

## **GAS DPP RESET 2017 - QUESTIONS FOR SUPPLIER EVIDENCE STAGE OF FORECASTING EXPENDITURE PROCESS**

### **FIRST GAS DISTRIBUTION**

1. With reference to First Gas' 2016 AMP forecast material and historical Vector ID information, we request the following information from First Gas please:
  - 1.1 Additional explanation for the step changes and quantum of system growth and consumer connection expenditure forecast. [Further clarification: The first area is that we have identified a significant step change in the **system growth capex** and **consumer connection capex** expenditure between 2016 and 2017. We have searched your AMP for support of this step change in expenditure but could not find an adequate explanation. There is some commentary in section 5.8, Appendix F and section 8.3 of your 2016 AMP about **system growth capex** in general but the step change between 2016 and 2017 remains unexplained. Additionally, there is some commentary in section 5.7.2 and section 8.4 of your 2016 AMP that briefly discusses **customer connections capex** but there is no explanation for the step change increase in expenditure. The second area that we are seeking further supporting information regards the drivers for the sustained increases in **system growth capex** and **consumer connection capex** over the 2017 to 2021 forecast period. While new customer connections are forecast to increase by only 3.0% and gas volumes forecast to increase by only 2.9%, **system growth capex** and **customer connection capex** are predicted to require an additional \$13.5m and \$16.4m of total expenditure respectively over the 2017-2021 period. We searched your 2016 AMP for an explanation of these quanta of expenditures but could find nothing that adequately explained the lack of correlation with tradition gas pipeline growth indicators such as volumes and/or new connections.

In relation to the first area (step change from FY16 to FY17), this is primarily due to a number of projects being deferred from FY16 into FY17. Vector's FY15 GDB AMP (Section 5.15) presents a number of reinforcement projects that are required but have not yet been carried out. We have included these in our growth forecasts for FY17. This held down actual FY16 expenditure, while also increasing FY17 forecast expenditure.

Two projects account for \$2.04 million of the \$4 million expenditure for FY17.

- Hamilton intermediate pressure (IP) reinforcement (\$1.38 million). Upgrading the existing IP pipe from Te Kowhai gate station to Avalon
- Paraparaumu IP reinforcement (\$660,000). Up-rate the Paraparaumu IP20 pressure system.

Forecast consumer connection expenditure in FY17 totals \$4.4 million (net of customer contributions of \$385,000). This can be further broken down into the following sub-categories.

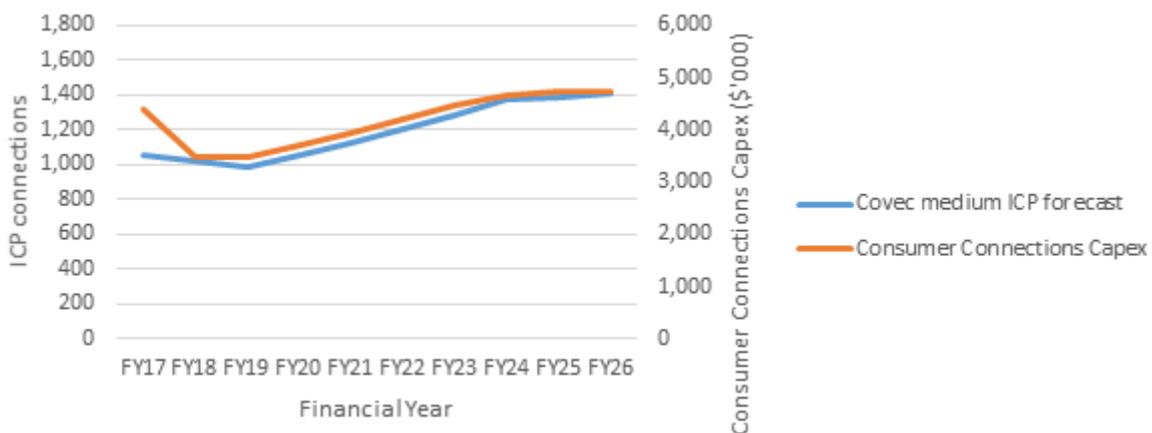
- Subdivision/mains extensions (\$2.5 million)
- Residential connections (\$2.0 million)
- Commercial connections (\$232,000)
- Easement costs (\$42,000).

In relation to the second area (sustained increases from 2017 to 2021), this again reflects some project deferrals that had been forecast for FY16-18 in the previous Vector AMP, to FY21-22 (this is discussed in Section 5.8.2 of the First Gas AMP). The sustained expenditure increase also reflects latest population growth forecasts in Tauranga, Hamilton and the Kapiti Coast. Most of our system growth capex is directed at reinforcing networks in these areas.

To forecast growth in consumer connections, we used an independent report from Covec economic consultants. The report forecasts low, medium and high levels of growth in ICPs. The medium forecast was used in our AMP to forecast the number of new connections for our distribution networks, and results in an average 3.3% growth in consumer connections per year over the 10-year period. Total new connections across the First Gas networks are shown in the table below.

Covec Forecast	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Total growth 10yr	Ave growth/yr
Total Low ICPs	957	918	876	945	1,015	1,091	1,168	1,259	1,273	1,289	34.6%	3.5%
Total medium ICPs	1,058	1,021	983	1,055	1,125	1,201	1,284	1,373	1,389	1,406	32.9%	3.3%
Total high ICPs	1,157	1,124	1,088	1,160	1,234	1,316	1,400	1,488	1,506	1,527	31.9%	3.2%

When we compare this rate of growth with planned levels of consumer connection capex (in Schedule 11a), we find that expenditure growth closely matches forecast growth in ICPs. The one exception to this is in FY17, due to the one-off increase explained above.



- 1.2 Some commentary on why, when compared to the former Vector non-Auckland gas distribution network, the First Gas distribution network is reduced by 400 km and has 4,500 fewer ICPs. In the First Gas 2016 AMP there is no explicit explanation for how the asset boundaries have changed post-sale.

The gas distribution assets purchased by First Gas do not perfectly align with the assets previously recorded as Vector's non-Auckland gas distribution business. Prior to the sale of Vector Gas Limited, Vector transferred ex-NGC assets within the Auckland region from Vector Gas Limited to Vector Limited, so that Vector would retain ownership of all gas distribution assets within the Auckland region. In addition, portions of two gas transmission pipelines were re-designated as gas distribution pipelines, with one segment transferred to the non-Auckland gas distribution business now owned by First Gas and one transferred to the Auckland gas distribution business owned by Vector. Historical network information reflecting these changes has been provided to the Commission in response to a section 53ZD request, and the asset transfers will be reported as disposals/additions in the 2016 disclosure year.

- 1.3 Explanation of the reason for the absence of expenditure in the reliability, safety and environment capex category of First Gas's forecast information, ie, is it included elsewhere?

All activities relating to reliability, safety and the environment are included in the Asset Replacement and Renewal expenditure category.

Capital expenditure can be classified under a number of the categories based on the definitions in the 2012 IM determination. We have tried to adopt a consistent approach across our regulated businesses of allocating forecast costs to the primary category driving the need for expenditure. We consider Asset Replacement and Renewal to be the most appropriate category for our planned activities.

Historically, Vector did include some expenditure in the "Reliability, Safety and Environment" category, both in its previous AMP and information disclosures. However, this only amounted to between 0.2% and 4% of the overall capital expenditure. Transmission did not use this category, but included all expenditure in the single "Asset Replacement and Renewal" category.

## **FIRST GAS TRANSMISSION**

1. With reference to First Gas' 2016 AMP forecast material and historical Vector and MDL ID information, we request the following information from First Gas please:
- 1.1 Additional explanation for the increase in the routine and corrective maintenance and inspection opex expenditure forecast, particularly between

2019 and 2021. [Further clarification: We have identified that the quantum of routine and corrective maintenance and inspections opex expenditure between 2019 and 2021 is unsupported by commentary in your 2016 AMP. While there appears to be a credible explanation for the \$6.1m increase in this expenditure category between 2017 and 2018 (removal of asbestos, maintenance strategic review, and a full geo-hazard risk assessment) a similar level of explanation did not support the ongoing expenditure between 2019 and 2021.]

Sections 6.4.2 & 8.8.2 in the AMP provide some of the main drivers of increased opex forecasts. As noted in the question, some of the reasons of the increase include removal of asbestos, maintenance strategic review, and a full geo-hazard risk assessment. Other initiatives that increase opex in 2017 include confined space pit inspections (\$232,000) and the disposal of assets at Otahuhu Power station (\$310,000).

Unless otherwise stated, the activities described require increased spend over the whole planning period (not just 2017 and 2018). The main other important components of this increased Routine and Corrective Maintenance and Inspection (RCMI) opex over the planning period are:

- Re-categorisation of MDL Asset Renewal and Replacement Category (ARR) to RCMI (\$930,000 per year). As noted in response to question 1.2 below, we have not used the ARR category in the First Gas AMP
- Geo-hazard remediation (\$1.13m per year). Our full geo-hazard risk assessment is expected to take ten years to complete, and there will be ongoing work associated with remediating identified risk areas over this timeframe. We have planned to remediate an average of 2-3 sites per year. The number of remediated sites and the cost per site is based on recent experience
- Asset disposal (\$260,000 per year in FYs 17-19). This will allow us to remove 200-300 metres of abandoned pipeline each year.
- Maintenance of new Henderson Compressor Station (\$124,000 per year from FY17). As noted elsewhere in our AMP, this new compressor station is needed to support a significant load increase at the Marsden Point Refinery.

1.2 Explanation of the reason for the absence of expenditure information in the asset replacement and renewal opex category of First Gas' forecast information.

Historically, neither Vector Distribution nor Transmission used this category in either AMP submissions or in information disclosures. To be consistent with

our previous (non-Maui asset) disclosures, we have classified most asset replacement and renewal expenditure as capital expenditure. Any minor replacement expenditure which cannot be capitalised has been included in the opex “Routine and Corrective Maintenance and Inspection” category. This is consistent with the IM Determination 2012 expenditure definitions.

MDL did use this category in both of its previous AMPs for the Maui pipeline, and in its information disclosures. This expenditure ranged from between 9% and 28% of overall network opex per year. We have made this year’s AMP consistent across all regulated businesses by adopting the approach described above.

1.3 Explanation of the reason why there is an absence of expenditure information in the reliability, safety and environment capex category of First Gas’ forecast information.

The answer to this question is essentially the same as the answer to question 1.3 of gas distribution above.

In addition, we note that historically, MDL did include some expenditure in the “Reliability, Safety and Environment” category both in its previous AMPs and information disclosures. This expenditure amounted to between 26% and 63% of the overall capital expenditure for the year. We have tried to be consistent in the use of expenditure categories across Transmission, Maui and Distribution assets by including all expenditure under the “Asset Replacement and Renewal” category (which we assess as the primary expenditure driver).