

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

Level 4 Tower 1
201 Sussex Street
Sydney NSW 2000
GPO Box 3892
Sydney NSW 2001

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Dear Tricia

Re: Gas Default Price-Quality Path: General Matters

First State Investments (FSI) is pleased to make this submission on the Commerce Commission's (Commission) process and issues paper related to resetting the default price-quality path (DPP) for gas pipelines. This submission sits alongside FSI's other recent submissions on topics within the DPP reset and Input Methodologies (IMs) review.

This submission addresses the non-IMs matters raised in the Commission's process and issues paper for resetting the DPP.

Forecasting opex and capex

We understand that the task of forecasting opex and capex to set regulatory allowances for the next DPP period will have unique challenges. The transactions that we have entered into will reshape the ownership of gas pipelines in New Zealand—so historical information on costs will need to be interpreted in light of the new ownership arrangements.

Given this situation, FSI:

- **Supports exploring the greater use of AMP forecasts to set opex and capex allowances for the next DPP.** We intend to prepare Asset Management Plans (AMPs) for our regulated gas transmission and distribution businesses this year (we note that this differs from the statement made in paragraph 6.6.4 of the DPP process and issues paper). The forecasts in our AMPs will use the established processes applied in the businesses that we are acquiring, which we consider should provide a high level of confidence in their accuracy.
- **Is prepared to present historical cost information in a way that is useful to the Commission.** We understand that the Commission also intends to cross-check suppliers' AMP forecasts against historical cost trends. Where possible, we are happy to present historical cost information in a way that fits this purpose—for example, by separately itemising costs spent on the transaction process.
- **Encourages the Commission to retain incentives for transactions that improve efficiency.** The Commission correctly decided in the 2010 IMs Reasons Paper (at paragraph 3.2.71) that merged businesses need to temporarily retain the benefits of efficiency gains to achieve outcomes that are consistent with those in workably competitive markets (the mechanics of how this works is expanded on at

paragraph 3.3.28 of the Reasons Paper). The approach for setting opex and capex allowances in the DPP reset should preserve incentives to pursue transactions that provide long-term benefits to consumers.

As the Commission will appreciate, we are focused on ensuring the smooth transition of the Vector Gas business and the Maui pipeline into FSI ownership. We look forward to working with the Commission over the coming months to help establish a credible view of the efficient costs that a prudent supplier would incur to meet expected service levels.

Other issues

A number of other issues are raised in the DPP process and issues paper. We provide our brief comments on those issues in Table 1.

Table 1: Summary of FSI's Views on Other Issues

Area	FSI Submission
Constant price revenue growth (CPRG)	<ul style="list-style-type: none"> ▪ We consider that the demand forecasts used to inform CPRG should be developed by consultants specifically engaged for that purpose (we understand that the last gas DPP reset used demand forecasts prepared for other purposes) ▪ We are keen to have input into the process used to generate demand forecasts, given that as a supplier we will have useful information on expected demand and industry trends
Productivity	<p>We understand that there are a range of possible approaches for determining sector productivity assumptions. If that the approach remains fit-for-purpose, we would expect the Commission to adopt the approach applied in previous DPP resets (for both electricity and gas)</p>
Form of control	<ul style="list-style-type: none"> ▪ We agree that a wash-up is necessary as part of implementing a pure revenue cap for gas transmission ▪ We agree with the Commission that the forecast of quantities used in setting prices should be the supplier's own forecast, as suppliers will have the best information available. Suppliers will also have incentives to appropriately forecast quantities because of the adjustment for the time value of money within the wash-up mechanism ▪ Transpower's EV account appears to be a suitable starting point for the pure revenue cap with wash-ups for gas transmission ▪ If tariff changes are introduced for gas transmission (for example through the implementation of auction-based pricing), then any over- or under-recovery of the revenue cap needs to be recovered in a way that maintains consumers' incentives in the auction system
Incremental rolling incentive scheme (IRIS)	<p>See FSI's recent submission on DPP issues relating to the IMs review</p>

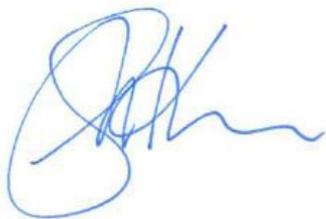
Area	FSI Submission
Company-specific issues	<ul style="list-style-type: none"> ▪ We agree that having a single price-quality path for gas transmission is appropriate ▪ We are also happy to assist the Commission to understand the impacts of the transactions we have entered into for the DPP reset
Quality of service	<ul style="list-style-type: none"> ▪ Gas transmission: As a commercial objective, we intend to maintain a quality standard of zero outages and we generally support regulation consistent with that objective. We therefore agree that an incident reporting system would be a useful addition to the quality regime. We also agree that the prospect of penalties should only arise where a GTB clearly contravenes acceptable industry practice, and that contravention caused or exacerbated the outage. Gas transmission system owners cannot be responsible for events outside of their control, so focusing incentives on matters that GTBs can control will help satisfy the regulatory intent ▪ Gas distribution: We support the Commission's suggested approach of engaging with stakeholders to determine whether improvements could be made to quality of service measures for gas distribution. We also agree that, because of the time needed for such engagement, progress should continue outside of the 2017 DPP reset.

Conclusion

We appreciate the Commission's clarity on the process being used to reset the DPP alongside reviewing the IMs. We also support the question and answer sessions held by the Commission, and look forward to engaging in the sector workshops the Commission is considering for quality of service and forecasting of revenue and expenditure.

Thank you for the opportunity to make this submission. We look forward to continuing our engagement with the Commission on developing and applying the regulatory settings for gas pipelines in New Zealand.

Yours sincerely



Gavin Kerr
 Director, Unlisted Infrastructure Investment
 Colonial First State Global Asset Management