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Dear Stakeholders

Notice regarding MPOC tariffs from 1 October 2023

Summary

The following tariffs will be charged from 1 October 2023 to 30 September 2024 (GY2024) for transmission services provided under the Maui Pipeline Operating Code (MPOC):

- Tariff 1: $0.002623 / GJ.km
- Tariff 2: $0.11959 / GJ

These tariffs represent an increase on current Tariff 1 and Tariff 2 of 28.4% and 28.2%, respectively. They are different from the indicative tariffs published in June due to two factors: we have revised our treatment of the wash-up amounts, and we have decreased our projected throughput.

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. It itemises the components of our total forecast allowable revenue as well as pass-through and recoverable costs and describes how much of each component has been allocated to the Maui pipeline system. Forecast GJ.km and GJ throughput are then used to calculate tariffs that satisfy the requirements of Schedule 10 of the MPOC.

Forecast allowable revenue

Firstgas is required to set prices to recover an amount no greater than the Forecast Allowable Revenue (FAR) under the current Default Price-Quality Path Determination (2022 – 2026).[1] The table below identifies the key components of target revenue required to cover the costs and return on investment associated with the Firstgas' provision of gas transmission services across the entire transmission system (both Maui and non-Maui).

Note that the Depreciation and Return on Capital figures in the table below come directly from the Commerce Commission's financial model. Firstgas' actual depreciation and return on capital can vary due to differences between actual and forecast asset revaluations, assets commissioned, and asset disposals. We have chosen to use the values from the Commerce Commission's model as a means of smoothing the effect of price increases.

[1] *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 1: Total forecast allowable revenue

Cost Component in $000s	GY2024
Operational expenditure	57,557
Pass-through and recoverable costs	21,875
Depreciation	56,778
Tax	9,602
Return on Capital	39,518
Total target revenue	**185,330**

Firstgas has forecast the following pass-through and recoverable costs for GY2024. These figures are also for the entire transmission system.

Table 2: Forecast pass-through and recoverable costs

Pass-through and recoverable costs in $000s	GY2024
Rates and levies	3,096
Net balancing costs	2,750
Mokau fuel gas	1,500
Capex wash-up adjustment	1,518
Revenue cap wash-up	13,011
Total	**21,875**

Schedule 10 of MPOC

Schedule 10 sets out the principles for MPOC pricing. It provides for Tariff 1 to recover the cost and return of capital, with reference to Optimised Deprival Value (ODV) or Optimised Depreciated Replacement Cost (ODRC). Tariff 2 is to recover operating expenditures.

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. Firstgas uses a portion of our total RAB in calculating Tariff 1 because that is consistent with the Commerce Commission's approach in setting Firstgas' maximum allowable revenue for the transmission system as a whole. If we were to use ODV or ODRC to calculate Tariff 1, then to the extent that those values were more or less than RAB, the resulting tariff would either over- or under-recover revenue from Maui Shippers, to the benefit or detriment of GTC Shippers. Using RAB avoids the potential for shifting costs between the Maui and non-Maui systems.

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 have estimated Maui pipeline system assets to represent 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 proportion of total RAB that corresponds to Maui pipeline asset values, for the purposes of setting MPOC tariffs.

We have used the resulting percentages ("Maui RAB Share") to apportion allowable revenue categories and elements of the pass-through and recoverable costs to the Maui pipeline.

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Tariff 1

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

- Depreciation has been apportioned according to historical percentages and Maui RAB Share.
- Tax has been allocated based on the percentage of Maui revenue in the last complete fiscal year.
- Return on capital and capex wash-up amounts have been apportioned according to Maui RAB Share.

The calculation of Tariff 1 is shown in Table 4 below.

Tariff 2

Tariff 2 recovers operational expenditure and pass-through and recoverable costs. Operational expenditure includes items such as routine and corrective maintenance, land management, system operations, and network support. Items such as land management and maintenance are allocated based on Maui pipeline length, relative to the entire transmission system; while system operations and network support are apportioned based on Maui RAB Share. Overall, we have allocated about 20-30% of operational costs to MPOC.

For pass-through and recoverable costs:

- Rates and levies have been apportioned based on the proportion of MPOC revenue recovery in GY2022
- Balancing gas costs have been allocated based on the average share of cash-outs at Maui Welded Points (excluding TP Welded Points) over the past three years.
- Mokau fuel costs have been allocated on the basis of Maui RAB Share.

The calculation of Tariff 2 is shown in Table 5 below.

Treatment of revenue wash-up

Firstgas received feedback from Shippers on the indicative MPOC tariffs published in June. Two submissions questioned the logic of applying the total of MPOC's share of the revenue wash-up amount to Tariff 2, noting that doing so would be unfair to some users of the Maui pipeline. Instead, it was suggested that recovery of the wash-up costs should be split between Tariff 1 and Tariff 2.

Firstgas considers that there is merit in this argument. We recognise that uneven price increases can disproportionately affect some Shippers compared to others. Further, Schedule 10 provides that recovery of revenue wash-ups can be done in a manner that endeavours to reduce pricing volatility for Shippers.

Accordingly, to determine the MPOC share of the revenue wash-up we have allocated the components of the wash-up in the same manner as outlined for individual items above:

- Actual versus forecast balancing costs were allocated by the share of non-TPWP cash-outs in GY2022
- Mokau actual versus forecast costs were allocated by Maui RAB Share
- The remainder of the revenue wash-up was allocated by revenue proportion in GY2022

To reduce price volatility, we have allocated MPOC's share of the revenue wash-up evenly to Tariff 1 and Tariff 2.

We have also taken the opportunity to examine other items previously accounted to Tariff 2. For the coming year, we have reclassified the capex wash-up amount as a Tariff 1 item.

Volume forecasts

Updated volume forecasts are shown in the table below. As we have done in previous years, Firstgas employed Aretê Consulting Limited to forecast gas flows for the coming gas year. The forecasting methodology uses a mix of statistical time series forecasts and deterministic methods to project future gas flows. An initial forecast was produced in March, followed by an updated forecast in July that used the most recent data. Predicted TJ and TJ.km values have both been revised downwards, reflecting recent trends. Both values represent a decrease of 14% from forecasts used for GY2023 prices.

Table 3: Maui forecast volumes

	GY2023 forecast	used for Indicative pricing	updated GY2024 forecast
Throughput forecast (TJ.km)	15,206,613	13,159,685	**13,110,285**
Throughput forecast (TJ)	152,027	133,207	**130,998**

Tariff calculations

The derivation of Tariff1 and Tariff 2 are shown in the tables below.

Table 4: Components of Tariff 1

	in $000s	
Tariff 1	**low estimate**	**high estimate**
Depreciation	17,033	18,876
Tax	2,605	2,605
Return on Capital	12,888	13,138
Capex wash-up	495	505
Tariff 1 share of revenue wash-up	1,352	1,352
Required revenue	34,374	36,476
Throughput forecast (TJ.km)	13,110,285	13,110,285
Implied Tariff 1 ($ / GJ.km)	0.002622	0.002782
Actual Tariff 1 ($ / GJ.km)	**0.002623**	

Table 5: Components of Tariff 2

	in $000s	
Tariff 2	**low estimate**	**high estimate**
Operational expenditure	10,116	16,729
Pass-through and recoverable costs	1,528	1,537
Tariff 2 share of revenue wash-up	1,352	1,352
Total operational expenditure	12,996	19,619
Throughput forecast (TJ)	130,998	130,998
Implied Tariff 2 ($ / GJ)	0.099209	0.149763
Actual Tariff 2 ($ / GJ)	**0.11959**	

We forecast that we will derive approximately 27% of our total revenue requirement from MPOC tariffs in GY2024.

As Shippers are aware, Firstgas is reviewing its transmission pricing methodology. One issue that we expect will be addressed as part of the review is whether, and to what extent, Schedule 10 of the MPOC remains fit for purpose, or whether there are other approaches that would be preferable for MPOC pricing. We look forward to engaging with Shippers and other stakeholders on this important work programme.

Kind regards

Pamela Caird
Transmission Commercial Manager