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7 December 2012

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Dear John,

Please regard this letter as our submission to the Commerce Commission ("the Commission") on the Reasons Paper for "Revised Draft Decision on the Initial Default Price-Quality Paths for Gas Pipeline Services", and on the accompanying Consultation Draft of a Gas Transmission DPP Determination 2013. Both those documents are dated 24 October 2012. In this letter we will use MDL to refer to the Gas Transmission Business (GTB) of Maui Development Limited. We will mostly limit our submission to issues that affect MDL itself, and will not be commenting on issues for Gas Distribution Businesses.

Introductory remarks

1. We are disappointed by the Commission's approach and revised draft decision on setting initial DPPs for Gas Transmission Businesses. In light of the draft decisions published now, it appears to us that the Commission is deliberately leading GTBs into applying for a Customised Price-Quality Path.
2. We arrive at this conclusion after considering the differences between allowances made by the Commission and forecasts provided by GTBs for opex and capex. For Vector Transmission and MDL respectively, the Commission has reduced opex by 22% and 34%, and capex by 39% and 93%.
3. In combination, the Commission has reduced MDL's forecast expenses by 57%. This is the largest cut made to any participant in the gas industry. We do not believe the Commission would realistically expect any supplier to maintain its planned operations on the basis of such a cut. As a result, we presume that the Commission intends that MDL should apply for a CPP.
4. If the Commission finalizes its draft decision without material changes then we may indeed be forced to apply for a CPP in response. Nevertheless, we will start this submission by stating why we think this is a bad approach. Most of the reasons that could force us to apply for a CPP could be eliminated with the introduction of an investment test instead. We believe this would be a materially better approach; for us and for consumers.
5. The remainder of our submission will address issues for and comments on the DPP itself. That is structured under the following headings:
 - Capital expenditure allowance issues
 - Forecasting issues
 - Operating expenditure issues
 - Recoverable cost issues
 - Compliance issues

- Miscellaneous issues
- General responses
- Closing remarks

Investment test approach would be better than CPP

6. The biggest reason that would cause us to apply for a CPP is the Commission's elimination of \$50 million, i.e. 93%, from our capital expenditure forecasts. The remaining sum is indeed close to our routine levels of annual recurring capital expenditure. The removed sum is effectively equivalent to our estimated capital expenditure on four specific projects:
 - 6.1. the White Cliffs pipeline realignment project that we have discussed in earlier submissions;
 - 6.2. land stability measurement and monitoring systems that are being installed as a result of the Maui pipeline outage last year;
 - 6.3. land stabilisation works that may result;
 - 6.4. replacement of the Open Access Transmission Information System (OATIS) used by MDL.
7. We acknowledge that forecasting the magnitude and timing of these project expenditures is difficult. However, this problem is not solved by preparing a CPP. A CPP assumes we could have detailed information on every investment programme for the duration of the entire regulatory period in advance, with sufficient accuracy that it can be verified by an independent verifier. This assumption is not valid. In particular, we would be unlikely to know what land stabilisation works might be desirable until new land stability measurement and monitoring systems have generated data over at least a year.
8. This leads to a Catch-22 situation. The Commission will not provide allowances for capital expenditures unless they can be independently verified, to a high degree of accuracy, in advance and in total. However, transmission pipeline capital expenditures typically have long lead times and are subject to large uncertainties that only get refined as the project is underway. If MDL cannot be confident of obtaining a return on such expenditures then the project is likely to be delayed or deterred. The resulting discouragement of investment is in contradiction to the purpose of Part 4.
9. This situation is made worse because a CPP is required to cover all potential investments in advance. It is not possible to re-open a CPP if additional expenditure is required as a result of an earlier project, or if estimates are refined as a project progresses. For example, the Front-End Engineering and Design (FEED) study for the White Cliffs project has already cost several million dollars, shared between Vector Transmission and MDL. The forecasts provided in our disclosures as a result of the Commission's section 53ZD notice included the draft results from that study. However, those estimates were based on a shared project to simultaneously realign the Maui and the Vector pipelines around White Cliffs starting in 2013. However, it is now possible that as a result of the Commission's draft DPP determination a shared project may no longer be possible. If this is the case then our costs would significantly increase. Situations like this cannot all be forecast in advance and neatly combined into a single CPP application at a single point in time.

10. We believe it would be better to deal with projects through an investment test. A CPP effectively covers and costs too much, and achieves too little. It achieves too little because a CPP is not a suitable substitute for the investment tests that may actually be required during the time frame of a regulatory period. We expect the Commission may understand even better than we do why it will cover and cost too much. Our understanding is that a CPP application needs to be accompanied by a verifier's evaluation of twenty opex and capex programmes or projects. At an organisation like MDL, which is relatively large in asset value but small in scope, it would be difficult to even find 20 projects or programmes in aggregate to evaluate. We believe we would have to go through extraordinary efforts and expense to essentially have all the operations of MDL covered in minute detail, subject to verification and certification, merely for the sake of trying to obtain a return for a few large projects that are actually relevant and which the government is encouraging us to complete.
11. We note also the lack of flexibility in a CPP decision once it is in place. If MDL applies for a CPP and then finds it has to undertake urgent major repair or relocation work on a portion of its pipeline, no further consideration can be given to recovery of the cost of this work until the next regulatory period.
12. If we were forced into applying for a CPP we believe this would be a bad outcome for consumers and for us. The financial costs of a CPP application could be passed through to consumers, which exposes them to expenses that in our view should be avoidable.
13. The bad outcome for us is caused by the distraction and disruption that the CPP process is likely to cause to our normal operations and by the risks we face in even initiating the process. We note that the Commission has dismissed the concerns expressed about these risks. In our view, however, the Commission has under-stated the risks associated with a CPP proposal. After incurring the initial expense and disruption of preparing a CPP application, we have no insight into the resulting outcome of any decision the Commission is at liberty to make; and we do not have an option to withdraw the proposal. The Commission's current draft decision on the DPP for MDL does not inspire us with confidence with respect to the treatment we can anticipate. The fact that we could have subsequent recourse of a merit appeal to the High Court is cold comfort.
14. As we have stated in earlier submissions, we believe it is desirable and should be possible to devise an investment test that is suitable for consideration by the Commission; and more suitable than a CPP. MDL itself would not undertake large capital expenditure projects without a thorough justification. After all, even if such a project leads to an addition to our regulated asset base, the permitted return from the WACC set by the Commission is well below the hurdle rate for investment used by any of the Maui Mining Companies that own MDL. (Considering the merits appeal by Vector against the Commission it is clear they regard the regulatory WACC as inadequate too.) As a result we believe the Commission need not be concerned about any risks of over-investment or "gold plating" of investments by GTBs. Our owners are certainly not incentivised to let MDL make any investments that they do not regard as strictly necessary.
15. MDL is willing to work with the Commission, and also with Vector Transmission, to design an investment test approach that is suitable for evaluation by the relevant internal governance bodies of each GTB itself and by the Commission. We believe this could be materially better than the more expensive, more complex, higher risk, less focused, and less suitable CPP approach.

Capital expenditure allowance issues

16. The single biggest source of error for us in the draft decision of the Commission is the arbitrary 20% cap on capital expenditure increases for GTBs. The Commission provides some reasons for wanting to impose such a cap, but ignores the fact that 100% of regulated GTBs are impacted by it. The Commission does not provide any reason for its selection of 20% as the appropriate level for the cap.
17. We believe the Commission's approach is simply unsuitable for transmission businesses. The Commission is essentially trying to evaluate GTBs in the same way as distribution businesses. The Commission notes "that both Vector Transmission and MDL have included a small number of major investments in the forecasts that they have provided". We submit this is normal, i.e. business as usual, for a transmission business. It is not a peculiarity of Vector Transmission and MDL. GTBs are characterised by large, infrequent, "lumpy" type of capex projects. Applying limits to those based on annual averages for recurring routine expenditures is inappropriate. For example, there is no useful relationship between the forecast cost of our White Cliffs project and our historical capital expenditure over the last 5 years.
18. We note the Commission argues that this problem can be solved or bypassed if affected GTBs apply for a CPP. As we have argued above, a CPP is actually not a suitable solution to the problem. Moreover, we would argue that if 100% of the gas transmission industry should apply for a CPP then the Commission has effectively discouraged investment and failed to devise a suitable DPP approach for GTBs.
19. As a secondary issue, we disagree with the Commission's approach to apply a generic scaling factor to all capital expenditure when applying the 20% cap. It leads to results that are completely unrealistic. Because the Commission has disallowed 93% of MDL's capex forecasts it should be clear that we would not be proceeding at a 7% expenditure level afterwards. Routine maintenance capital expenditures would still continue 100% as planned. However, we cannot undertake only 7% of a White Cliffs project so this would need to be reconsidered completely.
20. Therefore, if the Commission wants to make decisions on our capital expenditure forecasts we submit it should make those at an investment programme level. In future, those programmes will be described in detail in our Asset Management Plan, pursuant to Information Disclosure requirements set by the Commission. For current purposes we provided some detail in our cover letter of 3 August 2012 accompanying our initial response to the Commission's section 53ZD notice to MDL. We are willing to provide more detail on request.
21. As a final note on this issue, the inappropriateness of the Commission's approach is illustrated by its draft decision on our non-network capex allowance. We have very few non-network assets. The only non-network capex in our forecasts was \$50k for replacement of office computers and equipment in 2015. (A tiny lumpy activity.) The Commission has made a draft decision to scale this back to \$42k. We do not know how to interpret this. Should we replace only 80% of our computers? Should we strive to buy cheaper models? Although the \$8k difference itself is trivial, we see no rationale for the Commission's decision and do not know how we are expected to act in response.

Forecasting issues

22. We appreciate the Commission's use of the draft report on Gas Supply and Demand Scenarios prepared by Concept Consulting Group Limited for the Gas Industry Company Limited (GIC). We trust the Commission will base its final decisions on the final version of this report.
23. We do not have views on how a most-likely scenario could be extracted or developed from this report. In fact, we think the report does a good job of illustrating how widely different the outcomes can be under different scenarios. Because gas trends are driven as much by supply-side discoveries and production as by demand-side developments, and major changes are lumpy instead of gradual, we do not believe there is any reliable method to make long-term gas forecasts at the macro level relevant for GTBs.
24. This is also the main reason why we believe a revenue cap is more appropriate for us than a price cap.
25. Fortunately, most of our expenses are largely independent of throughput. From our capital expenditure forecasts of \$53.5 million for the regulatory period, only \$0.6 million depends in any way on throughput. This would be for a compressor turbine overhaul, which depends on the number of running hours of the compressor. The remainder of our capital expenditure forecasts, including all four projects specifically identified earlier, has no relationship to throughput or demand at all.
26. The situation for our opex forecasts is similar. Except for compressor expenses, which we will address below, these expenses have no relationship with throughput or demand.
27. As a result, we agree that elasticities on network scale factors for a GTB can be set to zero.
28. The Commission states that demand forecasts for GTBs are only needed for the ΔD factor proposed by the Commission. It appears that factor is only needed to reflect time lags between notional and actually anticipated revenue quantities. If such time lags were kept to a minimum, estimation errors in that factor would have smaller impacts.
29. Unfortunately, we have not been able to work out how the Commission has arrived at the ΔD factor set for MDL. Clarification of this would be helpful.
30. We are a bit concerned about the Commission's statement that it has found the historical trend growth between 2008 and 2011 in the average distance gas was transported on the Maui pipeline to be -4.4% per year. The quantities (i.e. Scheduled Quantities from Approved Nominations) we reported to the Commission in response to its section 53ZD notice to MDL, and our resulting calculations for average distance and annual growth rates, are set out below. We do not know how the discrepancy arises.

year annual growth rates	throughput (TJ)	nominations (TJ.km)	avg. distance (km)
2008	137,188	22,523,410	164
2009	139,326	20,660,423	148
2010	145,868	21,852,402	150
2011	132,963	18,713,763	141
Compound Avg. Growth Rate	-1.0%	-6.0%	-5.0%
Arithmetic Avg. Growth Rate	-0.9%	-5.6%	-4.9%
Simple Avg. Growth Rate	-1.0%	-5.6%	-4.8%

31. With respect to other forecasts, we support the Commission's assumption of 0% change in opex partial productivity. For a variety of reasons we expect such a change is more likely to be negative than positive. In the absence of any reliable evidence, however, we believe zero is a reasonable assumption.
32. We do not understand the Commission's rationale for preferring an all-industries price index instead of a more sector specific index.
33. In particular, we expect that using the all-industries labour cost index (LCI) will underestimate the labour cost increases that should realistically be expected in the energy sector.

Operating expenditure issues

34. The Commission's draft decision also eliminates 34% from our opex forecasts. We expect this may be explained by two reasons:
 - 34.1. use of a single base year instead of a longer reference period for opex expenses;
 - 34.2. ignoring specifically increased expenses for compressor fuel gas, pipeline monitoring and maintenance, and insurance.

multi-year baseline

35. Opex for a transmission pipeline can be lumpy too, similar to and often driven by lumpy capex projects. For example, the White Cliffs project is preceded by a FEED study that costs a few million dollars by itself. Until an actual investment decision is made, the costs of such a study are classified by MDL as opex. In years without such a lumpy project, such opex would not be incurred.
36. Another example of lumpy opex would be for intelligent pigging of the pipeline. This is not done annually, but is a material expense in years when it is done. Using only a single base year could lead to large swings in allowed opex depending on whether the base year included pigging operations.
37. If the Commission were to make its final decisions using a single base year, then GTBs would have a perverse incentive to delay pigging, and all other high cost infrequent maintenance activities, until the base year for the next regulatory period. We trust it should be clear that this is not an optimal outcome; neither for GTBs nor for consumers. Such errors can be avoided by using multi-year periods to set opex baselines for GTBs.

Compressor fuel gas

38. We have already explained in previous submissions why our compressor fuel gas expenses will be increasing over their historical levels. We appreciate that the Commission has acknowledged this situation. We are surprised that the Commission's draft decision does not provide any allowance for compressor fuel expenses, but we note the invitation to make further submissions on the topic.
39. We do agree that compressor fuel expenses are very difficult to predict. The requirements for compressor fuel depend in a non-linear fashion on throughput. This makes forecasts of compressor fuel expenses even more difficult than forecasts of throughput.

40. In light of this situation, and noting that our opportunities for managing compressor fuel gas are limited, we submit that this expense category should be added to the category of recoverable costs.
41. This position is strengthened by noting that the only way of managing compressor usage to a limited extent (other than simply not running the compressor at all) is to take balancing actions. Purchases and sales of balancing gas provide some opportunity for managing pressure in the pipeline and can substitute for compressor usage to a small degree. In most such cases, however, use of the compressors would be more efficient. Considering that balancing actions are already treated as a recoverable cost, we submit that extending recoverable costs to compressor usage would be the best solution.
42. In the meantime we have been concentrating on measures that will enable us to buy fuel gas at an advantageous price. We have conducted an open tender for fuel gas supply and are now confident that we have established a reasonable market price for fuel gas purchases during 2013. Our opex estimates for fuel gas costs rely on this price and a calculation of average usage over the past few years. If calculations based on average use are not acceptable, then treatment of fuel gas expenditure as a recoverable cost may be more acceptable. In any case we are prepared to share the information underlying our calculations with the Commission if requested.
43. In the alternative, we submit that the Commission would need to come up with some forecasts for the volumes required and price per GJ of compressor fuel gas over the regulatory period. Simply ignoring the problem and putting the forecast cost at zero is obviously unreasonable.

pipeline monitoring and maintenance expenses

44. As part of our discussion on capex we already mentioned the land stability measurement and monitoring systems that are being installed as a result of the Maui pipeline outage last year, and the land stabilisation works that may result. Such activities will lead to increased opex as well. This would be incurred for operating the new systems and for planning and managing the resulting works. We included estimates of those expenses in our opex forecasts.
45. We realize that the Commission may respond that such actions represent a step change in activities and should lead to a CPP application. As before, however, we submit that a CPP is not a suitable solution for dealing with the problem. A CPP will still be unable to provide any certainty for estimating opex in relation to projects that cannot yet be defined. Even if it could, a CPP is an excessively wide ranging, complex, involved and expensive approach to deal with a relatively narrow set of issues.
46. At risk of pushing the point, we suggest that unpredictable project opex could be considered as a recoverable cost as well. This need not apply to our baseline of recurring operational expenditure. For non-recurring operational expenditures a regime similar to balancing gas recoverables, subject to approval by the Commission, may be a possible way of dealing with such unpredictable expenses.

Insurance

47. We are mystified by the Commission's approach to dealing with insurance costs for MDL. We have submitted on our insurance situation before. We provided detail and background information for our insurance cost estimates in our response to the Commission's section 53ZD notice. It appears the Commission has completely ignored this. Instead, the Commission appears to assume that our total insurance costs would be equal to the proportion of insurance cost increases by Vector that are due to natural disasters. We are at a loss to understand this.
48. In our response to the Section 53ZD notice we explained why we could not provide insurance costs for earlier years. This situation has not changed. In the meantime we have been continuing the process of obtaining full quotes for the insurance cover needed for the Maui Pipeline. This will lead to quotes that are more accurate than those originally submitted with our Section 53ZD information, which were based on the best information we had at the time. We are happy to share our latest information on actual costs with the Commission.
49. In the meantime we submit that the allowance the Commission makes for insurance costs should reflect the actual cost of the insurance.

Recoverable cost issues

50. We appreciate the clarifications to the determination of pass-through and recoverable costs in Schedule 6 of the draft determination. In particular, we appreciate the Commission's approach to minimising the lag for recoverable and pass-through costs.
51. In light of that approach, we submit that Table 7 in Schedule 7 to the draft determination should be amended to cover periods of 1 January to 31 December of each year for balancing gas transactions by MDL. There is no need to have a longer time lag; certainly not for an additional 6 months. All of MDL's balancing gas transactions are publicly reported on a daily basis on the website of the Balancing Gas Exchange (www.bgx.co.nz).
52. We expect we should indeed be able to submit a statement on balancing gas transactions over the previous year by the due date of 15 January of each year. We appreciate the decision date for approval by the Commission of 28 February in each year. In order to give both of us more latitude, however, we propose a due date by 31 January and a Commission approval date by 31 March in each year.
53. We should remind the Commission that MDL does not charge balancing gas transactions to shippers. Our balancing regime seeks to recover costs from, and may provide compensation to, Welded Parties under the Maui Pipeline Operating Code (MPOC) instead. Assuming the Commission will only want us to recover net balancing costs, instead of gross balancing costs, we expect this may require an amendment of the provisions for balancing gas in the Input Methodologies for GTBs. We have previously submitted a proposed amendment for this.
54. In light of our comments above, we submit that amendment of recoverable cost provisions in the Input Methodologies can be extended to include compressor fuel gas and non-recurring (or infrequently recurring) pipeline maintenance opex.

Compliance issues

55. As we have submitted before, on balance we do not believe an ex-ante compliance approach is the optimal solution for GTBs. We acknowledge that it has advantages as well as disadvantages. We believe the biggest disadvantage may be incompatibility with the wash-up approach we use now for dealing with over- and under-recoveries. We believe our current approach is superior because it reduces risks to MDL and costs to our consumers.
56. We appreciate the Commission's invitation to provide views on a potential wash-up mechanism and how this could be implemented into the compliance regime. In light of time constraints for our submissions we will not include such views here. However, we will be happy to collaborate with the Commission in exploring a suitable mechanism and devising a solution if possible.
57. As we have submitted previously, if an ex-ante approach is taken then it is important to make time lags as short as possible. We submit the Commission should apply the same principles to notional quantities as it is now proposing for recoverable costs. As long as consistent and successive 12-month increments are used, it should not matter when the 12 months for counting notional quantities start. In MDL's case we propose that the most convenient period for determining prices would be notional quantities based on years from 1 January to 31 December. This coincides with our financial year and our Information Disclosure periods (as well as our proposed reporting period for recoverable and balancing gas costs), so those quantities will be available in audited and certified form already. This would represent the lowest cost and lowest risk approach.
58. Reducing the lag for notional quantities also reduces the impact from errors in estimates used for calculating the ΔD factor.
59. We do appreciate the sensible approach of aligning our assessment periods with our pricing year.

Miscellaneous issues

60. Section 3.1.2(2) of the Input Methodologies for GTBs needs to be amended to add membership costs of the Electricity and Gas Complaints Commissioner Scheme as pass-through costs; in similar fashion as the IM for GDBs. MDL is a member of that scheme. We assume we should be entitled to the same pass-through costs as GDBs.
61. We submit that the definition for "consumer" should be amended to match the definition in the Information Disclosure IM for GTBs. (Without such an amendment MDL only has two consumers.) That amendment would recognise that the sources of revenue for a GTB, and the customers that are subject to its prices, are shippers of gas. These are not necessarily consumers of gas.
62. Such an amendment may also affect the calculation of pass-through and recoverable costs. It is important to keep in mind that MDL does not receive regulated revenue from consumers of gas (in their capacity as consumer).
63. It is probably not necessary to have a separate equation 2 for MDL in section 8.4 of the draft determination. Equation 2 is algebraically identical to the main equation.

64. We believe it is excessive to require an audit of our annual quality compliance statement. The only data to be audited would be response time to emergencies. We doubt that the value of an external auditor for such a relatively simple evaluation would exceed the cost. Particularly if it needs to be done as an engagement that is separate from any other audit work. We propose that a director certification for such a statement should be adequate.
65. MDL and Vector Limited should be swapped with each other in Table 5 of Schedule 7 to the draft determination.
66. We note that the Commission has commented that gas transmission and distribution charges on average make up around 34% of the cost of gas paid by residential customers. This presumably is to provide context for its regulatory efforts. In order to provide further context for the regulation of MDL specifically, we would like to note that our transmission fees, based on our current tariffs, represent a maximum cost of:
 - 66.1. \$0.65 / GJ for customers of Vector in the North (based on Maui gas from the Oaonui production station to the Rotowaro offtake);
 - 66.2. \$0.16 / GJ for customers of Powerco and GasNet (based on Maui gas from Oaonui to the Frankley Road offtake).
67. In this context we also reiterate that our tariff rates are identical for everyone.
68. Finally, just to avoid alarming our customers, we would like to correct the statement in footnote 166 of the Reasons Paper that: "For billing purposes MDL counts the amount of gas twice (because gas enters and leaves the pipeline) so that billed quantity is twice the amount of gas transported." Our billed quantities are actually based on Scheduled Quantities from Approved Nominations, which are only counted once. It is correct that all gas is counted twice, i.e. by meters when gas enters and leaves the pipeline. As a result, the sum of all Metered Quantities will be approximately twice the sum of billed quantities.

General responses

69. We still support a revenue cap for MDL.
70. We agree that price adjustments should be based on current and projected profitability. However, the Commission is moving the goal posts by determining profitability after cutting out 34% of our opex forecasts and 93% of our capex forecasts. Assuming we will be profitable on that basis becomes practically meaningless.
71. We defer to Vector, who are the Technical Operator for MDL and the Critical Contingency Operator for all transmission pipelines, for specific comments on treatment and an appropriate definition for "emergency" situations.
72. In general, we do appreciate and support the addition of arrangements for "exemption for approved emergencies".
73. We support a rate of change of zero.
74. We agree that "other regulated income" for MDL should be zero.
75. We wonder if the regulatory period for MDL can be set separately as 4 years until 30 June 2017. If that is possible, it may be more convenient than having a dangling three-month period for MDL from July to September 2017.

Closing remarks

76. In closing, we would like to reemphasize that a GTB has many unpredictable aspects. Requiring a CPP to address those aspects does not make them any more predictable, or make forecasts any more reliable. We submit that a DPP for a GTB should be designed to handle and accommodate the inherent uncertainties of the business.
77. We have appreciated the opportunity to provide this submission. For any additional questions or clarifications please do not hesitate to contact us.

Yours sincerely,



Jelle Sjoerdsma
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for Maui Development Limited