

## **Gas DPP Reset 2017**

### **Summary of question and answer session**

**14 September 2016**

**Commerce Commission, 44 The Terrace, Wellington**

#### **Purpose of this document**

1. The purpose of this document is to:
  - 1.1 list the attendees at the question and answer session held following publication of the Gas DPP reset 2017 Policy Paper on 30 August 2016<sup>1</sup>; and
  - 1.2 set out a summary of questions (received before the session and raised at the session) and answers clarifying issues raised in the policy paper in note form, based on the Commission's current thinking.

#### **Attendees**

Dennis Jones, Orion	Commerce Commission:
David Freeman-Greene, Orion	Matthew Lewer (chair)
Stuart Dickson, Powerco	Graham Phelan
Richard Fletcher, Powerco	James Mulrennan
Nicolas Vessiot, Powerco	Brendan Dempsey
Lyn Taylor, Powerco	Paul Ware
Ian Fergusson, PWC	Tricia Jennings
Len Houwers, MGUG	Mark Worsley
Paul Cruse, Gas Industry Company	Simon Todd
Richie Wallace, Castalia Advisors	
Richard Sharp, Vector	
Kelvin Binning, Vector	
Nathan Hill, Vector	
Jelle Sjoerdsma, First Gas	
Michael Grasty Bottiger, First Gas	
Ben Gerritsen, First Gas (by phone)	
Matthew Gardner, Methanex (by phone)	

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<sup>1</sup> "Default price-quality paths for gas pipeline services from 1 October 2017 – Policy for setting price paths and quality standards" 30 August 2017, accessible at <http://www.comcom.govt.nz/dmsdocument/14656>

**Purpose of session**

2. Matt Lewer outlined that the purpose of the session was to go over key points from the policy paper, answer any questions from stakeholders to assist with preparation of submissions, and confirm next steps in the IM review and Gas DPP reset process.
3. For clarification of any questions and answers in this document, please email Tricia Jennings at [tricia.jennings@comcom.govt.nz](mailto:tricia.jennings@comcom.govt.nz).

## Quality of service

Stakeholder	Question	Answer
Powerco	Has the Commission examined the existing incentives for GDBs to avoid major interruptions?	Yes, we are aware the businesses have existing commercial, technical, and regulatory incentives to avoid interruptions, and have considered these.
Powerco	Has the Commission formed a view on whether an incentive gap exists, and if so whether this proposed metric is an efficient response?	Our concern is not that there are no incentives, but that they are not as clear as they could be.
Powerco	Has the Commission considered whether the proposed metric is better suited to an information disclosure / reporting context?	Yes, and it is a live option, particularly for distribution.  However, our concern (and our reason for enforceable standards in the DPP rather than disclosure-only rules under ID) is where a report identifies negligent or imprudent conduct. We consider it important that we are in a position to act in consumers' long term interests where the situation warrants it.
MGUG	Does the Commission believe that quality specifications issues are largely outside the control of GTBs?	We do consider GTBs have less responsibility for gas quality than for reliability. We acknowledge there is some control. Given the GIC's current work on gas quality we are reluctant to consider any action before that process is complete.
MGUG	Would the Commission be comfortable with an interim report as well as a final report?	Yes, and this is something we are actively considering.
First Gas	When discussing the proposed new quality measure following major outages, the paper at times refers to interruptions and at other times refers just to reporting obligations. Can the Commission please confirm whether the standard it is considering includes both, and whether the regulatory gap analysis is stronger for either minimising interruptions or adequately documenting causes, explaining responses etc?	Yes, what we are considering includes both a standard based on interruptions, and a reporting obligation triggered when that standard is breached.  We consider there is a gap in both cases.  The two can be independent. It is possible to have a quality standard without the reporting obligation, or (using our ID powers rather than our DPP setting powers, as suggested by Powerco) a reporting-only standard.

Stakeholder	Question	Answer
Powerco	How did the Commission form its view of distribution consumers?	We have not been able to have as much engagement with distribution consumer groups. Where there have been major events in the electricity sector, information on these has proved useful.
Powerco	Do you intend to capture all events, eg earthquakes 3 <sup>rd</sup> party events?	We wouldn't look to take enforcement action if there is no evidence of culpability.
Powerco	Who would make that call?	We would initially. We have a range of options, eg warning letters. Then assessment by Courts if we were to take enforcement action.
First Gas	Is any interruption a breach?	We would want to exclude <i>de minimis</i> breaches. We welcome input as to the threshold.
Powerco	Are consumers willing to pay more for increased expenditure to reduce risk?	Our intention is not to encourage an uneconomic level of risk aversion.
First Gas	If there is an interruption, are you proposing a return to consumers?	If this was to be paid back through future prices, the detail would need to be worked out.

## Constant price revenue growth

Stakeholder	Question	Answer
MGUG	Why would the Commission not use the supplier forecast (supported by Director declaration) rather than rely on an independent one?	<p>Cross-checking suppliers' demand forecasts may be quite intractable without an independent and transparent baseline. We are open to amending our CPRG forecasts as a result of objective and transparent information in the AMPs.</p> <p>We acknowledge that expenditure forecasts have some relationship to demand forecasts.</p>
MGUG	Why rely on only 4 years of ICP data?	There is no specific reason why 4 years is used. There is a trade-off between more information improving projections and the relevance of historic information to projecting the future.
MGUG	Does the Commission intend to review CPRG forecasting accuracy after 2017?	Assessing forecast accuracy is important to improving future forecast performance. This step will likely be taken in the next GPB DPP reset, and may be considered in future pieces of Summary and Analysis (for example, we recently looked at CPRG in the EDB space).
First Gas	Above paragraph 4.23, the heading "Factors affecting current gas forecasting environment" suggests a relationship between the gas pipeline transactions and demand forecasting. Can you please explain the link?	The CPRG forecasting environment won't be affected by the merger.
First Gas	The Commission proposes to increase GasNet's CPRG forecast to account for its proposed investments in the Bay of Plenty (an area that would normally be served from First Gas' existing distribution networks). Does the Commission propose to decrease First Gas' CPRG forecast to ensure that growth is not double counted?	In principle, we don't want to double count. If we can establish that that is occurring, it would be adjusted.
Vector	Would the Commission consider commissioning a more comprehensive demand study?	Recognising data limitations and uncertainty, we think the Concept Consulting report is fit for purpose. We are open to amendments.

<b>Stakeholder</b>	<b>Question</b>	<b>Answer</b>
Vector	Will Concept Consulting reconsider its report following receipt of Information Disclosure information?	This may be required, depending on the data received.

## Supplier-based forecasting

Stakeholder	Question	Answer
Powerco	Is the primary objective of reducing cost and complexity up to the point where the cost and complexity of the Gas DPP matches the CPP mechanism the right primary objective to be pursuing? Have the objective and problem definition changed?	<p>As noted in the Emerging View Paper paras 3.26-3.28 and Process and Issues Paper paras 3.29-3.32, our focus since the 2013 reset has been on greater tailoring, not simplification. We have not said that the DPP has a cost that goes up to the CPP.</p> <p>We are open to alternate assessment methods that achieve the same outcome, ie, meeting our expenditure objective.</p>
Powerco	Has the primary objective of tailoring resulted in a proposed framework that is highly discretionary and uncertain upfront, with no clear default position?	We believe the assessment framework is clear, and the data used is clear. We apply judgement in all our decision-making.
Powerco	Can the Commission explain its view that it believes there will be no additional cost?	We ran a pilot with Powerco, where we tested the process. The pilot supported the comments we made in the paper – that the process was relatively low cost, making use of existing data, AMPs, and internal supporting information. We have not said there will be no additional cost.
Vector	What metrics is the Commission expecting to use?	<p>We see the proposed metrics as a way to demonstrate what is needed. They are a suite to choose from, and we would not necessarily use them all. If AMPs are good quality, we may not need to ask for more information.</p> <p>We would like submissions on this. We don't think we necessarily have got all of the metrics right, so need input on this to ensure the method is relatively low cost.</p>
First Gas	Who does the AMP and supplier scrutiny?	As explained in the paper, Strata will be assisting us with this, and making recommendations. The Commission will make all of the decisions.
Orion	How far into the future will the scrutiny go?	The regulatory period is our focus (5 years).

Stakeholder	Question	Answer
Powerco	Looking at the timetable, has the Commission allowed itself sufficient time to give the sector confidence that the Commission can consider material changes, and sufficient time to make a significant change? If the result of this emerging view process is a material change, will that first be expressed in the draft decision? If a change is not made in the draft decision, does the Commission have an open mind to material changes being made after the draft decision (where material changes would involve material changes to the draft determination)? Does the timetable allow for that?	<p>We think we have sufficient time to consult on this proposed assessment framework and implement changes following receipt of submissions now, and following the February draft decision.</p> <p>Submissions can also make a case for any change to our stated process.</p>
Powerco	What steps has the Commission taken to involve other affected parties (eg, EDBs)?	<p>As we noted in paragraphs 3.67-3.68, we are doing this work for gas, and it may form part of our thinking for the next EDB reset. There are complicating factors such as IRIS. We will go through a full consultation process for that reset, and may start discussions next year.</p> <p>Our intention in mentioning this in the paper was because we knew electricity-sector stakeholders would probably be wondering what our intentions were in this regard.</p>
MGUG	Why would the Commission not use industry benchmarking as part of its metrics to assess OPEX?	We are not allowed to undertake benchmarking for setting starting prices under the Commerce Act.
MGUG	Can the Commission be more specific by providing an example for 3.95.3 (p34)?	If the risk-profile changes, eg, increases to point where expenditure is required.
MGUG	Could the Commission seek a declaration on capex that states that none of the projects are reliant on subsequent capex being authorised?	Something for submissions.

Stakeholder	Question	Answer
First Gas	The Commission previously defined the DPP as not involving “audit, verification or evaluation of supplier information”. As a summary statement of what low-cost means, this was quite useful in clearly distinguishing the DPP from the CPP. Has the Commission thought about a similar way to define the boundaries of the DPP under its proposed approach of scrutinising supplier expenditure forecasts?	There is some flex. We are going to have to exercise our judgement. The framework will allow for some projects to come through that would previously have required a CPP, but on a case-by-case basis.
First Gas	Paragraphs 3.120 sets out four possible fall-back options if expenditure is not adequately justified. Has the Commission formed an emerging view on which is preferable? How does the Commission propose to decide between these different fall-back options?	We will consider Strata’s recommendations, and submissions, and use our judgement. We would like to think that excluded expenditure relates to discrete aspects of supplier’s forecasts, but we have the option of addressing more systemic forecasting issues.
Orion	Would the Commission have confidence in independent scrutiny?	We would consider this, but would still look at our dashboard. If we are going to be relying on the independent scrutiny, we would want to be confident in what suppliers are investing in, why, and whether they can deliver.
Vector	Would you be linking in constant price growth?	This would be looked at.
First Gas	Is there any plan to allow for reopeners?	This is being dealt with under the IM review. The draft decision was not to allow for reopeners.
Powerco	How is information requested?	We anticipate this will be voluntary as there are incentives on the supplier to provide greater assurance. <sup>2</sup>

<sup>2</sup> There may be circumstances where we consider it necessary to use our section 53ZD information gathering powers to obtain further information.

Stakeholder	Question	Answer
Powerco	Do you have any concerns about Strata developing the framework and the mechanism?	The Commission designed the framework and gave this to Strata to do the implementation. We are in control of the process. We don't have any concerns about this and will make all decisions.
Powerco	Is the framework report from Strata final?	The report is, yes, however the framework is open to consultation.
Orion	Can you release the model?	Yes, this has dummy data.

## Other

Stakeholder	Question	Answer
MGUG	How did the Commission deal with Vector's pricing restructures in 2013?	<p>Price restructuring under DPP refers to the introduction of a new structure of prices.</p> <p>Vector's 2013 price changes did not fall within this definition.</p> <p>There is an issue around pricing methodologies, which we are discussing with GIC.</p>
MGUG	Is there an opportunity to reconsider price paths where suppliers alter their pricing structures – particularly split between fixed and variable?	Hasn't been considered. The intention behind reopeners is to deal with unforeseen circumstances outside the supplier's control.
MGUG	Has the Commission considered if there are impacts of pricing restructures in GTB on GDBs?	We would have to look at that.
First Gas	Can you clarify what you mean by reopeners?	<p>We can reopen the price-path in certain limited circumstances.</p> <p>If there was a change to health and safety rules for example.</p> <p>The issue of what reopeners we have is discussed in the IMs review. Our reason for mentioning this option in the DPP context is to make it clear that the 'clock does not stop' at the end of May 2017 for dealing with the impact of certain industry changes.</p>
MGUG	In determining efficiency gains to be shared with First State in 2020 what will be the Commission's baseline?	<p>Efficiency gains are shared implicitly through the DPP reset. The baseline is the previous period's price-quality path, particularly opex and capex allowances. Incentive regulation is a mechanism to ensure costs are controlled and can be efficiently and prudently minimised. At the time of reset expenditure allowances should reflect prudent and efficient costs for the supplier. Provided they are lower looking forward relative to looking back, consumers will share in efficiency gains via lower prices.</p>

Stakeholder	Question	Answer
MGUG	Will financial structure efficiency gains by First Gas be considered as efficiency gains to be shared under the incentive regulation?	No. The WACC decision is outside the scope of the DPP reset – the determined GPB DPP WACC is a given input to the determination of the DPP.
MGUG	What are dis-efficiencies discussed in C27?	This is a reference to the symmetric nature in which efficiency gains and losses should be shared. That is, a supplier may enjoy an efficiency gain during an RCP before it is shared with consumers at the time of DPP reset. Likewise, a supplier would incur an inefficiency for an RCP before it is then shared with consumers. In the example, if a supplier experienced identifiable losses in opex economies as a result of selling a part of its network there may be a case for it to bear that dis-efficiency for one RCP.
MGUG	How will the Commission determine whether routine capex is efficient?	The proposed approach to scrutinising supplier forecasts will assist in setting prudent and efficient expenditure allowances. Under a relatively low-cost DPP we rely on creating incentives for efficiency gains to be made and shared over time.
MGUG	How will the Commission ensure that apparent competition in a region does not create cross subsidies from regions not subject to this apparent competition?	Yes, we have considered the risks to Whanganui's consumers from the BoP investment. We have considered that, given the materiality of the BoP investment a single price-quality path is an appropriate low-cost method to accommodate the expansion.
Powerco	Will you be releasing determinations for technical consultation as IM review?	As noted in the paper, we will look at doing this in March 2017 but haven't decided yet. It will depend on the feedback that we get in relation to the draft determinations.