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by email

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Dear Ben

Process to amend IMs in preparation for Gas DPP reset

- 1 On 10 February 2022 the Commission released for consultation its draft decision on resetting the Gas Default Price-Quality Path (**Gas DPP**). In parallel the Commission released for consultation proposed amendments to the gas transmission and distribution input methodologies (**IMs**) required to give effect to the Commission's draft decisions on the Gas DPP reset.
- 2 A number of submitters have raised concerns regarding the process the Commission has followed to amend the IMs. You have asked us to comment on that process and its consistency with the requirements of the Act.
- 3 This note does not address the submitters' arguments regarding the substance of the proposed IM amendments or the Commission's justification for the amendments.

Background

- 4 The Commission is required to reset the Gas DPP by 31 May 2022, to take effect from 1 October 2022. On 4 August 2021 the Commission published a Process and Issues paper as a first step in its reset of the DPP. That Process and Issues paper outlined a range of issues for consideration, including flagging the potential implications of climate policy and technology change for DPP3.
- 5 The Commission received a number of submissions in response to its Process and Issues paper, including from those submitters that are now objecting to the Commission's proposed amendments to the IMs. Those submissions were published on 30 August 2021. Firstgas', Vector's and Powerco' submissions proposed accelerated depreciation (by reducing asset lives) to address the increased stranding risk associated with changes in the policy and technology environment for gas. MGUG made a cross-submission arguing against that proposal.
- 6 On 8 December 2021, the Commission gave notice of its intention to set a four-year regulatory period for DPP3. MGUG argues that it would have been appropriate for



the Commission to signal its intention to make further IM changes at this point in the process and that, by failing to do so, the Commission left submitters with the impression this was the full extent of its changes. The fact that the Commission did not signal further changes at this stage has no bearing on its ability to propose further changes at a later point in its consultation process. In any event, the Commission:

- 6.1 explained why it was giving early notice of this proposed change (to allow GPBs to hedge interest rates in the December window in which the risk-free rate is estimated); and
 - 6.2 nowhere indicated that this was the limit of the changes it was considering.
- 7 On 4 February 2021 the Commission gave notice of its intention to amend the IMs in anticipation of the Gas DPP reset. That notice explained that the Commission was considering amending the asset valuation IM to provide a mechanism to adjust asset lives for existing and new assets.
- 8 On 10 February 2021 the Commission published its proposed amendments to the IMs for consultation. As regards the proposed amendment to allow for a reduction in asset lives, which is the focus of submitters' complaints regarding process, the Commission set a submission deadline of 10 March and a cross-submission deadline of 25 March (four and six weeks, respectively). Interested parties have made extensive submissions in response to the Commission's proposed amendments to the IMs.

Process concerns raised by submitters

- 9 MGUG, Methanex, Fonterra and Pat Duignan (for Munro Duignan) have raised concerns regarding the process by which the Commission proposes to amend the IMs in order to give effect to its draft decisions for the Gas DPP reset. Their concerns can be grouped into two categories—
- 9.1 The submitters argue that they have not been afforded a reasonable opportunity to submit on the proposed amendments, and specifically that:
 - (a) the Commission ought to have signalled its intention to amend the IMs at an earlier point in the process (e.g. via an "emerging views" paper or similar);
 - (b) four weeks is an insufficient period of time to adequately respond to the Commission's proposals; and
 - (c) that a workshop would be appropriate given the nature of the proposed amendments.
 - 9.2 The submitters also argue that the proposed amendments are inconsistent with the scheme of the Act because the Act contemplates that amendments of this nature would be made via a comprehensive review under s 52Y rather than an amendment under s 52X.



The Commission's power to amend the IMs

- 10 The Commission is entitled to amend an IM at any time. If the Commission proposes to amend an IM by making a material change, the Commission must follow the same process as is required for a new IM.¹ The Commission must:²
- 10.1 publish a notice of its intention to amend the IM that outlines the process that will be followed and the proposed timeframes;
 - 10.2 publish its proposed IM in draft;
 - 10.3 give interested persons a reasonable opportunity to give their views on that draft IM; and
 - 10.4 have regard to any views received from interested persons within any time frames set.
- 11 The Commission may, but is not required to, hold a conference as part of its process for amending the IM.³
- 12 While the Commission can amend an IM at any time, amended IMs have limited effect in relation to existing price-quality paths. Section 53ZB provides that a DPP or CPP may not be re-opened within a regulatory period on the grounds of a change in an IM, except if the IM is changed as the result of an appeal. Amendments are therefore forward-looking and principally affect price-quality paths determined after the IM is amended.
- 13 Section 52Y requires the Commission to review each IM at intervals of no more than seven years. When reviewing an IM, the Commission must again follow the same process as it would for a new IM. Section 52Y requires periodic comprehensive reviews of the IMs, but does not preclude the Commission from amending IMs more frequently under s 52X, or conducting reviews under s 52Y earlier than seven years or at more frequent intervals.

1. Has the Commission provided submitters with a reasonable opportunity to give their views?

- 14 The statutory consultation requirements in s 52V mirror the common law requirements, which have been summarised by the Supreme Court as requiring the decision-maker to:⁴

...tell those to be consulted what is proposed, give them a fair opportunity to express their views and...consider their views with an open mind before making any [decision].

¹ Commerce Act 1986, s 52X.

² Commerce Act 1986, s 52V.

³ Commerce Act 1986, s 52V(2)(c).

⁴ *New Zealand Pork Industry Board v Director-General of the Ministry for Primary Industries* [2014] 1 NZLR 477 at [168].



Should the Commission have signalled its intention to amend the IMs at an earlier point?

- 15 Section 52V of the Act requires the Commission to issue a notice of its intention to amend the IMs and to outline the process and time frames. The Commission did so. The Commission is under no obligation to signal its intention to amend the IMs at any particular point in time, provided the process it proposes to follow meets the requirements of s 52V(2).

Was four weeks sufficient time to respond?

- 16 There is no strict rule regarding the period of time that must be allowed for interested parties to express their views. What amounts to a fair or reasonable opportunity depends on the context.⁵ In this case, the four weeks afforded submitters by the Commission must be assessed against the following contextual factors:
- 16.1 the Commission publicly notified its intention to amend the IMs on 4 February, and indicated the date on which its draft decisions would be published, as well as the timetable for submissions;
 - 16.2 four to six weeks is the period of time the Commission typically allows for submissions on a draft determination, and so the consultation process and period in this instance is familiar to all the participants;
 - 16.3 the proposed amendments are not extensive relative to other IM amendment processes in which the Commission has allowed a similar timeframe for submissions (including, for example the comprehensive IM Review in 2015/16);
 - 16.4 the submitters are all sophisticated participants in Commerce Commission regulatory processes, are well-versed in the issues and the Commission's past precedents, and are able to bring significant resources to bear when participating in consultation;
 - 16.5 the proposal to accelerate depreciation by shortening asset lives was raised in submissions in August 2021. MGUG provided its views in response in September 2021. The participants have therefore been engaged on this issue for some time and certainly well before the Commission published its notice of intention in February;
 - 16.6 the submitters have in fact expressed their views – in detail – on the Commission's proposed amendment in their submissions and have a further opportunity to comment via cross-submissions; and
 - 16.7 the Commission is required to make its final decision by 31 May and has therefore adopted time frames that are appropriate to meet that deadline.

⁵ Ibid. See also *Wellington International Airport Limited v Air New Zealand* [[1993] 1 NZLR 671 at 675.



17 Against that background, the four week period allowed by the Commission (plus an additional two weeks for submissions) was sufficient to meet the requirements of the Act and the common law standards of consultation.

Is a workshop required?

18 Section 52V provides that the Commission “may” hold 1 or more conferences. The permissive framing of that provision indicates that the choice of whether or not to hold a conference or workshop is at the Commission’s discretion.

2. Was the Commission’s process consistent with the scheme of the Act?

19 A number of submitters have argued that it was inappropriate for the Commission to propose this amendment as an exercise of its powers under s 52X and that, instead, the Commission ought to have deferred any decision on accelerated depreciation to the full IMs review that commenced on 23 February 2022 and will be completed in Q4 2023.

20 As described above, section 52Y requires periodic comprehensive reviews of the IMs, but does not preclude the Commission from:

20.1 amending IMs more frequently under s 52X; or

20.2 bringing forward the review of a particular IM as part of the wider s 52Y review process.

21 There are examples of both approaches in the Commission’s past practice in order to align the timing of IMs amendments with upcoming regulatory determinations. For example:

21.1 the Commission amended the IMs in the course of the EDB DPP3 reset in 2019 in order to give effect to certain draft decisions it proposed to make as part of that reset.⁶ In that case, as here, the Commission exercised its powers under s 52X on the basis that the amended IM would better achieve the s 52A purpose statement; and

21.2 in the 2015/16 IM Review the Commission fast-tracked its review of the airport IMs for land valuation so that the amended IMs would be in place well in advance of the 2017 price-setting events for AIAL and CIAL. The Commission also initially fast-tracked review of the WACC IM for CPPs in order to accommodate Powerco’s anticipated CPP application. The Commission ultimately was able to re-incorporate that issue into the wider review when Powerco indicated it was deferring its CPP application date.

22 These examples demonstrate that the timing of s 52Y reviews is not rigid and can be flexed (within the seven year envelope) to align with other aspects of the Commission’s work programme, and that the requirement to carry out the 52Y reviews does not deprive the Commission of its ordinary powers to amend IMs under

⁶ See: Commerce Commission, *Electricity Distribution Services Input Methodologies Amendments Determination (No. 2) 2019* [2019] NZCC 20 (26 November 2019); Commerce Commission, *Amendments to Electricity Distribution Services Input Methodologies Determination: Reasons Paper* (26 November 2019).



s 52X. There is an obvious benefit in making sure that appropriate IMs are in place for upcoming price-quality determinations, given those determinations dictate the terms of supply of regulated services for up to five years at a time. If the Commission were to, instead, defer consideration of the GPB IMs to the full IMs review, any changes would not take effect until DPP4.

- 23 Submitters have referred to the Commission's past statements that it will generally avoid making "fundamental" changes to the IMs outside of the s 52Y review cycle. In the course of the 2015/16 IMs review, the Commission developed a decision-making framework to guide its decisions to amend (or not amend) IMs. In subsequent amendment processes under s 52X (linked to price-quality determinations), the Commission has distinguished between what it described as the "fundamental" IMs (in s 52T(1)(a)) that it will not generally be appropriate to amend as part of a s 52X amendment process, and amendments to other IMs that:

23.1 make incremental improvements to price-quality paths; or

23.2 enhance certainty and correct for technical errors.⁷

- 24 The Commission has also noted, however, that the distinction is not absolute and that it has reconsidered fundamental building blocks in isolation in the past where there was a "compelling and urgent rationale for doing so".⁸

- 25 In its Draft Reasons Paper for these proposed amendments, the Commission has reiterated that reasoning and explained its position in light of the:

25.1 purpose of IMs in s 52R, which is to promote certainty; and

25.2 the purpose of Part 4 overall in s 52A, which is to promote outcomes consistent with outcomes produced in competitive markets.

- 26 The Commission rightly recognises that the s 52R purpose statement requires that IMs have a degree of durability. If they can be too readily changed, they do not provide the certainty that regulated suppliers are entitled to expect under Part 4 regulation. However, as the Commission notes, certainty is not an absolute and the overall Part 4 purpose statement requires the Commission to make decisions for the long-term benefit of consumers, including in terms of the specific outcomes listed in paragraphs (a) to (d) of s 52A. The Commission is required to give effect to both purpose statements.

- 27 We agree with the general thrust of the Commission's analysis of the interaction between s 52R and 52A. Specifically, we agree that giving effect to both s 52R and 52A will require, on occasion, striking a balance between the benefits of certainty and the need to make changes to better achieve the s 52A purpose. However, it is worth emphasising that the distinction the Commission draws between

⁷ See, for example: Commerce Commission, *Amendments to Electricity Distribution Services Input Methodologies Determination: Reasons Paper* (26 November 2019) at para 2.10 et seq.

⁸ See Commerce Commission, *Fibre Input Methodologies Main 2021 Amendments: Final Decisions* (29 November 2021) at para 2.18-2.20.



“fundamental” IMs, which it will only exceptionally amend outside a s 52Y review, and other IMs, which can be more readily amended under s 52X, does not appear anywhere in the Act itself. It is a heuristic the Commission has adopted as a means of giving effect to the balancing between ss 52R and 52A. Accordingly, while it is a useful analytical framework for undertaking that balancing exercise, the concept of “fundamental” IMs is not a rigid category to which the Commission is bound.

- 28 The question, then, is whether the Commission’s proposal to amend the asset valuation IM to address the increased risk of asset stranding outside of the s 52Y review process reflects an appropriate balancing of the s 52R and 52A purpose statements. In other words, does the Commission have a sufficiently compelling rationale to amend the IMs? In our view, the Commission is justified in amending the asset valuation IM on the basis of the factors set out in paragraph 3.25 of the Draft Reasons Paper, and particularly in light of the following:
- 28.1 regardless of one’s view of where exactly the policy discussion surrounding gas will settle, there is plainly an increased risk of asset stranding relative to the assessment the Commission might reasonably have made at the outset of DPP2. Given the Commission apprehends that increased risk now, it is appropriate to take steps to address that risk in the upcoming regulatory period;
 - 28.2 as the Commission says, early action lessens the probability that network stranding will become unavoidable and helps preserve options for managing future uncertainty;
 - 28.3 as a corollary, acting in this regulatory period mitigates the risk of a much greater price shock to consumers in DPP4 or beyond; and
 - 28.4 the Commission’s proposed mechanism is NPV neutral, and therefore effectively addresses the increased risk of asset stranding without changing the present value that is available to be recovered by suppliers through revenues over time.

Yours sincerely

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