12 October 2016

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Tricia Jennings
Project Manager, Gas Default Price Path 2017 Reset
Regulation Branch
Commerce Commission
44 The Terrace, Wellington 6140

By email: c/o regulation.branch@comcom.govt.nz

Dear Tricia,

Cross-submission on the Policy Paper for resetting default-price quality paths for gas pipeline services from 1 October 2017

1. This is Vector's cross-submission on the Commerce Commission's (Commission) consultation on default price-quality paths for gas pipeline businesses from 1 October 2017 policy for setting price paths and quality standards (the Policy Paper). This submission provides Vector's view on relevant matters raised in stakeholder submissions.

2. Vector's contact person for this submission is:

   Richard Sharp
   Head of Regulatory and Pricing
   09 978 7547
   Richard.Sharp@vector.co.nz

3. No part of this submission is confidential.

Forecasting expenditures

Tailoring

4. The issue of default price path (DPP) tailoring was raised in the First Gas Ltd (FGL's) submission. As discussed in Vector's submission on the Policy Paper, we do not consider *tailoring* entitles the Commission to arbitrarily manipulate materiality boundaries for assessing expenditures between suppliers. Vector does not support the FGL view to tailoring materiality boundaries between suppliers as being a reasonable use of Commission discretion.[1] Rather, such an approach explicitly violates the expectations of a DPP to apply general assumptions across suppliers. FGL has not provided any reason why this type of tailoring is necessary. Vector agrees with FGL's concern about uncertainty and transparent evidence for setting materiality boundaries for forecast expenditure. However, the most

[1] First Gas Ltd, *Submission on policy for setting price paths and quality standards in DPP for gas pipeline services from 1 October 2017*, p. 2

principled way of addressing FGL's concern is to increase the transparency around the setting of materiality boundaries and ensuring they are capable to be applied consistently across suppliers.

Expectations of efficiency savings in operating expenditure

5. Vector agrees with GasNet's concern about the Commission's expectation for supplier expenditure forecasts to have built-in efficiency trends.[2] This is not a realistic expectation for businesses. Many efficiency savings cannot be planned years in advance but occur as and when a savings opportunities arise.

Growth asset expenditure

6. The GasNet submission discusses the inability of the Commission's expenditure assessment framework to deal with new investments contemplated by suppliers. Vector agrees this is a shortcoming of the Commission's proposed framework. This shortcoming is mainly due to the Commission's framework looking backwards when assessing expenditures. This is not a suitable approach for assessing growth asset expenditure.

7. Vector encourages the Commission to ensure suppliers are given reasonable opportunity to invest in the growth of their network. The consequences of an inadequate growth asset expenditure allowance was highlighted by the Australian Competition Tribunal (the Tribunal) when reviewing the Australian Energy Regulator's market expansion capex allowance for Jemena's New South Wales gas distribution network. The Tribunal remarked:

> *JGN operates in an environment, and under a price cap, where fewer customers results in lower revenues, other things being equal, because natural gas is in competition with alternative energy sources, including electricity. An ME [market expansion] capex which did not enable it to effectively invest in new connections would not only result in the loss of opportunity to consumers to take up new connections at an economic level, but in the longer term may result in higher prices for the services to existing customers.*[3]

8. The Tribunal recognised the longer-term consumer benefit from having more connections to the network. In this respect, Vector suggests the Commission consider the longer term detriment to consumers from insufficient growth expenditure allowances.

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[2] *Ibid* n1, p.24.
[3] *Application by Jemena Gas Networks (NSW) Ltd* [2016] ACompT 5 par [198]

9. The Commission’s growth asset expenditure allowance should be sufficient to enable the supplier to invest to meet the Commission’s constant price volume growth forecast. Given the long-term declining trend for reticulated natural gas usage across customer segments, new connection growth will be the only means of meeting growing volume expectations. Therefore, growth asset expenditure must be adequate to deliver forecasted new connections. Suppliers should not be forced to deliver new connections by relying on other categories of expenditure.

Expenditure metrics for assessing business-as-usual compliance

10. Vector shares concerns raised by Powerco and GasNet around the suitability of the Commission’s proposed business-as-usual (BAU) metrics used to assess expenditures. We agree with Powerco and GasNet that the use of some uncommon metrics may lead to erroneous conclusions about expenditure efficiency i.e. measuring gas conveyed relative to operating expenditure as being indicative of opex efficiency. Using this type of metric will capture trends that could be purely weather driven.

11. Other uncommon metrics supposedly measuring the efficiency of opex are referred to by GasNet. GasNet highlighted that *Service, Interruptions and Emergency Opex* efficiency was being measured by comparing this category of expenditure against the number of interruptions to derive a cost per interruption. This also is an erroneous approach to measuring the efficiency of the expenditure. Vector recommends the Commission use expenditure metrics well understood by industry and aligned to information disclosure reporting. We encourage the Commission to engage with industry on this topic.

Yours sincerely
For and on behalf of Vector Ltd

Richard Sharp
Head of Regulatory and Pricing