

In the High Court of New Zealand
Wellington Registry
I Te Kōti Matua o Aotearoa
Te Whanganui-ā-Tara Rohe

CIV-

under: section 91 of the Commerce Act 1986

in the matter of: an appeal against the Gas Transmission
Services Default Price-Quality Path
Determination 2022 and the Gas Distribution
Services Default Price-Quality Path
Determination 2022

between: **MAJOR GAS USERS' GROUP**, an
unincorporated association of gas consumers
and acquirers having its address for service at
Level 5, 90 The Terrace, Wellington

APPELLANT

and: **COMMERCE COMMISSION**,
a Crown entity established under the
Commerce Act 1986, of Wellington

RESPONDENT

NOTICE OF APPEAL

Date: 29 June 2022

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TO: the Registrar of the High Court at Wellington
AND TO: the Commerce Commission

NOTICE OF APPEAL

1. The appellants give notice that they are appealing against determinations made to apply adjustments in the Gas Transmission Services Default Price-Quality Path Determination 2022; [2022] NZCC 20 (“**GTS DPP3**”) and the Gas Distribution Services Default Price-Quality Path Determination 2022; [2022] NZCC 19 (“**GDS DPP3**”)(together “**the DPP3 Determinations**”) insofar as those adjustments were determined by and are to implement the purposes of parts of Subpart 2 of Part 4 of the IM Determination (as defined in the DPP3 Determinations), as identified more particularly in clause 2 of this Notice, of the Gas Distribution Services Input Methodologies Amendment Determination (No. 2) 2022; [2022] NZCC [15] and the Gas Transmission Services Input Methodologies Amendment Determination (No. 2) 2022; [2022] NZCC [16] (“**the Amendments**” and each is an “**Amendment**”).
2. The parts of the Amendments pertinent to clause 1 of this Notice are those that respectively amended clause 4.2.2 of each Amendment by introducing:
 - a) cl 4.2.2(4), which allows the Commerce Commission (“**Commission**”) to apply an adjustment factor in respect of a Default Price Path regulatory period for the purpose of determining the remaining asset life for existing assets and the remaining asset life for additional assets, provided the Commission is satisfied that applying an adjustment factor would better reflect economic asset lives and doing so would better promote the purpose of Part 4 of the Act;
 - b) cl 4.2.2(3)(a)(ii) and cl 4.2.2(3)(b)(ii) which provide definition alternatives to give effect to cl 4.2.2(4) for “existing assets” and “additional assets” in cl 4.2.2(2) to determine allowable depreciation by a gas distribution business (“**GDB**”) and a gas transmission business (“**GTB**”) under cl 4.2.2(1). In this Notice GDBs and the GTB are referred to generically and each is encompassed with the term Gas Pipeline Business (“**GPB**”); and
 - c) other clauses or parts consequential on or intended to apply or to give effect to cl 4.2.2(4), such as clause 2.2.8(5), Schedules 1, 2 and 3 in the GDS DPP3 and Schedules 1, 2 and 4 in the GTS DPP3 and terms with such effects defined in cl 1.1.4(2) including “remaining asset life”, “forecast depreciation for existing assets” and “transitional adjusted asset life for existing assets”.

GROUNDINGS OF APPEAL

Background

3. By virtue of s 55B of the Commerce Act 1986 (“Act”), gas pipeline services are regulated under Part 4 of the Act (which provides for regulation of price and quality of goods or services in markets where there is little or no competition).
4. By virtue of ss 55(1), 55C and 55D of the Act, gas pipeline services are subject to information disclosure regulation and default/customised price-quality regulation.
5. Sections 53L(1)(a) and 53M(1)(c), (4) and (5) of the Act require default price-quality paths (“DPPs”) to be set for a regulatory period and, pursuant to s 53P, the Commission must before the end of a regulatory period amend DPPs to reset starting prices, rates of change and quality standards that apply for the following regulatory period.
6. On 28 February 2013 the Commission promulgated Gas Distribution Services Default Price-Quality Path Determination, known as **GDB DPP1**, to apply for a regulatory period running from 1 July 2013 to 30 September 2017. On the same date the Commission promulgated Gas Transmission Services Default Price-Quality Path Determination 2013 (consolidated and issued in a Determination on 27 March 2014) and known as **GTB DPP1**, to apply for the same regulatory period. In 2016 the two DPP1s were reviewed and amended. The replacement DPP2s set a regulatory period to run from 1 October 2017 until 30 September 2022.
7. On 31 May 2022 the Commission published the DPP3 Determinations, to apply during a next regulatory period of four years commencing on 1 October 2022. The DPP3 Determinations followed a public submission process initiated by the Commission on 20 April 2021.
8. The DPP3 Determinations include adjustments to enable GPBs to recover by way of accelerated depreciation amounts they might fail to recover on their cost of assets (i.e. if reductions or termination of demand for the services using those assets occurs earlier than the 45 year average deemed physical service life of the assets on which the depreciation allowances had hitherto been based). That premature loss of economic ‘life’ is referred to in Commission publications as “stranding”, and the assets which suffer it are referred to as “stranded”.
9. DPP3 Determinations implement the Commission’s intentions which culminated in the input methodology determinations (the Amendments) published on 30 May 2022.
10. As a result, over the four years of the DPP3 regulatory period commencing 1 October 2022, based on the Commission’s financial modelling outputs for mitigated and non-mitigated economic stranding risk, the overall additional cost

for consumers of accelerated depreciation is \$156 million. This is expected to increase the aggregate cost for GPB services for the Appellant group by around \$19 million in that regulatory period. Based on the Commission's consumer price bill model, residential households as a consumer group will pay around \$48 million over that four years to October 2026.

11. In determining that such adjustments were appropriate, the Commission acted on the basis that:
 - a) in approaching regulation under Part 4 of the Act the principle of ex ante financial capital maintenance (“FCM”) is necessary to ensure that GPBs receive a normal rate of return on investments and provide the incentive to make investments in gas pipeline services for the long-term benefit of consumers;
 - b) various pronouncements by the current government as to a goal of New Zealand being carbon-zero by 2050 and by the Climate Change Commission and MBIE recommending that energy policies be decided and implemented by government to encourage earlier transition to that goal, create considerable uncertainty over possible future demand for gas pipeline services from the GPBs;
 - c) there is a risk of a significant decline in demand and government phase-out of natural gas, raising a possibility that continuing with the past approach to standard asset lives (used to set depreciation allowances) would result in stranded asset losses for the GPBs when the revenue from the regulated gas pipeline business assets ceased, or ceased to be sufficient to complete recovery of the cost of those assets before an end of their regulatory deemed physical lives beyond 2050;
 - d) apprehension of loss from stranding would be inconsistent with the promise of FCM and is likely to compromise incentives for continuing investment by suppliers even if there continues to be a demand for natural gas by consumers, and may undermine continuity of safe and reliable gas supply, because an expectation of not recouping the costs of existing investments will affect suppliers' willingness to make continuing investments; and
 - e) while under-recoveries of cost of capital were considered to be unlikely through DDP3 and DPP4 (at least 8 years), the expectation that under-recoveries may eventuate in the future signals an economic stranding event. That threatens current investment incentives: “in terms of preserving incentives to invest and ex ante expectation of FCM, it is the material risk of economic network stranding that matters, not that the event has occurred or its occurrence is knowable” (Default price-quality paths for gas pipeline businesses from 1 October 2022, Final Reasons

Paper, published 31 May 2022 – “DPP3 Final Reasons Paper”, para 6.12 and Attachment C at C45); and

- f) increasing costs to consumers now reduces the revenue that will need to be recovered from consumers in future regulatory periods.

Errors of law

- 12. In making the DPP3 Determinations, the Commission erred in law.

First error of law

- 13. Under s 52P((3)(d), determinations (including the DPP3 Determinations) must be consistent with Part 4.
- 14. The Commission’s decision to make the adjustments was premature and on the basis of no (or no sufficient) evidence, and it was inconsistent with or misapplied or misconstrued the prevailing purpose of s52A of the Act:
 - a) the government has not determined a clear energy policy regarding the impact of climate change policy on gas pipeline assets nor yet developed a transition plan and it is not the Commission’s role to speculate on such a policy or act as if such a policy has been made. The only present certainty is uncertainty - in the words of Commission Reasons Papers at various places, there is “significant uncertainty”, “considerable uncertainty over possible future scenarios”, “no definitive data”, and it is “affected by policy intervention by current and future governments”;
 - b) it is too soon to have any sufficient confidence that gas pipeline assets will lose their economic lives at all or to what extent: it is unknown “if networks [will] wind down as a result of government policies to phase out fossil fuels” (C63.1, DPP3 Final Reasons Paper);
 - c) there is evidence that natural gas may be used for longer and in greater amounts than the Commission expects, or alternative uses may emerge for pipeline assets: it is “credible that networks may have some residual economic value of (as yet) unknown quantum in conveying alternative gases” as that “networks or parts of networks are decommissioned with limited or no residual economic value” (C43, DPP3 Final Reasons Paper);
 - d) the DPP3 Determinations anticipate and give excess weight to necessarily speculative potential results of current and future government and government agency decision-making;
 - e) the reasoning which led to the DPP3 Determinations has unnecessarily excluded some pertinent possibilities from working out the best response to decarbonisation and the apprehension of stranding risk. Suppliers and consumers will include in their calculations:

- i) the likelihood of changes in government priorities;
 - ii) the possible effects of a change in government; and
 - iii) the ease of amendment of s 55A so that regulation of gas pipelines can encompass the conveyance of gases other than natural gas, which enable the Commission (on its approach to the implications of the current definitions) to take into account more possibilities for avoiding the stranding of assets;
- f) the risk or likelihood of promoting outcomes that do not deliver long term benefit for consumers is high when there is serious uncertainty about the existence of consumers in the long term. The DPP3 Determinations are the result of speculation about a need for continuing investment to benefit future consumers but implement a mechanism intended to compensate suppliers for losses anticipated on current sunk costs. The DPP3 Determinations are premature without careful linkage and confining of the mechanism to future investment needed to benefit any long term consumers in the market for natural gas; and
- g) the effect is to reward suppliers (by allowing them to recover the full economic life of existing assets over a shorter period of time, as well as any additional assets in the future) at the expense of consumers, in circumstances where “there is significant uncertainty about the speed and extent of the decline [of gas consumption]” and “[t]here is no definitive data available on likely future demand” and “[m]uch of the uncertainty is due to that fact that pipeline usage will be affected by policy intervention by current and future governments in response to climate change, which will develop over time” and “[i]ndustry prospects will also be governed by factors such as the viability (or otherwise) of alternative energy sources for consumers, whether pipelines can be repurposed to carry alternative gases, economic interdependencies with services in sectors such as electricity, and consumer preference” (DPP3 Final Reasons Paper, C22).

Second error of law

15. The Determinations overlay the principle of FCM on the application of Part 4 input methodologies with the result that they do not promote outcomes consistent with outcomes produced in competitive market, for the long-term benefit of gas consumers, and in doing so the Commission erred in law by misinterpreting/misapplying s52A of the Act:
- a) the consequent outcomes become perverse if the assumption is unreliable that the regulated services would continue to be demanded and supplied into the long-term future. No further incentive is needed or useful for investments already made. The incentives that arguably are

compromised if there is not an FCM expectation are in respect of continuing investments to provide and maintain services of a kind and quality that might be demanded in the future;

- b) the Commission's justification for allowing compensation in advance for anticipated stranding loss on both existing assets (effectively an ex post assurance) as well as additional assets is that it maintains the credibility of FCM with suppliers and their investors. That is not a sufficient reason to permit conflict with the terms of s 52A;
- c) if gas pipeline services will terminate on or before 2050, the standard justification for assuring ex ante FCM is no longer valid, and nor is reinforcement of it. Consumers of gas pipeline services will, on this assumption upon which the Determinations are based, receive little or no benefit from long-term investments after termination, yet the adjustments made by the Commission will continue to incentivise long-term investments and have consumers paying for them (but not receiving their full benefit) and paying a high price to preserve the Commission's credibility with suppliers (while obtaining little or no benefit);
- d) there are adequate incentives and penalties to provide and support an on-going safe and reliable gas supply under price-quality pathway standards, the Gas Act and health and safety regulation;
- e) the Commission has not properly acknowledged the market risk premium and asset beta in regulatory WACC for the regulated periods of investment in historic RAB should already fully or partially reflect perceived risks of demand reduction (including stranding from technological, regulatory or other change);
- f) the adjustments are not consistent with outcomes produced in competitive markets in terms of s52A of the Act, including that:
 - i) in competitive markets suppliers must generally bear their stranding losses arising from a reduction in demand and cannot oblige their customers to bear them (a reduction in demand leads to lower prices in a competitive market, not higher ones);
 - ii) as assets become recognised as being at risk of stranding, or stranded, in workably competitive markets the outcome is that they are 'implicitly marked to market', reflecting the reduction in expected future cash flows from their reduced useful life. For assets held in companies with traded equity it will be seen in share prices. The Amendments enable the generation and preservation of cash flows on assets to negate that outcome produced in competitive markets;

- iii) prices elevated by accelerated depreciation allowances are not likely to be properly cost-reflective for both current and future consumers. Costs incurred to serve current consumers should be attributed and billed to them. In competitive markets costs incurred on assets which become stranded are not transferred to consumers. There appears to be little 'cost-reflection' for current consumers if they are now to bear costs intended to benefit assumed consumers in the future; and
- iv) the reasoning as to expectation of stranding is based on a range of future use scenarios that are narrower than would be applied in a competitive market:
- v) it is as equally "credible that networks may have some residual economic value of (as yet) unknown quantum in conveying alternative gases" as that "networks or parts of networks are decommissioned with limited or no residual economic value" (C43, DPP3 Final Reasons Paper).
- vi) Lower prices would normally be the result in competitive markets of perceived threats of stranding of existing assets, whereas higher prices to consumers now are likely to incentivise premature reductions in demand, disconnections and reduced new consumer connections, contrary to behaviour and responses in a competitive market. Such consumer decisions may be inefficient both economically, and in terms of energy efficiency and even in achieving timely least cost de-carbonisation.
- vii) Premature disincentives on consumer decisions to use gas, and investment in gas using equipment may bring forward stranding. In competitive markets that risk would weigh against a supplier pricing with such an effect (by higher prices), but by virtue of the DPP3 Determinations, and the Commission statements about its intentions on exercise of the powers it gave itself in the Amendments, suppliers can be indifferent to that risk as they can reasonably expect to be permitted to recover from the remaining consumers from time to time the costs of any premature end of economic life.

16. The adjustments in the DPP3 Determinations reflect a policy decision which is beyond the Commission's power to make and which is for Parliament to determine.
17. By enabling suppliers to recover the full cost of investment in potentially stranded assets (both existing and any additional) in the circumstances, the adjustments:

- a) have given primacy to ex ante FCM; and
- b) seek to achieve certainty over an uncertain future;

above the purposes of s52A and at the expense of consumers because the adjustments imposes costs on them unnecessarily, and any stranded asset compensation should be confined solely to achieving the relevant purposes of s52A.

Relief Sought

The appellant seeks the following relief:

- a) An order pursuant to s93 of the Act reversing those parts of the DPP3 Determinations constituting the adjustments as referred to in clause 1 of this Notice.
- b) Costs.

Date: 29 June 2022



Stephen Franks
Solicitor for the Appellant