

3 November 2016

Ms. Keston Ruxton  
Manager, Input Methodologies Review  
Regulation Branch  
Commerce Commission  
Wellington

Dear Keston,

## [Submission on Input Methodologies review Technical consultation update paper](#)

This is a submission by First Gas on the technical consultation update paper (the update paper) for the input methodologies review. Our main points covered in this submission are:

- The proposed urgent project allowance should be extended to cover costs that are prudently incurred prior to the date of a CPP application.
- The revenue cap wash-up arrangements for our Gas Transmission Business (GTB) should be simplified and less restrictive.
- We support the proposed approach to treating compressor fuel used for balancing as a recoverable cost. We also recommend a clarification of the balancing gas recoverable cost.

### Introduction

For the most part we are comfortable with the technical drafting provided by the Commission. Unless noted otherwise in this submission, we are comfortable that the drafting implements the approaches proposed by the Commission.

While we have tried to focus our comments on technical drafting, this is difficult given the number of significant changes on matters of substance from positions taken in the draft decisions. Some of those, such as the proposed changes to debt issuance costs and the approach to estimating the debt premium, will have material impacts. We appreciate that the Commission is still making improvements to its proposals, and we encourage the Commission to have an open mind and change its draft decisions where needed. However, it is difficult to consider material changes to draft decisions and technical drafting at the same time, particularly without the benefit of a reasons paper that clearly articulates what the Commission aims to achieve through its decisions.

Consulting on form and substance at the same time also leaves stakeholders guessing on the status of other suggested changes to draft decisions. For example, submissions raised the discrepancy on valuation of easements. This has not been addressed through amendments to technical drafting – but we are unsure whether this might be addressed in any event in the final decisions.

## **Urgent project allowance for CPPs**

We support the Commission's proposal to include an urgent project allowance for CPPs, and appreciate the clarification that this can also respond to costs incurred up to the commencement of a CPP. However, the Commission continues to exclude prudently incurred costs prior to the application date for a CPP.

As we set out in our earlier submission, there may be a considerable time lag between the commencement of an urgent project and the application for a CPP. In view of the Commission's discretion in setting this allowance in the first place, we still see no good reason for a mandatory exclusion of all project costs incurred prior to a CPP application date.

## **Revenue wash-up arrangements**

We continue to have significant concerns with the Commission's proposed approach to wash-up arrangements for the GTB revenue cap. We appreciate that the Commission has considered submissions on its draft decisions and is proposing amendments as a result. However, instead of choosing simple solutions, the Commission has maintained an unnecessary and undesirable level of restrictions and complexity.

### **Cap on amounts entering the revenue wash-up**

We urge the Commission to reconsider the proposed cap on wash-up amounts that can enter into the wash-up pool. We disagree with the Commission's statement that its selection of a 20% cap "provides an appropriate balance between being high enough to ensure that ex-ante compensation is not required, but is low enough to still provide an incentive to suppliers to prepare for large demand shocks."

One of the main reasons that our GTB has a revenue cap (rather than a price cap) is because we have limited ability to prepare for large demand shocks. In the absence of obtaining insurance for demand shocks (which is either unavailable or prohibitively expensive), the only plausible options for suppliers are to build up reserves to deal with such an eventuality or to implement pricing approaches that insulate revenues from changes in demand. We do not consider that either approach is in the long term interests of consumers.

We do not believe that any cap on amounts entering the wash-up pool is required given that the amount that can be drawn down in any year is capped. We continue to support the statement made by PwC in an earlier submission that:

"There is no principled reason why small variations in revenue should be washed up but large negative revenue shocks should not be."

If the Commission does apply a cap on wash-up amounts, then we submit that the Commission needs to distinguish the category or categories of wash-up amounts to which such a cap can apply. For example, we cannot think of any reason why any cap should apply on pass-through costs entering the wash-up pool.

### **Caps on draw downs and on increase in average prices**

We agree with the Commission that a combined wash-up mechanism that imposes caps on draw down amounts as well as on average price increases is overly complex. However, in our view, the Commission has selected the wrong mechanism to leave in place.

We do not support a cap on a yet to be specified "function of demand" that will need to take account of historical demand quantities. This approach seems to be a half-way house to the cap on weighted average price increases which the revenue cap mechanism is intended to avoid. We do not consider that there should be any need to "improve the workability" of a cap on increase in average prices.

In any case, we expect that our pricing mechanism will be significantly restructured as part of developing a new transmission access code for our GTB. Such a new code may include new types of access products for which historical prices and quantities do not exist. Caps that reference historical pricing quantities will therefore inevitably cause problems for our GTB.

The suggestion to have a “function of demand” does little to address this problem. Consider, for example, an apparently simple measure of demand such as GJ. For pricing purposes that measure is used differently between the Maui Pipeline Operating Code (MPOC) and the Vector Transmission Code (VTC) that is still in effect for the non-Maui pipelines. We do not yet know how that measure will be used in the new gas transmission access code that we expect to have in effect by 2018. The different meanings and usage of the measure for GJ are set out below.

<b>GJ usage</b>	<b>current MPOC</b>	<b>current VTC</b>	<b>2018 access code ?</b>
<b>pricing quantity</b>	Scheduled Quantity (SQ) resulting from nominations	Shipper allocations resulting from Metered Quantity (MQ)	Shipper allocations based on combination of SQ and MQ?
<b>inputs</b>	<ul style="list-style-type: none"> <li>- including nominations to and from bi-directional points</li> <li>- including nominations to and from Notional Welded Points (e.g. for gas trades on emsTradepoint spot market)</li> <li>- including Displaced Gas Nominations</li> <li>- adjustments for trades of Operational Imbalances</li> <li>- adjustments for Mismatch quantities and trades in an event that Shipper Mismatch arises</li> </ul>	<ul style="list-style-type: none"> <li>- receipt quantities</li> <li>- delivery quantities</li> <li>- adjustments for unaccounted-for-gas</li> <li>- subject to quarterly and annual corrections from Downstream Reconciliation Rules</li> </ul>	<ul style="list-style-type: none"> <li>- may be based on SQ in most cases</li> <li>- may include ‘backhaul’ nominations</li> <li>- may include ‘wheeling’ nominations</li> <li>- pre-determined allocation algorithms for variances between MQ and SQ</li> <li>- use MQ allocations for ‘no-notice’ capacity without nominations</li> </ul>

We submit that an unambiguous “function of demand” that is relevant for gas transmission pricing will be difficult to specify in the first place, and is likely to require amendment as we restructure our gas transmission services and pricing. We consider such an approach is neither necessary nor desirable.

If the Commission wishes to avoid shocks for consumers – an objective we support – then the simplest approach is to apply a cap on draw downs from the wash-up pool as a percentage of total revenue. Such a cap can be specified unambiguously and need not depend on any other parameters or historical demand definitions and quantities.

### **Definition of prices**

We do not object to the Commission’s proposal to delete ‘discounts’ from clause 3.1.1. We also accept the Commission’s proposed clarification for the meaning of ‘quantities’ in clause 3.1.1. However, it is important to keep in mind our statements above that the specific definitions of ‘quantities’ corresponding to our future supply of gas transmission services are likely to change within the next regulatory period.

For the definition of 'prices' in clause 3.1.1, we appreciate the clarification that it "does not include any tariff, fee or charge set by a capacity auction". We are unsure if this impacts on revenue wash-up arrangements, but we submit in any case that amounts entering the wash-up pool as a result of changes to auction revenue should not be capped in any way.

## **Compliance requirements**

We support the move of compliance requirements to the relevant DPP/CPD determination.

## **Recoverable costs**

We broadly support the Commission's proposal for "Compressor fuel recoverable cost" for balancing. In the absence of an ability to devise a 'bright line' test to distinguish between compressor use for throughput support versus balancing support we consider this a reasonable compromise.

The proposal is based on the current reality that compressors on our non-Maui pipelines are used for throughput support most of the time, while the Mokau compressor on the Maui pipeline is mostly used for balancing support when necessary. Now that First Gas owns all open access transmission pipelines, we should note that we are actively investigating ways to operate our fleet of compressors more efficiently across our entire system.

We also propose the following amendments to clarify recoverable costs related to balancing in the GTB IMs.

- Replace the current clause 3.1.3(1)(c) as follows:
  - any cost, credit or charge arising from a balancing regime specified in a transmission access code that is in effect for a GTB, including costs, credits and charges for imbalances, mismatch and peaking;
- Delete clause 3.1.3(2).
- Do not add the newly proposed clause 3.1.3(8).

Our proposal eliminates the need to be concerned about the type of pipeline user that is subject to a cost, credit or charge. It covers balancing regime transactions with all pipeline users, including charges for imbalances that are often referred to as cash-outs. This eliminates the need for the newly proposed clause 3.1.3(8). It should also allow sufficient flexibility to accommodate the existing balancing and peaking regimes in the MPOC and the VTC, as well as a future regime in a new gas transmission access code.

We propose the deletion of clause 3.1.3(2) because we can see little justification to obtain approval from the Commission for the recoverability of each transaction. Except for peaking charges, all balancing regime transactions arising under the MPOC are already publicly visible on the Balancing Gas Information Exchange website ([www.bgix.co.nz](http://www.bgix.co.nz)). Considering the number and nature of such transactions, it is difficult to understand on what grounds and by what process the Commission could review and approve the recoverability for each transaction.

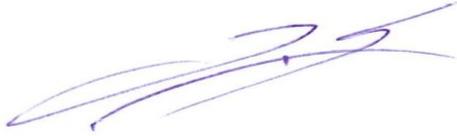
Should the Commission wish to retain a right to review and approve balancing recoverable costs then we suggest that clause 3.1.3(2) be amended to make this optional. For example, the clause could be reworded as follows:

For the purpose of subclause (1)(??), the Commission may require that approval for the amount of recoverable cost be obtained in respect of each cost, credit or charge in accordance with any applicable process specified in a s 52P determination.

## Conclusion

We appreciate the opportunity to provide this submission. We would be happy to provide additional clarifications and information if this is helpful. Please feel free to contact me at any time at [jelle.sjoerdsma@firstgas.co.nz](mailto:jelle.sjoerdsma@firstgas.co.nz) or in our Wellington office on (04) 460 2535.

Yours sincerely

A handwritten signature in purple ink, consisting of several fluid, overlapping strokes that form a stylized representation of the name Jelle Sjoerdsma.

**Jelle Sjoerdsma**  
Regulatory Manager