

Commerce Commission

Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022

31 May 2017

Stephen Gale, Acting Deputy Chairperson

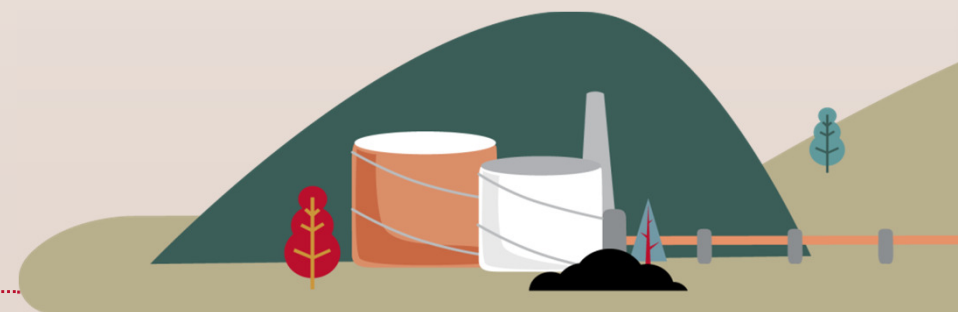


Introduction

Today we publish the default price-quality paths for five gas pipeline businesses (**GPBs**) for the 2017-2022 period

This presentation covers the following features of the reset:

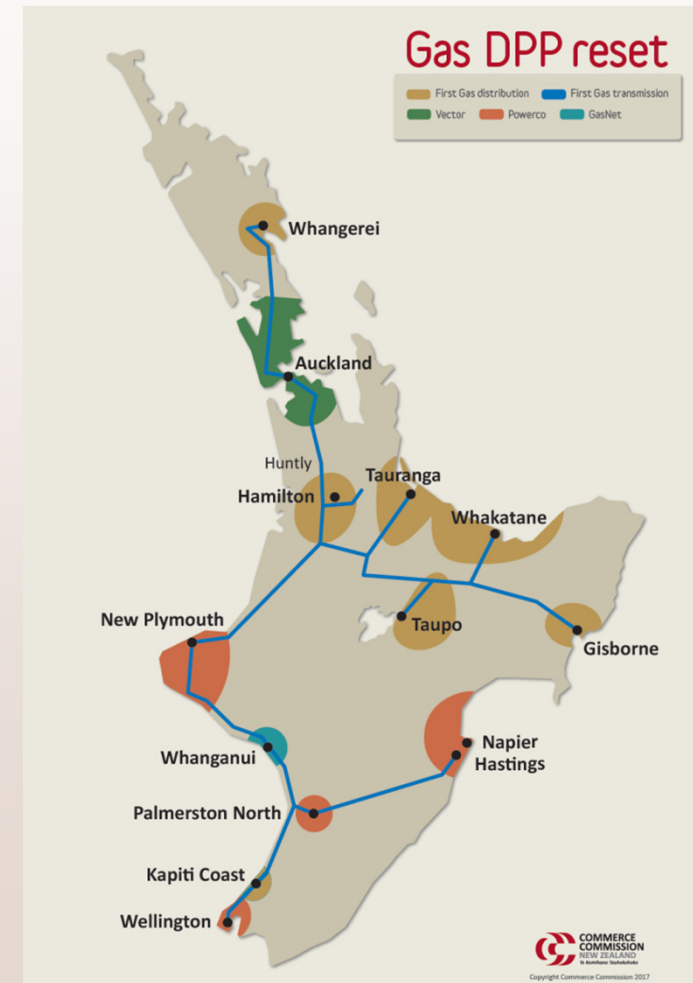
- Starting prices
- Changes since the draft decisions and the previous Gas DPP
- Impact of the reset
- Drivers of starting price changes
- Impact of changes in WACC on prices
- Opex and capex forecasts
- Quality standards



Suppliers subject to this reset

This Gas DPP reset applies to four gas distribution businesses (**GDB**) and one gas transmission business (**GTB**)

| Supplier | Type of business |
|----------------------------------|------------------|
| First Gas Limited (distribution) | GDB |
| GasNet Limited | GDB |
| Powerco Limited | GDB |
| Vector Limited | GDB |
| First Gas Limited (transmission) | GTB |



Starting prices

The starting prices are the maximum allowable revenues in the first year of the regulatory period. These have increased from the draft decisions

| Supplier | Final starting prices | Draft starting prices |
|------------------------|-----------------------|-----------------------|
| GasNet | \$ 4 m | \$ 4 m |
| Powerco | \$ 47 m | \$ 45 m |
| Vector | \$ 44 m | \$ 43 m |
| First Gas distribution | \$ 22 m | \$ 20 m |
| First Gas transmission | \$ 122 m | \$ 113 m |
| Industry total | \$ 239 m | \$ 225 m |

Changes since the draft decisions

Prices are higher than in our draft decisions (Feb 2017)
based on increased expenditure allowances and an updated
WACC

- We have increased the expenditure allowances for some businesses based on further evidence provided
- We have accepted additional investment for First Gas to maintain the integrity and resilience of its transmission network
- We have updated the WACC for increased interest rates

Changes since the previous DPP

Changes resulting from the IM review

- Introduction of a pure revenue cap with a revenue wash-up for GTBs
- How we estimate WACC

Changes during this reset

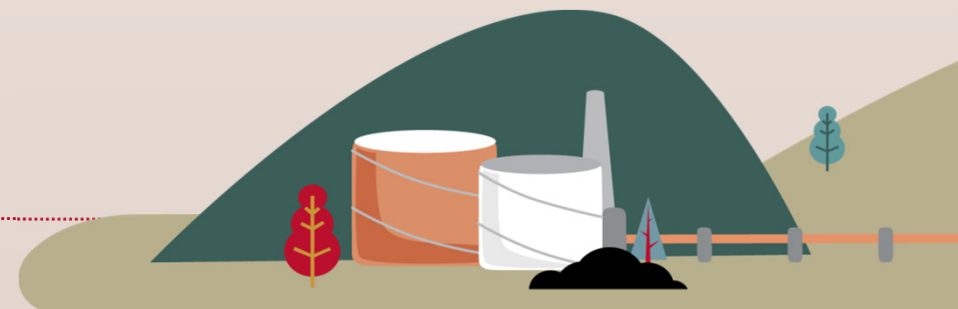
- Approach to forecasting the expenditure requirements
- A new quality standard for GTBs regarding major interruptions



How we have reset prices

We have reset the price paths based on forecast costs for all GPBs and demand for GDBs

- This approach ensures the price paths meet the GPBs individual capex and opex needs and consumers are charged prices that are aligned with the cost of service they receive
- If prices were rolled over from the 2013 DPP, the resulting profits would be excessive
- Prices for GDBs and revenues for GTBs will be indexed by CPI



Impact of the reset for GPBs

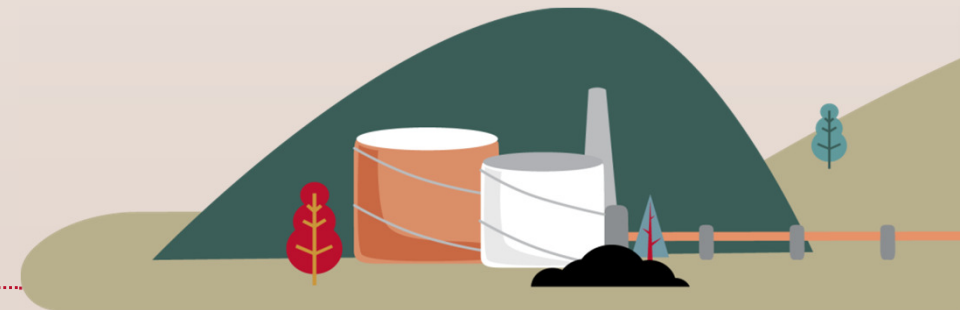
This table shows the impact of the reset over the five-year regulatory period

| Supplier | Forecast revenue based on final decision | Forecast revenue from a roll-over | % difference |
|------------------------|--|-----------------------------------|--------------|
| GasNet | \$ 19 m | \$ 22 m | -12% |
| Powerco | \$ 216 m | \$ 236 m | -8% |
| Vector | \$ 200 m | \$ 254 m | -21% |
| First Gas distribution | \$ 101 m | \$ 126 m | -20% |
| First Gas transmission | \$ 559 m | \$ 622 m | -10% |
| Industry total | \$ 1,096 m | \$ 1,259 m | -13% |

Impact of the reset on households

Distribution and transmission costs contribute significantly to household consumer bills

- Distribution and transmission costs contribute approximately 39% and 7% respectively to an average household consumer bill
- We have estimated that the pass through of this price reset would reduce average household consumer bills by approximately 6% in 2017/18



Drivers of starting price changes

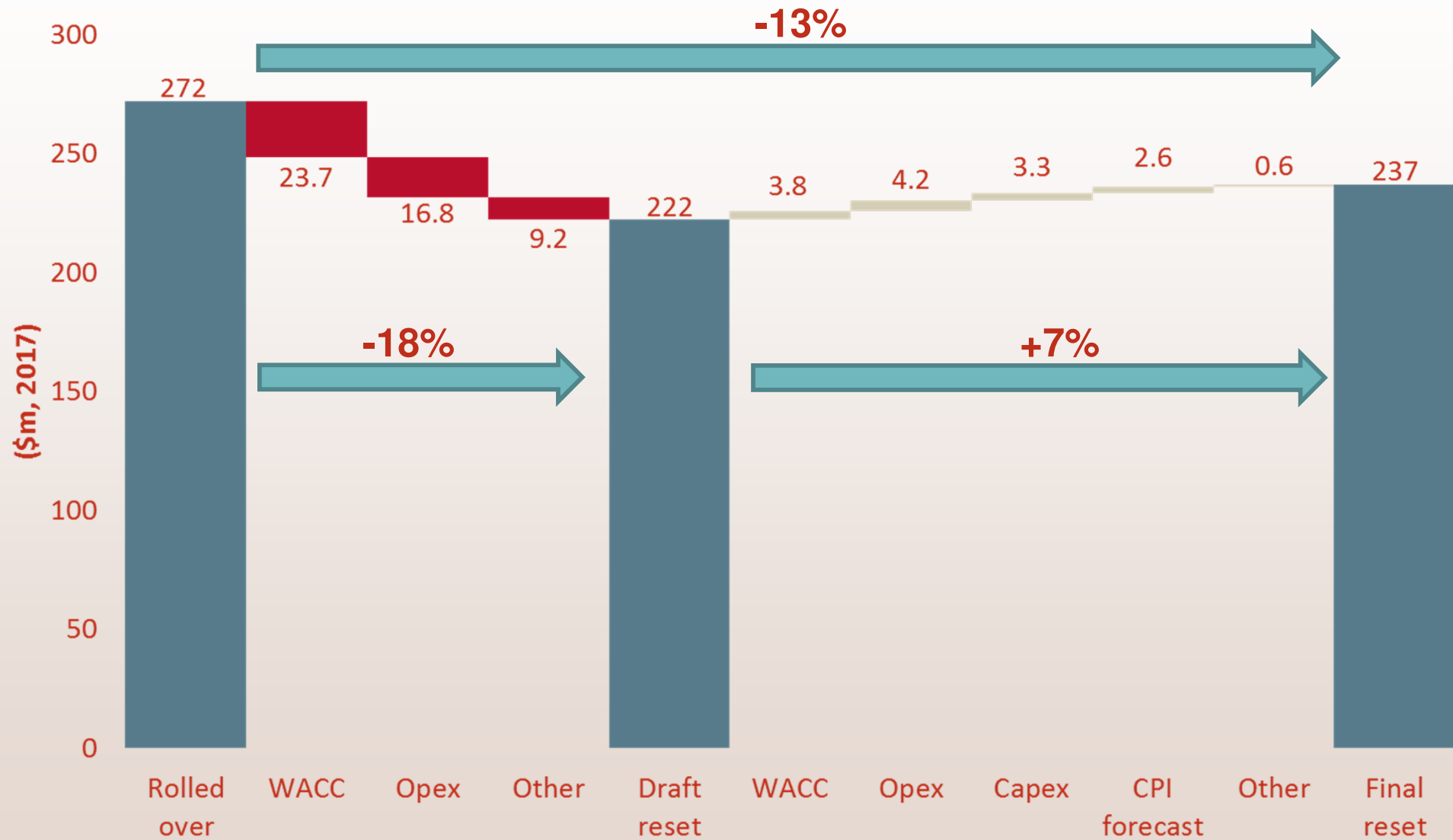
Lower starting prices have been influenced by two major drivers

- A lower WACC
- A lower opex allowance

- To a lesser extent, higher demand forecasts for GDBs have had an impact too



Drivers of starting price changes



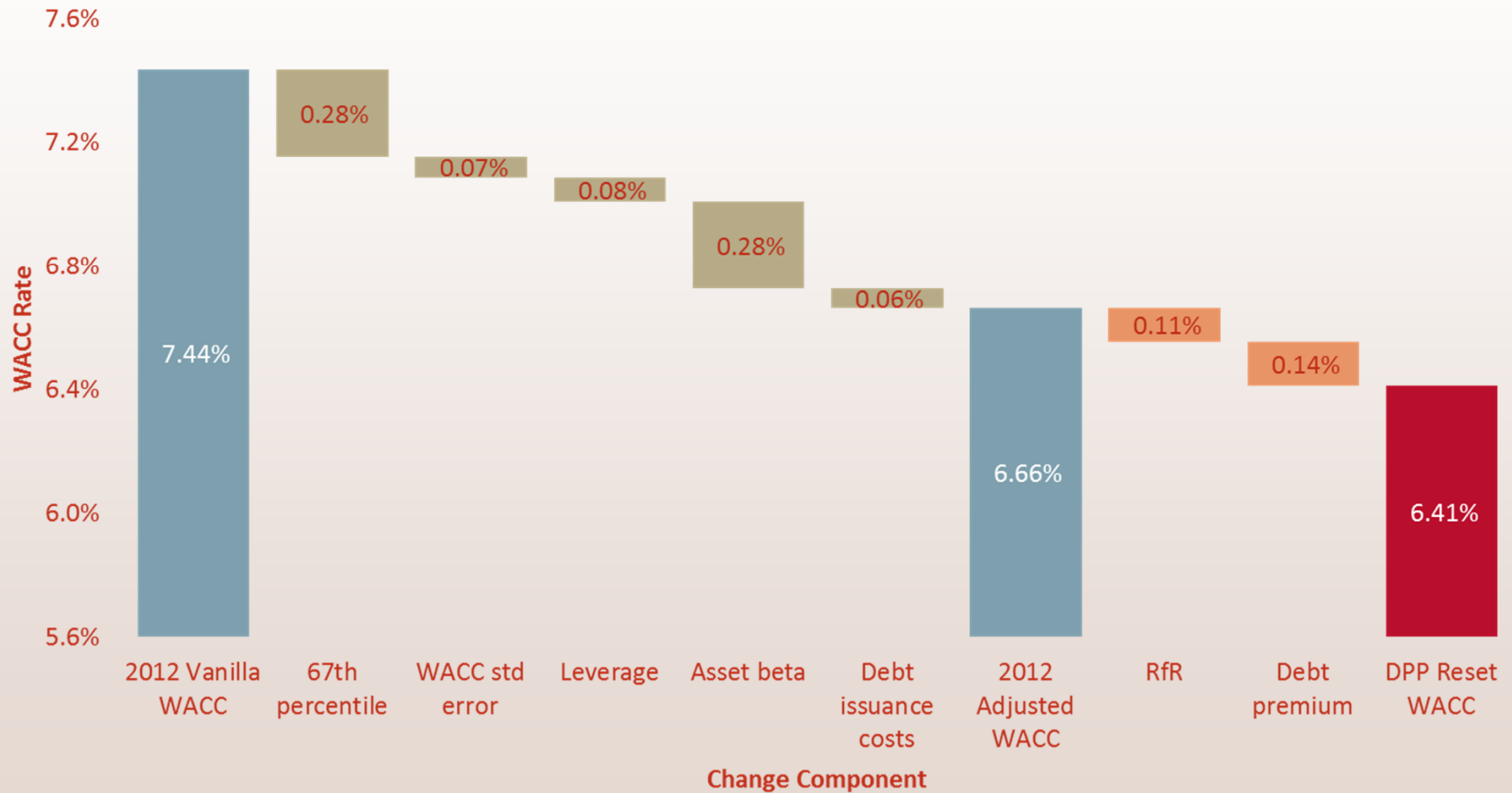
WACC reduction

The WACC rate used when setting prices has been reduced from 7.44% in the previous Gas DPP to 6.41% in this Gas DPP

- This change has been driven by a combination of changes in the input methodologies and market conditions
- This accounts for more than half of the revenue difference comparing our decision with keeping current revenue limits
- The WACC we used in the draft decisions has been updated for increased interest rates



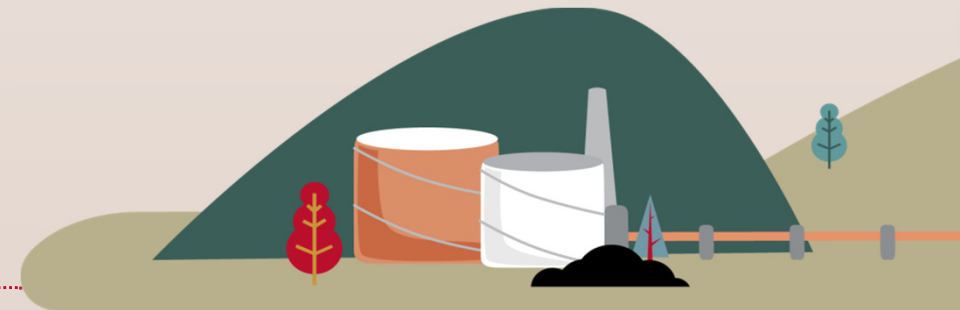
Cumulative effect of changes in WACC



Opex and capex forecasts

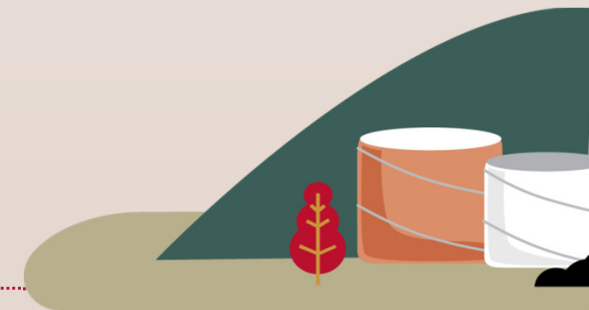
Our approach to forecasting supplier expenditure is based on suppliers' own forecasts in their AMPs

- Approach is consistent across all suppliers and ensures that price paths are more tailored to each GPBs' particular circumstances
- Only First Gas' transmission business and GasNet received a significant reduction to its capex forecast



Opex and capex average annual acceptance rates

| Supplier | Opex | Capex |
|------------------------|------|-------|
| GasNet | 100% | 90% |
| Powerco | 100% | 100% |
| Vector | 96% | 99% |
| First Gas distribution | 100% | 100% |
| First Gas transmission | 99% | 82% |
| Industry total | 99% | 92% |



Reasons for adjusting suppliers' expenditure forecasts

We have adjusted suppliers' forecasts if evidence was insufficient to justify substantial expenditure increases above the historic average

- Some smaller capex and opex projects by GasNet and Vector remain excluded as they are not properly justified (allowance adjusted to fall back)
- We have not included significant resilience expenditures for First Gas (White Cliffs preparatory works), as we consider this more suited to the scrutiny of a CPP proposal – First Gas supports this view and we will be further engaging with First Gas on this matter

Quality standards

We have introduced a new quality standard based on major interruptions for GTBs

- The new standard incentivises GTBs to maintain reliable gas transmission because interruptions can have a large impact when they occur
- The new standard does not apply to GDBs as the impact of interruptions in this sector is likely to be more localised
- We retain the quality standard for all GPBs based on the response time to emergency



Summary

We have reset prices based on forecast costs for all GPBs and demand for GDBs, resulting in a significant reduction in the prices for the next DPP

- The reduction in prices is largely driven by changes in the WACC used to set prices and the applied expenditure forecasts
- We have introduced a new quality standard for GTBs based on major interruptions



Questions

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