Commerce Commission
Via email: regulation.branch@comcom.govt.nz

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

Mercury welcomes the opportunity to provide feedback on the process and issues paper 'Resetting default price-quality paths for gas pipeline businesses from 1 October 2022 (Issues Paper). Our primary interest in the resetting process is to ensure final decisions help support the maintenance of and ongoing investment in, a reliable and secure supply of gas. Gas provides an important back up for renewable electricity generation in the New Zealand Electricity Market and will be needed for this purpose over the short term until Aotearoa completes its low carbon transition away from fossil fuels. Longer term, gas pipeline infrastructure will likely have a role to play in transportation of low carbon gases, particularly hydrogen, methane derived from hydrogen and/or biogas. While these technologies are not currently economic, they have the potential to feature in future Government plans for decarbonisation.

Separate from the reset process a review of Part 4 of the Commerce Act is needed for alignment with decarbonisation objectives

While it will not be possible before the current regulatory decisions are made, particularly as Default Price Path three (DPP3) must be set by 1 October 2022, if the Commerce Commission (CC) finds that it is unable to properly take into account the Government's climate change objectives because of the drafting of Part 4 of the Commerce Act, then the CC should request that Government consider a statutory amendment to avoid future policy confusion. We note that on page 17 the CC states that *'under the current legislative framework the scope for us to consider the 2050 net zero emissions target when making decisions under Part 4 is limited.'* The CC also notes on page 18 that it can have regard to the target but cannot do so where it detracts from the Part 4 purpose. On page 32 the CC notes that '*it is likely that neither biogas nor hydrogen can be considered 'natural gas'* under the Commerce Act meaning that an innovation allowance for conveying these gases would be beyond the scope of Part 4. This issue was raised by submitters who provided feedback to the Climate Change Commission on its draft emission budget advice to Government.

Mercury supports the Commerce Commission proposed approach to dealing with the forthcoming price-quality path reset

We note that for this reset the CC intends to retain approaches from the last gas default price-quality path reset (DPP2) where they remain fit for purpose, making changes where they would promote the purpose of Part 4 of the Commerce Act better, promote the purpose of the DPP regulation better, or reduce unnecessary complexity and compliance costs. We note also that the comments in the issues paper around the prospect of climate change affecting the way we create and use energy and the Government's commitment to net zero carbon emissions by 2050, and 100% renewable electricity by 2030, means the energy sector is in a period of transition, and the pace of change may accelerate. The Climate Change Commission has outlined in its advice, a decarbonisation pathway that would result in a decline in natural gas use alongside a potential role for low carbon gases. The Government will respond to the advice by 31 December 2021. This means the future of gas consumption is uncertain.

The Gas Industry Company (GIC) assessed two possible scenarios, a 'wind-down' scenario (gas consumption is phased out and gas infrastructure is decommissioned) and a 're-purpose' scenario (where gas consumption transitions from natural gas to a low carbon alternative). Taking these uncertainties into account the CC has set two priority outcomes (1) appropriate levels of expenditure on investment and maintenance to ensure safe and reliable gas supply; and (2) predictable natural gas pipeline prices for consumers while limiting excess profitability. Mercury supports this approach.

Approach to setting starting prices

Mercury agrees with the CC assessment that given the Climate Change Commission's recommendations and the significant uncertainty over the future direction of the gas sector, rolling over the prices applying at the end of the preceding regulatory period (DPP2) may be more appropriate in terms of Part 4 objectives, than attempting to set a fresh price path. This approach would result in greater short-term cash flows for GPBs but this is balanced by the significant stranding risk GPBs must manage over the lifetime of the assets. The advantages of this approach are simplicity and provision of some compensation for stranding risk.

Managing demand and capital recovery risk (form of control)

The CC currently uses a WAPC for GDBs and a pure revenue cap for the GTB. These forms of control were last reviewed in 2016 when growth in natural gas use was encouraged. The CC is considering whether these mechanisms are still fit for purpose in the current environment. In the 2016 Input Methodology review a mechanism was introduced to allow electricity distribution businesses to apply for shorter asset lives. This was to ease concerns over the risk of partial capital recovery of long-life assets. The CC has also previously provided ex-ante compensation to regulated fibre services to manage similar risk. We support the CC considering these mechanisms for GPBs. We note the summary of forecast opex and capex issues on page 8-9 and Chapter 6. We have no specific comments.

Issues common to rollover and price path reset

The CC has provided a table summarising the key issues on pages 8-10 of the issues paper. Mercury agrees with the summary and doesn't have additional issues. In particular, we note the issues common to rollover and price path reset that arise due to climate change policy uncertainty.

Timing of Input Methodology review

Mercury agrees with the CC assessment that it is not practical to implement any changes to the Input Methodology ahead of the DPP3 review as the Emissions Reduction Plan will not be ready until the end of 2021.The other mechanisms suggested by GPBs and GTB are worth considering in the interim.

If you have any questions please contact Sharron.came@mercury.co.nz.

Yours sincerely

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