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24 March 2016

Tricia Jennings
Project Manager, Gas DPP reset 2017
Regulation Branch
Commerce Commission
Wellington

By email: regulation.branch@comcom.govt.nz

Dear Tricia,

**Default Price Quality Paths for Gas Pipeline Services from 1 October 2017 –
Process and issues Paper**

1 This is Vector's submission to the Commerce Commission's (the Commission) Process and Issues Paper on the resetting the default price-quality paths for gas pipeline services from 1 October 2017, dated 29 February 2015.

2 Vector's contact person for this submission is:

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3 No part of this submission is confidential and we are happy for it to be publicly released.

Commission's consultation process

4 Vector supports the early release of the Commission's financial models that will be used to reset the DPP. We encourage the Commission to have a consultation on the financial models so that any concerns or possible errors identified by parties can be discussed in a transparent manner.

5 The Commission asked industry about their interest on having issue-specific workshops on particular topics. Vector supports the concept of having workshops on challenging issues. The two issues nominated by the Commission for dedicated workshops are 'forecasting demand and expenditure' and 'quality of service'. Vector looks forward to participating in the proposed workshops and assisting with a suitable outcome for these particular issues.

Form of control

6 As discussed in Vector's submission on the Commission's emerging view on the form of control, it does see merit in the Commission investigating whether a change in the form of control can improve certainty in DPP outcomes for suppliers and consumers. However, without more detail on the framework within which a "pure"

revenue cap would operate it is difficult assess whether it provides an improvement on the status quo.

Forecasting expenditure and demand

- 7 As mentioned above, Vector supports the Commission having a workshop dedicated to developing and refining its approach to forecasting expenditure and changing demand (referred to as constant price revenue growth (CPRG) in the Commission's model). We believe that greater consultation and feedback on forecasting will assist the Commission in developing fit-for-purpose forecasts for the DPP.
- 8 A key feature of the DPP and customised price path framework under Part 4 of the Commerce Act is the scrutiny involved with forecasting inputs necessary for setting a price-quality path. Vector supports innovation by the Commission in refining its approach to forecasting for the DPP so long as such innovation is consistent with the 'low cost' intention of setting price-quality requirements within the DPP framework.
- 9 The Commission's processes and issues paper also acknowledges the foreshadowed sale of Vector's gas transmission pipeline and non-Auckland gas distribution network to Colonial First State and the sale of the Maui pipeline also to Colonial First State does provide unique challenges for this particular DPP reset.

Forecasting operating expenditure

- 10 We support the Commission's consideration of a more tailored approach to determining suppliers' operating expenditure (opex) to the 'step and trend' approach used for the 2012-2017 DPP. The particular circumstances for this reset where three networks are subject to changes of ownership, means the step and trend model will likely provide a less certain guide as to operational expenditure for those networks.
- 11 Using supplier forecasts is the better way for recalibrating the opex building block for this DPP reset given the unique circumstances of the recent transactions.
- 12 The history necessary for applying a 'step and trend' approach is compromised by the imminent sale of the three pipeline businesses to Colonial First State. Should the Commission pursue the 'step and trend' approach it will have to significantly supplement its base year information from the legacy ownership of the networks to reflect the characteristics of the new ownership model. This undermines the utility of the 'step and trend' approach.
- 13 The Asset Management Plans (AMPs) for businesses already contemplate opex forecasts and provide a reasonable construct within which to assess supplier forecasts. We are confident the Commission will have enough information with the AMP and any specific supplier forecast it requests to assess the efficiency of such forecasts in the low cost way contemplated by the DPP.
- 14 We encourage the Commission not to progress the two alternatives of 'step and trend' or 'supplier forecasts' in parallel and then selecting a preferred approach.

This is likely to increase the information burden and cost on businesses for no tangible benefit. Running two processes in parallel risks doubling the information requirements to develop a credible 'step and trend' estimate.

- 15 Vector recommends the Commission "makes a call" on which approach it will use to estimate opex.

Forecasting capital expenditure

- 16 Vector supports the continuance of relying on the AMP for assessing supplier capex forecasts for the forthcoming DPP. Vector notes the cap on AMP forecasts based on 120% of historical expenditure has been the Commission's preferred approach for previous DPP resets for electricity and gas. This approach provides a fair balance for the forecast future needs of their networks but also provides a discipline against over-forecasting.
- 17 In Vector's experience, capex needs for its distribution network is lumpy. Therefore, historical outturn capex merely provides a rough guide as to how future capex needs for the network will be addressed. Another significant driver for capex is the demand for new connections to the network. Depending on the nature of the connection, it is very easy for the business to exceed its expenditure forecast for new connections. In this respect, the issue is not the forecast volume of connections but the type of connection being requested. While such capex needs can be insulated by customer capital contributions, in many instances they are insufficient to cover incremental cost of the connection to a standard connection. Where this is the case, it is very easy for a business to exceed its capex allowance due to unforeseen high cost of new connections to the network.

Capex wash-up adjustment

- 18 Vector supports the inclusion of the capex-wash up adjustment mechanism, as applied in the most recent EDB DPP, to be included as a recoverable cost in the next gas DPP reset. This mechanism ensures that the reset DPP reflects the final year's actual commissioned assets, rather than the forecast presumed in the DPP for the final year. This will avoid a material disadvantage for suppliers that had cause to commission assets in the final year of the DPP in excess of the Commission's forecast.

Demand forecasting – CPRG

- 19 As discussed above, Vector is happy to assist the Commission's workshop on its approach to forecasting CPRG for gas distribution businesses. At the Q & A session the Commission noted that it was considering reprising the analysis performed by the Gas Industry Company (GIC) for the last gas DPP reset of estimating CPRG but has also suggested that it may consider more supplier specific tailoring of CPRG forecasts. Should the Commission reprise the GIC's study then Vector encourages that it consults with stakeholders on the terms of reference to ensure any outputs are fit-for-purpose.

- 20 Vector cautions against the Commission applying unrealistic forecasts of CPRG that results in businesses being unable to achieve the forecasted regulatory return over the DPP presumed in starting prices.

Service Quality

- 21 Vector recognises the inherent challenges with developing a meaningful customer focussed measure of gas network quality. To that end, Vector is happy to participate in the Commission's quality of service workshop to explore better alternative measures or complements to the response time to emergency (RTE) measure. Vector acknowledges that RTE provides the right discipline on network operators to be sufficiently resourced for RTE events which addresses the broader community need of limiting the occurrences of pipeline leaks.
- 22 However, such a measure may not be the best measure of customer experience. At the same time Vector cautions against the Commission from unnecessarily migrating from RTE to a new measure of network quality for the new DPP which may not provide any more insight into the customer network experience or tangible reference of relative network quality. This will impose significant costs on suppliers to ensure any new service quality measure meets the rigorous standards required for a DPP.

Yours faithfully
For and on behalf of Vector Limited

A handwritten signature in blue ink, appearing to read 'Richard Sharp', with a stylized flourish at the end.

Richard Sharp
Head of Regulatory