

WANGANUI GAS

PUBLIC VERSION

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Mr David Steele  
Gas Pipelines Inquiry  
Commerce Commission  
P O Box 2351  
WELLINGTON

Email: david.steele@comcom.govt.nz

Dear David,

**REQUEST FOR INFORMATION - FROM JULY CONFERENCE**

Wanganui Gas Limited ("WGL") gave a presentation to the Commerce Commission ("the Commission") on Tuesday 27 July 2004 at its conference on the Gas Control Inquiry Draft Report, Public Version 21 May 2004. At the conference the Commission raised a number of questions in relation to WGL's presentation pertaining to the Company's network activities.

WGL has obtained from the Commission's website the document entitled "Gas Pipeline Inquiry Draft Report Conference Information to be Provided" (undated) and has extracted the questions asked of it. WGL responds to each of these questions below. For the purpose of this letter, WGL has retained the paragraph numbering from the Commission's document referred to above.

WGL requests that any comments or aspects of the information contained in this letter that are not currently disclosed by the Company (and hence public information) are considered as being covered by the existing section 100 Order. Should the Commission view this matter differently, WGL requests the opportunity to consider the Commission's position prior to public release of any information currently deemed confidential by WGL.

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Question 16

*“Information and evidence on whether WGL is a superior performer compared to the other gas pipeline businesses subject to the Inquiry. Why does WGL appear to be efficient within the comparative benchmarking study? Does WGL consider it to be because the benchmarking study fails to normalise correctly for customer density or is it due to good performance by WGL?”*

WGL responds by answering each related question in turn.

a) *Why does WGL appear to be efficient within the comparative benchmarking study?*

WGL has enjoyed long-term stable ownership as evidenced by the current arrangements that have been in place since December 1992. Also during this period the Company has maintained a high consistency within its Board of Directors and senior management. Thus from the perspective of the Inquiry’s historical time frame, there has been essentially stability in ownership structure, governance and management as affecting network business activity. In addition, through this period the company has undertaken significant business restructuring with the network division reducing to approximately one third of the employee numbers it had prior to 1992. While increased use of contract services has resulted, this work is well defined and empathetic with the on-going development of the discrete networks owned and operated by WGL.

GasNet’s business activities are dominated by the very mature and diversified natural gas reticulation in Wanganui city. This infrastructure operates intermediate pressure, medium and low-pressure reticulation segments and its initial rollout dates back approximately 100 years. [.....]. Ground conditions in Wanganui city are generally favourable and the region is not significantly earthquake prone. Generally the network is in good condition supported by well focused, on-going maintenance.

Both of its other mass-market networks (Marton and Bulls) have been built from the early 1980s and operate at intermediate or medium pressure. [.....].

The Company’s other networks of Flockhouse and Waitotara, being originally built to satisfy large commercial or industrial loads, are essentially “dedicated” networks.

WGL has undertaken further analysis of published and derived efficiency data for the period 1996/97 to 2003/04 and summarises its findings for a number of parameters in the table on page 3. The first part of the table lists a number of price indices, the second part lists a range of Company financial and physical parameters and the final part derived parameters considered relevant to consideration of productive efficiency by Meyrick and Associates (and others). Common to each listed parameter is the base year for the time series, statement of the base year parameter value and a calculated “equivalent compounded annual change” presented as a percentage. WGL has chosen to calculate

and show the compound rate which is mathematically equivalent to the observed time series changes, as it smoothes year on year variation, thus enabling easier parameter comparison. Relevant data and analysis is attached to this letter as Attachment One.

#### Economic Parameters

WGL reviewed Statistics New Zealand data for CPI between June 1997 and June 2004 and three PPI time series (where available) between June 1997 and March 2004. Statistics New Zealand advise that the PPI - Gas: Commercial Consumers time series is in fact an output index measuring movement in the price of gas to these consumers. While data for the same period was not available, it appears to closely approximate the PPI Outputs - Gas Supply time series. The analysis suggests that an inflation adjusted pricing path for a gas distribution company would lie within an annualised compound rate bounded at approximately 1.9 % and 4.6 % assuming contestable market behaviour is exhibited.

<b>Table of Parameters Relating to Productive Efficiency</b>				
<b>Parameter</b>	<b>Unit</b>	<b>Base Year</b>	<b>Base Value</b>	<b>Equivalent Compounded annual Change</b>
<b>Economic</b>				
CPI - June	-	<i>1996/97</i>	987	1.87%
PPI - Outputs - Gas supply - June	-	<i>1996/97</i>	985	4.61%
PPI - Outputs - All Industries - June	-	<i>1996/97</i>	990	1.98%
PPI - Gas: Commercial Consumers	-	<i>1999/2000</i>	1,029	4.30%
<b>Company</b>				
Throughput	GJ	<i>1996/97</i>	1,080,256	0.50%
Mains kilometres	Km	<i>1996/97</i>	343	0.59%
Number of connections	-	<i>1996/97</i>	11,181	-0.24%
Total revenue	\$	<i>1996/97</i>	3,277,704	1.40%
[.....]	\$	<i>1996/97</i>	[.....]	[.....]
After-tax profit	\$	<i>1996/97</i>	791,247	4.44%
Supply charge	\$/GJ	<i>1997/98</i>	3.60	-0.10%
<b>Derived</b>				
[.....]	S/Km	<i>1996/97</i>	[.....]	[.....]
Throughput per kilometre	GJ/Km	<i>1996/97</i>	3,149	-0.09%

## Company Parameters

“Throughput” and “Mains kilometres” values have both increased at an annualised compounded rate of approximately 0.5% indicating that during the period June 1997 to

June 2004 the network business has grown modestly, while in the same period the number of connections has in fact fallen. This change principally reflects rationalisation of connections maintained by gas retailers that they have viewed as no longer economic.

In direct contrast, “Total revenue” has risen at less than the lower bound of inflation while after tax profit has risen at about the upper bound of inflation. In fact the largest of three service charge components by dollar value, “Supply charge”, has fallen on an annualised basis. The other service charge components, GMS and Service Pipe, have increased in price causing “Total revenue” to have a positive escalator. Also please note that the base year for “Supply charge” is June 1998 as prior to this year a bundled price was used.

[.....].

## Derived Parameters

[.....]. “Throughput per kilometre” indicates an essentially constant relationship expected from the individual parameter analysis discussed above. This data is of most use when comparing network businesses as can be seen from the Meyrick and Associates study.

## Independent Analysis

WGL has also reviewed independent publications by Ernst and Young and subsequently PricewaterhouseCoopers of gas industry distribution (and transmission) company performance. WGL notes that with the significant industry ownership changes since the first independent comparison of 1997 disclosure data by Ernst Young in March 1998, it is very difficult, if not impossible, to reasonably analyse relative company performance. In fact two of the five distribution companies listed in the March 1998 document (Enerco and TransAlta) no longer exist, both NGC distribution and Powerco have undergone material asset changes and now there are only four distribution companies available for comparisons as at no time has Nova Gas Limited been included in public analysis.

However, WGL notes that in 1997 disclosure data published by Ernst Young in March 1998, that the Company recorded the lowest total (operating) costs per customer and kilometre, the lowest direct line costs per kilometre, lowest indirect line costs per customer and the lowest revenue per customer of the five companies. For the reasons given above WGL does not attempt to compare its performance directly with other gas distribution companies, however it would strongly emphasize that given its relative starting position in 1997 and its delivered performance since then, that it is not unreasonable to conclude that the Company is efficient.

b) *Does WGL consider it to be because the benchmarking study fails to normalise correctly for customer density or is it due to good performance by WGL?*

WGL does not consider that it has the requisite expertise to comment on a specific aspect of the Commission's benchmarking study other than to note that as the assumptions adopted to form the Outputs and Inputs became more sensitive to realities observed, the more closely Australian and New Zealand company productivity appears aligned.

In regard to WGL's performance within the benchmarking study, it remains of the opinion that it is a well performing New Zealand gas network company and that it was not surprised to have this confirmed within the benchmarking study. In fact as indicated in answer to a) above, WGL considers that its performance on the parameters shown is a demonstration that it is operating at a level of efficiency higher than the norm.

#### Question 17

*"The involvement the NGC directors have in discussing and approving the pricing strategy for WGL's network business."*

To answer this question WGL has chosen to describe to the Commission the process for the determination, approval and application of network tariffs.

In 1996/97 the management of WGL set out to establish a process for the determination of network tariffs. As well as taking into account the 1993 "Guidelines for Gas Distribution - Procedures to Comply with the Information Disclosure Regime", management also sought advice on appropriate methodologies from industry practitioners and experts. After due consideration management established the following process which, after endorsement by the Company's Directors, was adopted by the Company.

#### 1.0 Total Recoverable Revenue

It was decided that the Company would follow the approved method of determining its Total Recoverable Revenue (TRR) from a combination of return on investment plus the operating costs plus the cost of network depreciation.

#### 1.1 Return on Investment

It was agreed between management and the Directors that it was appropriate for the Company to receive a reasonable return on its investment in the infrastructure. [.....].

[.....]. The ODV valuation as at 30 June is updated annually and audited by the Company's financial auditors. Every three years the ODV is completely re-determined and audited by both engineering and financial auditors.

## 1.2 Operating Costs

It was also agreed that it was appropriate for the Company to recover its operating costs that were directly attributable to the network activities. For the allocation of common costs the Company followed the 1993 Guidelines referred to above.

## 1.3 Depreciation

It was also agreed that it was appropriate for the Company to recover such depreciation that was directly attributable to the network assets and allowable under taxation legislation and associated Inland Revenue rulings.

## 2.0 Determination of Tariff Structure

After determining the TRR for the contract year (1 October to 30 September) under consideration, [.....].

## 3.0 Board Approval

As part of normal Company practice, the proposed new tariffs are tabled at a Board meeting for approval before being advised to the retailers by 1 September and taking effect on 1 October.

[.....].

The NGC-appointed Directors' role in this process is as part of the full Board and simply one of governance with a view to ensuring that the TRR is appropriate and thus the resulting network tariffs and that management has followed the agreed Company process in determining them.

[.....], the NGC-appointed directors neither seek nor are given any more information than any other director with regard to the network tariffs.

### Question 18

*“Updated figures of revenue and volume percentages for the industrial, commercial and residential customer groups.”*

In July 2003 WGL provided the Commission with overview information about the Company including the network business activity. Amongst the information provided was data on network throughputs by class of user in response to question 1.2.4. In compiling the current information request, WGL have identified an error in the volume breakdown data provided. The corrected aggregate information for approximate volumes is reproduced here together with the volume values provided in late July 2003:

<i>Class</i>	<i>Number</i>	<i>Volume in GJ (Original)</i>	<i>Volume in GJ (Corrected)</i>
<i>Residential</i>	[.....]	[.....]	[.....]
<i>Commercial</i>	[.....]	[.....]	[.....]
<i>CNG</i>	[.....]	[.....]	[.....]
<i>Industrial</i>	[.....]	[.....]	[.....]

[.....].

The updated approximate volume information for 30 June 2004, together with the approximate revenue information on the same basis is provided below:

<i>Class</i>	<i>Number</i>	<i>Volume in GJ</i>	<i>Revenue in \$</i>
<i>Residential</i>	[.....]	[.....]	[.....]
<i>Commercial</i>	[.....]	[.....]	[.....]
<i>CNG</i>	[.....]	[.....]	[.....]
<i>Industrial</i>	[.....]	[.....]	[.....]

[.....].

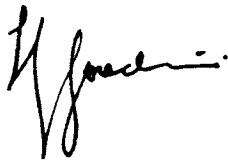
GasNet has classified connections based on GMS capacity for residential and commercial aggregation, by site for CNG and by existence of specific contract/agreement for industrial.

WGL wishes to emphasize to the Commission that it does not hold the data at the network level in the manner requested by the Commission. Therefore it has specifically prepared data sets for this purpose. These data sets are in turn based on a set of assumptions which may not be consistent with those used by a gas retailer, another network operator or a third party. The resulting aggregated information is therefore simply a view of the data available. WGL also notes that detailed data regarding the specific end use volumes is typically only held by retailers.

**For Assistance**

WGL is pleased to be able to assist the Commerce Commission's Gas Pipeline Inquiry through provision of this information. If there is a need to provide further clarification or any general queries please contact Mr Geoff Evans, Network Manager - *GasNet*, the independent trading division of WGL on 06 349 0131 or by email at [Geoff.Evans@gasnet.co.nz](mailto:Geoff.Evans@gasnet.co.nz).

Yours sincerely

A handwritten signature in black ink, appearing to read 'T. Goodwin'.

Trevor J Goodwin  
**CHIEF EXECUTIVE**  
**Wanganui Gas Limited**

