

Tricia Jennings  
Project Manager, Gas DPP reset 2017  
Regulation Branch  
Commerce Commission  
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Wellington  
(via email to [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz))

30 March 2016

Dear Tricia

**RE: Submission on Default Price-Quality Paths for gas pipeline services from 1 October 2017**

1. This submission is on behalf of the Major Gas Users Group (MGUG). Nothing in this submission is confidential.
2. MGUG was established in 2010 as a consumer voice for the interests of a number of industrials who are major consumers of natural gas.
3. Membership of MGUG includes:
  - Ballance Agri-Nutrients Ltd
  - Oji Fibre Solutions (NZ) Ltd
  - Fonterra Co-operative Group
  - Goodman Fielder New Zealand Limited
  - New Zealand Steel Ltd
  - New Zealand Sugar Company Ltd
  - Refining NZ
4. These industries are a significant part of New Zealand's economy, including; the primary industry export sector, in provision of energy security, and through import substitution assisting New Zealand's balance of payments. Their manufacturing base in New Zealand relies on a secure energy supply, which for natural gas includes secure and reliable gas transport (transmission and distribution). Collectively the group has invested significant long term capital in manufacturing facilities that consume about 30 PJ per annum of natural gas, or about 15% of the gas supplied to the market in New Zealand.
5. Our comments on the DPP reset covers our interest in gas pipeline businesses (GPBs), for both transmission and distribution.
6. From a MGUG perspective we note this IM review/DPP reset process is taking place when the majority of assets under control are going through a significant ownership change; pending regulatory approvals we will have one owner for the two transmission systems and

Vector's distribution assets outside Auckland. This suggests that forefront of the Commission's thinking on its emerging views should be:

- a. How the issues and options identified by the Commission are best responded to in the context of a common ownership model;
  - b. How gas industry arrangements for converging the access and pricing arrangements might also influence the issues and options for the Commission in setting the price path.
7. The gas industry has, for a considerable time, grappled with issues around access and pricing for the two separate transmission systems. Apart from the obvious questions of efficiency the two systems have each followed different access and pricing methodologies.
  8. The need for a more sensible convergence of the two is generally recognised, but it has proved challenging to deliver. Common ownership provides us with the strongest prospect yet of that convergence occurring. Out of that we should see opportunities for improvement in efficiency and cost, which will be relevant to the parameters setting the price path.
  9. Convergence of the two systems (with the resulting improvements in efficiency) is welcomed by MGUG. We note the Commission's initial view at page 33 to have one price-quality path for transmission. We think this is a sensible approach; we would expect this to result in lower overall opex, and improved productivity.
  10. However it is not clear how the gas industry work programmes will proceed, particularly how they will align with the process leading up to the reset. There are matters within gas industry arrangements which, from a consumer perspective, overlap with areas covered by the Commission. This is clearly the case with respect to quality standards. It is also relevant to gas transmission pricing methodology which, during the course of the current price path, has been applied in a way that has created unsatisfactory outcomes for consumers, as well as inefficient outcomes for New Zealand generally. From a consumer perspective we agree on the importance of coordination between the Commission and GIC.
  11. The following relates to the specific issues:
    - a. **Approach to setting starting prices** – consistent with the approach adopted for the current DPP MGUG supports the Commission's approach i.e. to set starting prices on the basis of current and projected profitability.
    - b. **Forecast opex/capex** –
      - i. MGUG considers it a reasonable approach to scrutinise forecasts provided by suppliers. They are in the best position to provide the information. What is important is the level of scrutiny provided by the Commission, which we would expect to be proportionate to cost materiality.
      - ii. We would expect common ownership to be a relevant factor in parameters determining opex. This may be different for capex but the influence of

common ownership may be relevant there as well. Forecasts should not be the sum of the two transmission businesses; rather they should be able to provide (and demonstrate) the benefits of the synergies generated through the common ownership model.

- c. **Constant price revenue growth** – It will be important that demand forecasts informing the price path are transparent, and subject to the submission process.
- d. **Productivity** – We would expect the benefits of common ownership to be a relevant influence on productivity. We note the Commission decided for the current DPP to hold the productivity factor at zero for the current period although we felt as though this was not well explained.

As a result consumers will not have benefitted from efficiency gains over the period of the existing DPP, and if the same approach prevails, this will prevail for the next five year period. Our expectation is that the common ownership model should deliver productivity improvements. Hence it is important the Commission undertakes the appropriate level of analysis support the assessment, including the examination of international benchmarking (which should be able to draw on the experience of the new owner).

- e. **Form of control** – MGUG’s submission of 24 March 2016 argues for a weighted average price cap for both transmission and distribution businesses. We maintain that view with regard to this submission.

With regard to Paragraph 4.14.4 a wash up mechanism along the lines of Transpower’s EV account mechanism would appear to offer a reasonable approach.

With regard to Paragraph 4.15 we note that capacity auctions were considered as a mechanism by which MDL could provide the right to acquire firm capacity – an auction was considered one mechanism for establishing a value for the right. Given industry discussion to date, and the projected demand versus capacity on the Maui pipeline we would not consider this to be an important revenue driver in the next regulatory period. Nevertheless we support the Commission’s intention to not undermine the design of an auction system.

- f. **Company specific issues** – MGUG agrees with the Commission to have one price-quality path for transmission. We acknowledge that this will require particular scrutiny as detailed in Paragraph 6.6 although regarding the comment in Paragraph 6.6.4 we would expect forecasts to be developed from the Asset Management Plans of the current owner.
- g. **Quality of Service** – MGUG supports the Commission’s attempts to develop more meaningful security and reliability standards for the transmission businesses.

The question for consumers is to understand what risks they are exposed to as a user of natural gas, along with the plans to mitigate or eliminate these risks

(preparedness). The current processes, including asset management plans, do not provide adequate and accessible information to assist consumers. How these are defined (and the standards to be applied) is something which could be appropriately formulated within an industry working group structure. It is difficult for consumers to define those standards in the absence of a discussion with the GPBs themselves. This makes it more sensible for a representative working group to be charged with defining the appropriate standard.

MGUG does not accept that a revenue linked quality standard should be discounted from consideration; it may provide an appropriate signal of consequence, ensuring the supplier is always mindful of the need to manage quality. A similar provision has been accepted by Transpower within its IPP.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Hale', with a large, stylized initial 'R'.

Richard Hale  
Hale & Twomey Ltd  
Secretariat for the Major Gas Users Group