Submission on

Policy for setting price paths and quality standards:

Default price-quality paths for gas pipeline services from 1 October 2017

28 September 2016

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1. Introduction

1. This is Powerco Limited's (Powerco) submission on the Commerce Commission's (Commission's) consultation paper, *Default price-quality paths for gas pipeline services from 1 October 2017 - Policy for setting price paths and quality standards*, dated 30 August 2016.

2. We want to highlight two serious concerns that Powerco has with the proposals in the consultation paper.

3. The first relates to forecasting of expenditure. The problem to be solved here is how to incrementally improve the forecasting methodology in a way that recognises the low cost nature of a DPP and the relative simplicity of the gas distribution pipelines sector.

4. There is common ground that the Asset Management Plans (AMPs) of each of the four GDBs are an appropriate starting point. Industry and Commission discussions earlier in the process focused on how the Commission might work with the four companies to establish a sufficient level of assurance that the preparation of each of the four AMPs was robust.

5. However the proposal now put forward is a complicated framework of bespoke proxy "metrics" and layers of increasing scrutiny. It emphasises tailoring and is highly discretionary for the Commission and its consultants. The proposal sets unrealistic expectations for the available information in the AMP and from the four businesses, and will be costly and time consuming to implement. Of particular concern, the proposal misunderstands the role in the legal framework of the DPP and more closely resembles a CPP (for example, where one of the four AMPs exceeds its bespoke metrics there is no default option for that business).

6. In this submission we outline a proposal that would address the problem to be solved – low cost incremental improvement appropriate to a DPP. We do this by returning to the original challenge of giving the Commission assurance as to the preparation and robustness of the AMPs.

7. The second concern relates to a proposal to impose an additional quality standard for major outage events. Here, there is no problem definition in the consultation paper.

8. This is a significant oversight, as there are a number of existing legal frameworks that address the issue of major outages in gas distribution. Further, there are strong contractual and commercial incentives for the four GDBs to invest in the resilience of their networks and to respond quickly to major outage events. We discuss as a case study the major outage event that we experienced on our Wellington network, the third party causes of that, the significant consequences for Powerco and our consumers, and the scale of our response.

9. We do not believe there is an incentive gap or an accountability gap that needs to be addressed by the Commission, nor do we believe that the additional regulation proposed will materially add to existing incentives or accountabilities. As noted above the consultation paper does not define a problem in this area. It also offers no evidence on the cost benefit of the additional regulation, nor does it discuss alternative options.

10. An alternative, if this remains an area of interest for the Commission, is for a GDB to publish a report after a major outage event explaining to consumers and the Commission the causes of the event, the consequences of the event, any lessons learned and any

changes in network management made as a result. We discuss this alternative in our submission.

11. Our full submission covers [all of the points raised by the Commission in its consultation paper]. Our submission is in the following format:

Part A: Forecasting expenditure

Part B: Forecasting constant price revenue growth

Part C: Setting standards for quality of service

Part D: Price restructuring

Part E: Treatment of Major Transactions

Part F: Information Disclosure reporting requirements

Part G: High Impact, Low Probability risks

2. Summary of Powerco's views

12. The following table summarises Powerco's views on the Commission's proposals and provides recommendations for consideration.

<table>
<tr><th>Forecasting expenditure</th><th>Powerco view</th><th>Recommendation</th></tr>
<tr>
<td>In consultation with Strata, the Commission proposes an assessment framework based on scrutinising suppliers' AMP forecasts.

The process includes five stages:

• Standard ID compliance check: this is already part of the existing price/quality regime;

• BAU variance check: this involves using quantitative metrics and ratios to assess whether the expenditure forecasts represent BAU or non-BAU expenditure. This is was the focus of the "pilot" with which Powerco was involved;

• AMP scrutiny: this is applied if any aspect of the expenditure forecast does not meet the BAU variance test. This stage involves qualitative scrutiny of</td>
<td>We support the Commission's view that the AMP is the correct starting point for determining expenditure forecasts.

However, we have concerns that the proposal is:

• not incremental change;

• not low cost; and

• not consistent with the DPP framework or the problem definition in the GDB sector.

The proposal outlined in the consultation document appears to focus on the objective of tailoring at the expense of other more important objectives, being the provision of a low-cost, default framework.

We are also concerned that the proposed framework does not meet the requirement of being "relatively low cost", which is mandated by s 53K of the Commerce Act. Specifically, we do not consider using the cost of a CPP as a benchmark is suitable.

As noted by Strata, the proposal adopts a "middle ground" between the DPP and CPP frameworks. This, however, is not the task at hand. Rather, the Commission has been tasked with developing a</td>
<td>We recommend the Commission revisit its objective of arriving at expenditure forecasts that are:

• robust;

• low cost to produce; and

• otherwise suitable for the DPP process.

Powerco's proposal is that, rather than abandoning the current approach of relying on historic costs, the Commission should instead complement the current approach with sensible reliance on the AMP.

Our approach is based on the following principles:

• reducing the threshold (currently 120% of historic costs) below which supplier forecasts are adopted without further scrutiny for the DPP, which would limit the perceived risk that suppliers are incentivised to pad their forecasts; but

• permitting reliance on supplier forecasts up to a higher threshold (greater than 120%) in circumstances where the Commission is satisfied that the AMP provides a sufficient explanation for the increase in expenditure; and

• if the Commission is not satisfied with the AMP, allow suppliers the option of providing additional supporting</td>
</tr>
</table>

expenditure forecasts; • *Supplier scrutiny*: if AMP scrutiny still does not show how the proposed expenditure fits in with the Commission's expenditure objective, the onus is on the supplier to provide any other information to support its forecasting. • *Decision*: this will determine whether expenditure is allowable, excluded, or is best suited to a CPP application	relatively low cost DPP. An example of where this task has been misconstrued is in the adoption of the CPP expenditure proposal, which we submit is incorrect. We have concerns that the degree of Commission discretion allowed for by the proposed framework creates a tailored, costly, and invasive exercise. This runs counter to what a DPP should be. Strata's proposed process uses proxy metrics to assess expenditure forecasts. We think these metrics are complex, will be costly to apply, and will produce uncertain results. Instead, we trust that the Commission has sufficient experience with the gas industry to assess expenditure directly.	information, but otherwise default to the lower percentage threshold. This approach is a pragmatic and low-cost method of arriving at a robust expenditure forecast, and represents an incremental improvement on the current approach. Unlike the current proposal, there is a genuine "default" option which suppliers can resort to – as opposed to being shoehorned into a customised price path process.
Forecasting CPRG	**Powerco view**	**Recommendation**
The Commission is proposing to adopt a very similar Constant Price similar CPRG forecasting approach to that used in 2013, with the inclusion of additional regional demand forecasts.	Powerco agrees that the 2013 CPRG forecasting approach remains fit-for-purpose and supports the proposal to use regional demand forecasts.	Powerco supports the Commission's proposal.
Setting standards for quality of service	**Powerco view**	**Recommendation**
The Commission proposes to retain the existing RTE standard, as well as introduce a new interruptions standard based on major interruption events. The major interruption event standard would give the Commission the	Powerco supports the retention of the RTE standard. However, the paper does not articulate a clear rationale as to why a new interruptions standard is necessary for GDBs. There is no evidence of an existing problem, and	There would be benefit in extending the RTE reporting timeframe from 30 to 45 working days to allow suppliers adequate time to undertake internal investigations and accountability processes. If the Commission considers it necessary to include a major interruption event requirement into its regulatory regime,

ability to take action against GDBs under s 87 of the Commerce Act for breaching the proposed standard (the details of which are currently unclear).	no basis to suggest that consumers are dissatisfied with the existing regulatory regime. Further, and as expressly noted in the consultation paper, GDBs are already strongly incentivised to avoid outages. These existing incentives are illustrated with reference to the major outage on our Wellington network in 2006 caused by a third party. The magnitude of the costs faced as a direct result of the outage, as well as those indirectly associated – such as legal fees, lost customers, interruption to BAU services – are enough to incentivise GDBs to take adequate steps to avoid such incidents. On the basis that no benefits arising from this standard have been identified, we are left to conclude that the costs (which may be high) exceed the benefits. In any case, outages due to negligence or imprudent conduct would be enforceable in court under the relevant health and safety regulations. Penalising such conduct under the DPP would have the effect of double-counting any damages.	Powerco considers this should be in the form of a reporting requirement within information disclosure regulation (ID) and not as a compliance requirement within the DPP with potential enforcement consequences.
Price restructuring	**Powerco view**	**Recommendation**
The Commission is interested in exploring options that would improve its Gas DPP price restructuring provisions, and as a starting point has indicated that it	Powerco agrees that the provisions for price restructuring included in the Commission's 2015 Electricity Distribution DPP determination could equally be applied to the Gas DPP. We agree with the Commission that estimating	We support the Commission's proposal.

will consider the Electricity DPP provisions that were updated in its 2015 Electricity Distribution Services DPP determination.	the effect of a new price signal is difficult and may place revenue at risk, and look forward to working with the Commission to mitigate this risk.	
Treatment of Major Transactions	**Powerco view**	**Recommendation**
The Commission is interested in improving its DPP transaction provisions and has suggested that consideration of the EDB DPP provisions will be a useful starting point. It intends to reconsider the continuing appropriateness of the current approach to allocation of ANR following a transaction. The Commission has also indicated it will consider the ongoing appropriateness of the DPP transaction provisions in addressing transactions which may occur with entities which have specific pipelines which are exempt from being subject to regulation under Part 4.	Powerco agrees that an appropriate allocation of ANR is necessary after a transaction to ensure that consumers in aggregate are not made worse off by the transaction. We also agree it would be useful to provide guidance in the DPP to address transactions which may occur with entities exempt from Part 4 regulation.	We suggest the Gas DPP Determination states that the major transaction provisions within the determination are extended to include transactions that occur in the final year of the previous regulatory period. This would ensure that the opening year's ANR can be adjusted to reflect the transaction. In relation to transactions which may occur with entities which are exempt from Part 4 regulation, we suggest the Commission consider the electricity distribution services DPP as a possible starting point that could be equally applied to gas distribution services.
Information Disclosure reporting requirements	**Powerco view**	**Recommendation**
The Commission is considering introducing two new ID reporting requirements:	We do not think this reset process is the appropriate forum to discuss and debate matters regarding ID reporting requirements.	These ID measures should be excluded from the current gas DPP reset process, and should be evaluated as part of an IDD review.

• Connection times for new customers; and • Response time to customer service enquires.	Any changes to the ID requirements should be subjected to appropriate industry consultation and review.	
High Impact, Low Probability risks	**Powerco view**	**Recommendation**
The Commission has advised that it does not consider that its AMP reporting requirements in regard to HILP risks are being fully met by suppliers. It is interested in views on the best means or forum for continuing discussions with suppliers regarding HILP risks	In Powerco's opinion this reset process is not the appropriate forum to discuss and debate matters regarding ID reporting requirements.	We recommend that further discussion regarding HILP risk requirements are excluded from this reset process, as this matter is most appropriately undertaken as part of an IDD review.

3. Part A: Forecasting expenditure

Overview

13. As we noted in the Introduction to this submission, the proposal in the consultation paper for arriving at expenditure forecasts is of material concern to Powerco.

14. In the consultation process thus far, the focus has been on incremental improvement of the forecasting methodology in a low cost way. This recognises the role of the DPP in the legal framework and the focus of the Commission, until now, on continuous improvement rather than wholesale reform or re-writing of methodologies.

15. It has been a common position that the AMPs of the GDBs are an appropriate starting point. There are only four GDBs and so only four AMPs, and the businesses are relatively simple. There is the potential for the Commission to gain an appropriate degree of assurance as to the preparation and robustness of each of the four AMPs in a way that is low cost and consistent with the DPP framework.

16. The proposal in the consultation paper, however, is radically different and comes as a surprise both in process terms and on the merits. The proposal is:

    16.1 not incremental change;

    16.2 not low cost; and

    16.3 not consistent with the DPP framework or the problem definition in the GDB sector.

17. In this section of our submission we start by returning to the legal framework for a DPP and the problem to be solved in relation to expenditure forecasts in this reset process. We then highlight how the proposal in the consultation paper misunderstands the legal framework for a DPP, and misunderstands what would be involved in implementing the complicated framework proposed. We also record our concerns with the process that has got us to this point. We finish by proposing an alternative that more appropriately addresses the problem to be solved in this DPP reset in this sector.

Legal framework for a DPP

18. As set out in section 53K, the overarching purpose of default/customised price-quality regulation under the Commerce Act is:[1]

> …to provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances.

19. This definition encompasses the frameworks for both default price-quality paths (DPPs) and customised price-quality paths (CPPs). The Commission has further separated

[1] Commerce Act 1986, s 53K.

these frameworks out, appropriately defining DPPs as being set in a relatively low cost way, while CPPs are tailored to a supplier's circumstances:[2]

> The purpose of [default/customised price-quality] regulation is to provide a relatively low cost way of setting price-quality paths for suppliers, while allowing individual suppliers the opportunity to have alternative price-quality paths that better meet their particular circumstances. We have taken this to mean that:
>
> - Default price-quality paths will be set in a relatively low cost way; and
>
> - Customised price-quality paths must be tailored to a supplier's circumstances.

20. The Commission's interpretation of the complementary roles of the two price-quality paths is consistent with Parliament's intention when the regulatory regime was introduced in 2008. The then-Minister of Commerce, the Honourable Lianne Dalziel, made the following comments during the parliamentary stages of the Commerce Amendment Bill:[3]

    20.1 In relation to the DPP: "The key feature of the default price path is that the rate of change in prices will be determined by the consumer price index, less a requirement for productivity improvement based on long-run productivity improvement rates for the sector".

    20.2 In relation to the CPPs: "Suppliers will be able to apply to the Commerce Commission for a customised price-quality path if they can justify this — for example, because they need to make significant new investments. The commission would be required to make decisions within 12 months".

21. More recently, the Commission outlined its interpretation of the differences between the DPP and CPP regimes, noting that CPPs required "a more intensive and complex process" as compared with a DPP.[4] The Commission emphasises that the Act "requires us to specify verification, consumer consultation, and information requirements, and step change in expenditure is more suited to a higher level of scrutiny etc".[5]

22. All this material confirms that a CPP is a supplier's bespoke option (which comes alongside additional costs, greater Commission scrutiny, and other checks and balances like customer consultation and verification), whereas the DPP is more of an off-the-rack, cost-friendly option, to which a supplier defaults if it chooses not to apply for a CPP.

23. The High Court provides an accurate summary of the DPP and CPP regimes in *Wellington International Airport Limited and others v Commerce Commission* (emphasis added):[6]

> DPP regulation is at times described by the Commission as 'one size fits all' or 'generic' regulation of a group of suppliers. This is a slight over-statement in that, as will become apparent, the Commission included a number of supplier-specific components when

[2] Commerce Commission, "Setting Default Price-Quality Paths for Suppliers of Gas Pipeline Services" (28 February 2013) at [1.6].
[3] Hansard, "Commerce Amendment Bill — Second Reading" (2 September 2008), Volume 649, p 18313. https://www.parliament.nz/en/pb/hansard-debates/rhr/document/48HansD_20080903_00001494/commerce-amendment-bill-second-reading.
[4] Commerce Commission, "Input Methodologies review draft decisions – Topic Paper 2: CPP requirements" (16 June 2016), at [30].
[5] Commerce Commission, "Input Methodologies review draft decisions – Topic Paper 2: CPP requirements" (16 June 2016), at fn 17.
[6] [2013] NZHC 3289, at [33] – [35].

> determining the DPPs. But **much of a DPP is generic and the Commission's capacity to take account of a supplier's specific circumstances is limited by the intention that a DPP be relatively low-cost**.
>
> ...
>
> CPP regulation is, on the other hand, individual supplier specific. A supplier subject to a 'one size fits all' DPP may make a proposal to the Commission for a CPP if it considers that it may better meet its particular circumstances. **In contrast to industry-wide DPP regulation, a CPP provides an alternative price-quality path addressed to the proponent supplier's particular circumstances.**

2017 – 2022 gas DPP reset: problem definition

24. In resetting the gas DPP, the Commission has stated its focus is on refining the DPP, as opposed to radically changing the existing regime.

25. In its most recent policy paper, the Commission noted:[7]

> We are taking an incremental approach to making changes to how we set the DPP. We will make improvements on the 2013 reset where they either better promote the incentives suppliers have, or reduce costs and complexity. However, the core of how we approach the reset has not changed.

26. As we set out in previous submissions, we agree with the Commission's position that there are no significant issues with the current gas DPP. Rather, any changes made to the existing regime should be by way of refinements, as opposed to an overhaul of the present system.[8]

27. This holds true for expenditure forecasts.

28. In our view, and consistent with the legal framework set out above, the objective is to arrive at expenditure forecasts that are:

    28.1 robust;

    28.2 low cost to produce; and

    28.3 otherwise suitable for the DPP process.

29. With this in mind, we support using the four AMPs produced by the GDBs as a basis for forecasting expenditure. The challenge – or problem to be solved – is identifying a low cost way in which the Commission can get the necessary assurance that the AMPs have been produced with appropriate governance and supervision and are robust.

30. We consider that this approach can meet the objectives of being suitably straightforward to compile and assess (hence low cost) and, with appropriate safeguards, sufficiently robust for the purposes of a DPP. For this reason we agreed to work collaboratively with

[7] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [X3].
[8] Powerco, "Feedback on Input methodologies review: Gas pipeline default price-quality path reset 2017" (28 January 2016), at [7]; Powerco, RE: Powerco response to Commerce Commission's request for comment on Default price-quality paths for gas pipeline services from 1 October 2017" (30 March 2016), at [7].

the Commission staff to find low cost, robust ways to get that assurance. This is consistent with our previous submissions on this topic.[9]

The Commission's emerging view proposal

31. At face value, the Commission appears to have taken on board Powerco's suggestion of using the AMP as the basis for forecasting expenditure. However, the proposal set out in the consultation policy paper[10] loses sight of the distinction between the DPP and CPP processes, which runs counter to the objectives of the DPP regime.

Misunderstanding of the DPP framework

32. We outline below the areas where we think the Commission's approach is contrary to the legal framework for a DPP.

Objective of tailoring

33. In its assessment of forecasting expenditure the consultation paper elevates tailoring to the primary objective of the exercise. The purpose of the chapter dealing with forecasting expenditure is stated as being:[11]

> …to increase the level of tailoring for resetting the Gas DPP in 2017.

34. This objective is reiterated throughout the Commission's discussion of forecasting expenditure.

35. The primacy given to tailoring in this section of the consultation paper runs counter to the legal framework for a DPP. As noted above, the High Court has observed:

> …much of a DPP is generic and the Commission's capacity to take account of a supplier's specific circumstances is limited by the intention that a DPP be relatively low-cost.

36. In our view, the consultation paper has misunderstood the DPP framework in the way that it has clearly elevated the objective of tailoring. This is not the primary purpose of the DPP, and it should not be pursued to the detriment of a low cost, default framework (as discussed below).

37. We consider that tailoring should be a secondary outcome, and should not be pursued "at all costs", and certainly not to the detriment of the objectives of the DPP framework. This approach is consistent with the framework of the DPP regime, and aligns with the High Court's views in *Wellington Airport v Commerce Commission* discussed above.

Inappropriate reference for "relatively low-cost"

38. The consultation paper loses its way on the objective of tailoring in part because it incorrectly frames the low-cost imperative of a DPP.

39. The consultation paper states:[12]

[9] Powerco, "Feedback on Input methodologies review: Gas pipeline default price-quality path reset 2017" (28 January 2016) at [40] – [42].
[10] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016).
[11] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.1].

> [o]ur view of what constitutes a relatively low-cost DPP is relative to the alternative, which for suppliers is a CPP.

40. This is incomplete in a fundamental way. It is necessary but not sufficient that a DPP be a lower cost option than a CPP. It is clear from the legal framework that a DPP must be a materially lower cost option. It must be different in complexity, character and cost. It must be low cost in an absolute sense, not only a relative sense.

41. When compared with DPPs, CPPs should be of a different magnitude of cost and complexity, involving additional features such as customer consultation, independent expert verification, audit, and in-depth Commission scrutiny. The Commission has previously shared its view that a "relatively complex customised price-quality path proposal" is likely to cost $2.5 million.[13]

42. There can be no suggestion that a DPP remains legally appropriate if it increases in cost and complexity to a level just short of that. Yet that is the framing in the consultation paper. And it is within that framing that the consultation paper develops its complete re-write of the expenditure forecasting process, introducing a significantly more complicated, discretionary and costly edifice.

Strata's statement of its objective

43. Strata Energy Consulting (Strata) reports on a proposed framework and methodology for the DPP reset. The first paragraph of the Executive Summary of the Strata Report states:

> The Commerce Commission has engaged Strata Energy Consulting to undertake development of a framework that can be used when setting default price paths (DPP) for gas pipeline businesses (GPBs). The framework would be used as part of the next DPP reset in 2017.

44. Given the central role of Strata in developing the proposal put forward in the consultation paper, we are concerned that Strata has misunderstood the objective of its task.

45. In its proposed framework document, Strata sets out its approach in the follow terms:[14]

> For the distribution businesses, the goal is to explore the feasibility of a middle ground between the broad, potentially expansive inquisition of a CPP assessment and the current DPP approach.

46. We are concerned at Strata's description of its task, as this is fundamentally not the aim of a DPP. A DPP bureaucracy that comes in somewhere between the current low cost DPP and the $2.5m mark of a CPP is not consistent with the legal framework or the sector's expectation.

47. This approach by Strata is also the genesis for a second inconsistency with the legal framework, whereby the Strata proposal does not allow suppliers to opt for a "default" option. Instead, suppliers are compelled to engage with the Commission in a process which is, in Strata's own words, a "middle ground" between the DPP and CPP.

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[12] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.45].
[13] Commerce Commission, "Resetting the 2010-15 Default Price-Quality Paths for 16 Electricity Distributors" (30 November 2012), at fn 242.
[14] Strata, "Low cost review framework for gas pipeline expenditure: Proposed Framework and Methodology – a report for The Commerce Commission" (29 August 2016), at [11].

48. It may be that Strata was inadequately briefed on the legal framework and the role of a DPP, or misunderstood the task at hand. Either way, Strata's statement of the objective it had in mind when developing the proposal in the consultation paper is not consistent with the legal framework discussed above.

Use of the CPP expenditure objective

49. The approach to the expenditure objective is a further example of where the consultation paper has incorrectly imported CPP analysis into the DPP context.

50. The consultation paper notes that when assessing expenditure forecasts the Commission must exercise some judgement. An expenditure objective helps guide that judgement.[15]

51. The consultation paper then describes a choice for the expenditure objective that could guide judgment in selecting low-cost robust forecasts for a DPP:[16]

> Our preference is to align the expenditure objective with one of our pre-existing requirements. Either:
>
> - the expenditure objective for ID, in particular, whether costs are efficient and performance efficiencies are being achieved; or
> - the expenditure objective for CPP applications. Broadly, capital and operating expenditure should reflect the efficient costs that a prudent non-exempt business would require to meet demand in the regulatory period and over the longer term and comply with applicable regulatory obligations.

52. Having asked whether it is appropriate to align the low cost DPP framework with the ID framework or the CPP framework, the consultation paper surprisingly chooses the CPP:[17]

> Aligning the expenditure objective of this DPP assessment framework with the CPP equivalent is appropriate because, in principle, DPPs and CPPs have the same objectives. They are both about delivering long-term benefits to consumers through price paths derived from expenditure allowances that reflect the following:
>
> - right investments (consideration of alternatives);
> - right timing (not in advance or deferred);
> - right cost (tendering processes, unit costs etc); and
> - right resources to deliver (delivery plan).

53. To say that alignment of the DPP expenditure objective with the company specific CPP expenditure objective is appropriate "because, in principle, DPPs and CPPs have the same objectives" is to fundamentally misunderstand the DPP/CPP framework. Of course both price paths are intended to deliver long-term benefits to consumers (as is the

[15] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.74].
[16] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.76].
[17] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.77].

ID regulation). However the key point is that the DPP and the CPP must reach that objective in very different ways.

54. The consultation paper is correct that CPP expenditure allowances should reflect scrutiny of "right investments (consideration of alternatives); right timing (not in advance or deferred); right cost (tendering processes, unit costs etc); and right resources to deliver (delivery plan)." However that level of detailed scrutiny is not intended or appropriate for a DPP.

55. The consultation paper argues this expenditure objective would be applied differently in a DPP context.[18] This assertion does not save the proposal nor does it obscure the consequences of the choice. The expenditure objective for CPP applications is inherently unsuitable for the DPP context, a point that is demonstrated by the complicated and costly proposal in the consultation paper that flows from the choice of expenditure objective.

High discretion model

56. A further sign of how far the proposal in the consultation paper has strayed from the DPP framework is the high level of Commission discretion when applying its forecast expenditure assessment.

57. Under the heading "Key considerations for 2017", the consultation paper notes that "[t]he framework is flexible and we have retained discretion in its application to suppliers' forecasts, particularly in the scrutiny we apply".[19]

58. An example of this discretionary approach is the way the Strata proposal chooses not to engage with supplier forecasts directly, but instead proposes to develop proxy "metrics" – metrics which will not be specified in advance, and appear to be reliant on the Commission's discretion.[20] This takes the framework away from the intention of the IMs to declare regulatory requirements in advance, let alone the intention of a DPP to provide a clear, low-cost, sector-wide default price path.

59. This discretionary approach informs each step of the Strata framework. If one of the four AMPs fails the bespoke metrics set by the Commission and its consultants, that business is committed to a path of AMP scrutiny and supplier scrutiny. There is no "default" option – an essential element of a DPP. Rather, the proposed forecast assessment process commits both the business and the Commission to a discretionary scrutiny and tailoring exercise. That exercise will inevitably be heavily influenced by the judgement of the Commission's consultant, without the checks and balances that are employed in a true CPP process.

60. We discuss below the implementation of the proposal in the consultation paper. The degree of discretion that would be imported into the DPP process moves the Commission's forecast expenditure assessment from a relatively low-cost, standardised process, to a tailored, costly, and invasive exercise. In other words, the level of discretion is more akin to CPP scrutiny. This, in our view, is not correct.

[18] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.80].
[19] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.35].
[20] Commerce Commission, "Gas DPP Reset 2017: Summary of question and answer session" (14 September 2016), at p 7.

The proposal is not "relatively low-cost"

61. The consultation paper and the Strata report under-estimate the cost and complexity of the proposed framework. Strata proposes three stages:

    61.1 The "BAU check" stage. At this stage the Commission, advised by its consultants, compares each of the four AMPs against proxy "metrics".

    61.2 The "AMP scrutiny" stage. Here, the Commission, advised by its consultants, reviews an AMP for detailed explanation of any variation from any one of the metrics set for that AMP.

    61.3 The "supplier scrutiny" stage. If the Commission and its consultants are not satisfied with the level of detailed explanation in the AMP then the Commission requests that the supplier provide further detailed justification for the way in which the forecast varies from the relevant metric. There is no opting out from this stage.

62. As an initial observation, this is a long way from the problem definition discussed earlier in this process: how to give the Commission sufficient assurance that the process and governance for the development of each of the four AMPs is appropriate.

63. We comment on each of the Strata stages below.

BAU check

64. The Strata's report notes that the first step in the process – the "BAU check" – uses:[21]

> …input data metrics and calculates ratios and applies materiality boundaries to the ratios.

65. We disagree with Strata's decision to base its proposal around proxy metrics. The alternative is for the Commission to use its own judgement to assess expenditure forecasts directly (the current approach).

66. When compared with the alternative of assessing expenditure forecasts directly, the proposal by Strata to introduce proxy metrics means:

    66.1 the framework is much more complex. Every aspect of the assessment exercise changes: different expertise is required, different information is required, and there is a greater use of internal resources and external consultants.

    66.2 the framework immediately moves the AMP away from a business document relevant to how each of the four GDBs run their business, to a document centred around regulatory "metrics" chosen not by the business but by the Commission and its consultants. This would be a major step backward for the sector. It is an asset for both the companies and the Commission that the four GDB AMPs are currently genuine, robust, business planning tools.

    66.3 the framework gets pulled into discretionary, bespoke regulation that, as discussed above, cuts across both the intention of the IMs to declare

[21] Strata, "Low cost review framework for gas pipeline expenditure: Proposed Framework and Methodology – a report for The Commerce Commission" (29 August 2016), at [48].

regulatory parameters in advance and the intention of the DPP to set a low cost, relatively generic - and default - price path.

67. The nature of the proposed metrics is also problematic. To name a few, we note the following:

67.1 The interpretation of cost categories used in the metrics does not seem well-considered, and leads to misinterpretation of results.

67.2 The metrics apply arbitrary forecasts. For example, interruptions are forecast by Strata and then translated into an average cost per interruption.

67.3 The metrics do not consider the drivers of costs for GDBs. For example, operational expenditure is not related to volumes transferred. We note that volumes fluctuate largely due to weather and there is no causality between volumes transferred and expenditure incurred.

67.4 Based on our experience during the pilot, we are concerned that there are errors exist in the price path methodology. For example, Strata's report contains a graph at Figure 8 indicating a lumpy and increasing expenditure pattern for operational expenditure that is not reflective of the figures in our 2015 AMP.

68. We provide further detail of our concerns with the proposed metrics at **Appendix 1**.

69. Finally, as a practical matter the introduction of these proxy metrics means the current AMPs are more likely to fail the BAU check stage, committing the business, and the Commission and its consultants, to the AMP scrutiny and supplier scrutiny stages.

70. This is because, as noted above, the AMPs are currently prepared as business planning tools, not regulatory compliance tools. They set out the needs and plans of the business, in a form and in concept in ways that meet business needs. As such they are very useful to both the four businesses and the Commission. However they will more likely fail a bespoke set of proxy regulatory metrics. In future this is possibly less likely as AMPs are re-cast to reflect the proxy regulatory metrics – but as discussed above that should not be seen as a positive.

AMP scrutiny

71. The next stage proposed by Strata is scrutiny of the AMP. This will occur where an AMP forecast contains a variance from one of the bespoke metrics applied by the Commission and its consultants to that AMP.

72. In our view Strata mischaracterises the nature and contents of a typical AMP. As a rule, AMPs do not have the degree of explanation and information that Strata asserts they do (or believes they should have). Again, these are business documents prepared to meet a business purpose, and there is a lot of value for the business and the Commission in that.

73. Each of the four GDBs take preparation of the AMP seriously, both for their own purposes and for the role it plays in the regulatory process. But they are not drafted with the intention of providing detailed explanation and information on variances from bespoke proxy metrics set after the AMP is prepared.

74. The point here is not necessarily to debate whether the four AMPs should be prepared with sufficient detailed explanation and information to satisfy any comparison to metrics

subsequently set (although as above we think that will distort the AMP from its current valuable role). The most immediate point is that the current AMPs were not drafted with that comparison against metrics subsequently set in mind – and for that reason, this "AMP scrutiny" stage is highly likely to lead to the next "supplier scrutiny stage".

75. Suppliers will inevitably be required to submit themselves to the final stage in the process – supplier scrutiny – which, like CPP analysis, comes along with additional complexity and costs.

Supplier scrutiny

76. The final stage is said to be scrutiny of existing board papers, strategy documents, and other materials. Even at this final stage, it is hard to see how the Commission and its consultants will be able to satisfy themselves that variances from the bespoke proxy metrics are appropriate.

77. The consultation paper asserts that these documents "should contain all the necessary information supplier governance bodies require to justify material expenditure commitments".[22] However this stage in the Strata framework misunderstands the nature of the business processes and documents involved.

78. It is not realistic to expect that board papers, strategy documents, and similar materials will contain the detailed information and explanation that the Commission and its consultants will be looking for at this stage (having already been through the BAU check against proxy metrics, and scrutinised the key business planning document – the AMP itself).

79. If the Commission and its consultants are not satisfied with the AMP itself, then it is unlikely that existing management and governance documentation will contain the additional information and explanation to the level expected by the Commission and its consultants. Rather, at this stage of the Strata framework, the business, the Commission and its consultants will be committed to a bespoke information gathering, testing and justifying process.

80. This seems likely to collapse into a CPP-like process, without the framework, processes and safeguards of the CPP option.

81. Standing back, we are concerned that the consultation paper materially under-estimates the way the implementation of the Strata framework will play out in practice. It will:

    81.1 change the character of AMPs and AMP assessment to one that is expert- and consultant-led at the expense of a business-focused exercise;

    81.2 lead to high numbers of variances from the bespoke metrics imposed on the four AMPs after the fact by the Commission and its consultants; and

    81.3 collapse the process down to iterative information requests and justification exercises akin to a CPP.

82. From our perspective, the proposed process falls short of the "relatively low-cost" regime promised by the Act, and is also likely to lead to drawn-out decision timeframes for the

[22] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [3.110].

Commission. We consider the proposed approach is more in line with a CPP application, and does not fit with the legal framework of a DPP.

Process concerns

Consultation timeframe

83. We are concerned that material changes are needed to the Commission's proposal for expenditure forecasts, and the current consultation timetable does not allow for that to happen. This creates at least the perception that as a practical matter our submission cannot be fairly considered.

84. The process issue is that the timetable envisages no further engagement until the Commission issues a draft reset decision in February 2017, followed by technical consultations as quickly as one or two months later (March / April 2017). [23]

85. Stakeholders perceive that the Commission will be reluctant to include a materially different or new proposal in its draft reset decision in February 2017. Also, the Commission has not left any room to develop material changes between the draft reset decision in February 2017 and the technical consultation on implementing the draft reset decision in March / April 2017.

86. In short, it is reasonable to read the consultation timetable for the remainder of this reset as not allowing for material change to the Commission's proposal, only refinement.

87. This is the first time the four GDBs have seen the Strata proposal. And Powerco submits that an alternative to the Strata proposal is needed, for the reasons discussed in this submission, not refinement.

88. Our process concern is that as a practical matter the current timetable does not leave opportunity for the Commission to consider any alternate proposals to the proposed framework.

89. We outline below an alternative approach to estimating forecast expenditure that is consistent with:

    89.1 the DPP framework;

    89.2 the focus of this reset process (which is on incremental improvement where need is identified); and

    89.3 the problem definition.

90. As a process suggestion, we submit that this issue needs to be worked through with the four GDBs before Christmas, so that the Commission can identify changes and generate a broad consensus ahead of the draft reset decision in February 2017.

Commission/Strata "Pilot"

91. Powerco also has particular concerns about the Commission's communications around the "pilot".

[23] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at Table 1.2.

92. Consistent with the original problem definition, Powerco agreed to work with the Commission to identify ways in which the Commission could get information on the governance and processes used to generate the existing business AMPs. The Commission asked to involve Strata in those discussions and we agreed.

93. The extent to which the original proposal altered from what we had agreed only became known at the end of May 2016, when we received a copy of the Strata model. Up to this point we were not aware that Strata would be developing metrics in isolation, or developing a framework in conjunction with the Commission.

94. Upon receiving a copy of the model and an overview of the proposed framework[24] we immediately expressed our concerns with the overly complex proposal. We were not provided an adequate opportunity to develop an alternative approach, nor were we consulted on the appropriateness of the metrics. Rather, the Strata proposal was published without incorporating any of our feedback or comments.

95. Following this experience, Powerco formally requested that the Commission caveat the Strata proposal to clarify that Powerco did not endorse the methodology used. In our view, this has not been adequately communicated to other interested parties (both in the consultation paper and during the question and answer session held by the Commission earlier this month), hence our need to make matter clear here.

Proposed way forward

Approach

96. As set out above, we think there is merit in returning to the problem definition. In our view, the Commission's objective is to arrive at expenditure forecasts that are:

96.1 robust;

96.2 low cost to produce; and

96.3 otherwise suitable for the DPP process.

97. In achieving this objective, it is also prudent to consider the relevant context in which the gas DPP reset is taking place:

97.1 *There are only four GDBs:* While this does allow for more tailoring to occur throughout the process, this is not an adequate reason to pursue this goal without taking heed of other, more important, objectives, such as retaining a relatively low-cost regime, and ensuring there is in fact a "default" option that GDBs can utilise.

97.2 *GDBs already produce AMPs, and the Commission is familiar with them:* It stands to reason that they are an appropriate source of information that both suppliers and the Commission can use to have a discussion in relation to forecasting expenditure.

97.3 *GDBs are not complex:* These are businesses that the Commission has expertise in dealing with, and so there is little likelihood that such businesses

[24] This occurred during a meeting between Powerco and the Commission on 24 May, where the Commission covered off its objectives and high-level framework. Strata dis

would be incentivised to try to hoodwink the Commission into approving inappropriate expenditure, nor would they be successful in doing so.

97.4 *GDBs have efficiency pressures:* Unlike electricity, gas is a secondary fuel, meaning there is little incentive for GDBs to gold-plate their forecast expenditure. While we are not pushing for deregulation of the gas industry, gas is a discretionary fuel and subject to competitive pressures. We believe that this is an appropriate consideration to bear in mind when considering the correct level of regulatory supervision. In our view, there are good reasons for GDBs to be at the lighter end of the regulatory spectrum.

98. Turning back to the Commission's initial proposal for forecasting expenditure, we agree with the Commission that the correct starting point is the AMP. This aligns with our previous submissions on the gas DPP reset.[25]

99. However, we believe the focus should be on balancing the right degree of supervision with the level of expenditure proposed. This is where we see our approach departing from that currently proposed by the Commission.

100. Essentially, we consider there is merit in the Commission balancing the consumer interest in:

100.1 an appropriate level of regulatory supervision; with

100.2 low cost regulation of GDBs.

101. Striking this balance would best meet the objectives of the legal framework underpinning the DPP regime. We propose a possible alternative process below, which we think better suits the purpose of the DPP regime.

Powerco's proposal

102. Powerco's proposal is that, rather than abandoning the current approach of relying on historic costs, the Commission should instead complement the current approach with sensible reliance on the AMP. Powerco's approach would:

102.1 improve the robustness of the expenditure forecast;

102.2 address the Commission's concerns that suppliers are incentivised to strategically pad their capex forecasts to meet the current 120% limit; and

102.3 preserve the low-cost objective of the DPP regime by not significantly increasing costs above the current level.

103. In summary, Powerco's approach involves the following key principles:

103.1 reducing the threshold (currently 120% of historic costs) below which supplier forecasts are adopted without further scrutiny for the DPP, which would limit the perceived risk that suppliers are incentivised to pad their forecasts; but

[25] Commerce Commission, "Feedback on Input methodologies review: Gas pipeline default price-quality path reset 2017" (28 January 2016), at [40] – [42].

103.2 permitting reliance on supplier forecasts up to a higher threshold (greater than 120%) in circumstances where the Commission is satisfied that the AMP provides a sufficient explanation for the increase in expenditure; and

103.3 if the Commission is not satisfied with the AMP, allow suppliers the option of providing additional supporting information, but otherwise default to the lower percentage threshold.

104. Powerco anticipates that its approach would involve the following steps:

104.1 Step 1: BAU variance:

(a) the Commission would calculate BAU expenditure (capex and opex) for the current regulatory control period on a predefined basis;

(b) if the supplier's AMP falls within a specified percentage threshold of BAU expenditure (applying a threshold less than the current 120%, to limit the perceived risk of padding), the Commission would use the AMP as the expenditure forecast;

104.2 Step 2: assess explanation provided in AMP:

(a) if the supplier's AMP exceeds the threshold, the Commission would proceed to scrutinise the explanation provided for the increased expenditure in the AMP applying pre-defined criteria. Powerco submits this step should focus on the process pursuant to which the AMP was prepared, and governance safeguards, in order to assure the Commission that the AMP is robust, rather than a costly line-by-line assessment of each cost item (which essentially replicates the CPP analysis);

(b) if the Commission is satisfied with the AMP, it would adopt the AMP as the expenditure forecast, subject to a further threshold of BAU expenditure (greater than the current 120%, but set at a level recognising that at a certain point a supplier should instead apply for a CPP);

104.3 Step 3: option to provide supporting information:

(a) if the Commission is *not* satisfied with its scrutiny of the AMP, it would advise the supplier of the perceived shortcomings, and the supplier would then have the option to provide additional supporting information to remedy those shortcomings, in which case the Commission would then adopt the AMP subject to the threshold mentioned above;

104.4 Step 4: default to step 1 BAU variance threshold:

(a) if the supplier elects not to provide further information (e.g. because it considers the costs outweigh the potential benefits), or the Commission remains unsatisfied, the expenditure forecast should default to the BAU variance threshold identified in step 1.

105. In our view, this alternative approach is a pragmatic and low-cost method of arriving at a robust expenditure forecast, and represents an incremental improvement on the current approach. And, unlike the current proposal, there is a genuine "default" option which suppliers can resort to – as opposed to being shoehorned into a customised price path process.

106. We have articulated a potential outline of our proposal at **Appendix 2.**

4. Part B: Forecasting constant price revenue growth

The Commission's emerging view proposal

107. The Commission is proposing to adopt a very similar Constant Price Revenue Growth (CPRG) forecasting approach to that used in 2013. The only proposed change would introduce the use of regional demand forecasts.[26]

Reason for proposal

108. The Commission has provided the following reasons for maintaining its 2013 approach:

108.1 The Commission has undertaken forecast error analysis of its 2013 approach and has found that there is no clear reason to believe that the current approach is not fit-for-purpose.[27]

108.2 The use of regional demand forecasts will promote a more robust forecasting approach.[28]

Powerco views

109. Powerco agrees that the 2013 CPRG forecasting approach remains fit-for-purpose and supports the proposal to use regional demand forecasts.

110. Given the sensitivity of the DPP financial model to CPRG it is vital that a robust and realistic methodology is applied and continually refined based on the latest data and analysis. A consistent forecasting approach applied to all GDBs, rather than relying on new connection forecasts in the AMP, meets this requirement.

111. Powerco is satisfied that the work undertaken by the Commission (such as its forecast error analysis and use of regional forecasts) has ensured the CRPG forecasting approach remains robust, realistic and fit-for-purpose.

5. Part C: Setting standards for quality of service

The Commission's emerging view proposal

112. The Commission has put forward two proposals in relation to quality standards within the DPP for GPBs. It intends to:[29]

112.1 retain the existing response time to emergencies (***RTE***) standard; and

112.2 introduce a new interruptions standard based on major interruption events.

[26] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [4.29]

[27] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [4.21]

[28] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [4.33]

[29] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.4].

113. We outline our view on each of these proposals below.

Proposal 1: Retention of RTE standard

114. Powerco supports the retention of the RTE standard in the DPP. We agree with the Commission that this standard helps to ensure the services GDBs provide are of the quality consumers expect.[30]

115. That said, we encourage the Commission to consider extending the time period during which suppliers may request an exemption from the quality path for events that exceed the quality limit. At present, suppliers have 30 working days to submit such a report. We suggest that this should be extended to 45 working days.

116. This small extension would give suppliers more leeway to undertake the necessary internal steps before reporting to the Commission. These steps include undertaking a thorough investigation of the emergency incident at hand, as well as drafting and internally reviewing the report prior to it being released to the Commission.

117. In our view this extension of 15 working days would not inconvenience the Commission's compliance assessment process, and would ensure that the final report was of a higher quality than one drafted under the current time constraints.

Proposal 2: Introduction of an interruptions standard

118. The Commission's proposed interruption standard focuses on major interruptions on a supplier's network, and includes a reporting obligation for suppliers following any major event.[31]

119. Under the Commission's proposal, suppliers would notify the Commission of any interruption that breaches the major interruption standard as soon as possible after it occurs, and then would be required to submit a report to the Commission within six months of the interruption. It would then be open to the Commission to commence enforcement proceedings under section 87 of the Commerce Act.[32]

120. We note that there are many features of this proposal that are not addressed in the consultation paper. For instance, the paper does not to define "major interruption", nor does it articulate the specific factors that may count towards an event being of sufficient significance to trigger this standard. Conversely, in the question and answer session earlier this month the Commission indicated that this standard would only apply to unplanned events on GDBs' networks. This in itself adds to the uncertainty surrounding this proposal.

121. We note that these details could have a radical impact on how the standard operates in practice. In our view these are matters that require thorough consultation. Leaving these concepts open at such at late stage in the current consultation process does not allow appropriate opportunity for GDBs to consider the potential impact of the proposed standard on their businesses and provide informed feedback to the Commission.

122. Powerco agrees with the Commission that following a "major event" (however defined) it is appropriate for suppliers to provide stakeholders – including the Commission – with

[30] Commerce Commission, "Setting Default Price-Quality Paths for Suppliers of Gas Pipeline Services" (28 February 2013, at [4.6].
[31] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.32].
[32] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.33].

information about the cause of the interruption, its impact, and whether similar events are likely to occur in the future.

123. However, observing that post-event reporting is appropriate in no way provides a foundation for the introduction of an interruption standard into the DPP, with all of the attendant enforcement concerns and consequences. It would be more appropriate, cost-effective, and proportionate to implement any improvements to 'major event' information requirements as reporting obligations, as opposed to DPP standards.

124. To go further and introduce a DPP standard, with DPP breach and enforcement consequences, requires first the identification of an incentive or enforcement gap, and second a demonstration that the benefit of the proposed new regulation outweighs the costs. None of that work has been put in front of the industry for consultation.

Absence of a problem

125. The Commission has not identified a problem with the quality of services offered by GDBs, for which this proposal is intended to be a solution.

126. The Commission has used the following considerations as a decision-making framework on which it has based its proposal:[33]

126.1 What do consumers demand in terms of quality of service?

126.2 Do existing regulatory and commercial arrangements provide effective incentives for GPBs to deliver services at a level consumers demand?

126.3 What aspects of the Commission's 'regulatory tool-kit' are most appropriate to remedy any gaps?

126.4 Do the compliance costs outweigh the consumer benefits?

127. The Commission then notes that consumers want a variety of quality aspects from their gas pipeline services, including:[34]

127.1 reliability;

127.2 system integrity;

127.3 quality of gas; and

127.4 customer service.

128. However, the consultation paper provides no evidence that customers are dissatisfied with current service levels from GDBs. Rather, the consultation paper lists the numerous regulatory and commercial instruments already in place that actively promote high-quality service in the gas industry, and seek accountability from GDBs for not doing so.

129. However, despite the lack of any evidence the consultation paper concludes that there "could" be "[p]otential gaps in the current regulatory settings".[35]

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[33] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.6].
[34] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at Table 5.1.

130. This, in our view, is an unsatisfactory basis for introducing new regulation for GDBs with potentially serious DPP breach consequences. When considered against the overarching framework of the DPP reset process – that is, not tinkering with approaches that remain fit for purpose[36] – there is no evidence to suggest that this matter is even within scope for this review.

GDBs are already sufficiently incentivised

131. Despite acknowledging that "suppliers have strong commercial and technical incentives to avoid interruptions",[37] the consultation paper also implies that GDBs are not sufficiently incentivised:[38]

> The principal purpose of the interruption report is to provide suppliers with an incentive to avoid major interruptions.

132. It is insufficient to simply assert without evidence that additional incentives are required, and from that basis propose new regulation with significant potential consequences for GDBs. In light of the numerous regulatory and commercial instruments the Commission lists which promote and enforce quality compliance, as well as GDBs' own interests in protecting their businesses and reputations, the onus is on the Commission to provide a clear problem definition that evidences an incentive gap, and demonstrate that a DPP major interruption report will improve incentives for GDBs and consumers having regard to the additional costs. None of this analysis is in the consultation paper.

133. To illustrate just what is on the line for GDBs when facing major events, and to demonstrate the existing incentives to ensure such events are avoided, we have set out an overview of Powerco's experience with its 2006 Wellington gas outage.

Powerco's Wellington gas outage: 2006

On 30 August at 10.30am, Powerco first received reports of consumers having no gas in the Wellington CBD. We later established the cause was a burst Wellington City Council water pipe.

Powerco deployed 120 workers around the clock over the following 12 days. It was an immediate and significant commitment by our people, and we are proud of the way they reacted and the work they performed. By 10 September the majority of the network was restored.

The costs to Powerco included restoration costs of around $3 million, substantial revenue losses, the opportunity cost of our staff dropping everything for two weeks to deal with the outage, and customers leaving Powerco's network. We also suspended all new connections in Wellington and the Hutt Valley during this time. In addition, we were very conscious of the extensive national coverage of the outage and the reputational impact for Powerco.

Following the incident Powerco reviewed its design and operating standards to identify

[35] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.16].
[36] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [2.21].
[37] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.19].
[38] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.58].

opportunities to reduce the risk of recurrence. The standard for new pipelines increased the required separation between gas and water pipes, but no practicable mitigation could be implemented for existing assets.

A number of observations can be made about our experience. First, it was not our fault. No amount of additional incentives on GDBs would have avoided this major outage. Second, the costs to a GDB are severe. We have very strong incentives to do what we can to avoid these outages. Third, GDBs react exactly as consumers would wish. Top of mind is safety, and the position our customers find themselves in when confronted with an outage. We work round the clock to respond.

There have been no further events of this magnitude (or near to this magnitude) in the past 10 years.

134. From our practical perspective of running a gas distribution network, and complying with our existing regulatory obligations, we view the suggestion in the consultation paper that the provision of an interruption report will incentivise compliance with quality standards as being out of touch with the commercial realities.

135. We provide, by way of example, some of the incentives we have to avoid a major interruption.

135.1 *Revenue effect*: Any restriction on gas supply has an immediate effect on Powerco, with 50% of revenue being derived from quantity-based charges.

135.2 *Commercial arrangements*: In the event of a major incident, provisions in our Use of System Agreements suspend all network fees[39] and set out the need to provide reports on major events.

135.3 *Safety requirements*: Most outages on our network are as a result of asset failure, and mostly due to third party damage. For gas distribution businesses this has safety implications and is therefore governed by safety legislation. Powerco has an audited Safety Management System to comply with the Gas (Safety and Measurement) Regulations 2010, and to comply with recognised operating standards.[40]

Costs outweigh the benefits

136. Given the lack of a problem definition, it is hard to see where the benefits arising from this proposal lie. However, the potential imposition of penalties under section 87 of the Commerce Act is a very real cost to GDBs, and we do not consider it proportionate or appropriate in such circumstances.

137. As illustrated by the case study of Powerco's 2006 outage, GDBs face considerable costs when dealing with outages. Some of these costs are able to be calculated – such as restoration and revenue costs – whereas others are intangible (the opportunity cost of staff devoting weeks to respond to the outage, loss of future customers, reputational damage, etc). Adding to this the potential for GDBs to also face penalties from the Commission (not to mention the costs involved in taking proceedings to court), this penalty mechanism seems out-of-place, and disproportionate to the situation.

[39] Powerco's Use of System Agreement at [9.13].
[40] Powerco operates to safety standard AS/NZS4645.

138. In any case, it seems to us that any negligent or imprudent conduct on the part of a GDB would be actionable in court under the relevant health and safety regulations. On this basis, there is no need to introduce an additional penalty regime, and runs counter to the consultation paper which states:[41]

> …where effective incentives already exist outside of [the Commission's] regime, there is no need for the DPP quality standards to duplicate these incentives.

Powerco's recommendation

139. If the Commission considers it necessary to include a major interruption event requirement into its regulatory regime, we believe this should be a reporting requirement within information disclosure regulation (ID) and not as a compliance requirement within the DPP with DPP breach consequences.

140. Including interruption reporting within ID is consistent with the closest thing in the consultation paper to a problem definition, which is that "at a minimum, there is a need for suppliers to provide information about the event, its consequences, and what could be done in the future to avoid it".[42]

141. Given the infrequency of major interruption events on distribution networks and the absence of evidence that illustrates the costs and benefits of the proposal, improving the regulatory reporting requirements seems like a more appropriate step.

6. Part D: Price restructuring

The Commission's emerging view proposal

142. The Commission is interested in exploring options that would improve its Gas DPP price restructuring provisions. As a starting point the Commission has indicated that it will consider the Electricity DPP provisions that were updated in its 2015 Electricity Distribution Services DPP determination.[43]

Powerco views

143. Powerco agrees that the provisions for price restructuring included in the Commission's 2015 Electricity Distribution DPP determination could equally be applied to the Gas DPP.[44]

144. From time to time Powerco may restructure pricing by either combining two or more consumer groups into one, separating an existing consumer group into two or more consumer groups, or by creating a new consumer group. Under the weighted average price cap (WAPC) form of control, quantities used to calculate Allowable Notional Revenue (ANR) and Notional Revenue (NR) are lagged by two years. Illustrating compliance with the price path when a price restructure occurs becomes challenging when there are no quantities for the lagged time period.

[41] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.12].
[42] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [5.18].
[43] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [6.11]
[44] Commerce Commission, "Electricity distribution services default price-quality path determination 2015 (9 July 2015), at 8.7 -8.10

145. The provisions for price restructuring in the Electricity DPP determination provides further clarification of the approach suppliers may take to estimate the lagged quantities that may not exist for the restructured prices. This is helpful guidance and clarifies a difficult process.

146. As noted by ENA[45] and acknowledged by the Commission,[46] price restructures create a volume risk where suppliers may under-recover revenues if consumer response to a new price signal does not match the quantities estimated for the NR calculation when pricing is set.

147. The Commission indicates further consideration is required on how GDBs represent compliance where the lagged quantities used to represent compliance do not address the consumer response to the new price signal provided following a price restructure.

148. Powerco agrees with the Commission that estimating the effect of a new price signal is difficult and may place revenue at risk. We look forward to working with the Commission to mitigate this risk. The issue of how compliance is represented could be resolved by introducing compliance provisions to the gas distribution services DPP as currently provided for in the electricity distribution services DPP[47], with the exception of clauses 11.8(b) and 11.8(c).

149. Clause 11.8(b) and 11.8(c) of the electricity distribution services DPP require the supplier provide a forecast of the quantities corresponding to each restructured price and also an explanation for any differences between actual and forecast quantities. This does not align with the requirements for the restructuring of prices using lagged quantities. It is specifically stated in the electricity distributions services DPP that suppliers must not forecast quantities but instead estimate the quantities that would have been taken up in the lagged period. Therefore, these estimated quantities are unlikely to align with a forecast or actual result for the pricing assessment period. We could provide this information if required, but it is not clear how this information would assist the Commission in assessing compliance with the price path, or prevent the risk of under-recovering due to the price restructure.

7. Part E: Treatment of major transactions

The Commission's emerging view proposal

150. The Commission is interested in improving its DPP transaction provisions and has suggested that consideration of the EDB DPP provisions will be a useful starting point.[48]

151. In particular the Commission intends to reconsider the continuing appropriateness of the current approach to allocation of Allowable Notional Revenue (ANR) following a

[45] ENA's submission on the problem definition paper "Response to the Commerce Commission's input methodologies review paper" (21 August 2015), para 87-88
[46] Commerce Commission, "Input methodologies review draft decisions topic paper 1: Form of control and RAB indexation for EDBs, GDBs and Transpower (16 June 2016), para 43-45
[47] Commerce Commission, "Electricity distribution services default price-quality path determination 2015 (9 July 2015), 11.7 to 11.8(a)
[48] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [6.22]

transaction. This would involve considering the treatment of pass-through costs, recoverable costs and any historic under-recovery against the price-quality path.[49]

152. The Commission has also indicated it will consider the ongoing appropriateness of the DPP transaction provisions in addressing transactions which may occur with entities which have specific pipelines which are exempt from being subject to regulation under Part 4.[50]

Powerco views

153. Powerco agrees that an appropriate allocation of ANR is necessary after a transaction to ensure that consumers in aggregate are not made worse off by the transaction.

154. The current gas and electricity DPP determinations both provide formulae to calculate a new ANR following a major transaction. These two determinations also both allow for an alternative approach to demonstrating compliance to be applied where the specified formulae are not workable. The approaches differ in detail and drafting but are conceptually similar and seek to achieve the same outcome.

155. The methodology set out in Schedule 3C of the Electricity DPP Determination is more thorough than the Gas DPP methodology and provides details of how to adjust pass-through and recoverable costs as well as ANR. We can see value in incorporating the Schedule 3C process into the Gas DPP Determination.

156. However, we understand that the Schedule 3C process does not work properly for transactions that occur in the final year of a regulatory period. This is because, where a transaction occurs in the final year, the higher expenditures and revenues that are forecast to materialise in the final year are not considered when setting MAR for the next regulatory period. Thus any revenues earned from the acquired customers in the next regulatory period would be included in the compliance statement and count towards the price cap but would not be incorporated in the new regulatory allowance. This increases the risk of a price-path breach (although the effect can be partially offset by the capex wash-up).

157. As a solution, we suggest the Gas DPP Determination states that the major transaction provisions within the determination are extended to include transactions that occur in the final year of the previous regulatory period (in the current DPP determination they apply only to transactions that occur within the regulatory period). This would ensure that the opening year's ANR can be adjusted to reflect the transaction.

158. We also agree it would be useful to provide guidance in the DPP to address transactions which may occur with entities exempt from Part 4 regulation. We suggest the Commission consider the electricity distribution services DPP as a possible starting point that could be equally applied to gas distribution services.

159. The electricity distribution services DPP already provides such guidance when transacting with exempt EDBs. The provisions under Schedule 3C of the electricity distribution services DPP specifically provide for the calculation of prices if a non-exempt supplier enters into a major transaction with an exempt supplier.

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[49] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [6.20]

[50] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [6.24]

8. Part F: Information Disclosure reporting requirements

The Commission's emerging view proposal

160. The Commission is considering introducing new Information Disclosure (ID) reporting requirements. The two additional requirements it has currently identified are:

94.1 Connection times for new customers; and

94.2 Response time to customer service enquires.

The Commission has invited views on:

94.3 Whether the proposed new ID requirements are appropriate, and whether it would be beneficial to collect other information; and

94.4 Whether producing this information would impose great costs on suppliers.

Powerco views

161. In Powerco's opinion the 2017 Gas DPP reset process is not the appropriate forum to discuss and debate matters regarding Information disclosure reporting requirements.

162. Any changes to the Information disclosure requirements should be subjected to appropriate industry consultation and review. In line with this view, we believe it would undoubtedly be better to evaluate these measures as part of the next Information Disclosure Determination (IDD) review, and therefore recommend that further discussion regarding the inclusion of these measures under ID is excluded from the gas DPP reset process. We look forward to working with the Commission on this in future.

9. Part G: High Impact, Low Probability risks

The Commission's emerging view

163. The Commission has advised that it does not consider that its AMP reporting requirements in regards to High-impact, low probability (HILP) risks are being fully met by suppliers.[51]

164. The Commission is interested in views on the best means or forum for continuing discussions with suppliers regarding HILP risks

Powerco views

165. In Powerco's opinion the 2017 Gas DPP reset process is not the appropriate forum to discuss and debate matters regarding Information disclosure reporting requirements.

166. We believe that any review of the effectiveness of current ID requirements, or of supplier's compliance with the requirements is most appropriately undertaken as part of an IDD review. We therefore recommend that further discussion regarding HILP risk requirements are excluded from the gas DPP reset process.

[51] Commerce Commission, "Default price-quality paths for gas pipeline services from 1 October 2017: Policy for setting price paths and quality standards" (30 August 2016), at [E4]

Appendix 1: Concerns with Strata metrics

a) General metrics

Metric	Comment
Gas supply to end users, measured in GJ and TJ	Volume has no direct impact on expenditure. Gas consumption varies significantly from year to year due to weather conditions greatly distorting the expenditure/volume relationship.
The GDB customer base, measured in ICPs at year end and change in ICPs	This is the net change in billable ICPs and therefore doesn't correlate to investment need to connect new customers.
The GDB distribution base, measured in km of pipeline	Length of network changes by <1% per annum and therefore not a strong driver of costs over a 5-year period.

b) Load factors and interruptions and Asset replacement, renews, growth and age/grade information

Analysis compared ratios of different datasets across historical trends and future predictions. As shown below, ICP based metrics or volume (GJ/TJ) based metrics are not appropriate indicators of expenditure. Capex and opex trends are more appropriate.

Metric	Comment
Expenditure per TJ, expenditure per ICP, expenditure per km of pipeline and expenditure per TJ per ICP	Expenditure is independent of volume. Volume is largely influenced by weather and can vary dramatically from year to year. Capex is driven by new connection numbers (**not** net ICP numbers) and by renewal needs.
Revenue per TJ, Revenue per ICP	Allowable revenue is set by the Commission so it is difficult to see how it is a measure of effective expenditure.
Interruptions per 100km of pipe length	The interruptions projections used are arbitrary forecasts made by Strata, not from Powerco forecasts (forecast interruptions is not disclosed). Further, the dashboard includes a cost of interruption metric which compares the cost of all fault costs with the number of supply interruptions. This approach is flawed because a lot of fault costs do not cause interruptions.
Capex and opex variation per ICP and per total gas supplied	Net ICP numbers change by <1% per annum – so is only a minor driver of expenditure. Total gas supplied is strongly weather dependent, and is also impacted by large industrial customers. Volume is a very weak driver of expenditure – no impact on opex and an indirect driver of capex (occasional lumpy investments).
Estimated Asset Investment and Network Opex (page 23 of Strata Pilot Study Report)	Compares base year RAB plus forecast growth capex over time to opex. Assumes other capex will match depreciation, rather than the actual other capex forecasts. It is not clear what this is trying to achieve.
Expenditure per TJ, expenditure per ICP and expenditure per TJ per ICP	The expenditure values are forecast for 10 years. The GJ and ICP values are forecast for 5 years.

	Thus for the last 1-2 years of the DPP regulatory period the analysis will have no GJ or ICP forecasts to compare to the GDB's expenditure forecasts.
Expenditure per km of pipeline; expenditure per interruption	GDBs do not provide forecasts of pipeline length or interruption in their AMPs. Thus there are no usable forecasts to compare to the expenditure forecasts.

c) Approach to setting materiality thresholds

Materiality boundaries are inconsistently applied and consider annual position relative to the base year rather than aggregate expenditure over time.

Boundary value	Comment
All metrics except total opex and total capex	Total opex and total capex include a variance margin (10%). No such margin is applied to opex and capex categories.
Total expenditure per GJ of gas and cost of interruptions	These boundary values are not set equal to the 'base year' value, but fluctuate over time. In most years they are lower than the base year value. This is inconsistent with how other materiality boundaries are set.
All	It seems any expenditure over the materiality boundary in any one year is "not accepted". This should be assessed over the full regulatory period – if the expenditure is below the boundary by $1000 in one year and above the boundary by $1000 the next year, there is no need for AMP scrutiny.
Changes in total capex (page 28 of Strata Pilot Study Report)	All years where total capex exceeds the base year are said to require further information. But capex forecasts drop steadily in later years. It would be more cost effective to focus on the years where the main changes occur. There is likely to be less value in focusing on other years where capex is declining, even if still above the base year value.
All	Expenditure assessments have been made out to the end of the relevant AMP forecasts (2025 in the case of the "pilot" which used Powerco's 2015-2025 AMP). The assessments should not be made of expenditure in years beyond the DPP regulatory period.

Appendix 2: Potential design of Powerco's alternative process