Commerce Commission
P O Box 2351
Wellington 6140

For the Attention of: Dr Simon Todd

28 November 2016

Dear Simon

Report on First Gas distribution 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 their gas distribution business; received for review on 28 November 2016.

2. Three questions were put to First Gas following AMP evidence assessment of their 2016 gas distribution 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.

4. The first question 1.1 has been divided into two parts for ease of assessment and is set out as such in the table. Question 1.1 sought to understand:

    1) The 2016 to 2017 stepped change in forecast system growth and forecast consumer connection capex; and
    2) The sustained growth in system growth and consumer connection capex forecast for the period to 2022.

<table>
<tr><th>Question</th><th>Question posed</th><th>Strata recommendation</th><th>Rationale</th></tr>
<tr><td rowspan="2">1.1</td><td rowspan="2">(1) Explanation for the step changes in system growth and consumer connection forecasts between 2016 and 2017.</td><td>(a) Strata recommends that the explanation for the stepped change between 2016 and 2017 for forecast system growth capex be accepted.</td><td>First Gas, in its supplier evidence assessment, indicates that over half of the step change is attributed to two significant reinforcement projects that were originally forecast by Vector, but which in Vector’s 2015 AMP, were subsequently deferred by Vector:

(a) Hamilton IP reinforcement and Te Kowhai gate station upgrade (originally forecast by Vector at $1.8m), now forecast by First Gas at $1.38m (Vector deferred until 2017) (see: Vector 2015 AMP, section 5.15, p.98)

(b) Paraparaumu IP reinforcement to uprate the IP 20 pressure system. (Vector forecast $522k originally. Vector deferred indefinitely) First Gas now forecast this project will cost $660k and must be delivered in 2017). (see: Vector 2015 AMP, section 5.15, p.100)

First Gas did not provide sufficient information to supporting the timing of these projects and had the forecast expenditure been in the 2018 to 2022 period, Strata would have recommended the exclusion of these projects on the basis of insufficient justification.</td></tr>
<tr><td>(b) Strata recommends that the explanation for the growth in consumer connection forecasts between 2016 and 2017 not be accepted.</td><td>First Gas provide a breakdown of the step change net forecasts between 2016 and 2017 totalling $4.4m (i.e. excluding capital contributions). The sub-categories break down is consistent with the First Gas AMP (Forecast ID schedule 11(a)(ii), Appendix B.1, p.121). The growth forecasts are explained as being based on medium level ICP forecasts from Covec economic consultants and forecast average p.a. ICP growth at 3.3%. However, the Covec economic consultant report dated 12 August 2014, is focused on forecasting ICP growth in Auckland only. It is entitled Auckland Connection Forecasts. The background to the Covec report states clearly that the purpose is to “develop 10 year forecasts of gross new connections to Vector’s electricity and reticulated gas networks <u>in Auckland</u>.” Covec report, p.1. No explanation has been provided by First Gas as to why Auckland-focused forecasts are</td></tr>
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Question	Question posed	Strata recommendation	Rationale
			applicable to growth in non-Auckland ICPs that span the length of the North Island, other than Auckland.
	(2) Explanation regarding the drivers for the sustained increases in system growth and consumer connection capex expenditure forecasts over 2017 to 2021.	Strata recommends that the explanation for the sustained increases in system growth and consumer connection capex over the assessment period to 2022 not be accepted and that the forecast system growth and consumer connection capex be held to upper variation boundaries of each capex category for each year: 2018 to 2022.	First Gas state in their reply that the sustained increases in system growth capex are attributed to project deferrals forecast in Vector's previous AMP (2015 AMP) and that these predominantly relate to network reinforcement. First Gas references section 5.8.2 of their 2016 AMP and states that the deferrals are discussed in that section. Section 5.8.2 discusses the Cambridge network but makes no reference to deferred projects. The 3 projects listed for FY21 to FY22 in section 5.8.2 have no forecast capex estimates attributed to them. The Vector 2015 AMP describes several rolled forward and deferred projects, including a project for Cambridge (described as two options) brought forward by Vector to commence FY16. The supplier evidence assessment response provides no clarity of whether these are the same projects; what the forecast expenditure is for these or why there is a sustained increase above materiality levels over the DPP assessment period. First Gas further state in their response that the sustained expenditure reflects latest population growth figures in Tauranga, Hamilton and the Kapiti Coast. First Gas provides no information to support this statement. First Gas then states that for forecast growth in consumer connections the Covec independent report is used. As stated above, Strata is not convinced that relying on medium-level forecasts of growth in Auckland ICP for the 10-year period 2014 to 2024 has any appropriate bearing on ICP growth on non-Auckland networks. Further, First Gas have not explained the difference between their ICP forecasts of 1% per annum and independent figure of 3.3% ICP growth per annum, the latter of which appears to have been relied on to justify capex expenditure. Strata do not consider that First Gas has sufficiently explained forecast step-

Question	Question posed	Strata recommendation	Rationale
			change growth in consumer connections from 2016 to 2017 or the sustained consumer connection growth forecast for the whole of the regulatory period to 2022. Strata further do not consider that First Gas has sufficiently explained the sustained growth in system growth capex for the whole period to 2022. Strata recommend that system growth capex forecasts be held to the upper materiality variance levels.
1.2	Please provide some commentary on why, when compared to the Vector non-Auckland gas distribution network, the First Gas distribution network is reduced by 400km and has 4,500 fewer ICPs.	Strata recommends that the explanations provided by First Gas be accepted as sufficient to satisfy supplier evidence assessment.	First Gas, in its response, explains that Vector, prior to the sale of its non-Auckland distribution assets to First Gas, transferred all its Auckland region, ex-NGC assets previously in Vector Gas Limited (which owned all non-Auckland network assets) to Vector Limited (that owns all assets in the Auckland gas distribution business). The transfer had the effect of reducing the network length and ICP connections in the non-Auckland gas distribution business. In addition, First Gas indicates that Vector re-designated two gas transmission pipelines as distribution pipelines. One segment was transferred to Vector Limited and became part of the Auckland gas distribution assets, the other segment was transferred into Vector Gas Limited, purchased by First Gas. This has the effect of increasing the overall length of the non-Akld gas distribution assets (but is unlikely to affect ICP numbers). First Gas has indicated that the transfers will be reported as disposals and additions in the information disclosure for the 2016 disclosure year.
1.3	Explanation for the reasons for the absence of forecast expenditure in the reliability, safety and environment capex category	Strata recommends that the explanations for the absence in forecast expenditure in reliability, safety and environment capex category be accepted as satisfying supplier evidence assessment.	First Gas explain 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 category as this most appropriately reflected their planned activities.

Summary of recommendations

5. Strata recommends that:

1) the explanations provided to question 1.1 not be accepted, except for the explanation for the step change forecast in system growth capex between 2016 to 2017. Strata therefore recommends that system growth capex forecasts and consumer connection capex forecasts be held at the upper variation boundary for each of the two categories of capex for the following years of the assessment period: 2018 to 2022.

2) the explanations provided to question 1.2 explaining the differences between the size and number of ICPs between Vector's previous non-Auckland gas network and First Gas's non-Auckland gas networks be acceptable as providing sufficient explanation to explain the differences.

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

6. 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