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Matthew Lewer
Manager, Price Quality Regulation
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Sent via email: regulation.branch@comcom.govt.nz

Dear Matthew

Feedback on resetting DPPs for gas pipeline businesses

First Gas welcomes the opportunity to provide feedback on the Commerce Commission's process for resetting default price-quality paths (DPPs) for gas pipeline businesses (GPBs).

The Commission ran a transparent and well-structured consultation process, and we commend the Commission staff on their proactive engagement with regulated businesses and consumers. We consider that the DPP reset process will continue to evolve over time, but could be improved in the near-term by:

- Ensuring a clearer understanding of the appropriate level of information required for DPP resets at the start of the reset process;
- Amending how the Commission assesses larger capital expenditure (capex) investments under the DPP; and
- Ensuring that the Commission's DPP models clearly set out the outcomes of the process.

We expand on these points below.

Positive engagement with regulated businesses

First Gas appreciated the proactive engagement with Commission staff throughout the DPP reset process. The consultation process was clearly explained, methodical and transparent, with numerous opportunities for parties to engage with the Commission.

We particularly appreciated the opportunity to meet with Commission staff following the release of the draft decision in February 2017. Face-to-face meetings enabled us to outline the rationale for our proposed expenditure in greater detail, and we could discuss the targeted information provided by our technical staff, which addressed the preliminary findings of the Commission's consultants (Strata Energy Consulting). We note that the Commission also placed considerable weight on the views of our customers and third party reviews of expenditure. We consider that this approach enabled the Commission to make informed decisions.

Need to consider the appropriate level and timing of information sought for DPP resets

First Gas recommends that the Commission continues to refine the level of information required from regulated businesses for the DPP reset process. This was the second material reset of the DPP for GPBs (and the first for First Gas), and we are confident that the DPP reset process will become clearer and more efficient over time, as the Commission repeats the process with all regulated businesses.

However, it is important that a distinction be made between the information requirements and scrutiny applied under the DPP reset process when compared with a customised price-quality path (CPP) application. From our involvement as both a gas transmission and distribution business, we observed that:

- The information sought by the Commission and Strata during the October and November 2016 assessment stage[1] was quite broad. Consequently, we provided relatively high-level answers to avoid a level of detail that we did not think was required;
- During consultation on the draft decision, it became clear to us that more detailed information would help to address the queries raised on our expenditure forecasts. This involved the collation of numerous technical documents to supplement the information provided in our 2016 AMPs.

On reflection, we would have preferred to engage on the more detailed questions during the earlier stages of consultation on the DPP reset. We would have been comfortable responding to more queries from Strata and could have addressed questions on particular projects (such as Gilbert Stream), which the Commission raised later in the DPP reset process.

The level of detailed information sought on our transmission and distribution businesses was greater than anticipated and does risk moving towards the type of information expected in a CPP application. As the level of scrutiny and information required for a DPP reset increases, this erodes the low-cost intent of the DPP. This may be appropriate for gas transmission (since we are the only regulated gas transmission business), but requires more careful consideration in other regulated sectors.

Requiring this level of information may also see regulated businesses put more emphasis and resource into AMPs that are used for the DPP reset every 5 years. This is not necessarily bad if it improves the quality of AMPs, but may lead to AMPs being primarily aimed at persuading the Commission of the need and level of expenditure – rather than directed at other stakeholders' information requirements.

Adjust expenditure assessment process to consider large capex investments

First Gas recommends that the Commission changes the process used to assess large "lumpy" capex investments, so that they are assessed separately from baseline capital expenditure. Large projects should be removed from the expenditure profile and assessed separately through evidence in the AMP and additional supplier information.

As illustrated by the assessment of our gas transmission business, large projects such as the White Cliffs realignment will invariably see a business's expenditure profile rise above the assessment margin set for capex (±10%):

- The inclusion of White Cliffs expenditure across the five years triggered detailed scrutiny of the full Asset Renewable and Replacement (ARR) capex category;
- Strata did not find sufficient support for the White Cliffs (and Gilbert Stream) expenditure, but was comfortable with the baseline ARR expenditure; however
- Due to the assessment process, the Commission had to set the ARR capex category at the fall-back allowance level for its draft decision — effectively disallowing a significant proportion of forecast ARR expenditure even though it had been supported by the information provided in our 2016 AMP.

Following a rigid process in cases like this is clearly problematic, since large projects skew the expenditure profile. The Commission should instead be able to consider the reasonableness of the baseline expenditure separately from the effect of large capex projects.

[1] During the BAU variance check and AMP evidence assessment stage.

Accommodating material growth capex

Another outstanding issue is how a material growth capex project that would not meet the threshold for triggering a CPP is accommodated under the DPP when a revenue cap is applied. The current rules appear to set up a quandary where such a growth capex project might be considered too large for a DPP (or might be identified shortly after a DPP reset), and even though the customer(s) driving this growth capex may be willing to pay the entire amount (over time) the regulated business is unable to increase its revenue to reflect the investment until the next DPP reset.

We recommend that the Commission review how such growth capex should be treated, given these investments are driven by the needs of customer(s) and regulated businesses should be encouraged to invest.

Improvements required to Commission's assessment models

First Gas recommends that the Commission continues to refine its assessment models and work with regulated businesses to ensure the outputs are clear and well understood.

We found that the financial model was often difficult to follow, and Commission staff were often not able to clearly explain how certain costs were calculated. For example, we queried why, in some areas, we had been allowed the full expenditure level we requested, yet the allowance was markedly different from our AMP figures. This query was never properly clarified.

We also note that the Commission adjusted our proposed capex allowances for each year, to address the different year-ends applied by the previous owners and what First Gas has elected going forward. We consider that a simpler approach could have been taken, with adjustments applied to only the first year of expenditure. This would have aided parties understanding of the allowances proposed by First Gas in its AMP contrasted with the Commission's final decision.

Concluding comments

We thank the Commission for the opportunity to provide feedback on its DPP reset process and believe the improvements we have outlined above would further improve the process going forward. First Gas appreciated the open and structured process taken for the GPB DPP reset, and the Commission's willingness to engage with the evidence we provided, in coming to its final decisions.

If you have any questions regarding this submission, please contact me on 04 979 5368 or via email at karen.collins@firstgas.co.nz.

Yours sincerely

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