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12 October 2016

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

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

Dear Tricia

Powerco Cross Submission to Default price-quality paths for gas pipeline services from 1 October 2017 - Policy for setting price paths and quality standards.

Introduction

1. Powerco Limited (Powerco) welcomes the opportunity to provide feedback on the views submitted in relation to on the Commerce Commission's (Commission's) consultation paper, *Default price-quality paths for gas pipeline services from 1 October 2017 - Policy for setting price paths and quality standards* (the consultation paper)

2. We have focused our submission on two areas where submitters have expressed views that diverge, to some extent, from our own. To that end, the key issues we discuss are:
   - Forecasting expenditure; and
   - Setting standards for the quality of service.

3. For the record, Powerco continues to be supportive of the Commission's objective of seeking incremental refinements to the regulatory process for setting expenditure allowances for Default Price-Quality Paths (DPPs) and our comments should be considered in light of this guiding statement.

4. We consider the retention of the response time to emergencies to be an appropriate standard for the quality of service for gas distribution businesses (GDBs) under a DPP. We do not believe the addition of the major event standard is appropriate for a DPP or aligned to the needs of distribution consumers. GDBs are incentivised by strict requirements imposed by other existing regulation and contractual obligations to operate a safe network, maintain a high standard of reliability and minimise loss of supply events. If the Commission considers that an additional report is required, then this would be more suited to information disclosure regulation than a DPP standard.

Forecasting Expenditure for a default price path

5. First Gas is supportive of tailoring and flexibility, and on the face of it broadly supportive of the Commission's proposed forecasting approach.

6. First Gas share our concerns in relation to the use of “screening metrics” and the usefulness of the proposed ratios., First also consider that there needs to be realistic expectations as to the information that would available through an AMP.
7. We agree with First Gas that some degree of tailoring may be appropriate for a DPP. Our concern is that any tailoring needs to respect the Commission’s principle of proportionality, reflect the needs of the supplier, and importantly should be framed at a level that is appropriate for a low cost DPP.
8. The proposal to apply the CPP expenditure objective to a DPP will, by necessity, increase complexity, costs and the level of scrutiny. The result is the overly intrusive and complex mechanism proposed in the consultation paper.
9. Powerco has proposed an alternative forecasting approach, which on the face of it, may look similar to that proposed by the Commission. The distinction is that it the alternative proposals reduces the issues of complexity and cost noted above and builds incrementally on the current arrangements (which is appropriate given that a there is no clear evidence that current arrangements are not fit for purposes and / or are creating the inappropriate incentives).. Powerco’s alternative proposal ensures the Commission has increased / appropriate levels of oversight and suppliers are incentivised to explain their forecast expenditure, either in the AMP or through and an optional additional review stage. A key feature of Powerco’s proposal is the application of a default position and the setting of an upper “threshold” boundary (the latter capping the quantum of expenditure increase that would be permitted as part of a CPP).
10. When we consider the comments made by First Gas, we believe their concerns would be addressed if our alternative approach were to be adopted for GPBs. The approach could equally apply to gas transmission businesses but a distinction could be made between distribution and transmission when setting an appropriate default and upper threshold. It is generally recognised that the investment profile for gas transmission is inherently more prone to fluctuations (lumpier) in nature than that experienced for gas distribution. We consider it may be appropriate to identify a higher upper band to accommodate the larger one-off investments required by gas transmission businesses.
11. We further note the concerns of GasNet, Vector and ENA would also be addressed if the Commission were to modify the approach proposed in the consultation paper to align with our principled approach noted in our substantive submission of 28 September 2016.
12. Vector and GasNet have also proposed an alternative approach to expenditure forecasting. In essence, these proposals are very similar to Powerco’s proposed approach.
13. The MGUG support—
    a. the Commission’s approach to supplier scrutiny of opex and capex forecasts using supplier AMPs;
    b. quantitative and qualitative assessments of how suppliers’ forecasts differ from baseline expenditure as a pragmatic and low cost approach to assessing whether forecasts are reasonable; and
    c. a principle versus prescription approach is taken to cost scrutiny.
14. The MGUG further note that the Commission’s underlying principle should be to reduce costs and complexity of its regime.
15. Powerco agrees that the Commission’s underlying principle should be to reduce costs and the complexity of its regime where this is possible. This principle will be not be achieved for a DPP by aligning the DPP “forecasting” methodology to the CPP expenditure objective. It creates the need for detailed supplier scrutiny and introduces unavoidable complexity and cost.
16. The use of ratios to determine “business as usual expenditure” as supported by MGUG is also not a pragmatic or low cost approach. Superficially, calculating a few simple metrics does appear to be attractive, simple and therefore low cost. However, as we illustrate in our

submission to the consultation paper, the metrics proposed by the Commission in the STRATA report do not provide a reasonable estimate of business as usual expenditure, establishing appropriate benchmarks is not easy and setting thresholds around each of these metrics likely to be contentious.

17. A reasonable level of supplier scrutiny is appropriate if expenditure forecasts in the AMPs differ from baseline historic expenditure levels and this expenditure, up to an upper band, is not explained. We agree that a principled approach to any supplier scrutiny is appropriate.

18. We share the concern of several suppliers that the Commission, or their consultants, Commission may have an unrealistic expectation of the level of information available for supplier scrutiny at the latter end of the regulatory forecast period. ENA reminds the Commission that AMPs are in essence planning documents which are updated regularly, and as acknowledged in the determination, the plans are expected to be more comprehensive for the beginning of the period than latter years. We agree with other suppliers that in our experience, projects required later in a DPP regulatory period will not yet have the required level of supporting information (such as Board papers or project brief documents) noted as examples in the consultation paper.

19. Our proposed approach provides scrutiny of opex and capex when appropriate. This approach follows the guiding principle noted by the MGUG to reduce costs and complexity of the regime. By comparing expenditure to historic levels, an assessment is made against historic expenditure and if any expenditure outside a normal range is not explained by the suppliers AMP, then the choice is made by the supplier to either undergo supplier scrutiny or accept the lower band of the capex or opex allowance.

20. We do not agree with the MGUG that the use of ratios should be extended to provide a form of benchmarking as a basis to encourage downward pressure on prices. The ratios mentioned by the MGUG are already available under the information disclosures published by GDBs annually. We support ENA's concern at the suggestion expenditure allowances may be set as "stretch targets" in order to drive efficiencies into DPP price paths. This doesn't appear consistent with incentive-based regulation that provides suppliers with the opportunity to retain benefits of efficiency for the regulatory period. Benefits from the efficiency are then shared with consumers. If the objective is to reveal efficient expenditures over time then the Commission should use the existing incentive framework based around the IRIS / capex incentive mechanism.

21. Several suppliers have commented on the use of a base year as the comparable basis from which to assess forecast capital expenditure. We share the view that a historic average is more appropriate when considering movements in capital expenditure over time. Often large projects will cross a regulatory year which significantly reduces the use of a single year as a reliable and robust comparative point. We also draw the Commission's attention to the STRATA report where the base year used actual commissioned assets. It is more appropriate to use capital expenditure for any historic comparative as commissioned assets can be distorted by the impact of large projects.

22. At the Commission's question and answer session in September, Powerco raised the possibility of suppliers providing ISO55000 certification as a means of assuring the Commission of the strong governance and robust asset management systems employed by suppliers. In initial discussions with the Commission, it was indicated that to use suppliers AMPs, the Commission needed greater assurance on the framework and approach used by suppliers for developing their AMPs. We suggested that ISO55000 certification could provide the Commission with that assurance. It is expected that such certification would lend support to a suppliers expenditure forecasts but would not necessarily remove the need for the suggested process based on AMP or supplier assessment. We encourage submitters to review our proposed alternative expenditure forecasting approach as this may remove their concerns.

Setting Quality of Service Standards

23. Suppliers continue to support the response time to emergencies (RTE) quality standard for GDBs. Our consumers consider safety as the most important quality of service standard. As the Commission has noted in the consultation paper, issues around reliability are not a concern for our consumers and reliability metrics indicate all GDBs have a very low number of interruptions each year.

24. As noted by ourselves and other suppliers, there is no evidence that consumers desire the introduction of the proposed major interruption reporting metric, or that it would improve outcomes for consumers if such an event took place. We remind the Commission that in the consultation paper, only one major interruption was noted for GDBs in the past eleven years. This interruption was caused by a third party on Powerco's network. Supply was returned as soon as possible to consumers and Powerco worked with consumers and service providers to minimise any loss. Everyone involved was kept informed.

25. We agree with GasNet, Vector and First Gas that there are already strong reputational, commercial and other regulatory drivers (such as health and safety, the EGCC scheme) to ensure that GPBs minimise interruption times and manage their networks in a manner that ensures the risk of a major interruption. As the Commission notes, these submitters do not see the need to add metrics to a DPP that are already in place elsewhere. We agree with this view.

26. While we do not agree there is a need for a report to be issued if a major event were to occur, if it is required, it is better suited under the requirements of an information disclosure regime than a DPP. Suppliers agree that a report could be produced within a six month time frame if it were limited to information GDBs would be expected to know. As explained by First Gas, suppliers will not know the cost of an interruption to consumers as we do not have that information, nor will we know how many customers are affected but we could provide ICP numbers. If this report were to be required, it would be useful for the Commission to discuss the requirements further with suppliers to ensure that they are achievable.

27. We do not support the MGUG view that there should be an interim report, or that there should be submissions and consumer consultation on the report. This seems outside of the scope intended by the Commission and it is difficult to see how submissions from those affected by the event would benefit the investigation into the cause of an event.

28. The consultation paper provided little information on what will constitute a major event, or how an interruption will be defined for GDBs. We agree with First Gas that if this report is required under a DPP then it should exclude events caused by third parties. In the case of a third party event, there may be legal and confidentiality issues which will limit the information that may be provided in any disclosed report. Further, by limiting interruptions those that relate top suppliers' actions and / or assets then the definition can be aligned to class C interruptions as specified in the annual information disclosure reporting. This is reviewed by the Commission already and publicly disclosed.

29. We do not support the Commission's view that a major event on a GDB's network should result in a breach of the DPP. There has been no evidence provided to indicate this is an issue requiring regulatory intervention. GDBs are incentivised by strict requirements imposed by other existing regulation and contractual obligations to operate a safe network, maintain a high standard of reliability and minimise loss of supply events. If the Commission considers that an additional report is required then this would be more suited to information disclosure regulation than a DPP standard.

30. If the Commission were to continue with this metric it would be imperative to provide guidance on enforcement criteria. Currently GDBs mitigate the risk of such events on the network to the

extent practicable to meet our contractual and regulatory obligations. To go further, even if possible, would incur significant cost that would need to be passed on to consumers. The Commission would need to consider this in the setting of prices for the next regulatory period.

31. We are concerned at the suggestion the Commission, when reviewing any major event, should apply a Responsible and Prudent Operator (RPO) test. The MGUG suggest this is an appropriate test to determine enforcement requirements under s87 of the Commerce Act. An RPO test would typically be prosecuted and assessed via the courts and involves a comprehensive and detailed review of a suppliers actions, referenced against an accepted industry baseline. To include such a test as part of a review under Part 4 and particularly as part of a DPP assessment framework seems to go beyond the scope the regulatory regime.

32. We do not support the MGUG view that there be an interim report, or that there should be submissions and consumer consultation on the report. This seems outside of the scope intended by the Commission and it is difficult to see how submissions from those affected by the event would benefit the investigation into the cause of an event.

Contact for submission

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

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