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30 April 2014

Mr. John McLaren
Chief Advisor
Regulation Branch
Commerce Commission
PO Box 2351
Wellington 6140

Dear John,

Please regard this letter as our submission on the process and issues paper titled "Default price-quality paths from 1 April 2015 for 17 electricity distributors" and dated 21 March 2014. In this letter we will use the terms "MDL", "we", "us" or "our" to refer to the Gas Transmission Business (GTB) of Maui Development Limited.

Because we are not directly concerned with electricity distribution we will keep our submission short and avoid commenting on most of the substantive issues raised in the Commission's paper. Recognising, however, that the Commissions has a tendency to roll over its decisions for the electricity sector to our sector as well we would like to offer some comments and suggestions now. We will present those under the following headings.

- Forecasts should be based on multiple years of data
- Suitable models and data are hard to find
- Arbitrary caps are inappropriate
- Timings of capital expenditure and commissioned assets are different

Forecasts should be based on multiple years of data

As we have submitted before, we do not believe that a single base year is appropriate for future forecasting; certainly not in the gas transmission sector. We do not know how many years would be optimal for electricity distribution. In the gas transmission sector we do know that some significant components of operational expenditure, e.g. pipeline pigging, can be infrequent and lumpy.

When multiple years are used as a base period, then

a) it is not necessary to give equal weighting to all years; more recent years can be given a higher weight; and

b) expenditures made in earlier years should be adjusted for inflation.

By way of example, with a 4-year base period that could be used in the gas transmission sector, annual base expenditure (where n is the most recent year in the base period) could be calculated as:

$$40\%\ Exp_n + 30\%\ Exp_{n-1}\ CPI_n/CPI_{n-1} + 20\%\ Exp_{n-2}\ CPI_n/CPI_{n-2} + 10\%\ Exp_{n-3}\ CPI_n/CPI_{n-3}$$

Suitable models and data are hard to find

We understand that the Commission would prefer to rely on models over supplier forecasts. Doing so would require the following assumptions.

- Reliable and robust forecasting models can be prepared.
- Reliable data is available.
- A sufficient number of data points are available to allow parameter estimates with low error margins.

- Future trends will reflect historical data. In other words: future expenditures will reflect business as usual.

We will not comment on the electricity sector, but we do want to point out that most of these assumptions would be invalid for the gas transmission sector.

Arbitrary caps are inappropriate

The Commission is also inviting views on applying caps to supplier forecasts, e.g. relative to historical levels. The Commission already took this approach in setting DPPs in the gas transmission sector.

This approach will disincentivise investment, especially in the early years of a DPP period. Investors are disincentivised to contribute capital for investments exceeding the cap imposed by the Commission, due to the uncertainty, or even lack of, returns on such investments. Investment delays may lead to increased future costs. We believe this is an undesirable outcome and this approach should not be repeated or extended.

Timings of capital expenditure and commissioned assets are different

We appreciate that the focus in the Commission's paper is on forecasting capital expenditure. In the model for setting the price-quality path, however, the Commission is using forecasts of commissioned assets. For investment projects that take longer than a single year, or straddle years, the timing of capital expenditure and commissioned assets will be different.

Even greater concern can be caused with projects that straddle a DPP reset, being started in one regulatory period and commissioned in another. In such cases significant delays in gaining any return on capital expenditure are possible. We are also well aware that in carrying out its reset calculations for the next regulatory period the Commission will have to use data that will exclude any consideration of activities in the last 9-12 months of the current period.

In our case, the most significant capital expenditure projects we have in the near future are the Whitecliffs pipeline relocation and an OATIS (Open Access Transmission Information System) replacement. Both of these projects will take more than a year to complete. It will be a disincentive to starting those projects, and persuading our shareholders to provide capital for them, if there is no compensation for capital expenditure in the 1 or 2 years prior to the year in which those projects are completed; or, even worse, if there is no compensation at all until the next regulatory period. In order to avoid that, we believe the best approach is to indeed use actual capital expenditure forecasts in the modelling.

Conclusion

We have appreciated the opportunity to provide this submission. For any additional questions or clarifications please do not hesitate to contact us.

Yours sincerely,

Jelle Sjoerdsma
Commercial Operator, Maui Pipeline
for Maui Development Limited