Commerce Commission
P O Box 2351
Wellington 6140

For the Attention of: Dr Simon Todd

28 November 2016

Dear Simon

Report on First Gas transmission supplier evidence assessment responses

1. I am pleased to provide this report setting out Strata Energy Consulting Limited's (Strata) recommendations to the Commerce Commission on the explanations and evidence provided by First Gas in response to the questions posed to them by the Commerce Commission regarding the First Gas transmission business; received for review on 28 November 2016.

2. Three questions were put to First Gas following AMP evidence assessment of their 2016 Asset Management Plan (AMP), certified by First Gas directors on 28 September 2016.

3. The following table provides Strata's recommendations and reasons relevant to each of the questions posed by the Commerce Commission to First Gas.

Question	Question posed	Strata recommendation	Rationale
1.1	Please provide an additional explanation for the increase in the routine and corrective maintenance and inspection opex forecast particularly between 2019 and 2021.	Strata recommends that the explanations for the increase in routine and corrective maintenance and inspection opex particularly for the years 2019 to 2021 not be accepted as it does not provide a reasonable and thorough explanation of the increase in forecast opex in this category. Strata recommends that forecast routine and corrective maintenance and inspection opex be held to the upper variation bound for this opex category.	First Gas provide an explanation for the increase of opex in the category between 2017 and 2018 and in addition explain that in 2017 there are forecast confined space pit inspections and Otahuhu power station asset disposal costs also contributing to those costs. However, the explanations for the increased opex particularly from 2019 onwards are confusing and not compelling. Four additional reasons are given for the increase in routine and corrective maintenance and inspection opex: (1) $930,000 p.a of formerly asset replacement and renewal opex (categorised by MDL) reallocated to routine and corrective maintenance and inspection opex. However, MDL in its 2015 AMP was forecasting to spend no more than $510k (constant) p.a in this category during the period 2018-2022. The difference is not identified or explained by First Gas. (2) In addition to Geo-hazard assessment, First gas forecasts $1.13m of geo-hazard remediation of sites each year over the entire forecast period. However, the assessment is supposed to account for a step up in expenditure 2017 to 2018. Strata would expect the remediation, if any, to prudently follow the assessment and considers it unlikely that remediation would be conducted at the same time as the incomplete assessment is occurring. Moreover, there is no explanation of what the remediation itself entails or why it will be opex that is spent rather than capex. First Gas state that the remediated sites and the cost per site are based on recent experience but provides no explanation of what that recent experience has revealed. (3) 2017-2019 will (in addition to the disposal sums for Otahuhu) provide for $260k p.a. for the removal of between 200 and 300m of abandoned transmission pipeline p.a. (4) A sum of $124k has been forecast annually from 2017 to provide maintenance of the new Henderson Compressor Station, not commissioned until 2017. While components 3 and 4 might be considered reasonable as part of routine

Question	Question posed	Strata recommendation	Rationale
			and corrective maintenance and inspection opex, components 1 and 2 are not considered reasonable and are not properly explained.
1.2	Explanation of the reasons for the absence of forecast expenditure in the asset replacement and renewal opex category	Strata recommends that the explanations for the absence in forecast expenditure in the asset replacement and renewal opex category be accepted as satisfying supplier evidence assessment.	First Gas explain that to rationalise its forecasting and ensure opex is attributed to the primary driver most asset R&R is capitalised and any “minor” AR&R opex that remains, which cannot be capitalised has been included in the routine and corrective maintenance and inspection category. In their answer to question 1.1, First Gas indicate that “minor” is $930k p.a. First Gas acknowledge that while Vector neither used this category in its distribution and transmission businesses that MDL did. However, for consistency they have opted not to include AR&R opex in their forecasts going forward. First Gas consider this is consistent with the Commission’s 2012 IM Determination.
1.3	Explanation for the reason why there is an absence in expenditure forecast information in the reliability, safety and environment capex category	Strata recommends that the explanations for the absence in forecast expenditure information in the reliability, safety and environment capex category be accepted as satisfying supplier evidence assessment.	First Gas explain in their responses relating to distribution that upon reviewing the available categories of capex expenditure and the 2012 Input Methodology Determination, it considered that it was most appropriate to adopt categories of expenditure for their regulated businesses that represented the primary driver for the capex need. In First Gas’s view, it was most appropriate to allocate all capex expenditure previously forecast in the reliability, safety and environment category for the distribution business (by Vector) to the asset replacement and renewal capex category as this most appropriately reflected their planned activities and is considered the primary expenditure driver.

Summary of recommendations

4. Strata recommends that:

   1) the explanations provided to question 1.1 not be accepted and that the forecast levels of routine and corrective maintenance and inspection opex be brought down to the upper variation boundary for routine and corrective maintenance and inspection opex from 2019 to 2022.

   2) the explanations provided to question 1.2 explaining the reasons for the absence of forecast expenditure in the asset replacement and renewal opex category be acceptable as providing sufficient explanation to satisfy supplier evidence assessment; and

   3) the explanations provided by First Gas to question 1.3 regarding the reasons for the absence of expenditure in the reliability, safety and environment capex category are accepted as sufficient to satisfy supplier evidence assessment.

5. Accordingly, Strata considers that First Gas has adequately addressed questions 1.2 and 1.3 posed by the Commission, but has not adequately addressed question 1.1.

Regards

Bill Heaps
Managing Director
Strata Energy Consulting Limited