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Head of Energy, Airports, and Dairy Regulation
Commerce Commission

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Dear Andy

Resetting default price-quality paths for gas pipeline businesses from 1 October 2022

Nova Energy ("**Nova**") appreciates this opportunity to comment on the process of resetting default price-quality paths for gas pipeline businesses (GPBs) from 1 October 2022 (DPP3). Nova is a major wholesaler and retailer of natural gas produced by Todd Energy (**Todd**). Nova also operates three gas fired co-generation plants and supplies gas to Todd Generation Taranaki, which operates 4 x 50MW open cycle gas turbines.

One key issue underlying the Commission's decisions to be made in respect of DPP3 is the potential impact on gas demand given Government policy and the Climate Change Commission's (CCC) recommendations. This gives reason for limiting the term of DPP3 to four years, but in other respects Nova does not think the expected market changes or uncertainty over the period to October 2026 are sufficient to warrant assuming that gas volumes will reduce significantly over DPP3.

Gas market developments

Todd and other oil and gas exploration companies, such as OMV and Greymouth Petroleum, have active drilling programmes underway which ultimately should overcome the current tightness in gas supply, which largely result from the current constraints in gas production at the Pohokura gas field. Nova's expectation is consistent with Concept Consulting's paper prepared for the Gas Industry Company (GIC), notwithstanding that Todd has submitted that the probabilities of success of new drilling programmes are lower than has been adopted by the GIC in its draft report. Nova has recently signed contracts with industrial customers to supply gas that extend for five years and longer.

Natural gas will continue to play an important role as New Zealand transitions to a low emissions economy consistent with the Government's climate change policy and legislation. Natural gas as a fuel (including the associated transmission and distribution assets) will be exposed to competition from alternative fuel sources such as biomass, especially as the price of carbon emissions is expected to rise through time. The transition away from natural gas as a fuel is expected to occur as and when consumers undertake asset replacement expenditure.

We also note that the CCC's advice to Government expects a significant proportion of reductions net emissions in the next decade to come mainly from electrification of transport, carbon capture and sequestration from forestry, reductions in emissions from thermal generation (coal fired generation in particular), and through new investment in renewable electricity generation. It is also recognised that there are barriers to the transition away from natural gas in the short term such as availability of biomass fuel and electricity transmission and distribution capacity to support conversion to electricity as a fuel source. While these constraints can be removed, it is unlikely that the demand for natural gas will be materially displaced before 2030 – well within the timeframes of this reset period.

The recommendation by the CCC to ban new residential connections will signal to consumers that gas should be replaced by electricity, but any impact of that on total demand would also be minor over the DPP3.

The CCC also recognises the important role of gas fired generation in providing peak period electricity demand and back-up for dry hydrological sequences well beyond 2030. An element of gas supply that is less well recognised is its role in meeting cooking and heating requirements during peak winter demand periods. Direct gas usage by consumers during peak demand times is around 150% more energy efficient than using electricity supplied by open cycle gas turbines. That is also assuming there is adequate generation available, and the electricity networks have sufficient capacity to meet an increase in peak demand.

The value of gas in this context is also likely to be increasingly recognised by consumers as both electricity retailers and distributors move to pricing plans that reflect higher peak period costs. This leads to Nova's view that while it is appropriate to consider the longer term implications of climate change policy, gas will still have an important role to play over DPP3, and it would be incorrect to assume a significant fall in gas demand over that time frame.

Greening of gas and alternatives for gas pipelines

With large amounts of capital being invested into investigating and developing alternatives to fossil fuels such as green hydrogen and biogas, and improving the economics of their production, we can expect to learn much more about the potential for using the existing pipeline networks for transmission of renewable gases over the next five years. That will be the appropriate time to map out the long term future for the gas pipeline networks.

A 4-year DPP is appropriate given the uncertainty over future developments and is preferable to speculating now on possible future outcomes.

Lower cost of capital

The benchmark risk free rate of return has been extraordinarily low in the wake of the extended economic recovery from the global financial crisis, and subsequent stimulus policies to overcome the negative effects of the covid-19 pandemic. The U.S. Federal Reserve Board continues to project low interest rates well into the future. As such the lower cost of capital should be factored into a reset of DPP3.

If the Commission regards a fall in prices over DPP3 as a potential negative for consumers in subsequent years, then it could consider, in conjunction with applying a lower cost of capital, allowing offsetting higher asset depreciation rates (shorter asset life); so long as the NPV for GPBs and consumers is neutral. This would also reduce this risk for both parties of future pipeline redundancy.

Roll-over of prices

It can be taken from the points above that Nova does not favour a roll-over of current prices. Nova believes the building blocks approach is the better method for determining the DPP3. If gas distribution prices are to remain relatively stable in the short term, then there should be an offsetting benefit for consumers in the longer term. In considering the impact on consumers, it should be noted that gas prices have already risen significantly as a result of cost pressures on the supply side and the increase in the cost of CO_2-e emissions.

Summary

Natural gas will remain a critical energy source for New Zealand industry and consumers for many years to come. It is important to prepare the inevitable changes required to reduce carbon emissions, but the best path to that remains uncertain. The gas pipelines may well become part of the solution in the regions they reach. The GBPs are themselves incentivised to help deliver those solutions.

Yours sincerely

[redacted]

Commercial and Regulatory Manager

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