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Mr Matthew Clark
GPB DPP Reset Manager
Regulation Branch
Commerce Commission
44 The Terrace, Wellington 6011

Dear Matt,

Vector Gas Pipeline Business Default Price Path Process and Issues Paper Cross-Submission

1. In this cross-submission Vector responds to key issues raised in the submissions of stakeholders to the Commission's Process and Issues Paper for the Gas Pipeline Business (GPB) Default Price Path (DPP) Reset.

2. At a high level, all stakeholders coalesced on similar themes relevant for the GPB DPP Reset. Where stakeholders differed was in the tools and processes to be adopted by the Commission for resetting the GPB DPP.

3. Whilst differences in stakeholder views is to be expected. We consider it important for the Commission to at least understand how the different recommendations will impact the current DPP and beyond. To that end, the Commission should quantify the tools it settles on for resetting the DPP – including how they are consistent with the long term benefit of consumers (the LTBC).

Common agreement that Net Zero 2050 has created demand uncertainty

4. Most submissions acknowledge the government's legislated commitment to Net Zero 2050 has significantly changed the outlook for demand and asset utilisation for GPBs. The following extracts from selected stakeholder submissions illustrate the point:

   a) The Major Gas Users Group (MGUG) note:

      While we agree that the medium to long term future of gas consumption is uncertain, we don't consider that the pathway for gas within the shorter timeframe for the next regulatory period (2022-2027) is subject to the same levels of uncertainty.[1]

[1] Major Gas Users Group (MGUG), *Letter to Andy Burgess Re GPB DPP3 Reset – Process and Issues Paper*, p.2

b) Greymouth Gas note:

> *Greymouth considers that significant uncertainty exists in the New Zealand (NZ) gas sector and future direction will be influenced by Government decisions on climate change policy. The NZ energy sector will experience material changes to achieve the legislated target of net zero emissions by 2050.*[2]

c) Firstgas note:

> *We agree with the Commission's analysis that the gas industry has seen significant change since the last IMs review in 2016, particularly with the adoption of a legislated net-zero carbon emissions target and the resulting policy direction proposed by the Climate Change Commission (CCC).*[3]

5. Accordingly, managing the risk of greater long-run demand uncertainty is a matter acknowledged by all stakeholders. Where parties differed was on how to address the uncertainty within the context of 2022-2027 DPP. Across submissions there were two high level contrasting views:

    1) A business-as-usual approach (by virtue, disregarding the impact of Net Zero 2050 has on current and projected profitability) and

    2) Recognising the impact of Net Zero 2050 and considering whether it necessitates some modification for the assessment of current and projected profitability.

Approach 1 'Business-as-Usual is appropriate'

6. Submission from MGUG, Methanex and Greymouth Gas all advocate quite strongly for a business-as-usual approach for the DPP3 reset. The key reasoning from these submissions is that the immediate future should be the focus of the Commission. In that context, there is no reason for the Commission to review any inputs for their suitability for the DPP given the commitment to Net Zero 2050.

7. In this regard, MGUG note:

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[2] Greymouth Gas, *RE GPB DPP3 Reset*, p.1

[3] Firstgas, *Resetting DPPs for gas pipeline businesses from 1 October 2022 Process and Issues Paper*, p.4

We do not see uncertainty being materially different from previous DPPs in determining the settings for DPP3. Consequently, our view is that the Commission should proceed with a price reset based on precedents set in DPP1 and DPP2…[4]

8. The other key element from these submissions is that the uncertainty to demand from Net Zero 2050 has less significance for the DPP3 period. On this basis, the Commission should not reconsider the appropriateness for any of the inputs used for setting the DPP.

> *…the question is whether either pathway would materially manifest itself within the shorter timeframe for the next regulatory period (2022-2027) to an extent that this would determine whether the Commission should adopt anything other than a Business As Usual approach for the DPP3 settings.*[5]

9. Accordingly, the implication from these submissions is that the regulatory framework should only change after demand shock has been experienced. For example, Methanex notes:

> *In all of its scenarios, the CCC has forecast that considerable remaining natural gas demand will persist into the late 2030s with natural gas demand of between 73 and 87 PJ in 2039 depending on scenario.*[6]

10. The business-as-usual recommendation by implication is prioritising today's prices over long-term price and service durability. This is because the assumption is that inaction today will have no impact on the price/revenue level when the natural gas market reduces to half its current size to be between circa 73-87 PJ.

11. Houston Kemp show in their report the expected prices per GJ to recover the GPB MAR when the CCC's forecast for the New Zealand natural gas market is expected to contract to 87PJ. The report highlights significant and unsustainable increases to the price level. For this reason, Vector considers the business-as-usual approach fails the LTBC.

12. The internal inconsistency with the business-as-usual recommendation is clear in the submission from Greymouth Gas. Greymouth Gas note the current regulatory regime for the sector is only fit for purpose when there is a stable long-term outlook.[7] They also note the New Zealand gas sector is on a downward trajectory – it is a question of the speed of

[4] MGUG, *Letter to Andy Burgess Re GPB DPP Reset – Process and Issues Paper*, p.1
[5] MGUG, *Letter to Andy Burgess Re GPB DPP3 Reset – Process and Issues Paper*, p.3
[6] Methanex*, 2022-27 Default Price Quality Path Reset for Gas Pipeline Businesses,* p.3
[7] Greymouth Gas, *RE GPB DPP3 Reset*

the descent. However, they also recommend the Commission adopt a reset for GPBs using current and projected profitability based on inputs settled in 2016. The underlying assumption being these inputs are appropriate to determine the long run profitability even though they do not recognise the downward trajectory acknowledged by Greymouth Gas.

13. Should the Commission adopt the business-as-usual recommendation then it will require GPBs to reconsider their asset management stewardship. A business-as-usual approach will exacerbate the level of RAB to be recovered over future periods from a much smaller natural gas market. In effect, the approach will result in GPBs having to give highest priority in business decisions to managing stranding risk. This is a suboptimal outcome as it will result in network elements being prematurely retired irrespective of customer needs. We do not consider such an outcome to be in the LTBC.

When to recognise the impact of Net Zero 2050 – Approach 2 're-orienting the pathway for recovery'

14. CEG in their expert report for Vector note the importance of addressing stranding risk before it is too late. CEG describe the time-period in which a regulator is able to address the risks from stranding as the "window-of-opportunity" (WOO).[8] This refers to the period where prices/revenues are tilted in a way for invested capital to be recovered before the stranding risk is likely to manifest – i.e. before aggregate demand contracts to a level below which investment recovery can occur through cost based prices. Indeed, CEG note missing the WOO will mean any later corrective action will be less effective and the expectation of FCM and NPV=0 is not being targeted.

15. The forecast changes to prices undertaken by Houston Kemp on behalf of Vector, Powerco and Firstgas highlight potential change to the price level based on a GJ per forecasted MAR.[9] This work highlights how significant price changes will become for GPB users in the lead up to 2050. Accordingly, critical time for the Commission to make decisions is now to ensure it is acting within the WOO for re-orientation.

Ex-ante compensation

16. Methanex note the methodology applied by the Commission when setting an ex-ante allowance, able to be recovered through revenues for stranding risk for Chorus in relation to the risk of wireless technology bypass would require a similar type of analysis and

[8] CEG, *stranding risk depreciation v uplift*, p.2
[9] Houston Kemp, *Consequences of declining gas pipeline utilisation*, p.9

assumption to be applied to GPBs. This is in effect what CEG has done in their expert report for Vector. In that report CEG noted Net Zero 2050 suggests a premium of circa 500 basis points[10] on the baseline WACC based on the approach applied to Chorus.

17. Vector notes the strong recommendation by CEG is that for the stranding risk faced by GPBs, the more appropriate economic tool is to accelerate the depreciation of invested capital. CEG note the specific risks presented by Net Zero 2050 require either ex-ante allowances or depreciation acceleration to occur when willingness to pay (i.e. aggregate demand is the highest). This requires action today based on the CCC's projections for the natural gas market.

Are Customised Price Paths (CPP) a better solution for addressing the changes for Net Zero 2050

18. Methanex note that the DPP as a relatively low cost and general mechanism is not suited to addressing complex or emerging issues such as Net Zero 2050. In this regard, Methanex suggests such decisions are better considered in a CPP application. CPPs are designed to manage specific business needs which are not addressed in the DPP. Vector notes the impact of Net Zero 2050 applies in equal magnitude across the natural gas transportation sector. Therefore, Vector considers the impact of Net Zero 2050 is a matter that is entirely within the remit of the DPP.

19. The fact that Net Zero 2050 is a new challenge for the setting of DPPs for the GPB sector does not by itself mean that it should not be considered as part of a DPP. Rather, the DPP is still required to be set to target the LTBC. A failure to consider Net Zero 2050 for the DPP will mean a relevant consideration to ensure the targeting of FCM targeting of FCM is being omitted for the setting of the DPP.

Part 4 of the Commerce Act and decarbonisation objectives

20. Vector agrees with Mercury that there is an urgent need for the Commission to consider how decarbonisation should align with the Commission's responsibilities for administering Part 4 of the Commerce Act. We agree with the example provided by Mercury around the limited scope for considering green gas development (in particular hydrogen) as part of the DPP reset.

21. However, Vector believes the legal opinion of Chapman Tripp is unequivocal in the requirement for the Commission to consider Net Zero 2050 when determining the right

[10] CEG, *stranding risk vs Uplift*, p. 14

price/revenue level for the DPP is in the LTBC. In this regard, the Commission must consider what is the right level of investment recovery needed for the DPP3 period ensure a reasonable expectation of FCM is able to be maintained given Net Zero 2050.

Conclusion

22. The submissions to the Commission's Process and Issues Paper demonstrate the importance of conducting a Workshop on critical decisions for the next DPP – in particular the topic of managing the risk of capital recovery. Such a Workshop should enable the Commission to ensure it has sufficient stakeholder input into the critical decisions needed to set the 2022-2027 DPP consistent with the principles of Part 4 to meet the LTBC.

Yours sincerely

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