIS mechanisms for the gas sector in terms of potential adjustments to information provided on a disclosure year basis to information on a pricing year basis.
- 5.9 Both MDL and Colonial did not favour the implementation of IRIS mechanisms. MDL noted that the cost-benefit of designing, implementing and maintaining a practical and effective IRIS could turn out to be negative,³⁷ and Colonial noted that an IRIS seems premature.³⁸ These submitters appear to support our emerging view above.

Gas distributors

- 5.10 AMP information provided by suppliers indicates that capex expenditure for gas distributors is likely to be relatively small over the next DPP regulatory period. This indicates the benefits of a capex IRIS are likely to be limited.
- 5.11 IRIS incentives are sensitive to accurate forecasting which is particularly difficult for gas distributors given capex and opex are heavily influenced by customer connections which are, by their nature, difficult to predict. While this risk could be mitigated, to some extent, if we performed a more detailed expenditure review with respect to gas distributors, it would not resolve the difficulty of identifying true under/out performance.
- 5.12 Powerco considered that the case for introducing capex incentives at this stage is less compelling than for an opex incentive and recommended deferring consideration of financial incentives until the next DPP reset.³⁹ Colonial considered that an IRIS is unlikely to be warranted for gas distributors.⁴⁰
- 5.13 The comments above in respect of gas transmission businesses in terms of the complexity of IRIS and the benefits associated with allowing the existing EDB IRIS to settle first also apply to gas distributors. These factors, along with the submissions from stakeholders, have led to our emerging view that we should not develop an IRIS for the upcoming DPP.

Opex IRIS currently applying to CPPs

- 5.14 In the event that a capex and opex IRIS are not implemented for the DPP, there are three options in respect of CPPs:
- 1) we retain the existing asymmetric IRIS;
 - 2) we remove the existing asymmetric IRIS altogether; or

³⁷ Maui Development Limited "Submission on the gas pipeline stakeholder meeting" (28 January 2016) at 6-7.

³⁸ Colonial First State "Submission on the gas pipeline stakeholder meeting" (29 January 2016) at 7.

³⁹ Powerco "Feedback on IMs Review: Gas Pipeline DPP Reset 2017" at 2 and 8.

⁴⁰ Ibid, at 1.

- 3) we replace the existing asymmetric IRIS with a symmetric IRIS.
- 5.15 Our emerging view is that the opex IRIS applying to CPPs should be removed ie, we prefer option 2. We do not favour option 1 on the basis that maintaining an asymmetric opex IRIS is not appropriate.⁴¹ For example, where efficiency losses are not rewarded and penalised in equal measure (ie not treated symmetrically), it gives rise to significantly different retention factors in different years, which can distort supplier behaviour. Option 2 is preferred over option 3 for the reasons outlined earlier in terms of complexity and cost.

⁴¹ Commerce Commission "Incentives for Suppliers to Control Expenditure During a Regulatory Period: Process and Issues Paper" (20 September 2013) at 28-31.

6. Company specific issues

Purpose of section

- 6.1 In this section, we signal our approach and seek views on company specific issues for this DPP reset. This section covers issues that result from the proposed (and not yet finalised) First State managed infrastructure funds' purchase of the gas transmission business and non-Auckland distribution network of VGL, as well as the gas transmission business of MDL.

Our initial view

- 6.2 Our initial view regarding the impact of the Colonial transactions and the consequence that there will be one entity owning both transmission pipelines – is to have one price-quality path for transmission.
- 6.3 The Commission is considering options as to what base year to use for Powerco due to information disclosures not being available until 31 March 2017 and would like to understand Powerco's preferred option.

Colonial First State

- 6.4 The Commission understands that, subject to fulfilling remaining conditions (including Overseas Investment Office Approval), the transactions for the First State managed infrastructure funds' purchase of the gas transmission business and non-Auckland distribution network of VGL, as well as the gas transmission business of MDL, will be structured as follows:
- 6.4.1 on 31 March 2016, Colonial will purchase 100% of the shares in VGL; and
- 6.4.2 soon after, VGL will purchase all the pipeline assets of MDL.
- 6.5 Our initial view is that there should be one price-quality path for transmission. Benefits of this approach include simplicity and not needing common cost allocations. However, as we could potentially set two price-quality paths, we are interested in whether there are any factors that might suggest that doing so is appropriate (and why). The distribution network being bought by Colonial will be regulated separately.
- 6.6 There are a number of potential information disclosure and DPP compliance issues to work through in the current DPP period as a result of the Colonial transactions. The Commission is also working through the forecasting and modelling issues that may result, which include:
- 6.6.1 implications on modelling from the choice of year-end dates for information disclosure;

- 6.6.2 availability of historical opex and capex information that is disaggregated between the Auckland distribution network and the non-Auckland distribution network, especially for common costs;
 - 6.6.3 whether disaggregated network data that is key to setting a DPP (regulatory asset base (RAB), regulatory depreciation, tax book value, tax depreciation, adjusted depreciation asset value, and amortisation of initial difference in asset values) can be derived from other information held; and
 - 6.6.4 Colonial is unlikely to have an AMP containing opex and capex forecasts.
- 6.7 The Commission seeks feedback on any issues that stakeholders have identified that will result from these transactions, including any errors in the IMs. We will also be in discussions directly with Colonial and Vector regarding a number of issues.
- 6.8 Greymouth Gas queried, in its submission on the gas pipeline stakeholder meeting,⁴³ whether the sale price would reset the “total allowable recoverable money upwards for the relevant pipelines in the next default price path period”. In response, we note that we do not take into account the amount of sale prices when setting the allowable revenues in DPP resets.

Powerco

- 6.9 Gas information disclosures are required 6 months after year-end. If the base year⁴⁴ for Powerco is chosen to be the year ending 30 September 2016, then the disclosure would be made by 31 March 2017, just two months before release of the final decision. The Commission considers that this may be too tight a timeframe.
- 6.10 Options include using a base year ending 30 September 2015 or requiring the disclosure through other means, for example, a s 53ZD notice, within 5 months rather than 6 months. The latter approach would result in the disclosures being received 3 months prior to the final decision, which is the same as the timeframe for EDB DPP decisions. The Commission would like to understand Powerco’s preferred option.

⁴³ Greymouth Gas "Submission on the gas pipeline stakeholder meeting" (28 January 2016).

⁴⁴ See paragraphs 3.25 and 3.26 for discussion on the relevance of the base year.

7. Quality

Purpose of section

- 7.1 In this section, we signal our approach and seek views on issues relevant to the setting of quality standards for gas pipeline services.

The 2013 DPP

- 7.2 The Act requires the Commission to set a quality standard for suppliers of gas pipeline services.⁴⁵ In 2013, we set quality standards based on annual targets for response time to emergencies (RTE). The specific targets are:
- 7.2.1 all suppliers of gas pipeline services must take 180 minutes or less to respond to any emergency; and
 - 7.2.2 gas distributors must take 60 minutes or less to respond to 80% of emergencies.
- 7.3 When we set this quality standard, we were aware of the difficulties that exist in developing an outage or reliability-related quality standard for gas pipeline services. We also considered the other regulatory measures in place for quality of gas services, and the differences between electricity and gas.
- 7.4 The characteristics of gas are different to those of electricity and so it is not appropriate to transfer the quality standards that exist in electricity across to gas pipelines. There are also significant differences between gas transmission and gas distribution.
- 7.5 The quality standard set by the Commission is not the only influence on gas pipeline services' quality of supply. Other agencies have overlapping responsibilities in this area, how we have taken this into account in our initial views for future quality standards is discussed below.

Our initial views

- 7.6 For gas transmission services, we intend to consider whether there are other quality of service standards for gas transmission that could be implemented – for example, a quality standard of zero outages combined with a comprehensive incident reporting obligation.

⁴⁵ Commerce Act 1986, s 53M(1)(b).

- 7.7 For gas distribution services, our initial view is that the current quality standard for RTE should remain, but we will consider whether there are other quality of service standards for gas distribution that could be implemented – for example, a quality standard relating to major outages combined with a comprehensive incident reporting obligation.
- 7.8 For gas distribution services, we also intend to reassess the current information disclosure measures to ensure readiness for any development of standards for the 2022 reset.
- 7.9 We are aware that stakeholders are willing to participate in discussions around any additional quality of service standards and measures, and so we will work with the GIC to ensure a streamlined approach to industry discussions.

Gas transmission services

- 7.10 Responsibilities for the security, reliability and safety of gas transmission services in New Zealand are shared across the Commission, Worksafe and the GIC.
- 7.11 Worksafe NZ is responsible for the Health and Safety in Employment (Pipelines) Regulations 1999, which impose a certificate of fitness requirement on gas and petroleum pipelines and all equipment necessary for the safe operation of those pipelines.
- 7.12 The GIC has an objective to ensure that gas is delivered in an efficient and reliable manner, and it does this in part by being involved in amendments to the Maui Pipeline Operating Code (MPOC) and the Vector Transmission Code (VTC). These agreements set out general commercial and operating terms and conditions for access to the MDL and Vector transmission systems.
- 7.13 The GIC also administers the Gas Governance (Critical Contingency Management) Regulations 2008 which set out how industry participants plan for, and respond to, a serious incident affecting gas supply via the gas transmission pipelines.

- 7.14 There have been four unplanned interruptions on the transmission systems in the last five years⁴⁶ and there have been no emergencies since the commencement of the gas transmissions DPP on 1 July 2013 (ie no RTEs have been reported).⁴⁷ While outages on the transmission systems may be rare, they have a large impact when they do occur. We are interested in understanding whether there are other quality of service standards for gas transmission that would incentivise mitigating the risk of such events.
- 7.15 Section 53M(2) states that a price-quality path may include incentives for an individual supplier to maintain or improve its quality of supply. One of these incentives is reporting requirements if the supplier fails to meet the quality standards.⁵⁰
- 7.16 We seek views on whether a quality standard of zero outages, combined with a comprehensive incident reporting obligation, would provide improved incentives for gas transmission businesses and meet consumer requirements. In this case, any outage would be a contravention of the price-quality path. However, due to the low probability nature of outage events on transmission systems, and as the root cause may be outside the control of the gas transmission business, we do not consider that a revenue linked quality standard is appropriate at this time.
- 7.17 Instead, the report into the event would identify any issues with process in order to ensure quality of the regulated service and it could also indicate where more enforcement activity is required. A contravention can also potentially lead to enforcement action, which could include penalties and compensation sought through the Courts.
- 7.18 Another factor contributing to incentives around quality of transmission, and one that has been raised by the GIC and stakeholders, is that the AMPs produced by gas transmission businesses could be improved to better set out the processes that ensure quality is maintained.

Gas distribution services

- 7.19 The Gas (Safety and Measurement) Regulations 2010 contain the primary legal requirements that keep interruptions to a minimum in gas distribution, including requirements around safety, quality, reliability and continuity of supply. We do not seek to duplicate these.

⁴⁶ MDL “Transitional Asset Management Plan 2015”, at 40; Vector Gas Limited “Transmission Asset Management Plan 1 July 2015 to 30 June 2025”, section 4, at 13.

⁴⁷ MDL “Transitional Asset Management Plan 2015”, at 38; Vector Gas Limited “Transmission Asset Management Plan 1 July 2015 to 30 June 2025”, section 4, at 7.

⁵⁰ Commerce Act 1986, s 53M(2)(d).

- 7.20 Our initial view is that the current quality standard with regards to the RTEs should remain. However, the Commission also plans to consider whether there are other quality of service standards for gas distribution that could be implemented – for example, a quality standard relating to major outages combined with a comprehensive incident reporting obligation.
- 7.21 We plan to conduct a reassessment of the current information disclosure measures for any development for the 2022 reset. In its submission on the gas pipeline stakeholder meeting, Powerco proposed that insight be gained “...into customer value preferences and metrics that could provide appropriate information on network quality performance and customer service trends. The next step should be to consider the practicality and net benefit (if any) of an extended suite of metrics”.⁵¹ We propose to consider, with stakeholders, indicators relating to connection times and other customer service measures. This does not have to be on the same timetable as the 2017 DPP reset but we do want to be able to inform future measures.

⁵¹ Powerco "Submission on the gas pipeline stakeholder meeting" (28 January 2016).