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Commerce Commission

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

10 February 2017

Sue Begg, Deputy Chair

Introduction

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

This presentation covers the following proposed features of today's draft decision:

- Key changes since the previous Gas DPP
- Proposed starting prices and impact of the reset
- Impact of changes in WACC on starting prices
- Opex and capex forecasts
- Quality standards
- Next steps

Suppliers subject to this reset

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

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

Key changes since the previous DPP

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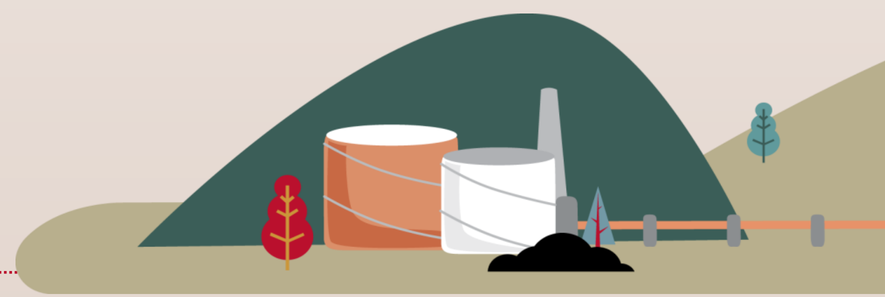
Key changes implemented

- A pure revenue cap with a revenue wash-up for GTBs (IM review)
- A reduced WACC rate (IM reviews and market drivers)

Key changes proposed

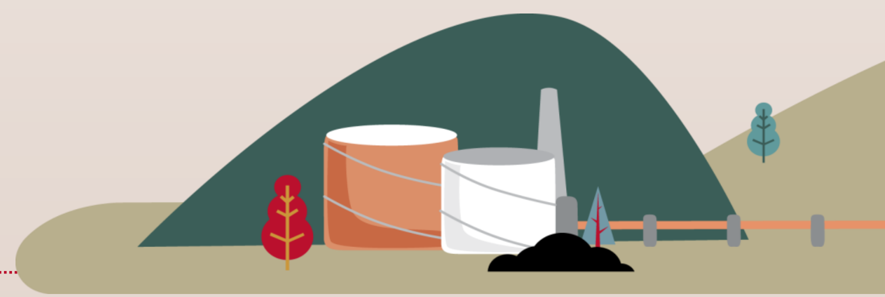
- Approach to forecasting expenditures
- Approach to determining constant price revenue growth rates
- A new major interruptions quality standard for GTBs
- A five year regulatory period



How we propose to reset price path

We propose to reset the price path based on the current and projected profitability of each supplier

- If prices were rolled over from the 2013 DPP, the resulting profits would be excessive
- We propose that the next DPP will apply for a five year regulatory period
- Price path will be indexed by CPI (X-factor will be zero)



Proposed starting prices

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The proposed starting prices are the maximum allowable revenues in the first year of the regulatory period

Supplier	Starting prices	Impact of reset on price/revenue cap
GasNet	$4.1m	-13%
Powerco	$45m	-16%
Vector	$43m	-23%
First Gas distribution	$20m	-26%
First Gas transmission	$113m	-16%
Industry total	**$225m**	**-18%**

Impact of the reset for GPBs

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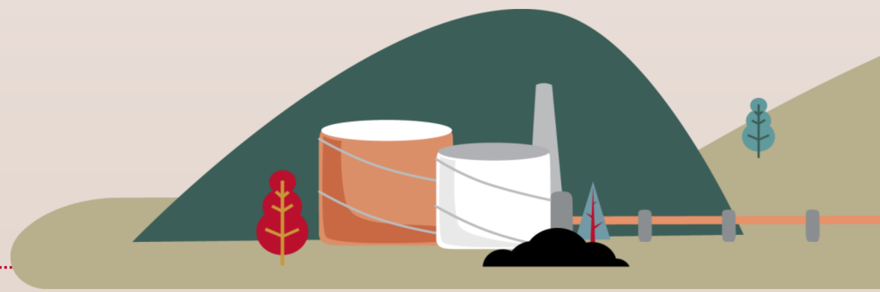
This table shows the impact of the reset in NPV terms over the 5-year regulatory period

Supplier	Forecast revenue based on draft decision	Forecast revenue from a roll-over	Forecast over-recovery if prices rolled over	% difference
GasNet	$18m	$20m	$3m	-13%
Powerco	$193m	$228m	$35m	-16%
Vector	$184m	$237m	$53m	-23%
First Gas distribution	$88m	$120m	$32m	-26%
First Gas transmission	$494m	$582m	$88m	-15%
Industry total	**$977m**	**$1,188m**	**$211m**	**-18%**

Impact of the reset for consumers

Distribution and transmission costs contribute significantly to consumer bills

- Distribution and transmission costs contribute approximately 39% and 7% respectively to an average household consumer bill
- We have estimated that our draft decision would reduce these consumer bills by approximately 8% in 2017/18
- Our proposed price reductions, however, are likely to affect major industrial users and commercial users differently



Factors affecting starting price

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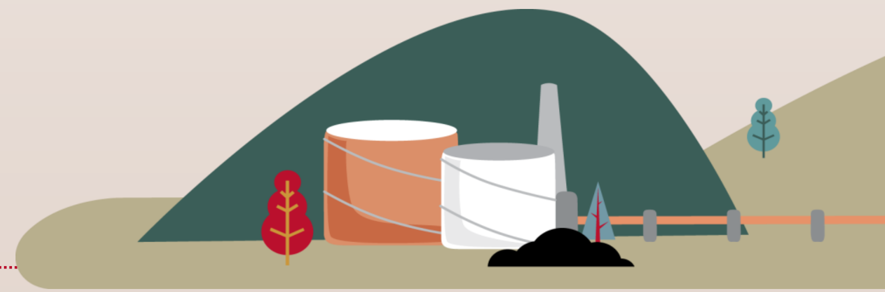
The proposed starting prices have been influenced by three major drivers

- A reduction in the WACC rate
- Opex and capex forecasts that we have allowed
- The constant price revenue growth forecast (GDBs only)
  - Forecasts are generally higher than for last period
  - Produced at a regional rather than aggregate level



WACC reduction

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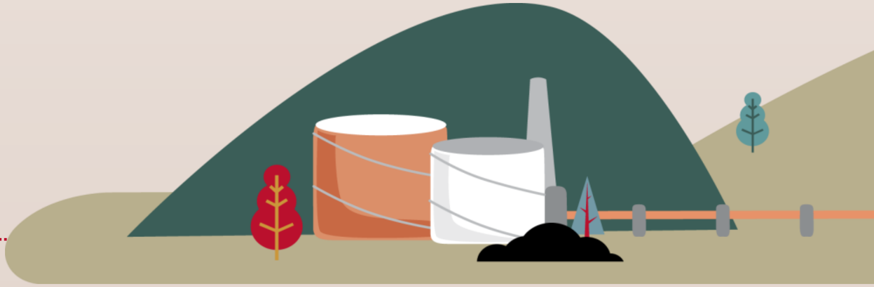
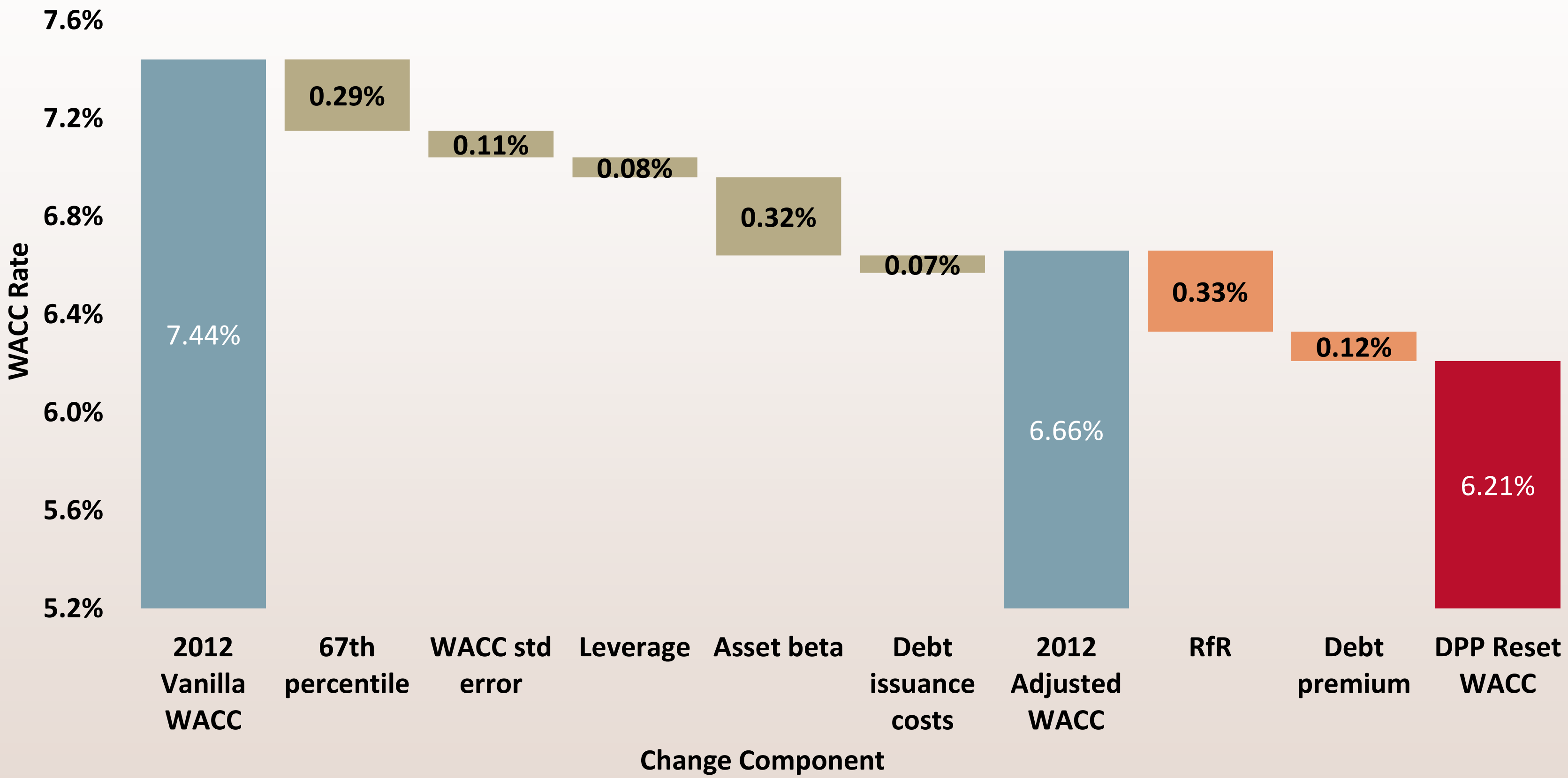
The WACC rate used when setting prices has been reduced from 7.44% in the previous Gas DPP to 6.21% in this Gas DPP

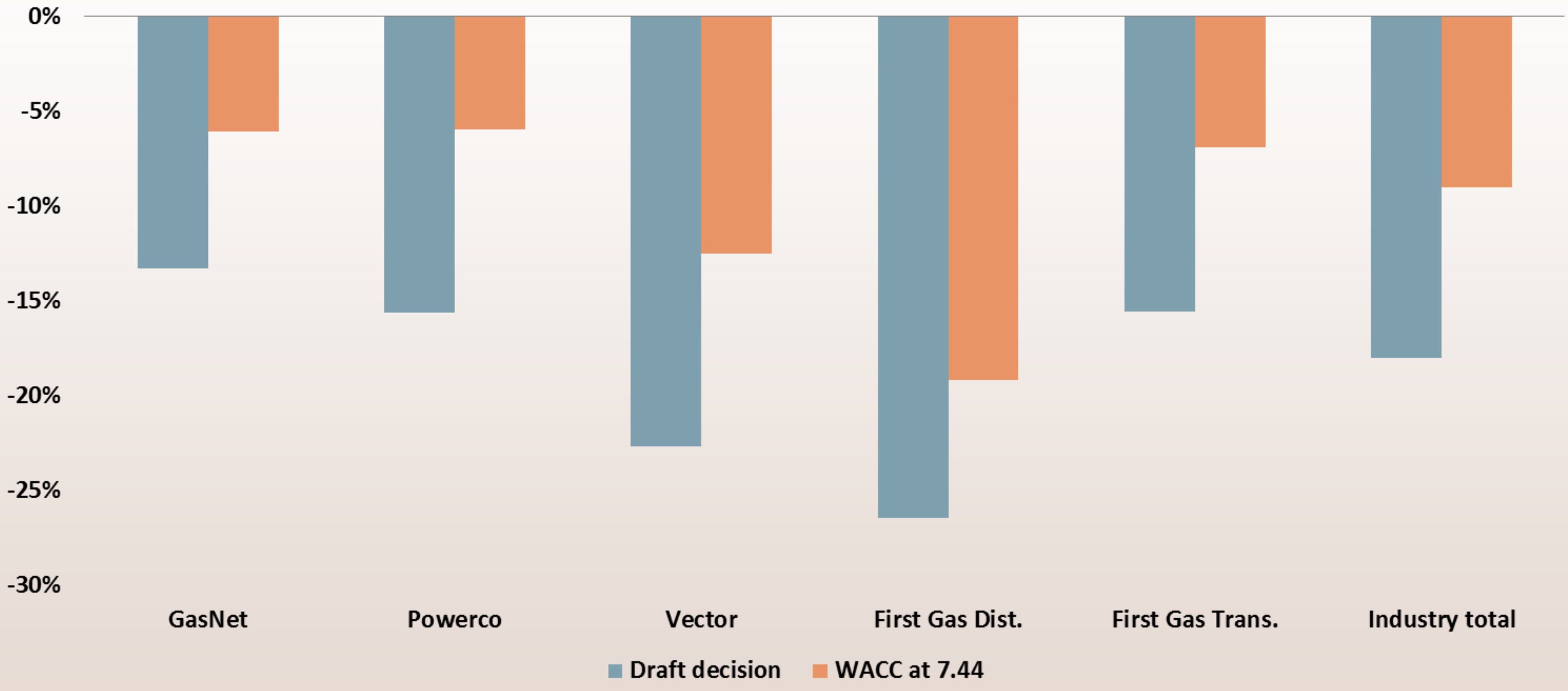
- This change has been driven by a combination of changes in the IMs, and market conditions
- This accounts for approximately half of the revenue difference comparing our draft decisions with keeping current revenue limits
- The WACC rate of 6.21% used for this draft Gas DPP reset is for illustrative purposes only and will be updated in the final decision



Cumulative effect of changes in WACC



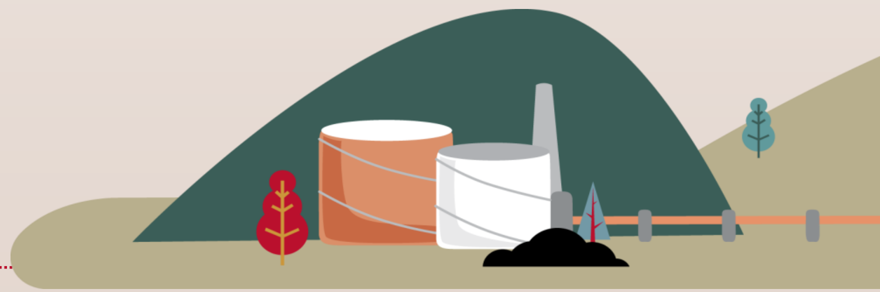
Impact of changes in WACC on price reset



Proposed opex and capex forecasts

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

- Approach is consistent across all suppliers
- Only First Gas’ transmission business received a significant reduction to both opex and capex compared to its own forecast



Proposed opex and capex average annual acceptance rates

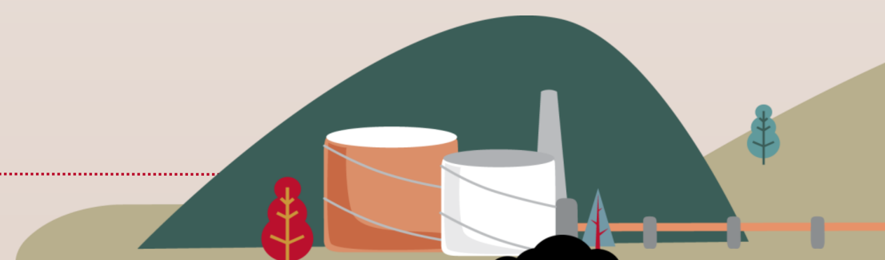
Supplier	Opex *	Capex *
First Gas distribution	100%	61%
First Gas transmission	93%	58%
GasNet	100%	89%
Powerco	100%	100%
Vector	96%	99%
Industry total	**95%**	**76%**

* % of expenditure included in this draft Gas DPP reset compared to suppliers' own forecast provided in their Asset Management Plans

Reasons for adjusting suppliers' expenditure forecasts

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

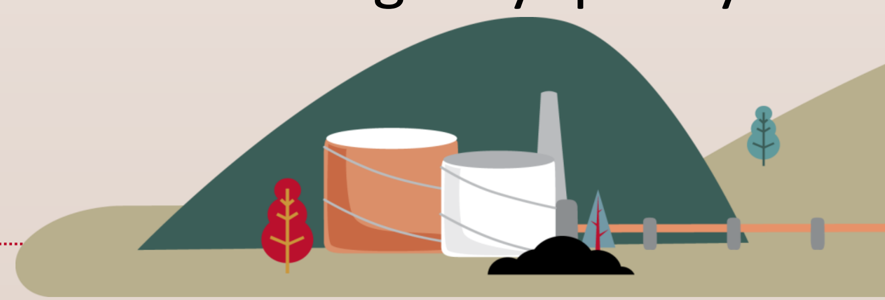
- Some capex and opex projects by GasNet, Vector and First Gas excluded as not properly justified (allowance adjusted to fall back)
- We have not included significant resilience expenditures for First Gas ($23m, White Cliffs preparatory works), as we consider this more suited to the scrutiny of a CPP proposal



Proposed quality standards

We propose to introduce a new quality standard based on major interruptions for GTBs only

- 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 propose to retain the response time to emergency quality standard for all suppliers



What may change from draft to final

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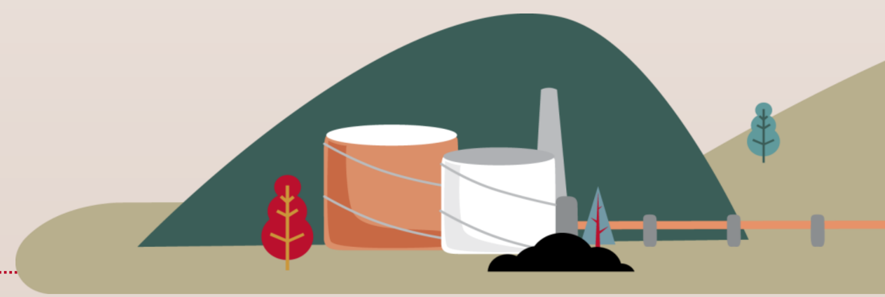
Proposed Gas DPP may change in our final decision

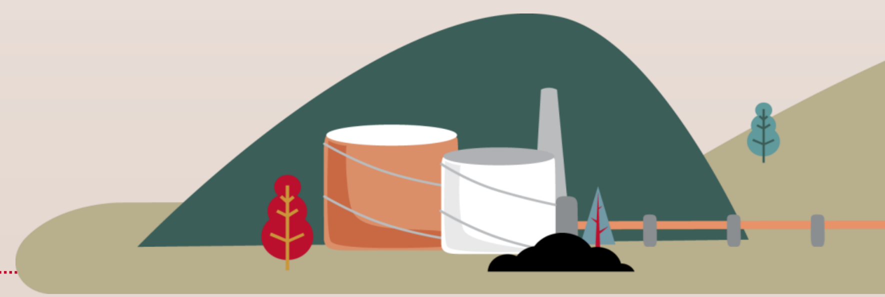
- Starting prices may be adjusted in our final decision due to:
  - changes in market conditions affecting the WACC rate used
  - additional evidence provided prior to our final decision leading to greater acceptance of suppliers' expenditure forecasts – this would result in a starting price increase
  - updated information (eg, CPI)



Summary

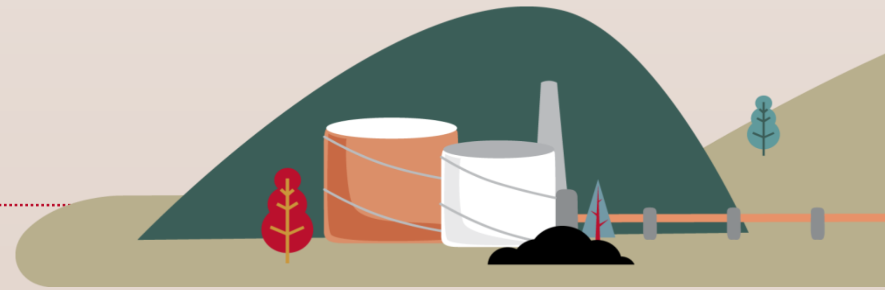
We propose to reset prices based on the current and projected profitability of each supplier resulting in a significant reduction in the prices proposed for the next DPP

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



Proposed next steps

Publication/event	Intended timing
Submissions on this paper	10 March 2017
Cross submissions on this paper	24 March 2017
Publish revised determinations for consultation	April 2017
Submissions on revised determinations	April/May 2017
Final decision	31 May 2017



Questions

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