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24 March 2017

Ms Tricia Jennings
Project Manager, Gas DPP reset 2017
Regulation Branch
Commerce Commission
44 the Terrace, Wellington 6140

Dear Tricia,

Vector cross-submission to the Draft Reasons paper for Default Price-Quality Paths for Gas Pipeline Businesses from 1 October 2017 to 30 September 2022

1. This is Vector's cross-submission submission on the Commerce Commission's (the Commission's) Draft Reasons Paper for Gas Pipeline Businesses (GPB) from 1 October 2017 to 30 September 2022, released on 10 February 2017 (GPB Draft Reasons Paper 2017). No part of this submission is confidential.

Engagement with suppliers during the supplier scrutiny stage of expenditure forecasting

2. Vector agrees with Powerco's suggestion about giving suppliers an opportunity to present additional information to the Commission during the supplier scrutiny stage. As discussed in detail in our submission the process followed by the Commission for supplier scrutiny was not clear and gave rise to different interpretations of information being sought.

3. An opportunity to present material and discuss Commission concerns with asset management plan (AMP) forecasts will reduce the likelihood of miscommunication. We also believe this engagement will allow the Commission and suppliers to seek clarification about the additional information sought to assist with gaining comfort around AMP expenditure forecasts.

Models and reports

4. Vector also agrees with Powerco's suggestion for more transparency with the different pieces of information relied on by the Commission for setting expenditures. The Commission's engineering expert Strata produced a "business as usual" variance check model and a report on expenditure information and supplier explanations. However, it is not easily traceable as to how the conclusions of these pieces of information are addressed in the Commission's expenditure model. We encourage the Commission to provide greater transparency as to how its expert consultant's review has been incorporated into the Commission's expenditure model.

Measured approach for significant price changes

5. Vector supports First Gas Limited's (FGL) suggestion of a smoothed starting price adjustment (SPA) where the price change is of a magnitude of greater than 10 percent. As proposed by FGL a smoothed SPA should still provide a net present value equivalent price change for customers over the default price path (DPP) but removes the abrupt change to prices and requirement for the business to make significant changes in a hasty manner.

6. A more measured price change process will enable suppliers to make well considered cost saving measures to address the new revenue discipline imposed by the DPP recalibration. This should also apply to starting price adjustments where prices are expected to increase by more than 10 percent i.e. the smoothing of significant price changes resulting from the starting price adjustment should be symmetric. This would insulate consumers from "bill shock" that may result from the impact of a SPA.

7. A smoothed price change would also allow the Commission to effectively monitor flow through of any price cuts to supplier prices into final retail prices paid by end-users over the adjustment period. A single sudden significant price adjustment is less likely to encourage pass-through to final prices paid by customers.

Vector non-network expenditures

8. The Commission has invited Vector in this cross-submission round to provide further information on non-network expenditures included within Vector's Auckland gas distribution business (GDB) AMP but disallowed by the Commission. The Commission's GPB Draft Reasons Paper indicated these expenditures were excluded due to the Commission's policy on the treatment of economies of scale arising from the FGL transactions. In this cross-submission we provide more detail on the expenditure categories and how they were forecasted and limit our comment on the economies of scale policy which we provided our view on in our submission.

9. Vector notes the Commission's GPB Draft Reasons Paper our non-network capital expenditure allowed by the Commission is approximately $300K less than forecasted in our 2016 AMP. Our 2016 AMP included several significant IT projects to occur over the five-year period, the following provides a more granular view of the individual projects (shared across Vector's businesses):

a. IT infrastructure upgrades including the purchasing of new communications network switches for reliability and enhancement to cyber security capability to combat targeting of utility infrastructure.

b. A significant upgrade of Vector's Global information system (GIS) upgrade common across Vector's networks due to occur in FY18.

c. SAP and Siebel upgrade (these system is used widely across our business including managing all interactions with field service providers) forecasted to occur in FY21.

d. Gentrack (our billing database) is undergoing an upgrade in FY17.

e. An overdue upgrade of company-wide operating system software.

10. Given the transition period as a result of the FGL transactions many of these projects have been deferred until the sold businesses were able to fully transition away from Vector. Therefore, IT capital expenditure for the 2016 disclosure year will be artificially depressed when compared to historical expenditures and also significantly depart from the forecast included in Vector's AMP.

11. The Commission has also made more substantial cuts to Vector's non-network operating expenditures. Non-network operating expenditure is split between system operations and network support (system support) and business support expenditures. System support expenditure includes both a mix of direct and indirect expenditures.

12. Vector's memo to the Commission on 25 November 2016 discussed our non-network expenditures and reclassification between the categories of non-network expenditure. Nonetheless, our understanding of the Commission's GPB Draft Reasons Paper and accompanying documentation is that our system support expenditures have been cut by approximately $330K per annum.

13. The cuts to this category of expenditure do significantly impact Vector's recently developed capability to deal with Auckland growth initiatives. In dealing with the challenges of Auckland's growing population Vector has invested significantly in our processes to minimise the costs to the business from this challenge. We have saved significant labour hours by investing and improving processes relating to customer interfaces with our business. Our self-service portal has dramatically reduced our touchpoint time with customers and, at the same time, improved the customer experience.

14. Despite these process improvements, Vector has still had to increase our resourcing in this area to handle the challenges of Auckland's population growth.

15. Vector has created two new roles around community liaison which were in response to feedback received from Vector customers on our engagement on infrastructure upgrades and new deployment. The Community liaison roles have assisted with engagement with local communities to ensure new infrastructure projects deployment occurs, to the extent possible, with community support. These roles sit across our network and non-network businesses and have an active role with facilitating community support for a variety of projects undertaken by the business.

16. Vector has also significantly increased our resources with customer initiated developments and customer connections. These staff are not dedicated to Vector's GDB but work across our network businesses and do have a function assisting customers where they need other non-network solutions. We now have 10 more full time people than were dealing with developments and new connections than were involved with that function in FY2013.

17. In relation to non-network business support costs, the Commission's forecast DPP allowance is set approximately $200K lower than Vector's 2016 AMP. As discussed in our 25 November memo, Vector has increased our health and safety and cyber security capability in the last year and will not scale down these functions despite the FGL transactions. In FY2013 Vector's health and safety function accounted for approximately $86K of business support costs for Vector's Auckland GDB but our increased capability in this area, in part driven by legislative change, (and reduced scale) means this area is forecasted to account for $260K for FY2017.

Capital contributions estimation error

18. Vector has reviewed the Commission's models and we believe there is an estimation error for capital contributions. We understand the Commission has used FY2017 dollars to estimate capital contributions and not FY2016 dollars. This results in an over-estimation of capital contributions of approximately $215K for Vector over the five year period.

Regards
For and behalf of Vector Limited

Richard Sharp
Head of Regulatory and Pricing