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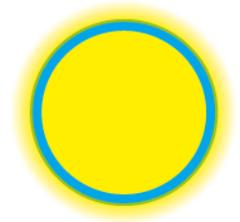
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**POWERCO**



Dear Tricia

**Powerco Submission to Default price-quality paths for gas pipeline services from 1 October 2017 to 30 September 2022 – Draft Reason’s Paper and Draft Determination**

*Introduction*

1. Powerco Limited (Powerco) welcomes the opportunity to comment on the Commerce Commission’s (the Commission) gas pipeline services Default Price-quality Path (the DPP) Draft Decision, associated Draft Determination, models and reports. Specifically, our submission comments on the:
  - *Default price-quality paths for gas pipeline businesses form 1 October 2017 to 30 September 2022 – Draft Reasons Paper* (the Draft Decision);
  - *Draft Gas Distribution Services DPP Determination 2017 – 10 February 2017* (the Draft Determination);
  - Gas DPP reset 2017: draft decision – models
  - *Gas DPP – Strata BAU Variance Check and AMP Evidence Assessment – Powerco*
  - *Gas DPP – Strata Dashboard – Powerco*
  - *Gas DPP – Strata recommendations following supplier evidence assessment responses – Powerco.*
2. Powerco is a gas distribution business (GDB). As such, we have not considered aspects of the Draft Decision or any associated models and reports that relate solely to the gas transmission business.
3. We have focused our submission on three areas of particular interest to us:
  - The process to date
  - Forecasting expenditure including the CPP fall back allowance; and
  - Constant price revenue growth (CPRG)

*The Process to date*

4. Default Price-Quality Path (DPP) regulation is reasonably new for GDBs and as such it is expected the regulatory regime will continue to develop. Powerco continues to be supportive of the Commission’s engagement with GDBs in developing incremental refinements to the regulatory process.

5. We acknowledge that any change requires much communication and discussion between interested parties. We consider the process undertaken by the Commission since December 2015 has been robust, helpful, and in general has worked well.
6. The original stakeholder meeting held in December 2015 set the scene for on-going discussion, communication and consultation. We found the industry workshops and forums to be extremely useful in explaining the Commission's evolving position and views. The forums provided an opportunity for open discussion and subsequent consultation papers have indicated the Commission have listened to feedback presented in these industry forums.
7. This Draft Decision confirms refinements to the methodology for forecasting expenditure. We acknowledge the Commission's efforts to alleviate concerns GDBs had around the methodology originally proposed. We found the stepped explanation provided in the update on forecasting expenditure<sup>1</sup> particularly helpful. It provided clarity around the process we could expect and also established the fall-back expenditure positions the Commission were considering at the time.
8. We continue to encourage the Commission's engagement with the industry as the regulatory process continues to evolve. With this in mind, we believe there are two areas of the process that could be improved:

- a. The supplier scrutiny stage of the expenditure forecasting process.

Powerco received a request for additional information from the Commission to which we provided a written response. We suggest that it may be useful for GDBs to have an opportunity to present any additional information to the Commission. This would allow the Commission to ask any further questions or seek clarification on any points. The Commission could at that time highlight any areas that they did not consider answered in full and an updated version of the written report could be provided.

- b. Models and reports.

The Commission has provided models and a modelling map to accompany the Draft Decision. It has also published the Dashboard report<sup>2</sup> and the BAU variance check and AMP evidence assessment<sup>3</sup> completed by Strata energy consulting (Strata).

All of these models and the reports are useful and explain various steps of the expenditure forecasting process to any interested parties.

The Strata BAU variance check and AMP Evidence report is easy to read and step through. It would be useful, and transparent to other interested parties, if the figures in the report could be quickly and easily be tied back to the Dashboard report also provided by Strata.

While the Dashboard report may be easy to understand for the Commission it presents difficulties for other parties. There is a large amount of information provided in the form of graphs but the significance of the information in the graphs, or how that information is used, is not clearly explained in the Dashboard report. The Dashboard report could be further developed to be informative and quickly understood.

### *Expenditure forecasting*

#### **The forecasting approach**

9. A key component of the expenditure forecasting process is the Commission's confidence in GDBs' asset management plans (AMPs). We recognise that if the Commission is to rely on the

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<sup>1</sup> Commerce Commission. Gas DPP reset 2017 – current views on forecasting expenditure – 31 October 2016.

<sup>2</sup> Strata energy consulting. "GAS DPP BAU Variance Check and AMP Evidence Assessment Powerco". 31 October 2016

<sup>3</sup> Strata energy consulting. "Dashboard – Powerco". 13 December 2016.

AMP forecasts it needs to gain assurance that the forecast expenditure is aligned to either a historic average level of expenditure or any increased expenditure is justified.

10. Powerco supports the approach of comparing business as usual (BAU) expenditure to forecast expenditure and the further step and trend analysis for operational expenditure (opex). For the Commission to gain the assurance it seeks, it is imperative that appropriate metrics are used in the analysis.
11. Expenditure drivers for gas distribution businesses may be different than those of other businesses. Establishing appropriate benchmarks is not easy. We encourage the Commission to continue to work with GDBs to develop robust and agreed metrics that will provide improved analysis of expenditure patterns.
12. In comparing the BAU expenditure to forecast, the Commission has set a variance tolerance of 5 percent for opex and a 10 % tolerance above the historic average for capital expenditure. We support this pragmatic and low cost approach to determine categories of forecast expenditure that require further scrutiny. Powerco agrees with the Commission that the 5 percent and 10 percent variance tolerances are appropriate. Capex tends to be more volatile than opex as capex projects tend to be of a higher value and may cross years.
13. The use of a multi-year historic basis to determine BAU expenditure is also appropriate to determine a normalised BAU expenditure level. Using a single base year would not necessarily reflect the efficient costs of a GDB. For instance, in one year a GDB may have abnormally low expenditure, and in the next two years abnormally high expenditure. Taking a historic average establishes a reasonable normalised level of expenditure for a 'business as usual' base line and provides a more reliable and robust comparative point.

#### **The CPP fall-back allowance**

14. The Draft Decision introduces a second fall-back position in the form of the CPP fall-back allowance. This provides an opex allowance to support the development of a customised price path (CPP) application. The Commission acknowledges that where it has not accepted expenditure forecasts because they represent projects more appropriately assessed under a CPP, that the Commission are forecasting the supplier will apply for a CPP.
15. We commend the Commission's approach of including an allowance to support the development of a CPP application. The Commission has recognised that some costs associated with a CPP application cannot be recovered from consumers through recoverable costs.
16. Powerco is in the process of applying for a CPP for its electricity business. It has been our experience that there are substantial costs incurred in preparing a CPP application that are not recoverable. We agree with the Commission that the CPP fall-back allowance serves the long-term interest of consumers by supporting the development of a CPP application in a timely manner.

#### *Constant Price Revenue Growth – the forecast of changing demand.*

17. The forecast of Constant Price Revenue Growth (CPRG) is a key input to the price setting process for GDBs subject to a weighted average price cap form of control. The CPRG forecasts change in demand expected over the regulatory period, influencing both starting prices and revenue growth over the regulatory period.

#### **The forecasting approach**

18. The Draft Decision applies fundamentally the same approach to calculating CPRG as in 2013. In essence this means Powerco's forecast growth is equally determined by the historic growth on

our network and projected growth modelled by Concept Consulting Group Limited (Concept Consulting).<sup>4</sup>

19. Concept Consulting have refined their approach and provided forecasts by GDB region for residential, commercial and industrial consumers. Further, more specific analysis of other drivers of gas demand such as population growth and GDB have also been incorporated into the model.
20. While we do not offer any alternative approach at this time, we continue to support the ongoing evolution of this key input to the price reset. We agree with Concept Consulting that the nature of the market GDBs operate in makes it challenging to develop accurate growth forecasts due to potentially volatility created by other energy markets such as electricity.<sup>5</sup>
21. This trend is likely to be exacerbated with the growth in the market of photovoltaic and storage technology providing consumers with greater choice.
22. We encourage the Commission to continue to work with GDBs in developing realistic forecasts for future regulatory control periods.

### **Combatting demand volatility**

23. The projections of demand supplied by Concept Consulting provide one half of the demand forecast. The other half is provided by extrapolating a GDBs historic growth.
24. The Commission note in the Draft Decision that historic growth in GDBs' fixed and variable quantities illustrate a 'varying trended pattern'. We caution against considering a short term trend indicative of a permanent change in growth. For example, the Commission note that where billed GJ increase while the number of ICPs decrease, it indicates that consumption per ICP is increasing<sup>6</sup>. We agree this is a valid comment for the year(s) in question but does not necessarily indicate a permanent or long-term trend. In Powerco's experience gas consumption is driven more by weather than a change in ICP numbers
25. The impact of volatility in results driven by weather can be mitigated to some extent by using a multi-year historic basis. We support the Commission continuing to use a multi-year historic basis.
26. We support the Commission's decision to update CPRG forecasts to include supplier data from the 2016 Information Disclosure results where available. Powerco has provided our information disclosure early to ensure the most recent data available can be used.

### *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 Lynette Taylor tel. (06)968 6235, email [lyn.taylor@powerco.co.nz](mailto:lyn.taylor@powerco.co.nz).

Yours sincerely



Richard Fletcher  
General Manager Regulation and Corporate Affairs

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4 Concept Consulting Group Ltd. "Approach to developing distribution network demand projections". 4 July 2016.

5 Concept Reporting. "Relative long-term demand risk between electricity and gas networks". 27 January 2016

6 Commerce Commission. "Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022 – Draft reasons paper. 10 February 2017.