



Maui Development Limited
PO Box 23039
Wellington 6140

19 December 2011

Telephone: (04) 460 2548
Fax: (04) 460 2549

commercial.operator@mauipipeline.co.nz

Mr. Paul Mitchell
Chief Advisor
Regulation Branch
Commerce Commission
PO Box 2351
Wellington 6140

Dear Paul,

Please regard this letter as our submission to the Commerce Commission ("the Commission") on the Draft Reasons Paper for "Initial Default Price-Quality Paths for Gas Pipeline Businesses" and the accompanying Draft Determination for Gas Transmission DPP. In this letter I will use MDL to refer to the Gas Transmission Business (GTB) of Maui Development Limited. I will not be commenting on issues and the Draft Determination for Gas Distribution Businesses and will limit myself to issues that affect MDL. Our submission is structured under the following headings:

- Introductory remarks
- Emergency definition refinement
- Balancing gas recoverable clarification
- Timings and lags
- Starting Price Adjustment
- DPP cannot accommodate new investment
- Ex-ante disadvantages
- Closing remarks

Introductory remarks

1. We confirm our preference for a Total Revenue Cap for MDL.
2. We support an annual rate of change (i.e. an X-factor) of 0% for MDL.
3. We agree with the practicality of a starting date of 1 July 2012 and an ending date of 30 September 2016 for the regulatory period.
4. Subject to MDL Board approval, we expect that we will leave our existing tariffs in place until 30 September 2012, and set new tariffs from 1 October 2012 such that we will comply with the DPP over the 15-month first assessment period.
5. We support the quality standard that has been set, subject to suitable amendment of the definition for emergency.

Emergency definition refinement

6. The definition of "emergency" in the draft determination includes the phrase "an unplanned disruption in the supply of gas". We note that nearly all unplanned disruptions in gas supply result from problems occurring either at sites where gas is supplied to the pipeline or at sites where gas is used. In those cases there is no need, and usually not even an opportunity, for MDL personnel to visit or arrive at the location of the incident. We propose that the phrase above be amended to "an unplanned disruption on the GTB's network infrastructure".

Balancing gas recoverable clarification

7. In the absence of a Customised Price-quality Path (CPP) application, recoverable costs for MDL consist of those for balancing gas. This is addressed in section 12 of the draft determination. We would like to clarify some issues relating to that.
8. We would indeed appreciate notification from the Commission by no later than 31 May of each year of the amount that we may treat as a recoverable cost. The Maui Pipeline Operating Code (MPOC) requires us to give at least 60 days notice for any change in our tariffs. For any price change to take effect on 1 October, therefore, we must have provided notice by 1 August. This leaves us with only a 2-month window of June-July to determine our tariffs for each upcoming assessment period and obtain internal approvals from the MDL Board. We expect this is about the minimum time that we would require.
9. In order to allow the Commission to notify us by 31 May in each year we are required to submit an annual balancing gas statement by 31 March of that year. If we follow the guidelines from Schedule 5 of the draft determination, using the most recent known amounts with minimal lag, such statements would be for periods ending 28 (or 29 in a leap year) February.
10. If the Commission could reduce its approval period for balancing gas statements, for example by allowing us to submit by 15 April, then we could submit gas balancing statements for a period ending 31 March of each year. This would match with the period used for CPI calculations.
11. In order to include balancing gas in the recoverable costs during the first assessment period (items ¹⁵V₂₀₁₂ and ¹⁵V₂₀₁₃ in Schedule 3 of the draft determination) we will also require the Commission's prior approval of the amounts to be included in that. We assume the Commission will be able to notify us of those amounts by 31 May 2012. We can submit the applicable balancing gas statements by 31 March 2012 (or 15 April if the suggestion above can be followed).
12. We propose that section 12.1 of the draft determination be amended accordingly; including correction of the dates in that section and addition of a Commission approval by 31 May 2012.
13. Section 12.2 of the draft determination will need to be amended to reflect the fact that MDL does not allocate balancing gas to shippers. (The only theoretical exception would be shipper mismatch under section 11 of the MPOC, but this mechanism is not used in practice.) MDL's balancing regime is set out in the MPOC. It is fairly complex and subject to ongoing change discussions. The outcome of that regime is that balancing costs of MDL are recovered to the extent possible from Welded Parties through a system of cashouts and incentives pool debits and credits. However, there is not necessarily a direct relationship between the balancing actions taken by MDL and the balancing charges assessed against Welded Parties.
14. We understand this means that clause 3.1.3(1)(c) of the applicable Input Methodology needs to be amended too. That clause refers to balancing charges "allocated to a person shipping gas". This needs to be amended to include Welded Parties and supplement the phrase "allocated to" with "recovered from".
15. Finally, we would appreciate it if the Commission could confirm that charges related to pipeline balancing (including mismatch prices and incentives pool debits and credits) will not be considered as a component of the Prices as defined in the applicable Input Methodology.

Timings and lags

16. We have already discussed some timing issues in the section above. We expect some similar issues will apply to the determination of pass-through costs. Our interpretation of Schedule 5 of the draft determination is that we will use the most recently known amounts of each cost when setting our prices. In practice this means we will probably use the most recently known costs for the 15-month period up to 30 June 2012 for the first assessment period; and 12-month periods up to 30 June of each year for later assessment periods.
17. We believe a similar approach should apply to the quantities that are used in determining notional revenues. The Commission is already using formulas that multiply prices in one period with quantities from another period. In that case we submit it would be best to at least use the most recently known quantities; i.e. the most recent 12-month or 15-month period at the time that prices are being set. We acknowledge that the period chosen has to be consistent from year to year.

Starting Price Adjustment

18. We acknowledge that in the absence of a Starting Price Adjustment the Commission is required by law to use the starting prices at 30 June 2010 for GPBs not subject to Gas Authorisations. We understand the position that the Commission has been placed in but note that it is most unlikely that the position GTBs now find themselves in was intended when the amendments to the Commerce Act were drafted.
19. As we have submitted before, we agree that prices based on our current and projected profitability are more appropriate than a roll-over of our prices on 30 June 2010 for a regulatory period running from 1 July 2012 until 30 September 2016. We encourage the Commission to proceed with Input Methodologies for Starting Price Adjustments. If application of those IMs would lead to a material difference in prices then we would support a section 55F(4) price reset.
20. We point out that the MPOC does not allow us to change prices more than once in any 12-month period. If we change prices on 1 October of any year, therefore, we cannot adjust our prices earlier than 1 October of the following year. We would appreciate it if the Commission can take that into account for the calculation of any Starting Price Adjustment.

DPP cannot accommodate new investment

21. We continue to support measures to accommodate new investment within a DPP. The effect of failing to do this will be that every material new investment by a GTB will require a CPP. We believe this will achieve the opposite of the Part 4 purpose as it will increase costs to consumers for every investment that is made, while discouraging such investments to begin with.
22. Ex-ante approval of new investment for regulatory purposes is also important. In its absence GTB directors will be asked to fund new investment at a time when they will be uncertain as to whether any return on it will be allowed. Discretionary investment proposals without a clearly visible return are extremely unlikely to be approved.
23. We note the expression of support by the Commission for the GIC's Gas Transmission Investment Proposal. We believe that this is an initiative that can be developed into the investment test that is needed.

Ex-ante disadvantages

24. The Commission's draft decision to apply an ex-ante form of compliance to prices has several disadvantages. We will list these below.
25. It requires the mixing of prices, quantities and costs across different time periods that is set out in the draft determination. The Commission's description of the formulas as "not necessarily intuitive" can be considered a major understatement.
26. The approach will only work well in a steady-state environment. If throughput quantities would be steadily increasing then our actual revenues would be higher than our notional revenues in every year. Conversely, if quantities are declining then our actual revenues would be lower; and we would never be able to fully recover our allowable notional revenue.
27. MDL's current price setting regime includes mechanisms to adjust for under- and over-recoveries. We do not see how these mechanisms can be continued, at least in a symmetrical fashion, under the Commission's ex-ante price setting approach. As a result we do not see an opportunity to compensate for any under-recoveries that occur as a result of a continued decline in gas quantities.
28. We believe the Commission's approach makes the return on capital for MDL significantly riskier than it was before. We have previously submitted that the Commission's Input Methodology for setting the Weighted Average Cost of Capital only takes account of uncertainty in the parameters for calculating the WACC. The ex-ante approach selected by the Commission strengthens our belief that the WACC determination by the Commission is inadequate.

Closing remarks

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

Yours sincerely,



Don Gray
General Manager, Commercial Operator Maui Pipeline
for Maui Development Limited