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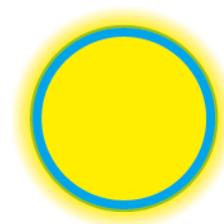
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Tricia Jennings
Project Manager, Gas DPP reset 2017
Regulation Branch
Commerce Commission
Wellington

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

POWERCO



Dear Tricia

RE: Cross submission on submission's made on the Commission's Gas DPP reset implementation paper.

This is Powerco's cross submission on submissions made on the Commerce Commission's 28 June 2016 consultation paper *Default price-quality paths for gas pipeline services from 1 October 2017 - Implementing matters arising from proposed input methodologies changes*.

We have also included comments on the draft gas DPP financial model as part of this cross submission.

Comment on Vector submission

Vector has expressed concern with the Commission's draft decision not to implement a Constant Price Revenue Growth (CPRG) reopener for GDBs and has proposed that the Commission introduce a supplier initiated CPRG reopener to address "the risk of unreasonable demand forecasts being based on erroneous assumptions".¹ Powerco agrees with Vector's recommendation. The Commission's reason for not introducing a CPRG reopener is stated as they are "not aware of any significant issues specifically related to CPRG for GDBs".² We reiterate comment in our IM review draft decision submission that the absence of current issues does not remove the possibility that significant GDB CPRG forecasting errors may arise in the near future.³ We also note the CPRG issues a number of EDBs have encountered where actual CPRG has varied significantly from the Commission's forecast. For example, Wellington Electricity (WELL), where actual CPRG on WELL's network during Regulatory Control Period 1 was significant lower than forecast, resulting in WELL failing to recover the revenue allowance set by the Commission.⁴ CPRG forecasting error can result in material under recovery of revenue and Powerco encourages the Commission to remove this risk by introducing a CPRG reopener for GDBs.

¹ Vector, Submission on Gas DPP Implementation paper, 4 August 2016, p. 2.

² Commerce Commission, Input Methodologies Review Draft Decisions: Topic 2 CPP Requirements, 16 June 2016, p. 30.

³ Powerco, Submission on IM review draft decision, 4 August 2016, p. 35.

⁴ Wellington Electricity, Submission on proposed scope, timing and focus of Input Methodologies review, 31 March 2015, p. 2.

Vector does not support the introduction of a pass-through balance for GDBs. Vector's submission indicates that they have not experienced issues with the current 'ascertainable' approach and see little benefit in moving to a pass-through balance approach. Powerco agrees with Vector's views. Powerco has not experienced issues with the current approach and are concerned that the introduction of a pass-through balance would add a great deal of administrative burden for little gain (risk reduction).

Comment on GasNet submission

GasNet are supportive of the Commission's proposal to introduce a pass-through balance for GDBs. As outlined above and in our initial submission, Powerco has concerns with this proposal. Powerco does however agree with GasNets comment that if a pass-through balance is introduced for GDBs the "default price-quality path (DPP) determination will need to address the transition between the ascertainable approach and the pass-through balance approach to ensure any unrecovered costs from the current regulatory period can be recovered".⁵ To ensure these costs can be recovered Powerco suggests that the Commission employ a mechanism similar to that applied when suppliers transitioned from the Authorisation regime to the current DPP regime, that being; any unrecovered costs from the current regulatory period are included in the first year of the new regulatory period, or alternatively spread across the new regulatory period if including them in the first year would result in price shocks to consumers.

Comment on draft DPP financial model

Powerco agrees with the Commission that publication of the model specifications is useful and acknowledges the high quality of the Commission's documentation. Our review indicates that the model complies with the specifications and that it is able to accommodate anticipated IM amendments.

The Commission has made changes in the draft DPP financial model to accommodate GPBs that have disclosure year ends that differ from the 30 September regulatory period year end. Powerco does not have a strong opinion on these changes as we are not directly affected due to our 30 September disclosure date aligning to the regulatory period. However, we note that this change adds additional complexity to the model by creating part Building Block Annual Revenue (BBAR) years at the beginning and end of the Regulatory period for some suppliers.

The draft DPP financial model introduces an 'Early Base Year' function that provides the Commission with the option to use 2015 Information Disclosure data (ID) should the Commission have insufficient time to incorporate 2016 ID data into its DPP determination. Given the timing of GDBs disclosures, Powerco is the only supplier affected by this option. Powerco is keen to ensure the inputs used in the final determination are as current as possible and will continue to work collaboratively with the Commission on this matter as part of the gas DPP reset process.

The Commission's draft financial model is largely the same as the 2015-2020 EDB DPP reset financial model. In our view having consistency across the gas and electricity financial models is the correct approach as it leverages the work already developed. However, one key component missing from the draft gas financial model, that was included in the EDB financial model, is the Internal Rate of Return (IRR) worksheet. The IRR worksheet summarises all cash flows for a regulatory period and proves that they are consistent with the Financial Capital Maintenance (FCM) principle. Powerco encourages the Commission to include this IRR worksheet in the gas

⁵ GasNet, Submission on IM review draft decision and gas DPP implementation paper, 1 August 2016, p. 2.

financial model as it is a far more transparent illustration of FCM than the mathematic derivation presented in Attachment A of the detailed specification.

It would also be useful if the IRR worksheet could be extended in light of the recent EDB profitability reports produced by the Commission. Presenting the ex-ante nominal ROI for each year of the regulatory period would be a useful reference point for any future ex-post analysis of actual profitability.

Powerco acknowledges the work undertaken to date by the Commission in developing the summary and analysis EDB profitability report. We believe that this is an important step in developing ex-post analysis of profitability and is far more insightful than the existing ROI schedule. However, in our opinion, there are elements that require further clarification and development before the analysis can be considered a complete record of how a regulated supplier has performed against regulatory controls. For example, the Commission should review its current practice of removing the revaluation building block from DPP nominal cash flows to derive real cash flows (and therefore an implied real ROI) as this approach appears to ignore the price inflation in nominal expenditure forecasts. Powerco strongly encourages the Commission to continue improving its profitability analysis because Return on Investment (ROI) is arguably the Information disclosure (ID) reporting metric that is subject to the most consideration and dialogue by interested parties, but is also the most complex.

The IRR worksheet could also be used to demonstrate how cash-flows are determined in leap years where there are 366 days, as it would be helpful to prove that the model achieves FCM in these situations.

Thank you for the opportunity to provide comments on this consultation. If you wish to discuss any of the points made, or clarify any matters, in the first instance please contact Nathan Hill tel. (06)759 8582, email nathan.hill@powerco.co.nz.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. Fletcher', written in a cursive style.

Richard Fletcher
General Manager Regulation and Corporate Affairs