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Ms. Keston Ruxton
Manager, Input Methodologies Review
Regulation Branch
Commerce Commission
PO Box 2351
Wellington 6140

Dear Keston,

This letter contains our comments on the "Emerging views on opportunities to improve the way default and customised price-quality paths work together" paper dated 29 February 2016 for the Input Methodologies review. In this letter we will use the terms "MDL", "we", "us" or "our" to refer to the Gas Transmission Business (GTB) of Maui Development Limited. Our comments are limited to emerging views that affect the gas transmission sector.

Our comments follow the same structure as the Commission's paper and are provided under the following main headings.

- Context for gas transmission
- Comments on specific emerging views
- Comments on the real-world example

Context for gas transmission

We appreciate the Commission's approach in starting with the context and the problem definition used for developing its emerging views. We particularly appreciated the clarification of the Commission's thinking (in paragraph X4) about the relevant factors that are involved. Without limiting other considerations that may also need to be taken into account, we consider those factors appropriate and useful.

We would like to emphasise that the future context for the gas transmission sector is likely to be different from that for other sectors. Our main points arising from that are as follows.

- We support a more tailored DPP for gas transmission
- In the case of a single supplier there are more opportunities to use a DPP reopener
- Situations requiring a gas transmission CPP can be reduced
- The problem definition for gas transmission should have a different emphasis
- The need for a gas transmission CPP should only depend on the scope of changes

We support a more tailored DPP for gas transmission

With respect to the interplay between DPP and CPP arrangements we believe it is important from the outset to note that the gas transmission sector represents a special case. After completion of the conditional acquisitions by Colonial First State Global Asset Management of the Vector and MDL GTBs there will be only one remaining supplier of gas transmission services in New Zealand. As a result, we assume (and do so in the remainder of this letter) that for the next regulatory period only a single price-quality path for gas transmission will be in effect.

The key implication from this is that the 'standard' reason to have a DPP/CPP regime may no longer apply. As the Commission explains (in paragraph 19), the current regime is based on the premise that a generic DPP applicable for multiple suppliers can be set in a relatively low-cost way, while individual suppliers may apply for a CPP that better meets their particular circumstances. This premise falls away if the Commission only needs to set a price-quality path for one supplier.

In that situation, from the outset, the DPP can and should be tailored – as far as efficiently possible – to fit the particular circumstances of that single supplier. The Commission's use of the word 'tailoring' calls to mind a useful analogy. If a clothing shop had only a single customer it would be pointless to have off-the-rack standard-sized garments. Instead, the shop would want to ensure that its garments always fit the size of its single customer. The Commission is in a similar situation when setting a price-quality path for only one supplier. Instead of setting a less than optimal DPP first and allowing it to be customised later, the lowest-cost approach would be to 'get it right' the first time.

In the case of a single supplier there are more opportunities to use a DPP reopener

We welcome the Commission's emerging views on potentially expanding the role of DPP reopeners. We expect this will be particularly useful, and can be accomplished at relatively low cost, when a DPP applies to only a single supplier.

In that case:

- it is relatively simple for the Commission to apply additional scrutiny to the reopener for that single supplier, to the degree it considers necessary, without incurring costs to scrutinise multiple suppliers; and
- there is no need for the Commission to consider the impact that a DPP reopener for gas transmission could have on other suppliers.

We can support most of the factors listed in paragraph 48 of the Commission's paper as relevant in determining the circumstances when a DPP reopener can be appropriate. For gas transmission, however, we offer the following caveats.

- The cost of scrutiny required for the DPP reopener is probably not a relevant factor. In the case of a single supplier, it should make no difference whether this cost is incurred for a CPP or for a DPP reopener.
- The magnitude of impact on consumers should make no difference on the choice between a DPP reopener or a CPP. When a reopener applies to only a single supplier, the Commission can apply the necessary levels of appropriate and proportionate scrutiny in either case.
- The opportunity to have a DPP reopener that applies for only a single supplier is actually a benefit in our case. The concern expressed in paragraph 48.5 does not apply.

We acknowledge that, as the Commission foreshadows, a DPP reopener framework will need to include an application process. Managing the application and the reopener process itself will take some time and involve some costs. Nevertheless, we expect that the scope for a DPP reopener can be smaller than for a CPP, leading to shorter delays and lower costs.

Situations requiring a gas transmission CPP can be reduced

This is a simple consequence of the above points.

- A CPP should no longer be necessary to deal with a DPP that was not suitable for an individual supplier from the outset. The expenses and delays caused by applying for a CPP can be avoided by determining an appropriately tailored DPP for gas transmission.

- If a situation can be dealt with under a DPP reopener then the number of situations in which a CPP process may be needed will also reduce. This should lead to lower costs and a reduction in potential project and investment delays.

The problem definition for gas transmission should have a different emphasis

In our view, the most relevant part of the Commission's problem definition for the gas transmission sector is "changing aspects of the current regulatory settings for price-quality paths to enable them to better meet the circumstances of individual suppliers".

With respect to the three situations listed by the Commission we expect the first two are not difficult to deal with for the gas transmission sector. In both cases, when setting the DPP, the lowest-cost approach will be to accommodate the individual circumstances of the single supplier for which it applies.

The only remaining problem then is how to deal with the situation where circumstances materially change during the regulatory period from those assumed when the DPP for gas transmission was set. This still requires an ability to change the price-quality path. The question then becomes under what circumstances that change is achieved by:

- determining a new price-quality path, similar to the current CPP process; or
- amending an existing price-quality path through a reopener process.

It is relevant to keep in mind that circumstances could materially change more than once during a regulatory period. This implies that, if a supplier can make only one CPP application during that period, options for a reopener process always need to be created.

The need for a gas transmission CPP should only depend on the scope of changes

Our view is that the only relevant criterion in the gas transmission sector for choosing between a CPP or a DPP reopener process is the scope of changes that arise. (Assuming the initial DPP was appropriately tailored to begin with.) More specifically, the degree to which those changes affect inputs in the price-quality path that can be adjusted independently of other inputs. (This corresponds with paragraph X4.2 in the Commission's paper.) In other words, the degree to which changes impact multiple inputs and the degree to which those inputs are interdependent.

Considering the other factors listed by the Commission in paragraph X4 as possibly relevant for choosing between a CPP or a DPP we offer the following comments.

- The level of scrutiny that should be applied is not relevant by itself. For a single supplier, the appropriate or proportionate depth of scrutiny can be applied in both cases. As we indicated above, we only consider the required scope or breadth of scrutiny that arises from changes after setting the initial DPP as relevant for gas transmission.
- Confidence in forecasts from a single supplier is not a distinguishing factor. If confidence is low, then additional and proportionate scrutiny can be applied.
- The degree of certainty on timing and/or cost for a project should only determine whether that project can be included in an initial DPP.
- The number of affected suppliers is obviously not a factor in the gas transmission sector.

Comments on specific emerging views

Following our contextual observations above, our comments on each of the emerging views from the Commission are set out below.

Emerging view 1: We are open to taking a more tailored approach to setting the DPP where this can be done without significantly increasing cost

We support this view and believe it will be particularly applicable for the gas transmission sector. If only a single supplier is affected by a DPP then the lowest-cost solution is to have an optimally tailored approach from the outset.

The degree of certainty of timing and cost of a gas transmission project can feed into the Commission's assessment of whether or not the expenditure for it can be built in when the initial DPP is set.

As we indicated above, the level or magnitude of project costs should not be a relevant factor when setting a DPP (other than guiding the appropriate or proportionate level of scrutiny). In this regard we would appreciate the Commission's clarification of what seems to be an inconsistency between paragraphs 41 and 76 of its paper. In the former, as we read it, a substantial step change in expenditure could not be accommodated within a DPP; whereas in the latter, which relates to the real-world example of a pipeline pigging project, the step change could be accommodated within a DPP. We submit the latter is appropriate, consistent with our views above.

Emerging view 2: We consider that 'single-issue' CPPs are not appropriate

We understand the broad objections to a 'single-issue' CPP that the Commission has raised.

In the gas transmission sector we do not expect that single-issue CPPs need separate consideration. If a single issue can be considered when determining a DPP for an industry with a single supplier then it should already be included in its DPP. If it arises at a later stage then all the other considerations listed above can apply.

Emerging view 3: We should apply a proportionate scrutiny principle in continuing to refine the CPP requirements and in assessing CPP proposals

We support this view. In the special case of the gas transmission sector this view should be extended to DPP reopeners as well.

Emerging view 4: We are open to expanding the role of DPP reopeners

We strongly support an expansion of the role of DPP reopeners. As we indicated above, this can be particularly relevant and cost effective for the gas transmission sector where a DPP will be applicable for only a single supplier.

For gas transmission we expect that reopeners for constant-price-revenue-growth (CPRG) and for quality standards will not be applicable. The risk of having to deal with a large number of reopeners for gas transmission does not exist.

We expect the most common trigger event for a DPP reopener for gas transmission will be the initiation or commencement of a major project for which the cost and/or timing was still uncertain when the DPP was initially determined. This could be more beneficial for consumers than including such projects in the DPP capex allowances in advance. The requirements for a reopener could be that:

- costs for a project should exceed a certain value or percentage of the RAB or revenue;
- the project costs and timing can be appropriately scrutinised for the reopener process; and
- the project does not have a material impact on other types of costs or operations, or interdependencies with other inputs used in setting the price-quality path.

Emerging view 5: The quality-only CPP option should be replaced with a DPP reopener

This is not applicable for the gas transmission sector.

Emerging view 6: We are open to considering a CPP reopener for contingent and unforeseen projects

We appreciate having this option already for the gas transmission sector. We expect it may be useful for other sectors too.

In the special case of the gas transmission sector, with a future DPP applicable to only a single supplier, we consider that it may be possible to accommodate contingent and unforeseen projects in a DPP (via a reopener) as well.

- For contingent projects this is a strong view. If such projects can meet the requirements for a reopener that we listed above then we consider it should be possible to include them as a contingent project under the DPP.
- For unforeseen projects, if included, this would require an additional step. In this case the reopener process would need an explicit step to assess the impact of the project on other types of costs or operations and the interdependency of changes to inputs already used for setting the existing price-quality path.

If a project fails the interdependency test under either of these scenarios the Commission would have the ability to decline an application for a DPP reopener. In that case a CPP application would remain as an option.

Emerging view 7: We are open to considering approval of net additional costs incurred prior to CPP approval

We support this view. Following up on our previous comments, we suggest that similar arrangements should be possible under a price-quality path reopener as well. For example, if a contingent project materialises it could be better to start without delay, instead of waiting for a DPP reopener process to be completed. In that case, the prudently incurred costs for such a project should be provided for under the DPP reopener as well.

Emerging view 8: We are open to providing for the expansion of the range of pass-through costs that can be added when setting the DPP

We welcome and support this view. We agree that it is peculiar to restrict such arrangements to levies only. Particularly when a DPP applies to only a single supplier, we see no downside from the Commission’s suggested expansion.

Comments on the real-world example

We appreciate that the Commission is using gas transmission scenarios as an example for application of its views. We will discuss both example scenarios below.

Planned expenditure where the cost and timing is relatively certain but represents a step change from historical expenditure levels

We support the Commission’s view that this should be accommodated in setting the DPP (noting our earlier request for clarification of the possible inconsistency with paragraph 41).

Major projects that are certain to happen but where the timing and cost is still uncertain

We disagree with the Commission’s view that this scenario would always require a CPP.

For gas transmission particularly, the need for a CPP instead of a DPP reopener (after the initial DPP has been set), only needs to depend on the impact of a project on other types of expenditure and operations and on the interdependency between changes to the inputs used for the existing price-quality path. The uncertainty of a project by itself need not be a relevant consideration. That uncertainty only affects the time when a project can be included in a price-quality path.

Our White Cliffs project is a good example of a major project for which a CPP should not be required in our view. In this case, the project consists of pipeline relocation away from an area with coastal erosion. The purpose and scope of this project are well known in advance. While its costs and timing are still uncertain, there is essentially no material linkage between this project and other recurring operations and types of expenses. Therefore, it cannot lead to changes in any other inputs that would be used in our price-quality path determination.

When the project plans and costs for White Cliffs firm up they can be subjected to appropriate and proportionate levels of scrutiny on a stand-alone basis, without any need to re-scrutinise other expenses and operations that will not be affected and are irrelevant. We consider that the White Cliffs project is a prime example of an item that could be included as a contingent project for a DPP reopener.

It is again relevant to note that there could be multiple projects with uncertain timing and costs. Unless a single supplier can apply for multiple CPPs during a regulatory period, it will always be necessary to provide for a price-quality path reopener after a CPP has been set. For the gas transmission sector in particular, it should make no difference to include the same reopener provisions in the DPP.

We accept that on a case-by-case basis the Commission may still require a CPP for a major project, even if it was originally included as a contingent project in a DPP. The Commission could exercise that option as a result of information it obtains from scrutinising the project. However, a CPP should only be required if such a project has an impact on other elements of the building blocks used to set the existing price-quality path. If this is not the case, then requiring a CPP for every major project will add costs for consumers and is likely to lead to unnecessary delays.

Conclusion

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

Yours sincerely,

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for Maui Development Limited