

2 August 2022

Dear Stakeholders

Notice regarding MPOC tariffs from 1 October 2022

The following tariffs will be charged from 1 October 2022 to 30 September 2023 (GY2023) for transmission services provided under the Maui Pipeline Operating Code (MPOC):

- Tariff 1: \$0.002043 / GJ.km
- Tariff 2: \$0.093284 / GJ

These tariffs represent an increase on current tariffs of 11.5% and are lower than the tariffs published in our provisional pricing memo published in June 2022¹. The major factor in the reduction from provisional prices is that forecast total transmission volumes have increased. Provisional prices were based on forecast Maui pipeline throughput of 143 PJ; while the final prices listed above are based on a revised Maui pipeline throughput forecast of 152 PJ.

The purpose of this memo is to explain how these tariffs have been calculated, with specific reference to the requirements of Schedule 10 of the MPOC. We start by itemising the specific components of our revenue allowance – namely forecast allowable revenue and pass through and recoverable costs. We then describe how total revenue has been allocated to the Maui pipeline system to fall within a range that meets the requirements of Schedule 10 of the MPOC.

Forecast allowable revenue

Firstgas' total forecast allowable revenue for GY2023, as provided by the Commerce Commission in its 2022 gas Default Price-Quality Path (DPP) Determination,² is shown in the table below. These figures represent the *total* forecast allowable revenue across the *entire* transmission system (Maui and non-Maui), as the Commerce Commission does not distinguish between different transmission pipeline systems in its DPP Determination.

Table 1: Total forecast allowable revenue

Component in \$000s	GY2023
Opex	48,183
Depreciation	48,486
Tax	17,510
Return on Capital	33,048
Total	147,227

In addition, Firstgas has forecast the following pass through and recoverable costs for GY2023. These figures are also expressed as costs across the entire transmission system.

¹ Proposed changes to pricing: Transmission pricing for GY2023, published 1 June 2022 on OATIS.

² Gas Transmission Services Default Price-Quality Path Determination 2022, Commerce Commission, 31 May 2022, https://comcom.govt.nz/data/assets/pdf_file/0023/284522/Gas-Transmission-Services-DPP-Determination-2022-31-May-2022.pdf

Table 2: Forecast pass-through and recoverable costs

Pass through and recoverable costs in \$000s	GY2023
Rates and levies	3,304
Net balancing costs	2,065
Mokau fuel gas	1,602
Revenue cap wash-up	2,569
Total	9,541

Schedule 10 of MPOC

Schedule 10 sets out the principles for MPOC pricing. It provides that Tariff 1 will recover the cost and return of capital, with reference to Optimised Deprival Value (ODV) or Optimised Depreciated Replacement Cost (ODRC). Tariff 2 will recover operating expenditures. Schedule 10 specifies that both Tariff 1 and Tariff 2 may be adjusted to reduce pricing volatility for Shippers.

Since the implementation of Part 4 of the Commerce Act in 2010, asset values have been expressed as a Regulatory Asset Base (RAB) that is rolled forward to adjust for capital expenditure, depreciation, and inflation revaluations. Initial RAB values were established from 2009 regulatory disclosures, which were based on ODV or ODRC. The Commerce Commission estimates Firstgas' opening RAB for the total transmission system for GY2023 to be \$918.0 million³.

Neither the Commerce Commission nor Firstgas maintains separate RAB accounts for the Maui pipeline. To derive updated asset values for the Maui pipeline system, we have identified Maui pipeline-specific assets in our asset register. Some transmission assets are used by both the Maui pipeline and the non-Maui system, and so a degree of judgement is required in determining appropriate allocations of these shared assets to the Maui pipeline system.

We estimate Maui pipeline system assets to be valued in the range of \$299.4 million to \$305.2 million, representing about 32.6% - 33.3% of Firstgas' total transmission RAB. Please note that these figures are not part of our Information Disclosures to the Commerce Commission and have not been audited as separate components of the RAB. Rather, these values represent our best estimate of the Maui pipeline asset values for the purposes of setting MPOC tariffs.

We have used the resulting percentages to apportion allowable revenue categories and elements of the pass through and recoverable costs to the Maui pipeline.

³ As per Gas DPP3 final – Financial model – 31 May 2022, available at <https://comcom.govt.nz/regulated-industries/gas-pipelines/gas-pipelines-price-quality-paths/gas-pipelines-default-price-quality-path/2022-2027-gas-default-price-quality-path?target=documents>

Tariff 1

Tariff 1 includes the categories of depreciation, tax, and return on capital:

- Depreciation on historical assets has been apportioned according to historical percentages.
- Tax has been allocated on the basis of the percentage of Maui revenue in the last complete fiscal year.
- Return on capital has been apportioned according to asset value percentage as a proportion of total RAB.

Table 3: Components of Tariff 1

Tariff 1	\$ in 000s	
	low estimate	high estimate
Depreciation	\$14,801	\$16,043
Tax	\$4,654	\$4,654
Return on Capital	\$10,778	\$10,987
Required revenue	\$30,233	\$31,684
Throughput forecast (TJ.km)	15,206,613	15,206,613
Implied Tariff 1 (\$ / GJ.km)	0.001988	0.002084
Actual Tariff 1 (\$ / GJ.km)	0.002043	

Tariff 2

Tariff 2 recovers operational expenditure and pass-through and recoverable costs. Operational expenditure for the Maui pipeline has been adjusted to exclude the allowance for non-Maui compressor fuel. Additionally, some components of operational expenditure have been allocated using pipeline length as a more appropriate allocator, rather than percentage of RAB.

For pass-through and recoverable costs:

- Actual rates applicable to the Maui pipeline have been used in the table below.
- Balancing gas costs have been allocated based on the average share of cashouts at Maui Welded Points (excluding TP Welded Points) over the past three years.
- Mokau fuel costs have been allocated on the basis of asset value percentage as a proportion of total RAB.
- The revenue cap wash-up, which represents an under-recovery of revenue from GY21, has been allocated according to the percentage of revenue derived from Maui tariffs for that year.

Table 4: Components of Tariff 2

Tariff 2	\$ in 000s	
	low estimate	high estimate
Operational expenditure	\$11,736	\$13,675
Pass-through and recoverable costs	\$2,428	\$2,449
Total operational expenditure	\$14,163	\$16,124
Throughput forecast (TJ)	152,027	152,027
Implied Tariff 2 (\$ / GJ)	0.093164	0.106060
Actual Tariff 2 (\$ / GJ)	0.093284	

We forecast that we will derive approximately 29% of our total revenue requirement from MPOC tariffs in GY2023.

As Firstgas has previously indicated, we will be reviewing our pricing methodology, including any implications of Schedule 10 of the MPOC, later this year, to inform our future approach to transmission pricing. We expect the review to allow us to view transmission pricing from a holistic perspective, identifying improvements to our pricing methodology that we can implement in the near term, as well as providing a sound basis for adapting to future changes in the use of gas transmission services. We look forward to engaging with Shippers and other stakeholders as this work programme unfolds.

Kind regards



Pamela Caird
Transmission Commercial Manager

APPENDIX 1: SPECIFIC QUESTIONS RAISED BY SHIPPERS

Firstgas responses in blue.

1. Breakdown of MPOC tariff setting components for GY2023 and GY2022

GY2023 components are set out above. For GY2022, we expected at the time of tariff setting to recover 27.6% of revenue from MPOC tariffs. For more information, please see the *Ex-ante Price Setting Compliance Statement* published on our website at <https://firstgas.co.nz/about-us/regulatory/transmission/>

2. Information equivalent to Table 1 of the GY2022 Pricing Methodology document with data for GY2023 and GY2022

The 2023 Pricing Methodology will be published in early September 2022, in line with requirements set by the Commerce Commission, at <https://firstgas.co.nz/about-us/regulatory/transmission/>

3. Information equivalent to Table 2 of the GY2022 Pricing Methodology document with data for GY2023 and GY2022, and further broken down by the three revenue categories set out in Table 1

The 2023 Pricing Methodology will be published in early September 2022, in line with requirements set by the Commerce Commission, at <https://firstgas.co.nz/about-us/regulatory/transmission/>

4. Explanation of any adjustments made by Firstgas to arrive at the same rate of increase for both MPOC Tariffs

Applying the same rate of increase for both MPOC tariffs achieves tariffs that meet the requirements of Schedule 10 of the MPOC, so we see no reason to apply different rates of increase.

5. Breakdown of pass-through and recoverable cost components for GY2023 and GY2022

These costs are for the entire transmission system, as reported to the Commerce Commission.

Pass-through and recoverable costs in \$000s	GY 2023	GY 2022
Rates and levies	3,304	3,050
Balancing costs and revenues	2,065	816
Mokau fuel gas	1,602	1,073
Capex wash-up adjustment	-	846
Revenue cap wash-up	2,569	1,962
Total	9,541	7,748

6. Commentary with details on historical costs and pricing trends for each component

Rates and levies are actuals or estimates based on the most recent year.

Balancing costs are estimated from 3-year trends. Balancing costs have increased in recent years, reflecting the tight gas supply.

Mokau fuel gas costs similarly are based on 3-year trends.

There is no capex wash-up adjustment to be made in the first year of the regulatory period.

Revenue cap wash-up amounts reflect over- or under-recovery of Firstgas' allowable revenue from two years prior to the pricing year.

Further information on pricing components can be found in our *Ex-ante Price Setting Compliance Statement*, which will be published in early September on our website at <https://firstgas.co.nz/about-us/regulatory/transmission/>

7. Commentary on measures being taken by Firstgas to apply downward pressure on those costs and increase cost efficiency, including the measures Firstgas is taking to reduce the socialisation of costs where Firstgas can reasonably direct them to the causers of those costs (Balancing Gas and Fuel Gas costs being examples)

Balancing and Mokau fuel gas are transacted as needed, generally on emsTradepoint. For balancing gas, Firstgas notifies the market of its intention to balance, with the objective of increasing the number of available bids and offers as much as possible, and thus obtaining the best possible price. For Mokau fuel gas, Firstgas endeavours to transact at a favourable price, at times with the assistance of gas brokers.

The cash out process under the MPOC and the D+1 pilot agreement assign some of the costs of balancing to causers, but some costs remain with Firstgas. The running of Mokau supports a higher linepack than would otherwise be the case and provides a means by which pipeline imbalances can be managed. This provides an increased level of pipeline security to the benefit of all pipeline users.

8. More information detailing the movement in 'other parameters'

The comment in the provisional pricing memo was describing the net effect of changes in volume projections, reservation and overrun assumptions, and cost projections.

9. More detail on how Firstgas arrived at the 15.62% increase from the implied increase of 12.2%, including more detail on the quantum and make-up of the lost revenue (including capital recovery and operating cost elements)

The final prices represent an increase of 11.5% over GY2022 prices. Please refer to the body of this memo for more information on GY2023 tariff components.

10. More information on decision-making process concerning how the lost revenue was reallocated, with reference to Section 3.7.1 of the GY2022 Pricing Methodology

The pricing process began with estimations of transmission volumes for the coming year and used those estimates as an input into pricing. In this way, the loss of the Refining NZ demand and revenue was effectively spread across the system. This process is analogous to the pricing changes that occurred when Refining NZ increased its demand. Then, the increased volume and revenue similarly affected tariffs across the transmission system.

11. Did FGL consider achieving compliance with clause 2.5.2 of the 'Transmission Services Input Methodologies Determination 2012' (pricing principles) before it set the provisional prices? If not, why not? If not, will it do so for the final prices?

We aim to set prices that are consistent with the pricing principles, where possible, including when releasing provisional prices. The 2023 Pricing Methodology will be published in early September and will assess consistency with the pricing principles.

12. To what extent are the provisional prices, and will the final prices be, consistent with the pricing principles?

The 2023 Pricing Methodology will be published in early September and will assess consistency with the pricing principles.

13. What numeric values are i) the "Optimised Deprival Value or Optimised Depreciated Replacement Cost" (as appropriate), and ii) "the revaluation gains/losses on the asset", that were and will be used in setting the provisional and final prices, with reference to clause (a) of Schedule 10 of the MPOC?

Please see the body of the memo.

14. What is "the useful life of the asset [in years]" that was or will be used in setting the provisional and final prices, with reference to clause (b) of Schedule 10 of the MPOC?

The depreciation used above is a proportion of the depreciation provided in *Gas Transmission Services Default Price-Quality Path Determination for GY2023*.

15. Please would FGL provide any assumptions, context and other information required for an industry participant to understand the answers to questions 13. and 14.?

Please see the body of the memo. For more information about *Gas Transmission Services Default Price-Quality Path Determination*, please refer to the Commerce Commission's website at <https://comcom.govt.nz/regulated-industries/gas-pipelines/gas-pipelines-price-quality-paths/gas-pipelines-default-price-quality-path/2022-2027-gas-default-price-quality-path?target=documents>

16. What published reference justifies historical determination of GJ.km calculations under the MPOC? If there is no reference, please would FGL perform those calculations afresh pursuant to clause (d) of Schedule 10 of the MPOC?

Firstgas has used a forward-looking estimate of GJ.km for GY2023; that is, the figure that we've used is our estimate of GJ.km for GY2023.

17. If natural gas throughput volumes keep reducing, e.g. 50 PJ/pa, would FGL set transmission prices that recovered all revenue and costs that the Commerce Commission permitted it to, notwithstanding that that would result in exponentially increasing transmission prices per GJ?

This question is not relevant to pricing for GY2023 but will be considered in the upcoming transmission pricing review.

18. In its DPP3 presentation on 31 May 2022, the Commerce Commission said that “[it is] making its decision today so GBPs can supply [i.e. transport] [natural] gas as long as there is demand”. Please would FG confirm that it will transport natural gas in all parts of its pipeline as long as there is demand for natural gas in any part of its pipeline?

This question is not relevant to pricing for GY2023.

19. Please would FGL describe what additional natural gas safety and reliability that consumers will receive in the forthcoming gas year (compared to the current gas year), and over the DPP3 period (compared to the DPP2 period)?

Safety and reliability measures are detailed in our [Asset Management Plan](#). The 2022 Asset Management Plan update will be published by 30 September of this year at <https://firstgas.co.nz/about-us/regulatory/transmission/>

20. With an allowance for compressor costs in its memo, please would FGL confirm that it will continue with its prevailing Mokau operations and system pressure settings?

We have no plans to change the operation of Mokau compressor station. However we are always looking for ways to improve system operations, which can affect the operation of our compressor stations. In terms of pricing, Mokau fuel gas is a pass-through, so if we end up spending less than anticipated this year, the excess will be returned to Shippers in a subsequent pricing year.

21. Further to clause 3.7.1 of the ‘Pricing Methodology for Gas Transmission Services From 1 October 2020’ (“2020 pricing methodology”), what is FGL’s policy on requiring revenue from certain areas notwithstanding loss of volume? How did the loss of volume at Refining NZ pan out pricing for surrounding areas?

Please see response to question 10.

22. Further to clause 3.7.2 of the 2020 pricing methodology, FGL said it ‘agree[s] that further work to understand standalone costs and incremental costs of servicing different customers is appropriate’ and ‘it expect[s] that this work will commence after GTAC has been implemented’. With GTAC now scrapped, please would FGL provide an update on the standalone and incremental cost project including timings and particulars?

Please see above regarding our review of the pricing methodology.

23. Please justify FGL's claims of asset-stranding risk given its statement in its Draft Pricing Methodology for Gas Distribution Services that its "gas transmission and distribution networks are ideally placed to support the development, transfer and use of emerging fuels such as hydrogen or biogas. For more information, visit our website: www.gasischanging.co.nz."

This question is not relevant to pricing for GY2023.