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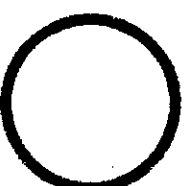
30 June 2009

Network Performance Branch  
Commerce Commission  
PO Box 2351  
Wellington

Attention: Brent Alderton, Acting Director

**POWERCO**

**POWERCO GAS PRICING METHODOLOGY  
MEDIUM TERM PRICING STRATEGY**




Attached to this letter is Powerco's Medium Term Pricing Strategy, as requested by the Commerce Commission in its letter to Powerco on 21 May 2009.

This Pricing Strategy was approved by the Powerco Board of Directors on 30 June 2009 and contains more detail on Powerco's expected price movements for each service class in each remaining year of the control period.

Powerco intends to review these prices based on customer reactions. Powerco will not make any material departure from the prices in the Pricing Strategy without the Commission's approval of an amendment to the Pricing Methodology in accordance with Clause 7.5 of the Gas Authorisation.

Once approved by the Commission, Powerco will publish this information on its website in line with Clause 7.4.5 of the Gas Authorisation.

Yours faithfully

  
Director

Date: 30 June 2009



## MEDIUM TERM PRICING STRATEGY

The Commerce Commission asked Powerco to provide more detail on its expected price movements for each service class in each remaining year of the control period.

a. Explanation of medium-term price strategy

In the medium term, Powerco intends to continue the tariff harmonisation and restructuring exercises that it began in 2009/10 and to continue to increase the proportion of revenue derived from fixed tariffs. As before, Powerco is extremely concerned to ensure that price impacts on individual customers are kept within acceptable bounds. For the years following the initial year of the price methodology, Powerco intends to limit the effect of price increases to less than a 10% increase in total distribution charges. As set out in the pricing methodology report, Powerco believes that the necessary tariff restructuring and harmonisation can be completed in a further five years.

Powerco's provisional prices and the movement in the prices are set out below.

**Powerco Gas Network**  
Proposed Annual Prices and Movements  
Proposed Prices

	2009/10		2009/10		2010/11		2010/11		2011/12		2011/12	
	Fixed/Day	Variable/GJ	Fixed/Day	Variable/GJ	Fixed/Day	Variable/GJ	Fixed/Day	Variable/GJ	Fixed/Day	Variable/GJ	Fixed/Day	Variable/GJ
Hawke's Bay	2G06	\$ -	\$ 14,4270	\$ -	\$ 0,4900	\$ 14,6208	\$ -	\$ 0,4925	\$ -	\$ 14,8162	\$ -	\$ 4,2058
	2G11	\$ 0,4850	\$ 3,6900	\$ 0,4900	\$ 4,0475	\$ 0,4925	\$ 4,0475	\$ 0,4925	\$ 4,2058	\$ 0,4925	\$ 4,2058	\$ 4,2058
	2G12	\$ 0,7094	\$ 3,6500	\$ 0,7803	\$ 3,6566	\$ 0,8584	\$ 3,7306	\$ 0,8584	\$ 3,7306	\$ 0,8584	\$ 3,7306	\$ 3,7306
	2G14	\$ 2,2168	\$ 2,9440	\$ 2,3942	\$ 2,5784	\$ 2,5657	\$ 2,8362	\$ 2,5657	\$ 2,8362	\$ 2,5657	\$ 2,8362	\$ 2,8362
	2G16	\$ 2,4828	\$ 2,3022	\$ 2,7311	\$ 2,5324	\$ 3,0042	\$ 2,7857	\$ 3,0042	\$ 2,7857	\$ 3,0042	\$ 2,7857	\$ 2,7857
	2G18	\$ 4,4337	\$ 2,2311	\$ 4,8770	\$ 2,4542	\$ 5,3647	\$ 2,6396	\$ 5,3647	\$ 2,6396	\$ 5,3647	\$ 2,6396	\$ 2,6396
Manawatu & Horowhenua	3G06	\$ -	\$ 15,2940	\$ -	\$ 0,4900	\$ 15,2940	\$ -	\$ 0,4925	\$ -	\$ 15,2940	\$ -	\$ 4,5394
	3G11	\$ 0,4850	\$ 4,5394	\$ 0,4900	\$ 4,5394	\$ 0,4925	\$ 4,5394	\$ 0,4925	\$ 4,5394	\$ 0,4925	\$ 4,5394	\$ 4,5394
	3G12	\$ 1,0480	\$ 3,8049	\$ 1,0480	\$ 3,8049	\$ 1,0480	\$ 3,8049	\$ 1,0480	\$ 3,8049	\$ 1,0480	\$ 3,8049	\$ 3,8049
	3G14	\$ 3,1922	\$ 3,6332	\$ 3,1922	\$ 3,6332	\$ 3,1922	\$ 3,6332	\$ 3,1922	\$ 3,6332	\$ 3,1922	\$ 3,6332	\$ 3,6332
	3G16	\$ 4,1677	\$ 3,5998	\$ 4,1677	\$ 3,5998	\$ 4,1677	\$ 3,5998	\$ 4,1677	\$ 3,5998	\$ 4,1677	\$ 3,5998	\$ 3,5998
	3G18	\$ 8,6573	\$ 3,1812	\$ 8,4240	\$ 3,1812	\$ 8,0028	\$ 3,1812	\$ 8,0028	\$ 3,1812	\$ 8,0028	\$ 3,1812	\$ 3,1812
Wellington	4G06	\$ -	\$ 16,4140	\$ -	\$ 0,4900	\$ 16,4140	\$ -	\$ 0,4925	\$ -	\$ 16,4140	\$ -	\$ 5,3061
	4G11	\$ 0,4850	\$ 5,3061	\$ 0,4900	\$ 5,3061	\$ 0,4925	\$ 5,3061	\$ 0,4925	\$ 5,3061	\$ 0,4925	\$ 5,3061	\$ 5,3061
	4G12	\$ 0,7689	\$ 5,7752	\$ 0,7689	\$ 5,7752	\$ 0,7689	\$ 5,7752	\$ 0,7689	\$ 5,7752	\$ 0,7689	\$ 5,7752	\$ 5,7752
	4G14	\$ 6,1207	\$ 5,5533	\$ 6,1207	\$ 5,5533	\$ 6,1207	\$ 5,5533	\$ 6,1207	\$ 5,5533	\$ 6,1207	\$ 5,5533	\$ 5,5533
	4G16	\$ 7,5189	\$ 5,4235	\$ 7,7500	\$ 5,4235	\$ 7,9806	\$ 5,1814	\$ 7,9806	\$ 5,1814	\$ 7,9806	\$ 5,1814	\$ 5,1814
	4G18	\$ 8,5700	\$ 5,2398	\$ 9,4270	\$ 5,2398	\$ 10,3637	\$ 5,0040	\$ 10,3637	\$ 5,0040	\$ 10,3637	\$ 5,0040	\$ 5,0040
Hutt Valley & Porirua	5G06	\$ -	\$ 14,6140	\$ -	\$ 0,4900	\$ 15,0524	\$ -	\$ 0,4925	\$ -	\$ 15,5040	\$ -	\$ 5,0550
	5G11	\$ 0,4850	\$ 4,2949	\$ 0,4900	\$ 4,6814	\$ 0,4925	\$ 4,6814	\$ 0,4925	\$ 4,6814	\$ 0,4925	\$ 4,6814	\$ 4,6814
	5G12	\$ 0,5260	\$ 4,1273	\$ 0,5733	\$ 4,4575	\$ 0,6249	\$ 4,6747	\$ 0,6249	\$ 4,6747	\$ 0,6249	\$ 4,6747	\$ 4,6747
	5G14	\$ 3,3636	\$ 3,9346	\$ 3,7066	\$ 4,2887	\$ 4,0773	\$ 4,6747	\$ 4,0773	\$ 4,6747	\$ 4,0773	\$ 4,6747	\$ 4,6747
	5G16	\$ 7,9806	\$ 3,1024	\$ 7,9806	\$ 3,4126	\$ 7,9806	\$ 3,7533	\$ 7,9806	\$ 3,7533	\$ 7,9806	\$ 3,7533	\$ 3,7533
	5G18	\$ 12,4143	\$ 3,0556	\$ 12,4143	\$ 3,3306	\$ 12,4143	\$ 3,6304	\$ 12,4143	\$ 3,6304	\$ 12,4143	\$ 3,6304	\$ 3,6304
Taranaki	6G06	\$ -	\$ 13,1008	\$ -	\$ 0,4900	\$ 13,6240	\$ -	\$ 0,4925	\$ -	\$ 14,1690	\$ -	\$ 3,1497
	6G11	\$ 0,4850	\$ 2,4667	\$ 0,4900	\$ 2,7874	\$ 0,4925	\$ 3,1497	\$ 0,4925	\$ 3,1497	\$ 0,4925	\$ 3,1497	\$ 3,1497
	6G12	\$ 4,7159	\$ 1,6132	\$ 3,3011	\$ 2,0078	\$ 2,3107	\$ 2,4897	\$ 2,3107	\$ 2,4897	\$ 2,3107	\$ 2,4897	\$ 2,4897
	6G14	\$ 6,7792	\$ 0,7343	\$ 5,6267	\$ 0,5186	\$ 4,6702	\$ 1,1483	\$ 4,6702	\$ 1,1483	\$ 4,6702	\$ 1,1483	\$ 1,1483
	6G16	\$ 13,0392	\$ 0,7110	\$ 9,7344	\$ 0,8888	\$ 7,3458	\$ 1,1105	\$ 7,3458	\$ 1,1105	\$ 7,3458	\$ 1,1105	\$ 1,1105
	6G18	\$ 16,3384	\$ 0,6300	\$ 13,3975	\$ 0,8625	\$ 10,3853	\$ 1,0781	\$ 10,3853	\$ 1,0781	\$ 10,3853	\$ 1,0781	\$ 1,0781
Hawke's Bay	2G06	0.0%	-0.4%	0.0%	1.3%	0.0%	1.3%	0.0%	1.3%	0.0%	1.3%	0.0%
	2G11	9.5%	10.0%	1.0%	3.9%	0.5%	10.0%	0.5%	10.0%	0.5%	10.0%	3.9%
	2G12	10.0%	-9.2%	10.0%	1.0%	10.0%	1.0%	10.0%	1.0%	10.0%	1.0%	1.0%
	2G14	10.0%	3.9%	8.0%	10.0%	8.0%	10.0%	8.0%	10.0%	8.0%	10.0%	10.0%
	2G16	10.0%	3.9%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
	2G18	10.0%	3.8%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Manawatu & Horowhenua	3G06	0.0%	-0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3G11	9.5%	3.9%	1.0%	0.0%	0.5%	0.0%	0.5%	0.0%	0.5%	0.0%	0.0%
	3G12	0.0%	18.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3G14	10.0%	-6.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3G16	10.0%	3.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3G18	10.0%	3.8%	-5.0%	0.0%	-5.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Wellington	4G06	0.0%	-0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	4G11	9.5%	0.0%	1.0%	0.0%	0.5%	0.0%	0.5%	0.0%	0.5%	0.0%	0.0%
	4G12	10.0%	-38.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	4G14	10.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	4G16	10.0%	0.0%	3.1%	0.0%	5.0%	0.0%	5.0%	0.0%	5.0%	0.0%	0.0%
	4G18	10.0%	0.0%	10.0%	0.0%	10.0%	0.0%	10.0%	0.0%	10.0%	0.0%	-4.5%
Hutt Valley & Porirua	5G06	0.0%	-0.2%	0.0%	3.0%	0.0%	3.0%	0.0%	3.0%	0.0%	3.0%	0.0%
	5G11	9.5%	10.0%	1.0%	9.0%	0.5%	8.0%	0.5%	8.0%	0.5%	8.0%	8.0%
	5G12	45.0%	-36.0%	9.0%	8.0%	9.0%	8.0%	9.0%	8.0%	9.0%	8.0%	8.0%
	5G14	10.0%	3.8%	10.0%	9.0%	10.0%	9.0%	10.0%	9.0%	10.0%	9.0%	9.0%
	5G16	10.0%	3.8%	0.0%	10.0%	0.0%	10.0%	0.0%	10.0%	0.0%	10.0%	10.0%
	5G18	10.0%	3.9%	0.0%	9.0%	0.0%	9.0%	0.0%	9.0%	0.0%	9.0%	9.0%
Taranaki	6G06	0.0%	0.0%	0.0%	4.0%	0.0%	4.0%	0.0%	4.0%	0.0%	4.0%	0.0%
	6G11	9.5%	0.0%	1.0%	13.0%	0.5%	13.0%	0.5%	13.0%	0.5%	13.0%	13.0%
	6G12	-10.0%	35.0%	-30.0%	24.0%	-30.0%	24.0%	-30.0%	24.0%	-30.0%	24.0%	24.0%
	6G14	-10.0%	36.0%	-17.0%	25.0%	-17.0%	25.0%	-17.0%	25.0%	-17.0%	25.0%	25.0%
	6G16	-10.0%	47.0%	-25.0%	25.0%	-25.0%	25.0%	-25.0%	25.0%	-25.0%	25.0%	25.0%
	6G18	-10.0%	0.7%	-18.0%	25.0%	-18.0%	25.0%	-18.0%	25.0%	-18.0%	25.0%	25.0%

**Proposed Percentage Price Movements**

A description of the price movements follows.

#### *Regional Tariff Harmonisation*

Prices for 2010/11 and 2011/12 are constructed so that prices for Hawke's Bay, Manawatu/Horowhenua, and Taranaki (residential) will converge by October 2014. In all cases, tariff movements have been limited by the constraint of limiting individual price changes to less than 10%<sup>1</sup>.

Tariffs for Manawatu/Horowhenua have largely been kept constant, and prices in Hawke's Bay and residential Taranaki increased. The exception is the G18 fixed tariff in Manawatu/Horowhenua, which is decreasing in order to harmonise with the other regions.

#### *Urban Tariff Harmonisation*

Prices for 2010/11 and 2011/12 are constructed so that prices for Hutt Valley/Porirua and Wellington will converge in five years. Wellington prices are mostly kept constant, while prices for the Hutt Valley/Porirua are increased gradually. There are exceptions to this pattern in the Wellington large commercial and industrial tariffs: the fixed tariffs for G16 and G18 in Wellington are to increase gradually, while the equivalent tariffs in Hutt Valley are kept constant. Also, the fixed G14 and the variable G16 and G18 tariffs in Wellington decrease in 2011/12 as part of the harmonisation exercise. The magnitude of price changes has been limited by the intention of keeping distribution price increases to individual customers to under 10% per year.

#### *Taranaki Restructuring*

The Taranaki G12 to G18 tariffs will continue to be restructured in the medium term. Tariffs for these groups will continue to be modified in a similar manner to the changes proposed for 2009/10: decreasing fixed tariffs and increasing variable tariffs. As with the urban and regional tariff harmonisation exercises, the magnitude of tariff movements is limited by the intention of keeping distribution

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<sup>1</sup> The term 'price' refers to the annual average charge from both the fixed and variable components.

price increases to individual customers to under 10% per year. Most of the restructuring will be able to be accomplished by October 2014, however the variable G14, G16, and G18 tariffs will need an additional one to two years before they align with the rest of the regional tariffs, so as to avoid rate shocks.

#### *Fixed Revenue*

As discussed in Powerco's pricing methodology report, Powerco intends to move over time to a more even split between revenue from fixed tariffs and revenue from variable tariffs.

In the medium term, Powerco's tariff harmonisation and restructuring exercises take precedence over revenue variability concerns, as tariff harmonisation will simplify tariffs and make them easier to understand. These price movements leave little room under the allowable revenue limit for further price adjustments. However, Powerco is concerned to ensure that some progress is made on this objective; for this reason, fixed tariffs for the G11 residential group will increase by 1% in 2010/11 and by 0.5% in 2011/12.

#### *b. Medium Term Price Strategy – Framework for Periodic Review*

The medium-term price strategy reflects Powerco's current intentions. Actual price changes will depend on the results of and customer reactions to previous price changes. Powerco cannot commit to a course of action that would lead to a significant number of disconnections.

There are three avenues through which Powerco intends to gather information on customer reactions:

- Customer response: particularly in terms of connection and disconnection rates;
- Consultation with retailers: to determine their views on gas retail tariffs and changes likely in the retail tariffs experienced by end-use consumers; and
- Consultation with customers: through interactions with customers and survey responses, determine customers' views on gas tariffs and the value for money they represent.

Each year, Powerco intends to collect this customer information as an important input into determining final prices for the following pricing year.

Variations in inputs to the quantitative cost of supply model (for example rates, levies and inflation) may result in actual prices that vary from those proposed by the medium-term price strategy. These variations are allowed without a consequent alteration to the pricing methodology and approval by the Commerce Commission<sup>2</sup>. At present, Powerco does not believe that variations in these inputs is likely to require an alteration to the medium-term price strategy but we will review inputs on an annual basis and if necessary seek an amendment to our Pricing Methodology.

In terms of service classifications and cost allocations, Powerco does not expect any changes in the remainder of the control period.

Where Powerco determines that the proposed medium-term price strategy cannot be implemented and that the creation of a new standard service or changes to the structure of the quantitative cost of supply model are required we will seek approval from the Commerce Commission in accordance with clause 7.5 of the Commerce Act (Powerco Natural Gas Services) Authorisation 2008.

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<sup>2</sup> Clause 7.5.3 Commerce Act (Powerco Natural Gas Services) Authorisation 2008.