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Dear Matthew

Feedback on recent CPP processes

This is First Gas' submission on the Commerce Commission's open letter requesting feedback on recent customised price-quality path (CPP) processes dated 3 July 2018.

Summary of key points

First Gas welcomes the Commission's review of recent CPPs. The findings of this work are of interest to us as we consider a CPP application for our gas transmission business to address the risk of coastal erosion near our pipelines at White Cliffs in northern Taranaki.

We disagree with the Commission's view that the principle of proportionate scrutiny is sufficiently defined in the Input Methodologies. We consider that the Wellington Electricity (WELL) CPP process demonstrates the value of considering high-priority, specific resilience issues outside of a full CPP process. This ensures a timely response to identified major resilience risks, without the resource required for a full CPP.

Most of the other topics canvassed in the open letter set out activities that we expect any prudent regulated business would undertake prior to submitting a CPP application. These activities require a degree of flexibility to reflect the drivers of the individual CPP applications, so we do not support these being codified into the CPP requirements. We expand on these points below.

Importance of consultation on CPP processes and experience to date

Industry consultation and feedback on the CPP process is of considerable interest to First Gas, as we are currently considering a CPP application for our White Cliffs realignment project. Expenditure for this project was excluded from the capital expenditure allowance under the 2017 – 2022 DPP for our gas transmission business. The Commission considered, and First Gas agreed, that this project would be better suited to the level of scrutiny involved in a CPP.¹

Since May 2017, we have been proactively working with Commission staff to identify the best approach to fund the White Cliffs project. Through that engagement we have sought an approach that:

- Reflects the specific need for a CPP: a geohazard risk impacting both major gas transmission pipelines at a single geographic site;
- Provides adequate opportunities for customers to comment on proposed options and timing for the proposed investment and the approach to cost recovery;

¹ Page 61 of *Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022: Draft Reasons Paper*, Commerce Commission, 10 February 2017, and detailed in *Default price-quality paths for gas pipeline businesses from 1 October 2017 to 30 September 2022:*

Draft reasons paper, First Gas submission to the Commerce Commission, 10 March 2017.

- Does not incur unnecessary cost and verification for the remainder of our capital programme and operating expenditure, since these costs will not change due to the White Cliffs project (the project is entirely separable from the rest of our transmission expenditure); and
- Balances the cost of the CPP application with the size of the price increases that our customers will face (with expected project costs of less than 10% of our Regulatory Asset Base).

We have not yet reached agreement with the Commission on the most suitable regulatory approach that achieves these objectives.

We therefore see the review into previous CPP processes as an opportunity to reflect on our unique situation. As with all regulatory interventions, it is important to understand if existing processes are meeting the policy intent in practice. The open letter reflects on the recent CPP applications from Powerco and Wellington Electricity (WELL), which we note were two very different applications.

Further work required on applying principle of proportionate scrutiny

The discussion in the open letter on the principle of proportionate scrutiny is a key area of interest to First Gas. We disagree with the view expressed by the Commission (on page 12) that “the principle of proportionate scrutiny is sufficiently defined.” Instead, we consider that further work is required to provide the certainty expected of Input Methodologies under s52R of the Commerce Act 1986.

The reality is that the principle was not applied in either the WELL or Powerco CPP applications. The limited scope of the WELL application was supported by a Government Policy Statement (GPS) on the topic, while the Powerco application was very broad in scope. As a result, we think that there is still considerable gap between the theory and the application of the principle. This creates a risk that what the Commission means by proportionate scrutiny differs from other stakeholders. We agree with the Commission’s view that it is “extremely difficult to provide a definitive codified definition”² of how the principle would be applied. However, failing to place reasonable limits on scope adds considerable uncertainty to the process, and reduces the value of the CPP option for parties with large, discrete funding challenges.

We have pursued the option of the modifications and exemptions (M&Es) process for CPP applications to tailor requirements to our specific needs. To date, however, M&Es have only been used for minor amendments to the standard requirements. We understand that the Commission would be reluctant to use the M&E process to fundamentally reshape the CPP regime to enable the application of proportionate scrutiny. There must be a better way to address these situations.

We think that the WELL CPP process may provide a workable solution to specific resilience projects. We encourage the Commission to reflect on the benefits of the process used for the WELL CPP application, and how customers perceived this more targeted engagement. The Commission characterises the WELL CPP as an exceptional case and one they don’t see duplicated in the future. The basis for this assessment is unclear, and we certainly see parallels between the resilience project we need to fund and the WELL earthquake resilience initiative.

The Commission does not seem to be actively seeking evidence on the impacts of taking a streamlined approach for “separable” resilience expenditure, and how the decision from this approach was viewed by customers and other stakeholders. We would certainly be interested in customer and stakeholder views on this topic, to explore whether the WELL CPP application presents an opportunity for specific resilience activities to be funded outside a full CPP process.

Requirements best set through early engagement between Commission and business

The experience to date with CPPs highlights the importance and value of early engagement between the Commission, the regulated business, and the verifier. Early engagement at the start of the process enables expectations to be set at the outset and ensures that the CPP process can be customised to the unique drivers of the application. This engagement subsequently provides greater certainty over the requirements and costs for the applicant.

First Gas considers that many of the topics canvassed in the Commission’s open letter reflect the activities any reasonable and prudent business would undertake in wanting to put its best case forward for additional investment. We consider that regulated businesses have strong incentives to provide the Commission, consumers and other stakeholders with assurance that the work is required

² Page 12, Open letter.

and is being completed at the least long-term cost to consumers. The more robust the application, the better likelihood of a positive outcome for the regulated business, and subsequently for consumers.

We consider that many aspects of the topics canvassed in the open letter are best defined through the early engagement with the Commission and the verifier. Further prescription of the CPP regime risks that the rules become too inflexible and unable to meet the drivers of each application. We would also not recommend further changes to the Input Methodologies at this stage. The Commission has only recently concluded the 2016 IM review, and the IMs are intended to have a 7-year review cycle, to provide regulated businesses with a degree of certainty.

Comments on other elements of the CPP process

We set out in Table 1 further comments on the other topics canvassed in the Commission’s open letter:

Table 1: First Gas commentary on the CPP process

Topic	First Gas comments
A Consideration of alternatives	<p>We do not consider that market testing of major investments should be required for all applications. For our gas transmission business, our investments are driven by security requirements, our risk management practices and broader regulations. For example, renewal and replacement of our pipelines are guided by:</p> <ul style="list-style-type: none"> • Health and Safety in Employment (Pipelines) Regulations 1999 (Pipelines Regulation); • The application of the consensus standard AS/NZS 2885 Pipelines - Gas and Liquid Petroleum; and • Gas Industry Company (GIC) requirements including the Gas Governance (Critical Contingency Management) Regulations 2008 (CCM Regulations). <p>The scoping of alternatives should be flexible enough to address the environment the business is operating within.</p>
B Use of cost-benefit analysis	<p>We agree that a cost benefit analysis (CBA) is beneficial when applying for a CPP. However, we note that it may be difficult to calculate a meaningful CBA where there are numerous intangible benefits associated with a project. In some instances, we consider that the link between the CPP application and a business’ asset criticality framework may provide greater insight for consumers and stakeholders.</p>
C Long term pricing impact	<p>We think it is sensible for CPP applicants to signal the long-term pricing impact of their CPP application. However, it must be clearly stated that the pricing impact is only indicative for an average consumer and must detail the assumptions that underpin the calculations.</p> <p>We also note that for our gas transmission business, it may be more useful to look at the pricing change for several of our larger customers, as they will be more directly impacted by changes in price.</p>
E Delivery and accountability of CPP commitments	<p>We agree that regulated businesses should be held to account for delivery of the CPP commitments for which they’ve been funded. We support a delivery report that is proportionate to the incremental funding granted through a CPP application.</p>

Topic	First Gas comments
F Link between price and quality	<p>We consider that it is reasonable that CPP applicants propose additional quality measures linked with the key drivers of the CPP proposal, where possible. This is more appropriately discussed up front with the Commission, rather than introduced during the consultation process.</p> <p>We note that in some instances, it would be difficult to impose additional meaningful quality measures. For example, with the White Cliffs realignment project, we are already held to zero major interruptions. It would not be possible exceed this quality measure.</p>
G Consumer consultation	<p>We consider that consultation requirements should be proportionate to the level of expenditure sought, rather than be prescriptive. For example, Powerco's consultation was extensive as its CPP application covered a wide range of areas with numerous customers affected. In contrast, the WELL CPP application was focused on one area of resilience, with one geographic group of customers impacted.</p> <p>One style of consultation will also not suit all businesses and CPP applications. For example, a representative consumer panel may not be effective for our gas transmission business since direct customer input can be gained from connected parties (i.e. major users and gas distributors).</p>
H Verification	<p>We agree that it would be useful for the verifier to signal early in the verification process, the projects and programmes they intend to verify. This enables a more efficient process where the business can focus time and resources on preparing the necessary information, rather than second guessing the requirements.</p> <p>We do not agree with the suggestion that the Commission seek an early indicative report from the verifier. An early report may not reflect the final verifier's view, and unduly inform the decision-making process. For example, an early report wouldn't be useful if the verifier has not received and reviewed all the supporting information.</p>

We welcome further discussion on the CPP process, as we determine the approach for funding our White Cliffs realignment project. If you have any questions regarding this submission, please contact me on 04 979 5368 or via email at karen.collins@firstgas.co.nz.

Yours sincerely



Karen Collins
Regulatory Manager