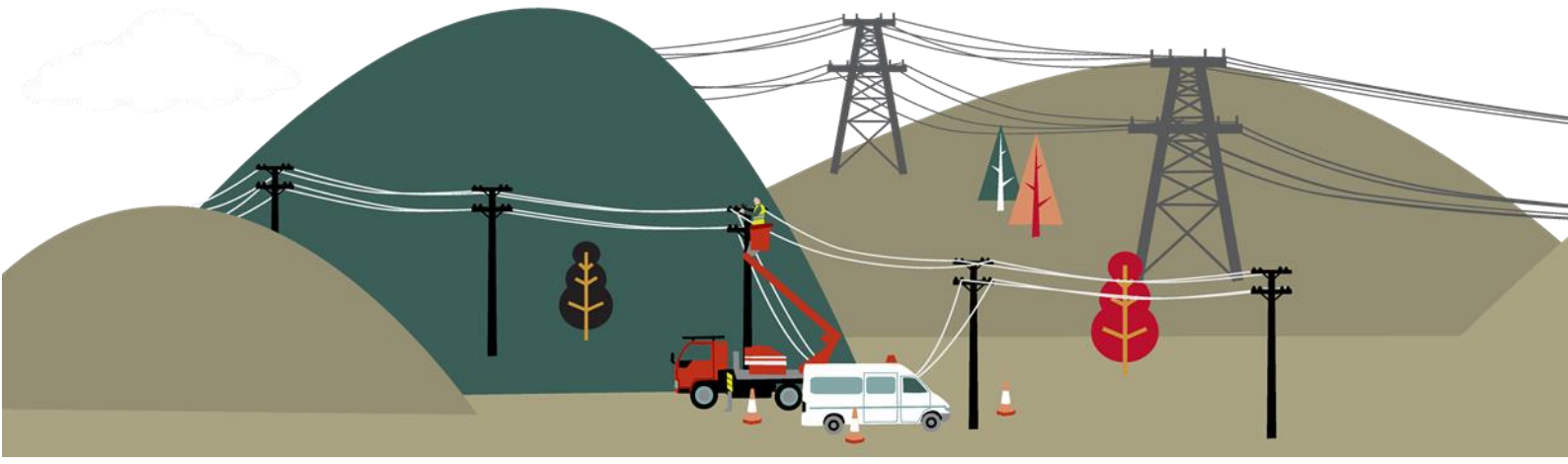
ISBN 978-1-99-101205-0
Project no. 15.01/45340

PUBLIC version

Amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths

Reasons Paper

Date of publication: 30 May 2022



Associated documents

Publication date	Reference	Title
4 August 2021	ISBN 978-1-869459-15-4	Resetting default price-quality paths for gas pipeline businesses from 1 October 2022 - process and issues paper
10 February 2022	ISBN 978-1-869459-78-9	Default price-quality paths for gas pipeline businesses from 1 October 2022 – Draft reasons paper (10 February 2022)
10 February 2022	ISBN 978-1-869459-79-6	Proposed amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths
10 February 2022	ISBN 978-1-869459-74-1	[DRAFT] Gas Distribution Services Default Price-Quality Path Determination 2022 – 10 February 2022
10 February 2022	ISBN 978-1-869459-75-8	[DRAFT] Gas Transmission Services Default Price-Quality Path Determination 2022 – 10 February 2022
10 February 2022	ISBN 978-1-869459-84-0	[DRAFT] Gas Distribution Services Input Methodologies Amendment Determination 2022 – 10 February 2022
10 February 2022	ISBN 978-1-869459-85-7	[DRAFT] Gas Transmission Services Input Methodologies Amendment Determination 2022 – 10 February 2022
10 February 2022	ISBN 978-1-869459-82-6	[DRAFT] Gas Distribution Information Disclosure Amendment Determination 2022 – 10 February 2022
25 March 2022	ISBN 978-1-869459-93-2	Amendments to input methodologies for gas pipeline businesse related to the 2022 default price-quality paths – weighted average cost of capital – 25 March 2022
30 May 2022	ISSN 1178-2560	Gas Distribution Services Input Methodologies Amendment Determination (No. 2) 2022 – 30 May 2022
30 May 2022	ISSN 1178-2560	Gas Transmission Services Input Methodologies Amendment Determination (No,2) 2022 – 30 May 2022
30 May 2022	ISSN 1178-2560	Gas Distribution Information Disclosure Amendment Determination 2022 – 30 May 2022
30 May 2022	ISSN 1178-2560	Gas Transmission Information Disclosure Amendment Determination 2022 – 30 May 2022
31 May 2022	ISBN 978 1 99 101206 7	Resetting default price-quality paths for gas pipeline businesses from 1 October 2022. Final. Reasons paper
31 May 2022	ISSN 1178-2560	Gas Transmission Services Default Price-Quality Path Determination 2022 – 31 May 2022
31 May 2022	ISSN 1178-2560	Gas Transmission Services Default Price-Quality Path Determination 2022 – 31 May 2022

Commerce Commission
Wellington, NEW ZEALAND

Contents

Glossary

Acronym	Definition
Additional assets	assets forecast to be commissioned during the DPP period
DPP	Default price-quality path
DPP3	Default price-quality path for the third regulatory period (1 October 2022 – 30 September 2026)
DPP4	Default price-quality path for the fourth regulatory period (1 October 2026 – 30 September 2031)
capex	Capital Expenditure
CPP	Customised Price-quality Path
EDB	Electricity Distribution Business
EDB DPP3	Default price-quality path for the third regulatory period (1 April 2020 – 31 March 2024) for Electricity Distribution
ERP	Emissions Reduction Plan
FCM	Financial Capital Maintenance
First Gas	First Gas Limited, parent entity which covers both their transmission and distribution businesses
First Gas Distribution	The distribution business of First Gas Limited
First Gas Transmission	The transmission business of First Gas Limited
Gas IMs	Input Methodologies for gas pipeline services
GAAP	Generally accepted accounting practice
GDB	Gas Distribution Business
GDB IM Determination	Gas Distribution Services Input Methodologies Determination 2012
GPB	Gas Pipeline Business
GTB	Gas Transmission Business
GTB IM Determination	Gas Transmission Services Input Methodologies Determination 2012
ID	Information Disclosure
IMs	Input Methodologies
IM Review	Statutory Input Methodologies Review
IRIS	Incremental Rolling Incentive Scheme
MEUG	Major Electricity Users' Group
MGUG	Major Gas Users' Group
NZ IFRS	New Zealand International Financial Reporting Standards
opex	Operating Expenditure
Part 4	Part 4 of the Commerce Act 1986
PQ	Price quality
RAB	Regulated Asset Base
the Act	Commerce Act 1986
Transpower	Transpower NZ Ltd
WACC	Weighted Average Cost of Capital

Executive Summary

X1 We are amending several input methodologies (**IMs**) applying to gas pipeline services before the default price-quality path (**DPP**) reset for gas pipeline businesses (**GPBs**) for the third regulatory period commencing 1 October 2022 (**DPP3**). The amendments apply to the IMs for DPPs and, where appropriate, also to the IMs for customised price-quality paths (**CPPs**) and information disclosure (**ID**).

X2 These are the only IMs we consider it is appropriate to change ahead of the DPP3 reset. The full statutory IM review (**IM review**), which we have started this year, will provide an opportunity to consider all other gas-related IMs.[1] The IM review will also provide a further opportunity to reconsider the IM changes we are making now.

Input Methodologies Amendments

X3 Table 1 sets out a summary of the IM amendments.

Table 1: Summary of input methodologies amendments for gas pipeline businesses

IM Amendment	Description
Economic network stranding – adjusting asset lives	We have introduced a mechanism to allow us to adjust asset lives when calculating depreciation for a DPP if we are satisfied that doing so would better reflect the economic asset lives and better promote the purpose of Part 4 of the Commerce Act 1986 (**Part 4**). For DPP3, this will allow us to shorten asset lives so that assumed asset lives better reflect the expected economic asset lives considering the expected decline in the use of gas networks. There are flow-on amendments for how depreciation is calculated for information disclosure.
Treatment of operating leases	We have aligned the ID and price-quality treatment of capitalised 'right of use' assets with new accounting standard New Zealand International Financial Reporting Standards (**NZ IFRS**) 16.
Capital expenditure capacity event reopener	We have introduced a capacity event reopener that will allow us to reconsider the price path in a DPP by approving an additional capital expenditure (**capex**) allowance if the supplier can demonstrate it needs additional capacity on its network that was not foreseen at the time the DPP was reset, or where it was foreseen, was not provided for due to uncertainty of need.
Capital and operating expenditure risk event reopener	We have introduced a risk event reopener that will allow us to reconsider the price path in a DPP by approving an additional capex allowance, or operating expenditure (**opex**) allowance (where this is a cost-effective alternative to capex), if the supplier establishes that: Part of its network has deteriorated or will deteriorate to the extent that failing to invest during the DPP period, beyond the allowance already provided, would: • materially adversely affect its ability to meet its quality standards; or • compromise the safety of any person or the integrity of assets; and • this was not foreseen at the time the DPP was reset, or where it was foreseen, was not provided for due to uncertainty of need.

1 Commerce Commission "Notice of intention – Input Methodologies Review 2023" (23 February 2022).

Chapter 1 Introduction

Purpose of paper

1.1 This paper provides our decisions and supporting reasons on amendments to the input methodologies for gas pipeline services (**Gas IMs**):

1.1.1 for Gas Distribution Businesses (**GDBs**) contained in the Gas Distribution Services Input Methodologies Determination 2012 (**GDB IM Determination**);[2] and

1.1.2 for the Gas Transmission Business (**GTB**) contained in the Gas Transmission Services Input Methodologies Determination 2012 (**GTB IM Determination**).[3]

1.2 The amendments to the GDB and GTB IM determinations relate to our decisions for the third regulatory period commencing 1 October 2022 (**DPP3**) and have been assessed in accordance with the decision-making framework outlined in Chapter 2. This paper excludes IM amendments relating to the weighted average cost of capital which were published in March 2022.[4]

The process we followed

1.3 The IM amendments made in the GDB and GTB IM amendments determinations, and described in this paper, are made in accordance with s 52X of the Commerce Act 1986 (**the Act**).

1.4 We published a Process and Issues paper on 4 August 2021 in relation to the DPP3 reset as we considered this desirable for the development of our thinking. That Process and Issues paper outlined a range of issues for consideration, including flagging the potential implications of climate policy for our decisions and the possibility of amending the IMs to allow for the shortening of asset lives. It also outlined the key dates in our process including the date of our draft decisions, the dates for submissions and cross-submissions on our draft decisions, and the date for our final decisions.

---

2 Prior to the amendments outlined in this paper, the principal determination was most recently amended in 21 December 2017 by Gas Distribution Services Input Methodologies Amendments Determination 2017 [2017] NZCC 31. An unofficial consolidated version of the principal determination and all subsequent amendments was published by us on 3 April 2018.

3 Prior to the amendments outlined in this paper, the principal determination was most recently amended in 21 December 2017 by Gas Transmission Services Input Methodologies Amendments Determination 2017 [2017] NZCC 32. An unofficial consolidated version of the principal determination and all subsequent amendments was published by us on 3 April 2018.

4 Commerce Commission "Amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths – Reasons paper" (25 March 2022).

1.5 We received a number of submissions and cross-submissions on the Process and Issues paper, including some which addressed the question of the possible reduction of asset lives.

1.6 In accordance with s 52V of the Act, we subsequently published a notice of intention relating to the potential Gas IM amendments we were considering on 4 February 2022.[5] The potential amendments noted included both the IM amendments set out in this paper and those that were made on 25 March 2022. In reaching a view on the potential IM amendments we considered the submissions on the Process and Issues paper.

1.7 We then proposed amendments and sought stakeholder views in our IM amendments draft reasons paper "Proposed amendments to input methodologies for gas pipeline businesses (**GPBs**) related to the 2022 default price-quality paths – Draft reasons paper" on 10 February 2022. We allowed four weeks for submissions and two weeks for cross-submissions. The draft decision was accompanied by draft amendment determinations showing how we proposed to give effect to the proposed changes.[6]

Our approach to consultation and submissions

1.8 In reaching the decisions outlined in this paper, we have considered submissions and cross-submissions received from stakeholders in response to our draft decisions referred to in paragraph 1.7 In reaching these decisions, we have also considered submissions received as part of the DPP3 reset consultation process insofar as they related to the GDB and GTB IM determinations.

5 Commerce Commission "Notice of Intention for potential amendments to IMs for Gas in 2022" (4 February 2022).

6 [DRAFT] Gas Distribution Services Input Methodologies Amendment Determination 2022 – 10 February 2022 and [DRAFT] Gas Transmission Services Input Methodologies Amendment Determination 2022 – 10 February 2022.

1.9 Major Gas Users Group (**MGUG**) and Methanex raised concerns in their submissions that the four week timeframe for submissions was unreasonably short.[7, 8] Methanex further submitted that the scale of the proposed regulatory response to the network stranding risk should have been signalled earlier.[9] MGUG, Major Electricity Users' Group **(MEUG**) and Munro Duignan also supported the holding of an open forum or workshop to explore the issues ahead of any final decision.[10, 11, 12]

1.10 As set out above we published two papers seeking submitter's views in relation to our amendments of the Gas IMs, and signalled the key dates in our process on 4 August 2021.

1.11 The notice of intention we published on 4 February 2022 also explained that we were considering amending the asset valuation IM to introduce a mechanism to enable us to adjust asset lives for gas pipeline businesses.

1.12 We have taken our consultations seriously throughout the process and have carefully considered submissions. We note that, notwithstanding the concerns regarding process raised by some submitters, submitters generally expressed their views in detail on core issues, including on our proposed IM amendment to introduce a mechanism to enable the adjustment of asset lives for GPBs. These submissions informed our final decisions.

1.13 During our process we were also conscious of the need to complete the DPP3 reset by 31 May 2022, so that the DPP3 price-quality path would commence on 1 October 2022 after the DPP2 price-quality path ended on 30 September 2022.

1.14 We also considered the request by stakeholders for a workshop. We decided against this given the opposing views of submitters on the core issues were clearly expressed in submissions. Holding a workshop would also have risked missing the 31 May 2022 DPP3 reset deadline.

1.15 We consider that in the overall context the four-week period allowed for submissions plus the additional two weeks for cross-submissions on our IM amendment draft decisions was reasonable in the circumstances.

---

7 Major Gas Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.6 para 5.

8 Methanex Gas DPP3 Draft Decision submission (16 March 2022) p. 11 paras 38-39, Munro Duignan Gas DPP3 Draft Decision submission (16 March 2022).

9 Methanex Gas DPP3 Draft Decision submission (16 March 2022) p.10 para 36.

10 Major Gas Users Group "Cross-submission on Gas DPP3 draft decision" (28 March 2022), p.2 para X2 - X3, p.4 para 7.

11 Major Electricity Users Group "Cross-submission on Gas DPP3 Draft Decision" (28 March 2022), p.2 para 6.

12 Munro Duignan Gas DPP3 Draft Decision submission (16 March 2022), p.1.

1.16 We also received a letter from Franks Ogilvie on behalf of MGUG on 20 May 2022.[13] The letter, amongst other matters, suggested that we should hold a further consultation round on our proposed IM amendments in light of the release of the Government's Emissions Reduction Plan (**ERP**) on 16 May 2022.

1.17 We considered whether further consultation was required as a result of the information in the ERP. However, we concluded this was unnecessary because, while some aspects of the ERP reflect policy that is different to other information (eg, the ERP does not adopt the CCC's recommendation to stop new gas connections), the ERP is generally consistent with Government's previously signalled intention to phase out fossil gas over time and other evidence before us on the future of natural gas that informed our final decisions. As such, the information in the ERP was confirmatory in nature. The relevance of the ERP for our DPP3 decisions is discussed in more detail in our DPP reasons paper.[14]

Structure of paper

1.18 This paper explains:

1.18.1 the decision-making framework we have applied to reach our decisions (Chapter 2); and

1.18.2 potential amendments we consider fall within the scope of this s 52X amendments process. It explains amendments that we decided to make, as well as those that we decided not to make (Chapter 3); and

1.18.3 why we have not introduced amendments to remove Regulated Asset Base (**RAB**) indexation or introduce ex ante compensation for the risk of asset stranding.

Effective dates for IM amendments

1.19 Section 52W of the Act requires us to publish, by way of notice in the *Gazette,* a brief description of any IM amendment and the goods and services to which it applies, the reasons for determining that IM amendment and how we are making it publicly available.[15]

1.20 The amendments discussed in this paper take effect at the start of the day following publication in the *Gazette* in accordance with s 52W.

---

13 Franks Ogilvie, Commercial and Public Law. Letter: Determination on Gas IM Amendments (20 May 2022)

14 This paper will be published on 31 May 2022 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.

15 Section 52W(1)(b) states that IM amendments are secondary legislation which means that the publication requirements for secondary legislation in the Legislation Act 2019 apply.

1.21 The amendments will therefore apply to any relevant price-quality determinations made after the start of the day on which the amendments take effect. This includes the Gas DPP3 determination scheduled to be made by 31 May 2021.

1.22 We have separately proposed amendments to the definitions of "IM determination" in the gas distribution and gas transmission information disclosure (**ID**) determinations, so that any amendments we make to the input methodologies (**IMs**) for information disclosure will also apply to the ID determinations.[16]

Materials released alongside this paper

1.23 Alongside this paper, we have published a:

1.23.1 Gas Distribution Services Input Methodologies Amendment Determination (**GDB IM amendment Determination**);[17]

1.23.2 Gas Transmission Services Input Methodologies Amendment Determination (**GTB IM amendment Determination**).[18]

1.23.3 Gas Distribution Services Information Disclosure Amendment Determination;[19] and

1.23.4 Gas Transmission Services Information Disclosure Amendment Determination.[20]

Publishing a consolidated determination

1.24 We intend to publish consolidated versions of the GDB and GTB IM determinations that incorporate the changes made by the GDB and GTB IM amendment determinations during the third quarter of 2022.

16 *Gas Distribution Information Disclosure Amendment Determination 2022 (*30 May 2022) and *Gas Distribution Information Disclosure Amendment Determination 2022* (30 May 2022).

17 *Gas Distribution Input Methodologies Amendment Determination 2022* (30 May 2022).

18 *Gas Transmission Input Methodologies Amendment Determination 2022* (30 May 2022).

19 Gas Distribution Services Information Disclosure Amendment Determination 2022 (30 May 2022).

20 Gas Transmission Services Information Disclosure Amendment Determination 2022 (30 May 2022).

Chapter 2 Decision-Making Framework

Purpose of this chapter

2.1 This chapter describes:

2.1.1 our framework for considering the scope of potential Gas IM amendments, which is relevant in considering what IMs it may be appropriate to amend outside of the full statutory IM review (**IM Review**) cycle in s 52Y of the Act; and

2.1.2 the decision-making framework we have applied in deciding the Gas IM amendments.

Framework for considering the scope of potential Gas Input Methodologies amendments

2.2 Our framework considers:

2.2.1 the statutory context for IM amendments;

2.2.2 our approach when deciding whether to consider amendments outside the statutory IM review cycle under s 52Y; and

2.2.3 the usual types of amendments outside the statutory IM review cycle and our approach to fundamental IMs.

Statutory context

2.3 When considering amendments to IMs, we must consider the purpose of IMs and the purpose of Part 4 of the Commerce Act 1986 (**Part 4**). This section discusses the tensions between making changes to improve the regime and the certainty intended by the IMs.

2.4 The purpose of IMs, set out in s 52R of the Act, is to promote certainty for suppliers and consumers in relation to the rules, requirements and processes applying to the regulation, or proposed regulation, of goods or services under Part 4. To that end, s 52T(2)(a) requires all IMs, as far as is reasonably practicable, to set out relevant matters in sufficient detail so that each affected supplier is reasonably able to estimate the material effects of the methodology on the supplier. In that way, the IMs constrain our evaluative judgements in subsequent regulatory decisions and increase predictability.[21]

21 *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [213].

2.5 However, some uncertainty remains inevitable.[22] As the Court of Appeal observed in relation to s 52R "certainty is a relative rather than an absolute value",[23] and "there is a continuum between complete certainty at one end and complete flexibility at the other".[24]

2.6 The s 52R purpose is primarily promoted by having the rules, processes and requirements set upfront prior to being applied by regulated suppliers or ourselves.

2.7 However, as recognised in ss 52X and 52Y, these rules, processes and requirements may change over time.

2.8 The power to amend an IM must be used to promote the policy and objectives of Part 4 of the Act as ascertained by reading it as a whole. While it was not identified as the predominant consideration, it is clear that Parliament saw the promotion of certainty as being important to the achievement of the purposes of Part 4 and price-quality (**PQ**) regulation.[25] While this is to an extent implicitly inherent in s 52A (for example, providing suppliers with incentives to invest in accordance with s 52A(1)(a)), it is also expressed in s 52R in relation to the purpose of IMs, but also in other aspects of the regime, such as the restrictions on reopening default price-quality paths (**DPPs**) during their regulatory periods.[26]

2.9 When considering IM amendments, we must therefore be mindful that this may have a detrimental effect on:

2.9.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with s 52A(1)(a); and

2.9.2 the role that the IMs play in promoting certainty for suppliers and consumers in relation to the rules, requirements, and processes in advance of being applied by us and suppliers in setting the DPP.

2.10 At times there will be a tension between making changes to improve the regime and better promote the s 52A purpose on the one hand, and certainty on the other.

2.11 While we will have regard to the s 52R purpose (and the other indications of the importance of promoting certainty), ultimately, we must nevertheless make decisions that we consider promote the s 52A purpose.

---

22 *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [214].

23 *Commerce Commission v Vector Ltd* [2012] NZCA 220, para [34].

24 *Commerce Commission v Vector Ltd* [2012] NZCA 220, para [60].

25 *Commerce Commission v Vector Ltd* [2012] NZCA 220, para [34].

26 For further discussion see *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [213]-[221].

2.12 Section 52A governs all our decision-making processes under Part 4, including our IM decisions. The other purpose statements within Part 4 are relevant matters but they should be applied consistently with s 52A.[27]

Amendments inside and outside the Input Methodologies statutory review cycle

2.13 All IMs must be reviewed at least once every seven years, as mandated by s 52Y. This process is key to delivering on the s 52R certainty purpose of IMs, while at the same time allowing the regime to mature and evolve in response to changing circumstances.

2.14 Given the certainty purpose of the IMs and the scheme set out in the Act to promote this purpose, we must carefully assess what amendments are appropriate to consider outside the statutory IM review cycle. Additionally, as noted previously, the predictability the IMs provide is key to promoting the s 52A purpose and, in particular, incentives to invest as required under s 52A(1)(a).

2.15 On the other hand, it is important that the IMs are fit-for-purpose going into a DPP reset, particularly as under s 53ZB(1) IM amendments made after a PQ path is determined (other than in limited circumstances) will not affect the PQ path until the next reset.[28]

2.16 Leading up to a DPP reset, we may therefore need to consider which topics are appropriate to consult on as potential s 52X amendments in order to identify changes to the IMs that are necessary to ensure that the DPPs are able to be workable and effective in promoting the outcomes in s 52A, as we have done in this case.

2.17 The IM Review that is currently underway is due for completion by December 2023.[29] It should be noted that the IMs that we are proposing to amend could be further amended at that stage. However, as noted above, given s 53ZB(1), we may not reopen the DPP3 PQ path to implement any IM amendments made as part of the IM Review after DPP3 takes effect.

---

27 We note that the High Court, in *Wellington International Airport Ltd & Ors v Commerce Commission* considered that the purpose of IMs, set out in s 52R, is "conceptually subordinate" to the purpose of Part 4 as set out in s 52A when applying the "materially better" test. See *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289, para [165].

28 Under s 53ZB(2) a PQ path must be reset by us with a new PQ path made by amending the PQ determination if: an IM changes as a result of an appeal under s 52Z; and that changed IM would have resulted in a materially different PQ path being set had the changed IM applied at the time the PQ path was set.

29 Commerce Commission "Notice of Intention Input Methodologies Review" (17 February 2022).

Amendments outside of the statutory Input Methodology review cycle

2.18 We typically focus on two types of amendments outside the statutory IM review cycle:

2.18.1 those that support incremental improvements to PQ paths; and

2.18.2 those that enhance certainty about, or correct technical errors in, the existing IMs.

2.19 We do not generally consider it to be appropriate to consider significant changes to fundamental IMs outside the statutory IM review cycle. Fundamental IMs are generally those that define the foundational building blocks used to set PQ paths (listed in s 52T(1)(a)), and that are central to defining the balance of risk and benefits between suppliers and consumers.

2.20 However, we can and will reconsider fundamental IMs outside of the statutory IM review cycle where we consider there are compelling and urgent reasons for doing so and have done so in this instance.[30]

The decision-making framework we have applied

2.21 In deciding whether to amend IMs as part of the DPP3 setting process, we have used a decision-making framework that we have developed over time to support our decision-making under Part 4 of the Act.[31] This has been consulted on and used as part of prior processes, and helps provide consistency and transparency in our decision-making.

2.22 Specifically, in respect of each potential IM amendment we have considered whether they would:

2.22.1 promote the Part 4 purpose in s 52A of the Act more effectively;

2.22.2 promote the IMs purpose in s 52R of the Act more effectively; or

2.22.3 reduce compliance costs, other regulatory costs or complexity (consistent with the purpose of DPP regulation in s 53K).

---

30 A prior example of this was the re-consideration of the Part 4 Weighted Average Cost of Capital (**WACC**) percentile decision in 2014. The compelling reason for this was criticism by the High Court of this decision in the IM merits appeal process, and the urgency was due to the upcoming default price-quality path and individual price-quality resets for EDBs and Transpower New Zealand Limited.

31 See, for example, Commerce Commission "Input methodologies review decisions: Framework for the IM review" (20 December 2016), para 59 and Commerce Commission "Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons paper" (26 November 2019), para 2.15-2.18.

2.23 As part of these considerations, we have also considered whether the potential IM amendment would detrimentally affect any of the matters in paragraph 2.22. As discussed in paragraph 2.12 above, while the other purpose statements in Part 4 of the Act (including s 52R and s 53K) are relevant matters, s 52A governs our decision-making process under Part 4. We may, therefore, make an IM amendment that does not promote the IM purpose in s 52R more effectively than the current IM where we consider that the amendment would promote the s 52A purpose more effectively. We further consider that we must generally only make IM amendments to promote the IMs purpose in s 52R, or to reduce costs or complexity, where this does not detract from the promotion of the purpose in s 52A.

2.24 We refer to the outcomes specified in paragraph 2.22 as the 'IM amendments framework outcomes' in this paper.

2.25 When we consider these matters, we also apply the regulatory framework we have developed for our decision-making when making or changing IMs, including the economic principles that help us give effect to the purpose in s 52A.[32]

32 See, for example, Commerce Commission "Input methodologies review decisions: Framework for the IM review" (20 December 2016), para 113 to 153.

Chapter 3 Amendments to the Gas Distribution Business and Gas Transmission Business Input Methodologies Determinations

Purpose of this chapter

3.1 This chapter describes our amendments to the GDB and GTB IM Determinations. Most of the amendments are the same for the GTB and the GDBs. The exception is the amendment to the taxation IMs for GDBs only as part of the treatment of operating leases. It explains amendments that we decided to make, as well as those that we decided not to make.

3.2 For each of these amendments, we explain:

3.2.1 the previous IM requirement;

3.2.2 our draft decision;

3.2.3 submitters' views;

3.2.4 our final decision; and

3.2.5 how the amendment is likely to promote an IM amendments framework outcome, as defined in Chapter 2, para 2.22 - 2.23, and why we have made the amendment now rather than as part of the IM Review.

3.3 We also explain why we have not introduced amendments to remove RAB indexation or to introduce ex ante compensation.

Summary of amendments

3.4 We are amending the GDB and GTB IM Determinations as follows.

Mechanism to adjust asset lives

3.5 We are amending the IMs by introducing a mechanism which enables us to adjust asset lives for GPBs. Historically, asset lives for GPBs have been long (up to 80 years for some assets) which matched their expected physical lives. But given the widely expected decline in the long-term use of natural gas the average remaining economic life of the assets is now likely to be shorter than the average physical life.

3.6 The mechanism we are introducing in the Gas IMs allows us to adjust asset lives if we are satisfied that doing so would better reflect their economic lives and better promote the purpose of Part 4. A change in asset lives will affect the quantum of depreciation which will be recovered in a DPP period: the shorter the life the greater the amount of depreciation per annum. Since asset lives also affect the calculation of depreciation under ID, there are flow-on amendments for depreciation calculations in ID to reflect the change in asset lives.

Treatment of operating leases

3.7 We are better aligning the ID and PQ treatment of capitalised 'right of use' assets with the New Zealand International Financial Reporting Standards (**NZ IFRS**). We propose that a generally accepted accounting practice (**GAAP**) based life can be assigned to depreciate right of use assets by GDBs and the GTB, and that GDBs adopt opening GAAP deferred tax balances (in respect of right of use assets and other assets that do not have a corresponding regulatory tax asset value) when calculating tax allowances for ID, DPP and customised price-quality paths (**CPP**) purposes.

Capital expenditure reopeners

3.8 We are introducing two reopeners for capital expenditure (**capex**) and one reopener for operating expenditure (**opex**) for capacity events and risk events. The capacity event reopeners apply to individual projects or programmes relating to customer connection capex, system growth capex, asset relocations capex and asset replacement and renewals capex. The reopener for opex only applies to risk events and where opex is more cost-effective than capex. The reopeners are introduced for the following types of situations:

3.8.1 projects and programmes that were unforeseen at the time of publishing supplier expenditure forecasts that the Commission based its allowances on; or

3.8.2 projects and programmes that were foreseen for later regulatory periods but were not sufficiently certain as to timing and were therefore not provided for in the DPP.

3.9 The capacity event reopener will allow us to reconsider the price path by providing additional capex if the supplier can demonstrate it needs additional capacity on its network beyond the allowances already provided for, including where assets are relocated.

3.10 The risk event reopener will allow us to reconsider the price path in the DPP if the supplier can demonstrate an unexpected material deterioration of an asset (or assets), or that an unexpected event has occurred such as a landslip, that is outside of its control, beyond the allowances already provided for, and would:

3.10.1 materially adversely affect its ability to meet its quality standards; or

3.10.2 compromise the safety of any person or the integrity of assets.

Economic network stranding IM amendments – adjusting average remaining asset lives

Previous IM requirement

3.11 The previous IM:

3.11.1 set asset lives to match the physical life of assets – this was on the basis that physical asset lives were a reasonable proxy for the economic lives of GPB assets; and

3.11.2 did not include a mechanism which allowed the asset lives to be adjusted on the basis of new evidence concerning the remaining economic life of the assets.

3.12 The Gas IMs also require that the straight-line method for calculating total regulatory depreciation allowances must be applied. Under the straight-line method of depreciation, the amount of depreciation calculated for each year is effectively determined by remaining asset lives.

Asset lives and Information Disclosure regulation

3.13 Under ID, depreciation of each asset for a year is the result of dividing RAB by the remaining asset life (in years). The relevant asset lives are generally defined by reference to Schedule A of the IMs for network assets, and to GAAP for non-network assets.[33] The lives specified in Schedule A are physical asset lives.[34]

Asset lives and the DPP

3.14 The asset lives used in calculating depreciation under the DPP differ between existing assets and new assets.

33 IMs clause 2.2.8.

34 Schedule A: Standard Physical Asset Lives.

3.15 For existing assets (those assets which are forecast to exist at the start of the DPP period), an average life is derived from dividing the total RAB by the total amount of depreciation. The total amount of depreciation is taken from past ID disclosures for each GPB and therefore reflects the asset lives used in ID (and as specified in Schedule A for network assets).

3.16 For new assets (those assets which are commissioned during the DPP period), the previous IM assumed that they have a 45-year remaining life in their year of commissioning.

3.17 The sum of the depreciation amounts calculated for new and existing assets for each year of the DPP period become the depreciation blocks of the building block model for setting prices under the DPP.

3.18 For the purposes of ID, the asset lives of the individual assets actually commissioned during the DPP period, however, are subsequently recorded by GPBs in accordance with Schedule A for network assets (and GAAP for non-network assets).[35] That is, the 45 year life assumption is only used for the purpose of setting the DPP.

3.19 When demand for gas pipelines service was expected to remain stable or grow (as has historically been the case), the use of asset lives reflecting physical asset lives and straight line depreciation resulted in a level of depreciation which provides GPBs with an opportunity to recover an efficient level of capital and a normal return on their capital over the assumed (physical) lives of the assets. This gave GPBs an ex ante expectation of financial capital maintenance (**FCM**), which promoted incentives to invest consistent with the Part 4 purpose.

Changing asset lives under the previous Gas Input Methodology

3.20 There is some ability for GPBs under the current Gas IMs to adjust asset lives prescribed in Schedule A for individual assets for ID purposes, for example where an asset has been refurbished, or where an engineer has determined that an asset has a physical life that is longer or shorter than the standard asset life specified in Schedule A. These adjustments affect depreciation calculations for ID purposes and the rolled-forward ID RAB, which is then used to inform future DPP resets. There is also an ability of GPBs to apply under a CPP for an alternative depreciation method where, given the supplier's circumstances, the alternative method would better meet the Part 4 purpose. The alternative depreciation method could involve a change in asset lives or switching to a different method of depreciation (that is, something other than straight-line depreciation).

35 Gas transmission services input methodologies determination 2012 (consolidated April 2018) – 3 April 2018 and Gas distribution services input methodologies determination 2012 (consolidated April 2018) – 3 April 2018.

3.21 However, under the previous IM there is no ability for either us or GPBs under either ID or DPP provisions to adjust asset lives to reflect a change in expected economic asset lives due to, for example, a real risk of economic network stranding.

We considered introducing a mechanism to adjust asset lives in the 2016 IM Review

3.22 In our 2016 review of the IMs we considered whether to introduce a mechanism to adjust asset lives. In particular, we were considering whether new emerging technologies could shorten the economic life of regulated assets. We introduced a mechanism to adjust the asset lives of Electricity Distribution Businesses (**EDBs**) given the anticipated impact of emerging technology on those businesses.

3.23 We considered whether to introduce a similar mechanism to the GPB IMs but "given the evidence currently available to us, decided not to make any changes to the IMs for GDBs at this stage". Instead, we noted that should it become clearer in the future that emerging technology developments risk would impact gas networks, then we have the ability to revisit the IMs for GPBs in response.[36] .

3.24 We note the risk now is not from new technology but from declining demand from consumers and material risk of phase out of the regulated service to meet the 2050 emissions target and related emission reduction policies. In both cases, the physical asset lives which the regulatory regime uses to calculate depreciation are longer than the expected economic lives of the assets, creating a stranding risk. In both cases, shortening the assumed asset lives to better reflect their expected economic lives mitigates the risk of stranding. The reasons for the expected decline in demand and potential phase out of the regulated service are discussed in detail in Chapter 3 of the DPP reasons paper.[37]

---

36 Commerce Commission "Input methodologies review decisions Topic paper 3: The future impact of emerging technologies in the energy sector" (20 December 2016), p. 104.

37 This paper will be published on 31 May 2022 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.

Our draft decision

3.25 In our DPP draft decision reasons paper, we proposed reducing asset lives for both GDBs and the GTB when setting DPP3.[38] This would better align assumed asset lives for DPP purposes with expected economic assets lives given expectations of long-term declining use of gas networks and the credible risk of network closure. Reducing asset lives brings forward depreciation so that little if any capital is expected to be still unrecovered when network closure is anticipated giving GPBs an ex ante expectation of FCM and promoting incentives to invest consistent with the Part 4 purpose. The proposed changes to the IMs for GPBs described below will allow us to implement this for DPP3 if we consider doing so would better promote the purpose of Part 4.

3.26 The proposed IM mechanism allows the assumed remaining life for ID and price-quality regulation to be adjusted to better reflect remaining economic lives.

3.26.1 Firstly, as part of setting the DPP, we would specify an adjustment factor to apply to the average asset lives for each GDB and the GTB so that the asset lives better reflect economic lives and not physical lives. The adjusted asset lives are then used to calculate forecast depreciation. The same adjustment factor would be applied to the calculated average remaining life for existing assets and to the 45-year life assumption for new assets.

3.26.2 Secondly, following the DPP reset, GPBs would be required to adjust some or all of the remaining asset lives for individual depreciable assets recorded for ID purposes. The adjustments would have to be done in a way that ensures that in the first ID reporting year of the new DPP regulatory period the weighted average remaining asset life of all assets under ID is consistent with the DPP weighted average remaining asset life for existing assets applied in the DPP modelling. The asset lives recorded in the ID registry for new assets commissioned would have to be adjusted commensurately in line with the reduction for existing assets of that same class. This ensures the extent of adjustment for individual new assets is consistent with existing assets of a similar type.

38 Commerce Commission "Default price-quality paths for gas pipeline businesses from 1 October 2022 – Draft reasons paper" (10 February 2022), chapter 6.

Submitters' views

3.27 We received a wide range of views on whether we should make the amendment and shorten asset lives in DPP3. A number of submissions commented on:

3.27.1 whether such a change should be assessed through the IM Review rather than as part of the DPP; and

3.27.2 whether there was sufficient evidence to conclude that government policies would reduce demand for natural gas and therefore whether an amendment to introduce an asset live adjustment mechanism is required.

Changes to the asset valuation Gas Input Methodology should only be made in a comprehensive IM review

3.28 Some submitters opposed changing the Gas IM outside of the statutory IM review process.

3.28.1 For example, MEUG considered that economic stranding was a systematic risk which could affect beta and that this ought to be considered in a comprehensive IM review.[39]

3.28.2 A number of other submissions, including MGUG, also submitted that changes to asset lives should be considered in the IM Review rather than this DPP.[40] MGUG considered the IM Review was the appropriate forum for changing a fundamental IM, this would provide more time to consider the issues and more time for submitters to contribute, and that our reasons for making the changes now were not compelling.

3.29 Systematic risk refers to the extent to which the returns on an investment fluctuate relative to the equity returns in the stock market as a whole. While the Government's climate change policies might possibly have an impact on systematic risk (although this may be small and hard to quantify), the Government's proposals to transition away from and eventually phase out the use of natural gas seem likely to have a more obvious and material impact on the remaining economic lives of GPBs. Accordingly, we are amending the IMs to recognise the shortening of economic asset lives but we are not making any other changes to IMs in relation to the Government's climate change policies at this time.

3.30 Our reasons for making this amendment prior to DPP3, and not as part of an IM Review, and why it better promotes the part 4 purpose than not making this change, are set out later in this chapter.

39 Major Electricity Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), p. 3.

40 Major Gas Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), X7.

The impact of Government policies on demand for natural gas

3.31 Some submitters disagreed with making changes for DPP3 as they highlighted there were no government policies in place to completely phase out production and use of natural gas by 2050. Some submitters considered that accelerating depreciation could precipitate a drop in demand. For example:

3.31.1 Fonterra noted there are no current or proposed regulations that would accelerate decline of natural gas arguing that we should not pre-empt potential legislation;[41]

3.31.2 MGUG considered that we had 'confused climate policy with energy policy' noting that new energy policy has not been formed. MGUG submitted that we were acting ahead of policy, and by accelerating depreciation we were risking price shocks which could destroy demand; and[42]

3.31.3 Nova Energy in its cross submission stated there is 'no solid foundation in fact or in government policy that there will be a complete phase out of gas from production and use by 2050.'[43]

3.32 Some submitters suggested the long-term outlook for gas pipelines was more positive than we assumed in the draft. Points raised included that:

3.32.1 the 2050 Net Zero target does not require the complete elimination of fossil fuel natural gas;[44] and

3.32.2 that some natural gas use continues after 2050 in most current demand projections.

3.33 On the other hand, other submitters supported making changes in DPP3.

3.33.1 Munro Duignan submitted that network closure by 2050 was a near certainty.[45] Munro Duignan favoured shortening asset lives for new assets but not existing assets.

41 Fonterra "Submission on Gas DPP3 Draft Decision" (10 March 2022), p.1.

42 Major Gas Users Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), X4, X8, X14.

43 Nova Energy "Cross submission for GPB DPP3" (29 March 2022), p.1.

44 Major Gas Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), eg, at 38. Greymouth Gas "RE: Default price-quality paths for gas pipeline businesses from 1 October 2022" (14 March 2022), p.4.

45 Munro Duignan Limited "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.1.

3.33.2 First Gas "strongly support the Commission introducing accelerated depreciation now, rather than waiting until later regulatory control periods". First Gas also supported the Commission's approach to determining appropriate depreciation allowances.[46]

3.33.3 Powerco "agree with the Commission's assessment of an increased risk of economic stranding … supports action now … We support the Commission's conceptual approach to develop a tailored and repeatable model of accelerated depreciation based on actual and forecast asset data."[47]

3.34 While there were a range of views on whether we should shorten lives as part of DPP3, we consider that amending the Gas IMs to include a mechanism which does allow revising asset lives improves our ability to respond to new developments in the DPP. Many submissions acknowledge that recent and/or possible future events will reduce demand for natural gas and could shorten significantly the remaining asset lives of gas pipelines. For example, MGUG does not dispute that a reduction in natural gas demand is likely.[48] In short, submissions generally seem to accept that economic lives of the assets are, or may soon be, shorter than physical asset lives due to the expected fall in demand for natural gas. Submissions disagree on how the regulatory regime should respond to this, including the timing of any response, whether adjustments should be made in respect of all assets or just new assets, and indeed whether any response is required (given, for example, the potential to repurpose the pipelines to carry other gases).

3.35 In our view, the acknowledgment that the declining demand for natural gas could shorten the economic lives of the networks in itself supports the case for amending the IMs to include a mechanism enabling changes to asset lives to be made, so that changes to asset lives can be made if and when this is considered necessary. When there is evidence that asset lives have substantially shortened and uncertainty about whether they may change further, an IM with a mechanism to amend asset lives to better reflect the economic asset lives of the assets, and to better promote the purpose of Part 4, is better than an IM without such a mechanism. We set out later in this chapter why we consider this amendment should be made now, ahead of DPP3, and not as part of an IM review.

3.36 The information about changes which have occurred in the gas sector since 2016, and those which are expected in future, is evidence we didn't have in the 2016 IM Review. It is evidence that now supports introducing a mechanism to adjust asset lives for GPBs.

---

46 First Gas "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.2-3.

47 Powerco "Submission on Gas DPP3 Draft Decision 14 March 2022", p.3.

48 Major Gas Users Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), X8.

Our final decision is to introduce a mechanism to adjust asset lives

3.37 We have amended the GPB IMs to introduce a mechanism to adjust asset lives where this would better reflect the economic asset lives and better promote the purpose of Part 4.

3.38 The likely declining demand for gas pipelines services means we can no longer assume the remaining economic lives of the gas pipeline assets will match their remaining physical lives. The new mechanism allows for an adjustment to the assumed asset lives.

3.39 Further, since the economic life of the assets depends on future levels of demand for gas, and forecasts of that demand will likely change over time, the Gas IM amendment allows for future adjustment of asset lives to the extent that doing so would better reflect the economic asset lives and better promote the Part 4 purpose.

How the amendments are likely to promote a Gas Input Methodology amendments framework outcome and why we have made this change now before DPP3

3.40 We have introduced the asset life adjustment mechanism to better promote the purpose of Part 4. It also better maintains the building block model we use to set prices for GPBs, and other regulated services, since the building block relies on the asset lives reflecting approximate economic asset lives.

3.41 Infrastructure assets like gas pipelines require significant up-front investment to build and maintain assets which provide services to consumers over many years. Their capital and operating cost is recovered over time from the consumers who benefit from those services. The costs should be recovered over the same period of time that consumers use the services. Otherwise:

3.41.1 If businesses are unable to recover their investment while there is still demand, they may be discouraged from investing in the first place (which would not promote incentives to invest for the benefit of consumers and would not provide the quality of service that consumers demand); and

3.41.2 Consumers will not face prices for services that reflect the underlying cost of providing of those services. This means consumers may not make efficient use of the GPBs' regulated services and/or efficient investment decisions in new consumer appliances.

3.41.3 The higher prices, which are likely to be necessary to recover a GPBs investment over their shorter remaining life, will fall disproportionally on those consumers which are still using gas near the end of the network's life rather than being shared across all gas consumers over the asset's remaining life.

3.42 The expected decline in demand for natural gas means that the physical economic lives of gas pipeline assets are no longer a good proxy for their economic lives. The evidence and other indications of shortened economic lives includes:

3.42.1 the Government's ban on offshore gas and oil exploration (which is intended in part to help New Zealand transition away from fossil fuels);[49]

3.42.2 the Government's initial response to the advice of the Climate Change Commission which sets outcomes and an approach to manage the phase-out of fossil fuels (including natural gas) in the energy system;[50]

3.42.3 comments from many gas industry participants, including in submissions on this process, which acknowledge the likely reduction in natural gas demand; and

3.42.4 analysis by ourselves, the Gas Industry Future Working Group, GPBs and their expert consultants, of a potential economic stranding risk due to the expected decline in demand for natural gas.

3.43 A discussion of the implications for natural gas pipelines given New Zealand's transition to zero carbon, and a full explanation of the case for shortening asset lives, is included in the DPP3 final reasons paper. See, in particular, Chapter 3 and Chapter 6 of that paper.

3.44 Continuing to use physical lives to inform price-quality paths, including in particular the DPP, risks undermining the incentives:

3.44.1 to invest;

3.44.2 to provide a quality of service which is consistent with the demands of consumers, and

3.44.3 to promote efficient pricing.

---

49 Press release from the Prime Minister "Planning for the future – no new offshore oil and gas exploration permits" (12 April 2018), accessed on beehive.govt.nz on 5 May 2022.

50 Ministry for the Environment "Te hau mārohi ki anamata: Transitioning to a low-emissions and climate-resilient future: Have your say: a snap shot of the emissions reduction plan" (14 October 2021), p.16. Ministry for the Environment "Te hau mārohi ki anamata: Transitioning to a low-emissions and climate-resilient future: Aotearoa New Zealand's long-term low-emissions development strategy" (November 2021), p.48.

3.45 That is, continuing to use physical asset lives when the economic lives are now likely to be shorter, undermines the objectives of the purpose of Part 4 which we must promote. As such, in the context of DPP3 we consider that introducing a mechanism to adjust the asset lives to better reflect the average economic lives would materially benefit consumers in the long-term by promoting GPBs incentives to invest so that they can continue to provide a quality of service that is consistent with the demands of consumers at efficient prices.

3.46 We therefore consider there is a compelling and urgent need to act now, and include a mechanism which can be used to adjust assumed asset lives in the gas pipeline sector, and ensure these lives more closely approximate the remaining economic life of the assets, in time for DPP3, rather than through the IM Review which would only changes lives from the default price-quality path for the fourth regulatory period (commencing on 1 October 2026) (**DPP4**). All our resets of PQ paths should seek to promote the Part 4 purpose.

3.47 Full reasons for shortening the asset lives of GPB assets in DPP3 is included in Chapter 6 of the DPP reasons paper. The reasons why remaining asset lives need to be shortened in DPP3 can be stated shortly as follows.

3.47.1 Because of declining demand and the Government's proposed phasing out of the use of fossil fuels like natural gas, asset lives in the current IM (which match physical lives) no longer reflect the expected economic life of the assets.

3.47.2 This gives rise to an asset stranding problem, as the maximum amount of revenue which GPBs can earn will not recover their RAB and expected future investment to meet consumer demand for services.

3.47.3 This in turn gives rise to an investment incentives problem since GPBs may be unwilling to invest if they do not have an expectation of recovering their investment.

3.47.4 To better promote the Part 4 purpose, and in particular to maintain incentives to invest, we need to shorten asset lives to match the remaining economic life of the networks.

3.47.5 To achieve shortening, we need to amend the IM to introduce an asset lives adjustment mechanism. In DPP3 this will be used to shorten lives, but it is possible it could be used to lengthen lives in subsequent DPPs, depending on the circumstances.

3.47.6 Our framework indicates we will make changes to fundamental IMs only where there are compelling reasons for doing so. There are such reasons in this case because if asset lives are not shortened, then incentives to invest are undermined which threatens investment over DPP3. Similarly, if asset lived are not shortened the building block model no longer ensures that prices in this period reflect the long-term costs of providing the service.

Further detail on how the asset life adjustment mechanism works

3.48 The amended IMs introduce an asset life adjustment mechanism.

3.49 An adjustment factor mechanism is transparent, easy to understand, and we expect it to be relatively straight forward for GPBs to implement in practice. Additionally, as noted below, it allows for further adjustment as part of future DPP resets – to decrease or increase asset lives.

3.50 While the EDB solution was introduced in response to economic network standing risks arising from technological change we consider an adjustment factor is also appropriate to deal with economic network stranding risk for GPBs under the current circumstances.

3.51 There are some differences between the adjustment mechanism for GPBs and that which applies to EDBs. These differences reflect differences in the reasons for changes in the asset lives of the two sectors.

3.51.1 We will not require an application from regulated suppliers before implementing the adjustment. The EDB mechanism requires EDBs to formally request an adjustment prior to the commencement of the next DPP period and provide supporting evidence. This difference reflects the sector-wide nature of the drivers for the adjustment mechanism in the gas sector.

3.51.2 There is no cap on the extent of the adjustment across existing and additional assets for each GPB for DPP purposes. The mechanism can be used to shorten asset lives (by applying a factor of less than 1) or extend asset lives (by applying an adjustment factor greater than 1). For EDBs the adjustment was capped at a 15% reduction (equivalent to a factor of 0.85) to average remaining asset lives of existing assets only. Not having a cap for GPBs reflects the unknown timing and pace of the expected decline in gas demand and phasing out of the use of natural gas.

3.51.3 The mechanism is not limited to a one-time adjustment in DPP3. In our IM reasons paper for the EDB mechanism, we stated that "because of the added complications that would occur if we allowed EDBs to make multiple adjustment, EDBs will only ever be allowed to make one adjustment."[51]

3.51.4 In contrast for GPBs, the Government has proposed a phase out of natural gas which makes the risk of economic stranding of gas pipelines both more imminent and relatively more material, than technology change does for economic stranding of EDBs, and we do not consider we should limit any adjustments for GPBs to a one-off change.

3.51.5 It is also possible that further adjustments in future regulatory periods and/or changes to how network stranding risk is mitigated and/or compensated for will need to occur for GPBs, as more information becomes available to inform an assessment of the remaining economic life of the networks, including information on the timing of the proposed phase out.

3.51.6 Where further adjustments to asset lives are made then, as noted above, it is possible for the proposed mechanism to be used to extend lives as well as shorten them, to account for new information and changing levels of risk if necessary. This reflects the uncertainty of the timing of future decline in demand for natural gas networks.

3.51.7 We note that for DPP3 we are not proposing to explicitly change the 45-year assumption for new assets in the DPP3 financial model or asset lives for new assets specified in Schedule A of the Gas IMs that are used for ID purposes.

3.51.8 Rather than changing the 45-year assumption for new assets, we are using a simple adjustment factor which (for an adjustment factor of less than 1) has the effect of reducing the 45-year assumptions for new assets in the DPP model but is tailored to the individual circumstances of each GPB.

3.52 Our proposed solution implies that if no further changes are made to depreciation in future regulatory periods, then asset lives will remain shorter. So, it implies accelerated depreciation for all future regulatory periods. This aligns with the EDB solution.

51 Commerce Commission "Input methodologies review decisions - Report on the IM review" (20 December 2016), p26.

An example of the asset life adjustment mechanism in DPP3

3.53 Shortening the asset lives for each GPB by applying adjustment factors increases the amount of straight-line depreciation modelled during DPP3 and shortens the period over which capital costs are recovered. The adjustment factors apply to both the weighted average remaining asset life calculated for each GPBs' existing assets in the DPP3 financial model, and the 45-year asset life assumption applying to new assets for that GPB.

3.54 As an example, assume we have applied an adjustment factor of 0.8 to asset lives for GPB A.

3.54.1 Assume that before applying the proposed adjustment factor GPB A has a weighted average remaining asset life of 27 years for its existing assets in the base year and 25 years (27 years - 2 years) in Year 1 of DPP3.

3.54.2 After adjustment the remaining asset life is 19.6 years (27 × 0.8 - 2 years) in Year 1 of DPP3.[52]

3.54.3 To determine the depreciation allowance for new assets, the Gas IMs assume a 45-year remaining life at the time of asset commissioning for all GPBs.

3.54.4 Our proposed adjustment factor for GPB A reduces the assumed life for new assets for GPB A to 36 years (0.8 × 45 years).

There are changes to how depreciation will be calculated under ID

3.55 The amendment to shorten asset lives also changes how depreciation is calculated for disclosure under ID. This has been addressed through new subclauses 2.2.8(5) and 2.2.8(6) of the Gas IMs. These subclauses specify how GPBs should adjust the asset lives used to calculate depreciation for existing assets in ID to mirror the effect of the asset adjustment factors on forecast depreciation when setting the price-quality path.

3.56 More specifically, for existing assets, GPBs should reduce or extend (as the case may be) the asset lives, such that:

3.56.1 forecast depreciation in aggregate across all the disclosure years in the DPP regulatory period is equivalent to the value of forecast depreciation for existing assets across all the years as specified in the applicable DPP determination for that GPB (this latter value is from the DPP financial model); and

[52] The asset adjustment factor applies to the base year (2021), not the first year of DPP (2023). The effect of subtracting 2 years calculates what the asset life would be in the first year of the DPP and after the asset adjustment factor has been applied.

3.56.2 subject to the equivalence of depreciation described above, the remaining average asset life for existing assets at the start of the first ID year in the regulatory period approximates the adjusted asset life for existing assets as stated in the applicable DPP determination for that GPB (again this latter value is from the DPP financial model).

3.57 New assets enter the registry with asset lives shortened or lengthened (as the case may be) commensurately with the percentage change applied to existing assets of that class. This avoids specifying new physical assets lives, while ensuring the extent of adjustment for new assets is consistent across asset types. This is more flexible as uncertainty over the specific timing and scale of the decline in demand resolves.

Treatment of operating leases

Previous Input Methodology requirement

3.58 A new accounting standard NZ IFRS 16 was issued in 2016 applying to financial reporting periods beginning on or after 1 January 2019 (although early adoption was permitted). The standard constitutes generally accepted accounting practice in New Zealand and is recognised as such by the Gas IMs.

3.59 NZ IFRS 16 fundamentally changes the accounting treatment of operating leases for lessees, by requiring operating lease payments, previously classified as operating expenditure, to be reported as capital expenditure. The resulting capital assets are shown on businesses' balance sheets as 'right of use' assets, with a value based on the present value of the future lease payments and depreciated over the lease term.

3.60 We considered the regulatory implications of NZ IFRS 16 for EDBs and Transpower New Zealand Limited (**Transpower**) prior to their recent price-quality path resets.[53] The IMs for those suppliers were amended to achieve better alignment with NZ IFRS 16 and minimise compliance costs.

3.61 At the time of the IM amendments for EDBs and Transpower we noted that:[54]

> The change in GAAP by the implementation of NZ IFRS 16 will have effects for other regulated businesses that have operating leases, and we will address these through our formal processes for each sector in due course.

53 Commerce Commission "Treatment of operating leases: Final decisions paper" (13 November 2019).

54 Commerce Commission "Treatment of operating leases: Final decisions paper" (13 November 2019), para X7.

3.62 Right of use assets have been capitalised by all GPBs in accordance with NZ IFRS 16 and have been included in the 'base year' RAB values rolled forward to the start of DPP3 in our DPP3 financial model.[55] In addition, values for additional assets forecast to be added to the RAB during DPP3 include right of use assets. As such, these assets give a return of, and on, capital during DPP3, as well as potentially affecting other elements of the DPP (eg, calculation of tax allowances).

Our draft decision

3.63 Consistent with the IM amendments made for EDBs and Transpower, we proposed accepting alignment with NZ IFRS 16 for gas PQ and gas ID purposes. This meant that DPP and CPP price paths, and returns on investment under ID, would be calculated using capitalised right of use asset values.

3.64 We proposed making two types of amendments to better align the existing IM treatment:

3.64.1 amending the asset valuation IMs applying to ID for both GDBs and the GTB to allow a GAAP-based life to be assigned to right of use assets.[56] The treatment flows through automatically for DPP and CPP purposes, as ID values are used as the basis for forecast DPP and CPP asset values – including for DPP3; and

3.64.2 amending the taxation IMs for GDBs (who are required to use the modified deferred tax method to calculate tax allowances) to allow the opening GAAP deferred tax balance to be applied to right of use assets and other assets that do not have a corresponding regulatory tax asset value.[57] This amendment required changes to the IMs applying to ID, DPPs and CPPs.

3.65 Further changes were considered and implemented for EDBs and Transpower, but we did not propose to adopt them for GPBs for the following reasons:

3.65.1 Pass-through or recoverable costs – a specific treatment is not required to be prescribed for GPBs because none of these types of costs specified in the Gas IMs would include the costs of right of use assets; and

3.65.2 Incremental rolling incentive scheme (**IRIS**), as an IRIS does not currently apply for GPBs no IRIS changes similar to those made for EDBs in respect of opex IRIS were needed.

---

55 The 'base year' for DPP3 for all GPBs is the disclosure year 2020.

56 This change is needed to enable a GAAP-based life to be assigned to network right of use assets. A GAAP-based life can already be assigned to non-network right of use assets under the current IMs.

57 Similar to Transpower, the GTB uses the taxes payable method which automatically applies the correct treatment to right of use assets, so no changes to taxation IM are proposed for the GTB.

3.66 We proposed implementing the IM changes such that they were applied for setting DPP3 PQ paths and would be applied to any upcoming ID disclosures.

Submitters' views

3.67 We received few submissions on the proposed amendments to address the implications of NZ IFRS 16. GasNet agreed with our proposed approach but commented that short leases of significant value will introduce depreciation spikes.[58] First Gas also supported the amendments, noting they had also supported the similar amendments for EDBs and Transpower in 2019.[59]

3.68 First Gas recommend that:[60]

> …the value of right of use assets, and the life of these, assets, follow the approach taken under GAAP. We have not considered the treatment of regulatory tax but in principle, we would support an approach that keeps the regulatory regime as simple as possible.

Final decision

3.69 Our final decision is to make the amendments proposed in the draft decision that:

3.69.1 a GAAP-based life can be assigned to depreciate right of use assets by GDBs and the GTB; and

3.69.2 GDBs adopt opening GAAP deferred tax balances for right of use assets and other assets that do not have a corresponding regulatory tax asset value when calculating tax allowances for ID, DPP and CPP purposes.

How the amendments are likely to promote a Gas Input Methodology amendments framework outcome

3.70 We have arrived at the changes with a view to best promoting the purpose of Part 4, promoting the IM purpose in s 52R of the Act, and addressing unnecessary compliance costs, other regulatory costs or complexity.[61]

3.71 With respect to the specific changes:

---

58 GasNet submission on Gas DPP3 draft decision (16 March 2022), p.2.

59 First Gas submission on Gas DPP3 draft decision (16 March 2022), p.24.

60 First Gas submission on Gas DPP3 draft decision (16 March 2022), p.24.

61 Note that the changes are not designed to leave GPBs perfectly neutral in a regulatory sense to the introduction of new accounting standard NZ IFRS 16. For instance, all GPBs will continue to receive the benefit from the return on capital (calculated using the WACC) on the new right of use assets over the incremental cost of debt used to establish their value. The benefit will be greater for right of use assets with longer lives. As for EDBs and Transpower, we intend to monitor the durations of new leases through ID to identify whether excessive benefits are accruing as a result of lease terms being extended.

3.71.1 the asset valuation IMs applying to ID generally require a 'physical asset life' to be used for depreciation purposes, which, for a non-network asset, is the asset's life as determined under GAAP. Where right of use assets are network assets however, there is no equivalent provision in the Gas IMs, and the remaining physical life provisions do not make sense for this type of asset. We consider the changes maintain the workability and effectiveness of the IMs in a way that is consistent with their original policy intent and the Part 4 purpose, and promotes certainty; and

3.71.2 allowing the opening GAAP deferred tax balance to be applied in respect of right of use assets and any other assets that do not have a corresponding regulatory tax asset value removes the overcompensation arising from applying a nil opening balance with no reversal of temporary depreciation differences consistent with the Part 4 purpose. The treatment also avoids the need to retain a separate regulatory notional tax asset record, and so avoids unnecessary compliance costs or complexity.

3.72 We acknowledge that the amendments affect elements of the asset valuation and taxation IMs for GPBs which we consider to be fundamental. We have made these Gas IM changes, outside of our statutory IM review cycle, because the lack of alignment with the changed GAAP rules would have increased compliance costs without any offsetting benefits making suppliers and consumers worse off, and we consider the changes will enable decisions which more effectively promote the s 52A purpose for DPP3 which will commence on 1 October 2022. Alignment with GAAP promotes certainty through maintaining the workability and effectiveness of the Gas IMs in a way that is consistent with their original policy intent and section 52A purpose.

Capital and operating expenditure reopeners

Previous IM requirement

3.73 Currently, the Gas IMs allow us to re-open the price paths we set for a DPP regulatory period. However, our ability to do so is limited to the following events:[62]

3.73.1 catastrophic events;

3.73.2 change events;

3.73.3 error events;

3.73.4 major transactions; or

3.73.5 false or misleading information has been provided.

[62] Commerce Commission "Gas Distribution Services Input Methodologies Determination 2012 and Gas Transmission Services Input Methodologies Determination 2012 (3 April 2018).

Our draft decision

3.74 In our draft decision we proposed reopeners to address capacity events and risk events that apply to individual projects or programmes. In the case of capacity events these relate to customer connection capex, system growth capex, asset relocations capex and asset replacement and renewals capex. The reopeners were introduced for the following types of situations:

3.74.1 projects and programmes that were unforeseen at the time of publishing supplier expenditure forecasts that the Commission based its allowances on; or

3.74.2 projects and programmes that were foreseen for later regulatory periods but were not sufficiently certain as to timing and were therefore not provided for in the DPP.

3.75 We considered it was appropriate that a greater level of scrutiny would apply to these reopeners than the approach taken in setting DPP capex allowances. We required that the additional expenditure needed to be prudent and efficient to be approved.

3.76 We proposed that the reopeners only applied to that portion of additional expenditure not covered through the GPB capital contributions policy and not already allowed for in the DPP allowances we set.

3.77 Our proposed reopeners which we classed as capacity event and risk event reopeners are described in the following sections.

Capacity and risk event reopeners

3.78 We proposed a capacity event reopener to allow us to reconsider the price path in the DPP if the supplier demonstrates it needs additional capacity on its network. It allows us to provide additional funding where investment is required to support:

3.78.1 large connections (including alteration to existing connections);

3.78.2 large system growth;

3.78.3 a combination of large connections and system growth; and

3.78.4 large asset relocation.

3.79 We proposed a risk event reopener to allow us to reconsider the DPP if the supplier establishes that part of its network has deteriorated or will deteriorate to the extent that failing to invest during the DPP period, beyond the allowance already provided, would:

3.79.1 materially adversely affect its ability to meet its quality standards; or

3.79.2 compromise the safety of any person or the integrity of assets.

3.80 Our view was that a risk event is an event where additional investment cannot be delayed until a future regulatory period. We stated that GPBs would need to demonstrate that the remediation investment was prudent and efficient supported by a probabilistic risk assessment, where appropriate.

3.81 In our draft decision we also noted that in investing in their networks for growth purposes, suppliers needed to understand that these investments risked being stranded in future due to the expected fall in demand for piped natural gas. We stated that this risk may mitigate supplier over-investment in growth and incentivise suppliers to seek greater contributions from new connecting parties including for wider network reinforcement. We also expected that, for large new connection and asset relocations capex not covered by capital contributions, suppliers would need to provide us with an undertaking from the third party driving the expenditure, that it was committed to the project in the reopener application.

Expenditure thresholds for reconsidering the default price-quality path

3.82 In our draft decision we considered appropriate reopener expenditure thresholds for GPBs. We set aggregate reopener expenditure thresholds for projects and programmes that may be applied for in any one disclosure year.

3.83 We set GPB maximum expenditure thresholds, which if exceeded would necessitate the supplier applying for a CPP, and minimum expenditure thresholds, which would balance the cost of processing a reopener application with the ability of suppliers to re-prioritise expenditure to meet the need, while maintaining network safety and quality obligations.

3.84 We considered that an appropriate maximum expenditure threshold, that balanced these considerations, was approximately 50% of what each supplier had been historically spending on its network, over the DPP2 period.

3.85 In our draft decision we proposed setting reopener maximum expenditure thresholds of:

3.85.1 $350,000 for GasNet Distribution;

3.85.2 $10 million for Powerco Distribution, Vector Distribution and First Gas Distribution; and

3.85.3 $15 million for First Gas Transmission

3.86 We also proposed setting reopener minimum expenditure thresholds for suppliers to avoid situations where the cost of administering the reopener was greater than the benefits to consumers.

3.87 In proposing minimum expenditure thresholds, we stated that suppliers should be able to manage minor changes in expenditure requirements within the DPP expenditure settings.

3.88 We proposed setting the minimum expenditure threshold amounts (net of capital contributions) that are reflective of the supplier business size, and to avoid situations where the cost of administering the reopener is greater than the benefits to consumers, of:

3.88.1 $2 million for First Gas Transmission, Powerco Distribution, First Gas Distribution and Vector Distribution; and

3.88.2 $100,000 for GasNet Distribution.

Submitters' views

3.89 In draft decision submissions, suppliers and industry stakeholders were generally supportive of the proposed reopeners.

3.90 MGUG supported the capacity event reopener only if "allowable capex is less than historical capex" and linked this to its view against accelerating depreciation for GPBs and our decision to use a top-down capex allowance setting approach for DPP3.[63]

3.91 MGUG stated that the risk event reopener was more fit for purpose "where technology and policies change more quickly",[64] while Fonterra expressed support for both reopeners, suggesting that the "rigour of review must be similar to as if a CPP had been applied for".[65]

3.92 Powerco supported the reopeners stating that these mechanisms "provide sensible optionality to complement the approach taken to capital expenditure for DPP3 and beyond".[66] Powerco also rightly noted that the proposed reopeners would not address known risks.[67]

3.93 First Gas supported the reopeners, stating that "the approach is both prudent given the level of uncertainty that the sector is facing in coming years" and the proposed thresholds were a "prudent approach".[68]

63 Major Gas Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.33-34.

64 Major Gas Users' Group "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.33.

65 Fonterra "Submission on Gas DPP3 Draft Decision" (10 March 2022), p.3 para 15.

66 Powerco "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.8.

67 Powerco "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.4.

68 First Gas submission on Gas DPP3 draft decision (16 March 2022), p.23.

3.94 First Gas encouraged the Commission to develop a simple and streamlined process for seeking a capex reopener and wanted to understand when a party may apply for a risk-event reopener given a project may need to proceed urgently prior to approval for example.[69]

3.95 Vector expressed general support for the reopeners, in principle, but considered they had limitations "as a tool" given "the time, expense and uncertainty involved in making an application".[70] Vector also provided several suggested changes, namely that:[71]

3.95.1 re-openers should also apply to increases in costs; and

3.95.2 reopeners should also apply to opex because "there may be situations where opex is more efficient (or a combination of capex and opex together)".

3.96 GasNet stated that, while it supported the reopeners, and understood that these were in response to dropping margins added to historical capex projections in our DPP3 capex analysis, it requested that these margins be reinstated to "account for typical year-on-year functions that tend to occur in capex". GasNet concluded that the capex allowances we had set in the draft decision were insufficient.[72]

3.97 GasNet also sought explanations for questions, such as, the difference between a capacity and risk event, if the maximum and minimum expenditure triggers applied to both capacity and risk event reopeners, and what the test of prudency and efficiency entailed.[73]

3.98 Like Vector, GasNet was concerned with reopener administration costs, citing the "level of administration that is likely to be involved in preparing reopener applications and thus the resource diversion and associated costs that will need to be expensed as opex irrespective of the NZCC decision on the application".[74] GasNet suggested that one way of avoiding it applying for a reopener every year was for its draft decision minimum/maximum triggers to be changed from $100,000/$350,000 to $200,000/$500,000.

69 First Gas submission on Gas DPP3 draft decision (16 March 2022), p.23.

70 Vector "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.28 para 113.

71 Vector "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.31 para 134.

72 GasNet "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.3 para 7.2.

73 GasNet "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.3 para 7.2.

74 GasNet "Submission on Gas DPP3 Draft Decision" (14 March 2022), p.4 para 7.2.

Final decision

3.99 Our final decision is to:

3.99.1 retain our draft decision to amend the Gas IMs to allow for capacity and risk event reopeners;

3.99.2 set reopener maximum and minimum expenditure thresholds consistent with our draft decision; and

3.99.3 introduce the ability for GPBs to apply for a risk event reopener to seek additional opex if the GPB can demonstrate that the proposed opex is a more cost-effective substitute than capex solutions.

3.100 In seeking additional expenditure, GPBs will also need to demonstrate that the need for the additional capacity or investment for the purpose of risk mitigation was for one of the following:

3.100.1 projects and programmes that could not reasonably have been foreseen by the GPB; or

3.100.2 projects and programmes that were foreseen for later regulatory periods but were not sufficiently certain as to timing and were therefore not provided for in the DPP.

3.101 Consistent with our default price-quality path for the third regulatory period (1 April 2020 – 31 March 2024) for Electricity Distribution Businesses (**EDB DPP3**) decision to introduce unforeseen capex reopeners, we consider that unforeseen projects and programmes include those that were broadly foreseeable but not expected until future regulatory periods or reasonably expected to be significantly less costly. This includes incorrectly forecasted projects and programmes with unforeseen timing or extent.[75] We will not consider applications for additional expenditure where we considered the need for the expenditure when setting the DPP and there has been no new event that changes the circumstances that existed at the time the DPP was set.

3.102 Our view is that for us to approve the additional expenditure, suppliers will need to provide us with justification that the project or programme is prudent and efficient under the expenditure objective. In assessing whether expenditure is prudent and efficient we believe that the reopeners strike the right balance between ensuring GPBs can invest to maintain a safe and reliable network, while ensuring that additional expenditure is in the best interest of consumers.

75 Commerce Commission "EDB DPP3 Final decision reasons paper" (27 November 2019), p.300 para G11.

3.103 GPBs can also apply for a CPP to better meet their circumstances. A CPP can be tailored to meet the specific needs of the GPB and their consumers and provides the flexibility to generally deal with uncertainties that GPBs may encounter

GasNet clarification questions and threshold changes

3.104 GasNet sought clarification of the delineation between a capacity event and a risk event reopener. In the Gas IM we have defined capacity events as those relating to a need for additional capacity to meet established or reasonably anticipated demand. Capex for asset relocations may also be included in this category.

3.105 We have defined risk events as those that are not related to a need for additional network capacity but are related to the need to address network integrity issues.

3.106 GasNet questioned whether the maximum and minimum expenditure triggers applied to both capacity and risk event reopeners. We can confirm that this is the case.

3.107 GasNet also suggested that we may wish to change the thresholds applicable to its business. This suggestion is closely aligned with its view that we allowed insufficient network capex in our draft decision.

3.108 We have not undertaken detailed analysis of each GPB's capex forecasts due to the cost of doing so, which would be inconsistent with the low-cost nature of a DPP. However, we have considered each GPB's forecasts separately. We have approved GDB forecasts of consumer connection capex and non-network capex. We have restricted system growth capex to historical average levels and introduced reopener provisions to allow GPBs to apply for an additional allowance in some circumstances.

3.109 We consider that the maximum and minimum reopener expenditure thresholds we proposed setting in the draft decision remain appropriate for GasNet to meet its ongoing operational needs in DPP3 and beyond while providing incentives to act efficiently. They align with the thresholds we proposed setting for the other GPBs in that they reflect the historical average expenditure and are balanced against the cost of processing the application.

*Cost of administering reopener*s

3.110 GasNet also sought clarification of how we would test whether expenditure was prudent and efficient and expressed concern about the cost of reopener administration and application. Vector also had a similar concern. These two questions also relate to some aspects of the Fonterra submission which advocated for a CPP level of scrutiny when we review reopener applications.

3.111 We consider that a test of whether expenditure is prudent and efficient, is an internal process that a well-run business should be applying to justify significant expenditure projects and programmes. We consider that well-run businesses should not have to create substantial new processes to meet our reopener application requirements.

3.112 We would expect that to demonstrate project expenditure is prudent, for example, a business should be able to show that it had adequately identified the need for the expenditure, that it had considered alternative solutions, and that it had applied economic test principles such as a cost-benefit analysis to identify the least cost solution. Additionally, we would expect that the proposed expenditure had been demonstrably reviewed internally and that, ideally, the GPB's Board had approved it, unless this was in response to an emergency.

3.113 We would also expect that a well-run business should be able to demonstrate that the costs it uses are efficient insofar as this is demonstrable. One way of doing this is to show that good industry practice cost estimation processes inform the cost estimates that feed into asset management plans and reopener applications. We would expect that a well-run business would also regularly review its standard cost unit prices to ensure that these are aligned with industry prices.

3.114 We do not expect that reopener applications will be unduly onerous in an administrative sense if these processes that ensure internal prudency and efficiency are part of the GPB's established procedures. The process documentation and frameworks should already exist. The application should provide us with sufficient information to satisfy us that the least cost solution to meet a verified need has been identified and that costs are efficient.

Risk event reopener applications to include operating expenditure

3.115 Vector stated that the reopeners should also be available for opex solutions or for a combination of opex and capex. We agree with this and have amended the Gas IMs to include the possibility of opex solutions, or a combination of opex and capex, for risk events.

3.116 For us to approve additional opex GPBs would need to demonstrate, using economic test principles such as a cost-benefit analysis, that an opex solution, or a combination of opex and capex, is more cost effective than a capex solution.

Reopener timing of application

3.117 We reviewed the question of reopener timing due to urgent work, raised by First Gas. We note that in the past, in other regulated sectors, we have taken a number of positions with respect to reopener timing:

3.117.1 for Transpower listed projects, an application for additional base capex can only be for expenditure that will be incurred after an application is made.[76]

3.117.2 there is also time restriction on when Transpower might submit the listed project application within the regulatory period (22 months before the end of the regulatory period);[77]

3.117.3 in the Chorus Fibre IMs, there is no restriction on the timing of individual capex proposals which may be made at any time during a regulatory period;[78] and

3.117.4 in the EDB IMs, there is no restriction on the timing of a reconsideration application for unforeseeable and foreseeable major capex projects during a regulatory period.[79]

3.118 We consider that flexible reopener application timing should be restricted to risk events only, where the GPB has identified an unexpected material deterioration of an asset (or assets), or that an unexpected event has occurred such as a landslip, that is outside of GPB control.

3.119 Because they will be incurring costs ahead of any approval, it will be in the GPBs interests to notify us that it intends to apply for a risk event reopener if a risk event occurs and to process the application in parallel with any urgent action it is taking to mitigate the event.

3.120 We expect that expenditure related to capacity events, and driven by third parties, will be well signalled. We have restricted our expenditure approvals related to capacity events to expenditure that will be incurred after a reopener application is made to us.

---

76 *Commerce Commission Transpower Capital Expenditure Input Methodology Determination* [2012] NZCC 2, clause 3.2.3(1).

77 *Commerce Commission Transpower Capital Expenditure Input Methodology Determination* [2012] NZCC 2, clause 3.2.3(1).

78 *Commerce Commission Fibre Input Methodologies Determination [2020] NZCC 21*, s. 4 of subpart 7 of Part 3.

79 Commerce Commission "Electricity Distribution Services Input Methodologies Determination 2012" (20 May 2020), subpart 5 of Part 4.

How the amendments are likely to promote a Gas Input Methodology amendments framework outcome

3.121 The approach we have taken to set capex allowances in this DPP reflects the fact that the DPP is intended to be a relatively low-cost form of regulation catering for a diverse group of businesses using a generic approach. A DPP is not intended to deal with circumstances that require significant scrutiny of costs of an individual business.

3.122 We take a top-down approach to setting the capex allowance for the majority of GPB capex. Allowances are based on supplier capex forecasts, capped at the GPB's historical average capex. We discuss our capex allowance setting approach more fully in our Gas DPP3 final decision reasons paper. [80]

3.123 In short, we consider that our top-down approach provides GPBs with sufficient expenditure to meet the typical ongoing capex needs of the business, and to manage the lumpiness of capex programmes, whilst reducing the risks to consumers from allowing too much expenditure.

3.124 However, new information or events may arise during DPP3 which warrants additional expenditure to deal with unexpected material deterioration of assets or projects that were unknown or uncertain at the time the DPP was set, where expenditure for these projects was not reflected in the capex allowances we set in DPP3. To provide some flexibility, we have introduced capex reopeners that are equivalent to those introduced in the EDB IMs during the EDB DPP3 process.

3.125 We consider that introducing these reopeners now and outside the statutory IM review cycle will increase the flexibility available to GPBs and reduce the potential for unintended consequences from the high-level capex setting approach we have taken.

3.126 We consider the introduction of these reopeners promotes the long-term benefit of consumers. They do so as they would allow for necessary additional investment in limited, specific circumstances during the period where the GPB can demonstrate the upfront allowance is insufficient due to unexpected material deterioration of assets or projects that are unknown or uncertain at the time the DPP was set (consistent with s52A(1)(a)).

3.127 The reopeners are the most appropriate DPP mechanism to accommodate both the low-cost design of DPPs and the risk of unforeseen or uncertain investment. Reopeners reduce the risk that consumers pay more than necessary upfront if a more generous allowance had been provided (consistent with s52A(1)(b) and s52A(1)(c)).

80 Commerce Commission "Resetting default price-quality paths for gas pipeline businesses from 1 October 2022. Final. Reasons paper" (31 May 2022), Chapter 5 and Attachment B.

Amendments for addressing stranding risk not adopted

3.128 Our draft decision identified a range of other options which could be used to mitigate stranding risk, for example, removing indexation of the RAB and introducing ex ante compensation, as we have done in fibre. Some submitters supported these options.

3.129 We did not favour ex ante compensation or removing RAB indexation at this time.

3.129.1 There is significant difficulty in calculating the extent of any ex ante compensation required. This can lead to over or under-compensation to the supplier. The implications for errors in estimation for ex ante compensation are much higher as once set, compensation should not be adjusted for changes in risk for existing assets. Financial modelling also showed that it was not necessary to support ex ante FCM at this time if we were to instead shorten asset lives.

3.129.2 It is not necessary to remove RAB indexation to address stranding risk in DPP3. Stranding risk can be managed independently of inflation risk by shortening asset lives. And there are potential implications for removing RAB indexation for shared assets between EDBs and GDBs, which would be difficult to resolve within the constraints of the DPP process.

3.130 We considered that both these options would be better considered in the recently commenced IM review. Any changes from the IM review process could be implemented by DPP4 at the earliest.

3.131 Both suppliers and other market participants noted that mechanisms to accelerate depreciation by shortening asset lives may be more appropriate than ex ante compensation mechanisms in the context of DPP3.