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11 November 2016

Tricia Jennings
Project Manager, Gas DPP Reset 2017
Commerce Commission
P O Box 2351
Wellington

[By email]

Dear Tricia

Response to questions about expenditure forecasts

1. This letter responds to your email of 4 November 2016, which attached four questions regarding GasNet's expenditure forecasts for the next gas distribution DPP regulatory period. We understand each of the questions was asked in the context of GasNet's 2016-2026 Transitional Asset Management Plan, published on 30 June 2016.

2. Below we provide a response to the four questions raised by the Commission.

Question 1.1: An explanation as to why there is an absence of expenditure in the replacement and renewal opex category of GasNet's forecast

3. All of GasNet's Replacement and Renewal Opex is capitalised. This is consistent with our treatment of this expenditure in our financial reporting. Additionally, our disclosure of expenditures are driven by the definitions used in the Gas Distribution Information Disclosure Determination, which requires expenditures to be categorised based on the "primary driver" of the expenditure. GasNet undertakes some small replacement or renewal work that is expensed but this is allocated to other asset categories as the primary driver of the expenditure relates to Service interruptions or Routine and corrective maintenance.

Question 1.2: An explanation as to why GasNet's network opex forecast is predicted to remain unchanged, while forecast total capex and the quantum of network assets to be managed, is expected to grow.

4. With the exception of the major capex project in 2016/17 and 2017/18 (discussed in our response to the next question) forecast Network Capex growth is expected to be modest. Excluding the major project, all forecast growth comes in the Asset Replacement and Renewal and Reliability, Safety and Environment categories. Network Capex may not drive material changes in Network Opex where assets are being replaced or renewed and there is therefore little increase in network length or the number of assets to be maintained.

5. Network Capex relates to construction of the network covering replacement, renewal and growth and is completed by a mix of direct and contract labour, much of which can be capitalised. There may be a need for additional staff to manage and administer additional contract labour in future, but the timing at which this might become necessary and the associated opex cost are inherently difficult to quantify. We have therefore taken a conservative approach and have not forecast any step increase in network opex.

6. Therefore we have no evidence to support a material change in Network Opex resulting from our forecast increase in Network Capex and hence the network opex forecasts have remained at a constant level. This is consistent with improving scale economies.

Question 1.3: An explanation that supports GasNet's system growth capex forecast, as this appears to be unsupported by either forecast growth in delivered energy or ICP connections.

7. Consumer Connections Capex and System Growth Capex (with the exception of 2016/17 & 2017/18) are both modelled at consistent levels across the forecast.

8. The step increase in System Growth Capex for 2016/17 and 2017/18 relates directly to the provision for a 4km main extension to supply one additional ICP - the planned Whanganui District Council Waste Water Treatment Plant.[1] This new plant is expected to increase gas throughput by 47,300 GJ per annum from 2017/18; this value was omitted from our forecast of gas conveyed in error.

[1] http://www.whanganui.govt.nz/our-district/major-projects/wastewater-project/Pages/default.aspx

9. Below is an extract from GasNet's 2016/17 Annual Plan, which has been approved by GasNet's Board, relating to the project. The project value in the Annual Plan differs from that in the AMP forecast by $20,000 per annum, which reflects a degree of rounding when preparing the AMP forecast.

7.2.3 Whanganui Waste Water Treatment Plant $270,000

Whanganui District Council have requested a supply of gas to the new Waste Water Treatment Plant (WWTP) in Airport Road to supply a new sludge drying plant to be constructed in 2017.

The gas network currently ends at Onetere Drive and does not have sufficient capacity to provide the quantity of gas required for the plant.

Preliminary design has been completed which involves a gas main extension from Putiki Drive to the plant of approximately 4 km in length. The cost of the main extension is estimated at $540,000 plus GST.

WDC engineers have advised that the gas supply will be required at the plant by the end of September 2017. In order to meet this timeframe it is planned to have commenced work in May 2017 and be completed in July therefore costs associated with the work will be split across the two financial years.

10. GasNet has found this exercise to be helpful in identifying areas where we can improve consistency across our reporting and information. We will take this into account when developing future AMPs and AMP Updates.

Question 1.4: An explanation that supports GasNet's replacement and renewal capex, as this appears to be unsupported by the condition grade of assets.

11. There is currently no direct system link between the disclosed condition grade of assets and GasNet's forecast replacement and renewal capex. The condition grade of assets is based on a desktop exercise by our Engineering Manager based on the known asset information (such as criticality, age, condition, etc).

12. The capex forecast is developed based on expected expenditure requirements, which particularly relate to the pre-natural gas metallic mains and service replacement (these assets are coming to the end of their useful life and are replaced based on recent information regarding asset condition and leakages[2]). We recognise that consistency

[2] See page 20 of GasNet's 2016-2026 Transitional AMP.

between condition assessments and expenditure forecasting is an area where we could further develop and enhance our asset management systems and this is an objective for the future.

13. Also, it is important to recognise that the condition grade of assets is not the only valid reason for asset replacement and is just one factor that asset managers take into account when making replacement decisions.

Contact details

If you have any questions please contact me on 06 349 0131.

Yours sincerely,

Geoff Evans
General Manager