Powerco Limited

CORPORATE OFFICE
84 Liardet Street
Private Bag 2061
New Plymouth
T 0800 769 372
F +64 6 758 6818
www.powerco.co.nz

30 March 2016

Tricia Jennings
Project Manager, Gas DPP reset 2017
44 The Terrace
PO Box 2351
Wellington 6140
New Zealand

[Sent by email to: regulation.branch@comcom.govt.nz]

Dear Tricia

RE: Powerco response to Commerce Commission's request for comment on the Default price-quality paths for gas pipeline services from 1 October 2017

1. This is Powerco Limited's (Powerco) feedback on the Commerce Commission's (Commission's) request for comment on the Default price-quality paths (DPPs) for gas pipeline services from 1 October 2017 – Process and issues paper (Process paper).
2. The focus of this submission is on those items raised in the Process Paper which specifically relate to the DPPs for gas pipeline services to be reset from 1 October 2017 (Gas DPP Reset).
3. Powerco's feedback on Input Methodology (IM) issues, specific to gas price-quality paths, has been addressed in an earlier Powerco submission submitted on 24 March 2016; which responded to the Commission's four emerging view papers'[1].
4. This submission should also be read in conjunction with our previous feedback following the Commissions IM review – Gas pipeline stakeholder meeting held 8 December 2015[2].
5. Powerco representatives participated in the Commission's Gas DPP Reset Question and Answer Session on the Process paper held on 10 March 2016. As with the December stakeholder meeting, we found this Commission initiative a useful and efficient way of engaging with Commission staff and industry stakeholders.
6. As we noted in our earlier submissions, Powerco considers that the current rules and requirements, for GDBs, developed progressively since 2010 and specified in either the IMs, DPP determinations and / or the information disclosure regime generally provide a fit for purpose framework that is achieving the regulatory objectives and broadly meeting customer expectations while allowing businesses to operate effectively and efficiently.
7. We do not consider that there are any significant IM or DPP issues that are currently impacting on the effectiveness of the regulatory framework for gas distribution; this does not mean that there are not opportunities for refinement and continuous improvement. Broadly we support the Commission's emerging thinking on where those refinements should be targeted.

[1] Powerco. "Submission on the four emerging view papers". 29 February 2016.
[2] Powerco "Input methodologies review: Gas pipeline default price-quality path reset 2017". 28 January 2016.

8. In providing this feedback we have been cognisant of the Commission's position that changes to regulatory settings should only be advanced where this appears likely to:[3]

   8.1 Promote the Part 4 purpose in s 52A more effectively;

   8.2 Promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); or

   8.3 Significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

9. Accordingly, we have kept our submission brief and responded directly to each of the Commission's suggested area of change and options presented in each case. We hope that this feedback will assist the Commission to further prioritise and narrow down the areas for potential change and which we will take to the next level of analysis; that being working to develop the necessary evidence and analysis to support change away from the status quo and testing this against the regulatory objectives highlighted above.

10. In our view the priority areas for further consideration for GDBs are:

    10.1 Updating inputs to the current CPRG model;

    10.2 Development of a process to provide the Commission with sufficient assurances to use AMP forecasts to set expenditure allowances; and

    10.3 Reviewing options to refine the range of quality performance metrics to apply at the 2022 regulatory control period.

11. Thank you for the opportunity to provide comments on the framework for resetting the gas DPP. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact either Oliver Vincent, tel. (06)757 3397, email oliver.vincent@powerco.co.nz, or Richard Fletcher, tel. 021 730 348, email rirchard.fletcher@powerco.co.nz.

Yours sincerely

Oliver Vincent
Regulatory Policy Manager

[3] Developing decision-making frameworks for the current input methodologies review and for considering changes to the input methodologies more generally – discussion draft – 22 July 2015, paragraph 16 [note: not finalised]

Appendix A – Powerco response to items raised in the process and issues paper

<table>
<tr><th>Gas DPP Reset Issue</th><th>Commission Emerging View</th><th>Powerco Position</th></tr>
<tr><td>Approach to setting starting prices</td><td>• Set starting prices for the DPPs on the basis of current and projected profitability, rather than on a roll-over of current prices.</td><td>• Powerco agrees with the Commission’s emerging view.
• However, we could also support the investigation of rolling-over prices from the current RCP as this could prove to be an optimal, lowest cost option.</td></tr>
<tr><td>Forecast opex</td><td>• Actively explore the option of using suppliers’ own forecasts as a starting point
• If step-and-trend approach retained, CC will need to reassess the inputs used to set the trend, and any adjustments to the base year.</td><td rowspan="2">• Powerco continues to support the use of suppliers’ own forecasts to inform both opex and capex allowances when setting a DPP.
• With regards to capex, Powerco considers that a suppliers’ AMP should be assessed by the Commission (including for forecast accuracy) and then relied on (as appropriate) to set DPP capex allowances.
• The recent independent review of 2013 gas AMPs has provided a good indication of the standard of the AMPs and the positive results provide support for using the most recent AMP as the forecast data source. If any forecast anomalies where identified in the AMP, the Commission and supplier could make appropriate adjustments after collectively exploring the matter further.
• A step and trend approach should be applied as a sense check if this is what is required to provide the Commission with the assurance it requires to use AMP forecasts.
• Although not directly relevant to Powerco, at the next RCP, we support the introduction of flexibility in the DPP approach to treat major one off investments (reopener and /or contingent project mechanism)</td></tr>
<tr><td>Forecast capex</td><td>• Actively explore the option of using suppliers’ own forecasts as a starting point and scrutinising them.
• Possible opportunity to increase the capex cap for suppliers that have demonstrated higher forecast accuracy in past capex allowances.
• Assessing the best way to treat major one-off investments.</td></tr>
<tr><td>Constant price revenue growth (CPRG)</td><td>• Explore options for refinements to the existing CPRG model.</td><td>• We recognise the challenges associated with developing a methodology that accurately forecasts CPRG for each supplier in a sector (although we consider it viable to achieve this for only four GDBs).
• We therefore support the Commission retaining the underlying approach to forecasting CPRG i.e. forecasting revenue separately for residential, industrial, and commercial users and applying and agreed demand forecast to these groups.</td></tr>
</table>

		• Information on load groups should continue to be provided by suppliers. • The Commission should update demand forecast inputs used to forecast revenue from gas quantities supplied to different load groups (i.e. request Concept Consulting Ltd to update its previous report referenced by the Commission at the last DPP reset). • We agree that there may be a case for tailoring suppliers' CPRG forecasts and that this option should be further reviewed (for example, relying on a suppliers own forecasts following assessment by the Commission). • We recommend that a working group should be formed to support the Commission's review of the inputs to the CPRG forecasting approach.
Productivity	• 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.	• Powerco supports the Commission considering the costs and benefits of retaining the current approach to setting the X factor and opex partial productivity. • More specifically, to avoid introducing unnecessary complexity the review should focus solely on the cost and benefit of retaining the current arrangements (and options for refining the inputs) and not introduce complex alternatives at this stage in the process.
Form of control	• Further analysis needed to make a decision for gas distribution but the emerging view appears to favour a WAPC • Choice of form of control may reduce the importance of CPRG forecasts. • 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.	• Powerco continues to consider that there are unique feature of the gas distribution sector in New Zealand that mean a WAPC is the most appropriate form of control for GDBs. • As noted above, an accurate forecast of constant price revenue growth (CPRG) is an important input to the WAPC setting processes. We have suggested previously that a working group is established to assess factors impacting on future gas demand and how the current CPRG mechanism can be refined. • Powerco supports the continued use of lagged quantities to be applied to a WAPC for GDBs. The mechanism has worked successfully to date and as the approach is not based on an annual forecast of quantities (unlike the alternative mechanism suggested in the Commission's paper); it has delivered price certainty and transparency.
IRIS	• 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	• We support the Commission's emerging view that the application of an IRIS mechanism to GPBs would not be beneficial to suppliers or consumers at this stage due to implementation complexity, associated costs outweighing potential benefits and there being little evidence of any perverse investment timing behavior. • However, we believe that an IRIS mechanism should not be ruled out for the future

	current asymmetric opex IRIS applying to customised price-quality paths (CPPs) should be removed for gas pipeline services	and that the Commission should continue to monitor GDB investment trends.

Company specific issues	• Consider options as to what base year to use for Powerco due to timing of information disclosures.	• As noted above Powerco's preference is for the Commission to use a suppliers AMP forecast to inform the allowance for a DPP period.
		• That said, if a step and trend approach is retained for the next DPP period, Powerco considers that there is some merit in establishing the opex base year as close as possible to the start of the next RCP period – i.e. year ending 30 September 2016 (selecting a single base year would also align better with any future IRIS mechanism).
		• The Commission has accurately set out the timing constraints for Powerco associated with using a 30 September 2016 base year.
		• Powerco's emerging preference if a step and trend approach is retained is for the Commission to:
		  ○ Adopt a 30th September 2016 year end;
		  ○ Powerco submits finalized but unaudited information disclosure in January 2017;
		  ○ Powerco provides audited disclosures in March 2017.

Quality of service	• For gas distribution the current quality standard for response time to emergencies (RTE) should remain, but CC will consider whether there are other quality of service standards that could be implemented. • Reassess the current information disclosure measures to ensure readiness for any development of standards for the 2022 reset.	• The current response time to emergencies (RTE) quality measure is an appropriate method of encouraging GDBs to meet the expected quality of service and security of supply levels. • As indicated at the Commission's question and answer session we are strongly in support of a GDB working group to review longer terms options for refining the quality metrics for GDBs. • We recognise that gaining further insight into customer value preferences and appropriate metrics could provide appropriate information on network quality performance and customer service trends that will support the development of an extended suite of metrics.