3 August 2022

Dane Gunnell
Manager, Input Methodologies Review,
Commerce Commission
P O Box 2351
Wellington

Via email: im.review@comcom.govt.nz

Dear Dane

Re: Process and Issues/Draft Framework Cross submission

1. This cross submission is made in response to the Commerce Commission *Part 4 Input Methodologies Review 2023 Draft Framework paper and Process and Issues Paper* dated 20 May 2022. The cross submission is made on behalf of the Major Gas Users Group (MGUG).

2. Our members have been consulted in making this submission. Nothing in this submission is confidential and some members may choose to make separate submissions.

3. Our submission is focused on gas IM matters unless otherwise stated.

General Observations

4. Having read the submissions of gas pipeline businesses (GPBs) we would make the following observations/ comments:

    a. Many assertions made by submitters lack supporting evidence. Arguments based on conjecture and assertions are not evidence, they are opinions. The Commission should insist on a higher standard of evidence from everybody.

    b. GPBs are not the voice for consumers. The Commission should do more to get the views of consumers on matters proposed by GPBs, particularly where GPBs claim that these are being promoted for the benefit of consumers.

    c. In framing and assessing arguments the Commission should be aware of and look for cognitive biases, particularly; recent tendency to weight the latest information more heavily than older data, zero risk bias, anchoring, and bandwagon effects. The only effective mitigation on cognitive biases is to be able to test and challenge factual evidence.

Summary of cross submission

5. This cross submission addresses the following matters:

   a. It supports calls for a deliberative rather than consultative process to develop the IM settings.

   b. It argues for keeping a measured perspective on future demand risk and notes that more recent information through the ERP has provided greater certainty in support of gas.

   c. It considers that GPBs would have a more credible basis for their arguments if there were consumers speaking in support of their claims for consumer benefits.

   d. It further challenges the Commission's acceptance that ex ante FCM compensation is a feature of workably competitive markets, by reviewing the Commission's reasoning for it in the Commission's Fibre IM decision and reasoning[1].

   e. Our disagreement with Vector's argument for a change in the Form of Control for GDBs, from weighted average price cap to total revenue cap.

   f. Why retaining director certification for annual AMP updates provides significant benefits for consumers.

   g. Limiting Climate Change Response Act 2002 (s5ZN) relevance for Commission decision making to relevant policy matters outlined in the ERPs, but not national targets and budgets. The ERPs support our calls for including renewable gases in the definition of gas pipeline services, as well as signalling confidence in the sustainability of gas pipeline services beyond 2050.

A more deliberative approach to setting the next IM

6. Supplier claims for revenue enhancement through WACC settings, or front loading their returns, need a better process to achieve consensus with consumers. We support calls from various submitters (Vector[2], Powerco[3]) for a better approach to setting the IM settings. We would support a more deliberative approach, one which defines the problem and develops a range of options before deciding on a preferred solution. We consider this will allow IM settings and issues to be explored in an integrated way. The timetable for the IM process would appear to have room for workshops or conferences to occur before the Commission makes a draft decision.

Uncertainty in the future and relevance needs to be kept in perspective

7. While arguments talk about the extraordinary situation of climate change policy risk as something new and different, we think that the level of uncertainty in the external environment

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[1] Commerce Commission – 13 October 2020 Fibre input methodologies: Main final decisions – reasons paper
[2] Vector submission on IM review draft framework paper 11 July 2022 – para 4.
[3] Powerco submission on IM review Process and Issues paper and draft Framework paper 11 July 2022 – p 2, para 3

and its relevance over the next 30 years should be kept in perspective. It is a different risk, but not necessarily any more unique than other strategic risks that are being managed with the usual risk management techniques[4]. We covered this point extensively in our cross submission on the DPP process and issues paper.[5]

8. In particular it is important for the Commission to distinguish different market risks between GDBs and GTBs and consider that GPB revenue risks depend on consumer segments. Our extensive submissions using factual evidence on these points during the DPP3 process also apply for this review.[6]

9. Since the time of the DPP3 submission process, the Government has released its Emission Reductions Plan (ERP). In it, the Government eschewed the advice of the CCC to set a date for banning new gas connections, and instead asked for a Gas Transition Plan to be developed including for renewable gases[7]. The Government's response in itself provides a higher level of reassurance than alluded to by the CCC advice. The more recent policy signal does not preclude gas pipeline services continuing beyond 2050.

10. As also noted in our earlier submission[8], when compared with a 30-year timeframe for decarbonisation, a continuing and underlying strategic risk for GPBs has been whether New Zealand has sufficient domestic supply beyond 4-5 years. This should weigh on justifying ongoing investment lives in gas infrastructure and ex ante FCM expectations.

11. This constant threat of supply shortage leading to demand risk in a relatively short to medium term hasn't previously raised concerns among GPBs when committing to infrastructure with 80-year asset lives.[9] Hence it's difficult to comprehend why policy settings that are yet to be determined, let alone play out over 30 years, should trigger such a high level of concern among GPBs.

12. Perceptions regarding long term demand risk have also changed since the initial CCC advice. This is not so much with respect to what was written in the advice, but rather a better understanding of the distinctions between hard advice (national targets), and what were the ideas and assumptions for the purpose of creating statutory required demonstration pathways in the advice. Subsequent ministerial statements about the importance of gas in the energy mix, and the ERP have made it clearer that there is no need to weigh towards an existential crisis for gas pipeline services.

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[4] E.g. Keeping options open, gathering better information, improving resilience, investing in no regrets moves, using short term tactics to manage strategic uncertainty

[5] 202109 MGUG-Cross Submission on DPP Process and Issues Paper – para 33-50

[6] Ibid , 202203 MGUG Submission on draft decisions IM and DPP3, 202203 MGUG Cross Submission on draft decisions IM and DPP3

[7] https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwjIm7veuZX5AhVXRmwGHVVNDvwQFnoECAsQAw&url=https%3A%2F%2Fwww.mbie.govt.nz%2Fdmsdocument%2F20265-terms-of-reference-gas-transition-plan&usg=AOvVaw0Rmbq43_mSL7MXoHWalE4F

[8] 202109 MGUG-Cross Submission on DPP Process and Issues Paper – para 51-55

[9] Schedule A Gas Transmission/ Distribution Services Input Methodologies Determination 2012

13. We would therefore expect that the Commission will have an improved and more balanced perspective on long term demand risk than it demonstrated in the gas DPP3 process.

Where is the consumer voice supporting GPBs position on investment incentives?

14. In the supplier submissions it seems a common theme for GPBs to point to the greater uncertainty for gas and advance that theme as a reason for the Commission to provide a broad range of support measures to “incentivise investment” for the benefit of consumers. Suppliers are seeking larger risk premium in the WACC, ex-ante FCM compensation for sunk investments, removal of RAB indexation, and changes in the form of control for GDBs.

15. While it seems unsurprising that suppliers would look to shift the settings that improve their returns given the opportunity to do so in an IM review, it should also be incumbent on suppliers to demonstrate why this would be in the consumers’ interest.

16. The various submissions from GPBs provide no evidence to support their claims that they are underinvesting or would underinvest to the detriment of consumers because of the current IM settings. MGUG has however given qualified support for considering gas pipeline repurposing to low carbon gases as an area where Part 4 hinders investment for the benefit of consumers. We consider that the most important solution to address this is to address the restriction of the definition of gas pipeline services in the legislation.

17. We would suggest the Commission give greater weight to GPB arguments where consumers support their calls for improved financial performance given that consumers have arguably a greater stake in the future of gas. Other than investment barriers for low carbon gas pipeline repurposing we have yet to see a submission from consumers that endorses supplier calls for higher prices. In the absence of consumer support we would expect the Commission to be actively seeking and listening to consumer voices to test supplier claims.

18. For further perspective on what weight to give the GPB voice we note that GPB’s stake in gas assets is relatively minor compared to the whole gas sector. GPBs have around $2 billion in their RAB.[10] The CCC has estimated that residential and commercial consumers alone would need to invest $5.3 billion to switch away from gas to electricity with further downstream consequences of upgrading electricity infrastructure being paid for by consumers[11]. If gas was no longer an option or became uneconomical, industries such as petrochemicals (Ballance, Methanex, Evoniks) and NZ Steel would be left with physically as well as economically stranded assets. Switching costs for high temperature process heat in dairy, and pulp and paper will run into billions of dollars. The ongoing upstream investment in petroleum exploration alone is around $1 billion a year[12] and the committed and ongoing investment in facilities run into many more billions. In this context GPB investment at risk is by our estimates, relatively minor. Furthermore the assets operating in competitive markets will receive no compensation if left stranded.

[10] Various Gas Financial disclosures Schedule 4– closing RAB value
[11] https://businessdesk.co.nz/article/gas-dilemma-why-govt-didnt-set-a-phase-out-deadline
[12] MBIE – Energy in New Zealand.

19. The supplier solution to their concern of maintaining ex-post FCM is to raise prices for gas connections. It is difficult for us to see this as being in the best interest of consumers and is not something that we would see as consistent with workably competitive market outcomes.

20. Despite the materially more important upstream and downstream stake in the ongoing future of gas, these stakeholders, including ourselves, therefore remain sceptical about GPB claims for changing the IM settings that purportedly are for the consumer benefit. This scepticism on consumer benefits is being reflected in the merit appeal.

Where is the factual evidence that GPBs are underinvesting?

21. While GPBs do not appear to provide any substantial evidence for their claims in their submissions, we've tried to find the evidence where important investment on behalf of consumers is not able to be financed. We've reviewed supplier Asset Management Plans (AMPs) as well as their annual reports (where these are available).

22. Powerco, in the Executive Summary to their AMP point to regulatory uncertainty impacting investment economics. In particular they emphasise their hesitance to fund accelerating a demonstration pathway for alternative gases and exploring options to repurpose existing networks[13].

23. First Gas' 2021 Distribution AMP appears confident that they can continue to make investments to both maintain the reliability and integrity of their network as well as continuing to advance work in repurposing their system[14]. These commitments and assurances are repeated in their 2021 Transmission AMP. Both AMPs demonstrate confidence in the long-term future of their assets.

24. Vector's 2022 gas distribution AMP update reassures stakeholders that Vector "remains agile, is working to preserve optionality", and details its 10-year forward investment program to 2032[15]. While Vector makes clear that the AMP doesn't bind them to deliver the investments should circumstances change, the AMP was signed off on 29 June 2022 by directors including that the forecasts in Schedules 11 a, 11b, 12 a, 12 b, and 12 c are based on objective and reasonable assumptions aligning with Vector's corporate vision and strategy.

25. Vector also publishes an annual report. Vector is a useful case study in the sense that its investment portfolio includes both regulated (gas and electricity networks), and unregulated (gas trading and metering) businesses. What we observe from these accounts are[16]:

    a. Regulated networks are the main profit drivers for Vector. The regulated networks represent about 62% of revenue, but contribute 82% of net profit in their segment reporting.

[13] Powerco- Gas Asset Management Plan 2021 – 1.1 Executive Summary
[14] First Gas 2021 Distribution AMP Update – Message from Chief Executive Officer p5
[15] Vector gas distribution amp update 2022
[16] Vector annual reports 2016-2021 and interim report 2022

b. Their dividend policy is signalling that prospects for the company are good. Vector has a dividend growth policy with dividends growing each year between 2009 and 2021[17]. On average 41% of positive operating cashflow and 42% of net profits is paid out as dividends.

c. There is no evidence that Vector is finding it difficult to borrow to fund its investments and it maintains a corporate credit rating from S&P of BBB+ (stable outlook)[18].

26. Vector's imperative for higher returns appear to us to be more about supporting their dividend policy than it does to benefit the long-term interest of consumers.

27. From their public statements GPBs don't appear to have any particular difficulty investing under current settings, and each has standard strategies in place to manage what is routine strategic uncertainty. The only GPB to raise a specific issue around investment barriers is Powerco with respect to regulatory uncertainty to invest in gas pipeline repurposing. MGUG has raised the same issue in its submission[19]. We see the solution in fixing the problem in the Commerce Act around the definition of gas pipeline services. First Gas has called for similar clarity in its submission[20]

28. While GPBs may see an opportunity to influence the Commission to reduce their risk and increase their regulated returns it seems a short sighted and counterproductive tactic that undermines the strategic interest of the sector, including for GPBs to remain relevant. Our submissions explain why raising prices faster relative to alternative energy choices doesn't strike us as particularly helpful for keeping gas transport relevant in the long term [21].

Ex-ante FCM compensation is not a tendency of workably competitive markets

29. GPBs stress in their submissions the need to preserve the ex-ante FCM principle. If this applies to investment decisions yet to be made this seems relatively uncontroversial. Whether regulated or not, every entity approaches investment decisions in a similar way. Before making the final investment decision firms assess whether they can expect to earn at least the cost of capital over the ***lifetime*** of the investment. Or as put by the HM Treasury Advisory Group[22]

> "***No commercial competitors would come into an industry if they did not expect to be able to recover the decline in real values of their assets, as well as earn a normal profit (the***

[17] A company that has a steady dividend growth is not only signalling to capital markets that they are performing well and generating sustainable free cash flows but is often taken as a powerful signal that prospects for the company are good.
[18] https://www.interest.co.nz/bonds-data/issuer-profile/36
[19] 202207 MGUG Submission on 2023 IM review Framework and Process and Issues papers – para 11,12, 22-27
[20] First Gas limited Submission on IM review Process and Issues paper and draft Framework paper 13 July 2022 – p3 Renewable gases identifying legislative restriction
[21] 202109 MGUG-Cross Submission on DPP Process and Issues Paper – para 17-26 reinforced in 202207 MGUG Submission on 2023 IM review Framework and Process and Issues papers – para 70-73
[22] (HM Treasury Advisory Group, Accounting for Economic Costs and Changing Prices: A report to HM Treasury by an Advisory Group, Vol. 1, HMSO, London, 1986, paragraph 19.

> ***opportunity cost of capital).*** *They would measure their return on investment after recovery of funds sufficient to maintain the real value of the financial capital they had invested*"

30. The key distinction to be made in this statement, is the meaning of "lifetime". In a stable environment, companies are prepared to make relatively long-term decisions. Where there isn't a reasonable expectation of ex ante FCM maintenance, that investment isn't made until the return matches the investment horizon. Long term demand risk is managed by shortening investment horizons, deferring CAPEX in favour of OPEX, risk transfer, selling the business to someone who has a different view of the future or has greater capability to create the necessary return. Ultimately, if there are no other choices, businesses close. These are all observable outcomes in competitive markets, including local examples, in the way GPBs in New Zealand behave[23].

31. Thus, the issue isn't whether the reasonable expectation of ex-ante FCM principle for new investment isn't relevant, it is. Rather it is that investment horizons (expected lifetimes) adjust based to reflect what is meant by lifetime.

32. To suggest that firms should be able to make long term investment decisions over lifetimes not expected to be met, and to transfer the risk of recovering the cost of that investment through higher prices, is to concede that a party should have an incentive to take unusual risks for which they will be compensated by their counterparty. This is the definition of moral hazard and needs to be avoided where the best long-term interest of consumers is being sought. The submission of Mr Pat Duignan made during the DPP3 process lays out this argument out more clearly[24].

33. Where we also hold a different view from the Commission, is the upholding of claim by GPBs that a "reasonable expectation of ex ante FCM" is an entitlement to ex-ante FCM compensation. The Commission seems to have accepted this view through its final reasons paper for the gas IM amendment for DPP3. We have dealt with this in some detail in our submission[25] and we continue to build on it here in response to supplier submissions.

34. The Commission recognised that when it set up the principle of ex-ante FCM in 2010 it did not contemplate the scenario of economic stranding, and that in fact determining how this principle should be interpreted has been a more recent challenge for the Commission.

> *Stranding risk was not envisaged when regulation of natural monopoly infrastructure was designed. Regulatory regimes that apply the building block method assume that once capital expenditure is added to the RAB it will remain there until fully depreciated. This understanding provides regulated providers with a degree of certainty that they will recover their investment in what are typically very long-lived assets.*

[23] AMPs reveal deferred CAPEX (First Gas) , policy shifts on who pays for gas connections (Vector), and outright sale of assets to parties who see more potential for returns (Vector and MDL sale to First Gas)
[24] Munro-Duignan Submission on Gas DPP3 draft decision – 14 March 2022
[25] MGUG Submission on 2023 IM review Framework and Process and Issues papers-final para 50-81

Fibre input methodologies: Main final decisions – reasons paper 13 Oct 2020 – para 6-1041[26]

35. The Commission has helpfully, at least in its Fibre IM decision, attempted to explain why it sees ex-ante FCM compensation as an outcome consistent with what is seen in workably competitive markets:

> *In workably competitive markets existing firms may be exposed to the risk of new entry that would erode upside returns when the market is profitable. When the market is unprofitable entrants are unlikely to arrive so incumbent firms are left to entirely bear any losses.* ***In workably competitive markets, firms will try to compensate for the downside risk of bearing the losses by increasing prices where they can and thereby keep an expectation of symmetric returns****.*
>
> Fibre input methodologies: Main final decisions – reasons paper 13 Oct 2020 – para 6-996

36. This statement is asserted without any evidence in the reasoning, and in our view is a flawed view of what actually is expected to happen in workably competitive markets when the market is "unprofitable":

    a. *Firstly*, "unprofitable" has to be taken in the firm's context. It may be the firm's view that the market is unprofitable, but it need not be a view shared by its competitors who may have better capabilities or structural advantages. It also depends on whether risk perceptions and appetites are commonly held. Hence the claim that *entrants are unlikely to arrive,* can only be considered as subjective, since it may be equally true that *entrants will arrive* if they have different capabilities, risk perceptions and risk appetites.

    b. *Secondly* in workably competitive markets firms invest and divest based on where they see the best opportunity for return on their capital. A firm that no longer expects to earn the cost of capital can look for a buyer. Even if it sold the asset at a discount to its book value (to match its ex-post assessment of return) it should do this to free up capital in order to reinvest it where it believes it can get a better return. To the extent it is unable to find a willing buyer, this reflects a difference in value perceptions and that the best decision for the firm is to continue to hold on to the asset rather than sell it at a price lower than it thinks it is worth.

    c. *Thirdly*, if a firm believes that it will have no competition why should it limit its price increases to keep an expectation of symmetric returns? If there is no competition it has entered a monopoly market and can behave as such to price its product accordingly including to a point where it is generating economic profits.

    d. Similarly, the definition of workable competition *in ARA v Mutual Rental Cars (Auckland Airport) Ltd and Fisher and Paykel Ltd v Commerce Commission* also highlights that it is not just new entrants that can influence and constrain the behaviour of existing market participants. Consider the example provided by gas generators in New Zealand facing

[26] Note that Fibre is regulated under Part 6 of the Telecommunications Act. In substance the purpose statement of Part 6 mirrors the wording of Part 4 under the Commerce Act. The decision-making process around fibre pricing appears the same to us to be able to draw valid parallels.

possible asset stranding risk by 2030 through Government policy[27]. Under this scenario, there is no expectation of a new entrant investing in new thermal generation.[28] By the Commission's reasoning these generators should be free to lift their prices into the electricity market now, in order to maintain their ex-ante FCM expectation ex-post rather than accept a possible economic stranding of their sunk investments. That would be an unexpected outcome and is not a feature of the wholesale electricity market where participants bid into the market based on their short run, not long run, marginal costs. If a generator tried to price its product consistently higher than its marginal price it would find that it would lose revenue over the long run to its incumbent rivals who are similarly left with potentially stranded assets.

37. We therefore don't consider the Commission's reasoning of what happens in workably competitive markets for cases of economic stranding risk to be robust. In general, we would expect that the competitive market outcome is for the firm to write down the impairment of the asset on their balance sheet and claim the depreciation tax loss on their immediate earnings rather than raise prices. We would therefore look for the Commission to provide a stronger evidence base supporting the proposition that firms *tend* to raise prices to ensure ex-ante FCM expectations in situations where assets may be left stranded.

38. We also note that the definition of workably competitive market outcomes doesn't require specific, precise outcomes. This point was made in the 2010 EDB & GPB Reasons paper where it refers to *tendencies* rather than specific, precise outcomes[29]:

> *For reasons given above, this is not fatal to the exercise of using the notion of workable competition as a guide when developing regulatory rules. Wisely, the NZ legislation does not require the Commission to achieve the same outcomes/results as would be produced by competition, but rather to promote rather broadly defined outcomes (which, to better avoid ambiguity, by explicitly distinguishing them from specific, precise, measurable outcomes, might better have been* ***described as tendencies****) that are consistent with those produced in competitive markets. These tendencies are then exemplified in terms of incentives and benefit sharing, not in terms of specific, well- defined outcomes/results*

Thus, the question for the Commission is whether suppliers *tend* to raise prices where asset stranding is a possibility for them, not whether one or two examples indicate that this does occur.

39. The Commission in its Fibre decision also asserts that its decision is justified on the basis of an implied regulatory compact it continues to deny exists[30]:

> ***In regulated markets regulation can cap potential profits without providing commensurate insulation from downside risk****. For example, firms may be exposed to stranding risk (e.g.,*

[27] The Minister hasn't resiled from the Government's policy position to drive towards this target. Equally industrial face the same stranding risk with their coal or gas boilers.

[28] Nova for example has announced that investment in new gas fired peakers is on hold precisely because of Government policy position on achieving 100% renewable generation by 2030. https://www.energynews.co.nz/news/decarbonisation/117412/unease-green-thermal-100-renewables

[29] Input Methodologies (EDBs & GPBs) Reason Paper – 22 December 2010 para 2.6.17

[30] Part 4 Input Methodologies Review 2023 Draft Framework paper para 4.26

through technical obsolescence, unfavourable demand shocks), and large catastrophic events such as natural disasters. These risks are potentially asymmetric when firms are not free to price in ways that would compensate for these risks (ie, in the absence of compensating upside).

Ibid – para 6.997

40. As the Commission has noted in past papers, regulated firm's profits are only capped on ex-ante basis. Ex-post firms can earn economic profits (or losses), particularly in the short term[31]. This is a design feature of the regulation, and equally is an outcome in competitive markets.

> *FCM is applied on an ex ante basis. Allowing regulated suppliers the opportunity to achieve a higher levels of profits over the short to medium term as a reward for efficiency gains, provides the incentives for those gains to be made in the first place, consistent with s 52A(1)(b). Those efficiency gains are then shared with consumers, consistent with s 52A(1)(c), when the price path is reset at the end of each regulatory period*

41. The Commission's statement in the Fibre decision further runs counter to the understanding of what the ex-ante FCM is supposed to mimic for regulated suppliers, i.e. outcomes observed in workably competitive markets. For suppliers in a workably competitive market there is no expectation that they can earn economic profits over the long term. While the upside is capped to "normal returns" in workably competitive markets, *there is no "compensating" downside protection*. Thus in our view it is false to claim that regulated firms have an implied bargain in their arrangements, because it is not correct that regulated businesses are somehow missing out on upside profit.

42. As noted in the EDB-GPB Input Methodologies Reasons paper, the ex-ante FCM/ NPV=0 principle for monopoly businesses is a principle to give effect to Part 4 S52A (1)(d) (*are limited in their ability to extract excessive profits*).[32]

> *The main reason economic regulation is required is to counter the market power of firms (i.e. the ability of firms that are not faced with competition or the threat of competition* ***to charge excessive prices and/or reduce quality)***

43. The conclusion from this discussion is that:

    a. The application of ex-ante FCM principle in the context of long-term demand risk wasn't considered at the time it was adopted as a guiding principle for Part 4. The meaning of this principle in this particular context is relatively new territory being explored by the Commission, and its views should be treated as emerging, rather than settled.

    b. The Commission has been explicit in linking ex-ante FCM compensation with workably competitive outcomes in its October 2020 Fibre decision, but it's claim on how competitive markets would be expected to behave doesn't appear with any evidence base. Further, the Commission's arguments in this decision run against what would *tend* to be observed in competitive markets. Consequently, we don't believe that the Commission can rely on its reasoning in the Fibre IM decision to justify raising prices to

[31] Ibid – para 2.8.18

[32] Commerce Commission, December 2010 *EDB_GPB Input Methodologies Reasons paper* – para 2.6.32

support ex-ante FCM compensation for sunk investments. Instead, we refer to our analysis in our submission for what would tend to occur[33].

A Change in Form of Control for GDBs is not warranted

44. Vector has called for a change in the form of control for GDBs from a weighted average price cap to a total revenue cap. This repeats Vector's same call made in the gas IM process and uses the same arguments that didn't prove persuasive to the Commission in that review.

45. The only material change, since Vector made its submission earlier this year, is the release of the ERP in May, which doesn't restrict new gas connections. Nevertheless, to address Vector's arguments in their submission we start with their following arguments in support of changing the form of control[34]:

    a. There is significant quantity forecast risk in the current environment; and,

    b. Government policy is affecting consumer response; and,

    c. Incentive to grow connections is not appropriate to net zero; and,

    d. Removing incentive to grow connections would better promote the ERP and net zero target.

46. None of these assertions are supported by any evidence that we could find. Hence, in order to give a factual rebuttal to Vector's assertions we looked at these claims to see if they could be validated. We did this by referencing the GIC's gas reconciliation data and looked at Vector's Active Contracted Gas Connections[35] from April 2016 to June 2022. April 2016 was chosen as this is the date from which First Gas took over Vector's North Island Distribution business. We then noted 4 key dates from which consumer response might be judged to test Vector's claim that government policy is affecting consumer response and leading to significant forecast risk:

    a. The April 2018 coalition government's announcement of the exploration ban.

    b. The Climate Change Commission's draft advice – February 2021

    c. Vector's connection policy change[36] – July 2021

    d. Covid restriction period in Auckland – April 2020 to December 2021

47. The ERP package was announced in May 2022 and is too soon to assess its impacts. Our expectation is that the announced measures which continue to remain open to continued gas pipeline services would be positively interpreted by consumers.

[33] MGUG Submission on 2023 IM review Framework and Process and Issues papers-final para 59-67

[34] Vector Submission on the Process and Issues paper 11 July 2022 – p4

[35] Active Contracted connections gives an accurate picture of where connections not only exist but also have a gas retailer providing gas to these connections.

[36] Vector changed its policy for new connections in July 2021 and required all new connections to be paid for by the connecting party.

48. We developed two statistical time series models for the connections. We used the open-source statistical software package “R” which is used extensively by the statistics community, to develop a time series model based on the data. While there are a number of statistical modelling approaches to choose from, we picked a simple exponential time series approach (ets). The model itself was assessed in terms of its validity using various statistical tests on the residuals. The model we developed met the test for independent and identically distributed (iid) residuals[37].

49. The first model was developed using the data from April 2016 to April 2018. This model was then used to forecast connection growth to June 2022 (Figure 1). The forecast included both a mean (expected) estimate, as well as a 95% prediction range. We then compared the actual connection growth with the forecast. The second model was developed using the data from April 2016 to February 2021, which in turn was used to forecast through to June 2022 and compared to actual (Figure 2).

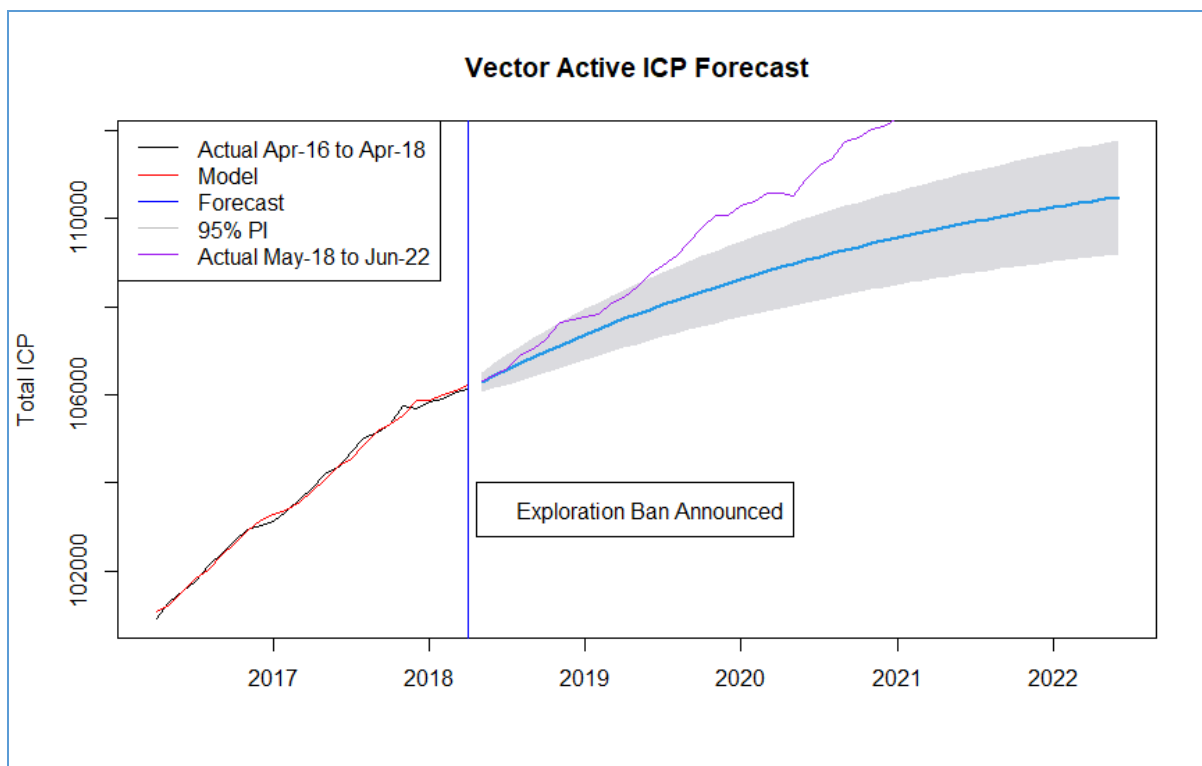

Figure 1: Time Series Forecast from Exploration Ban

[37] A model’s descriptive power can be validated if the error terms have a mean of zero, show constant variance, aren’t autocorrelated, and are normally distributed (iid)

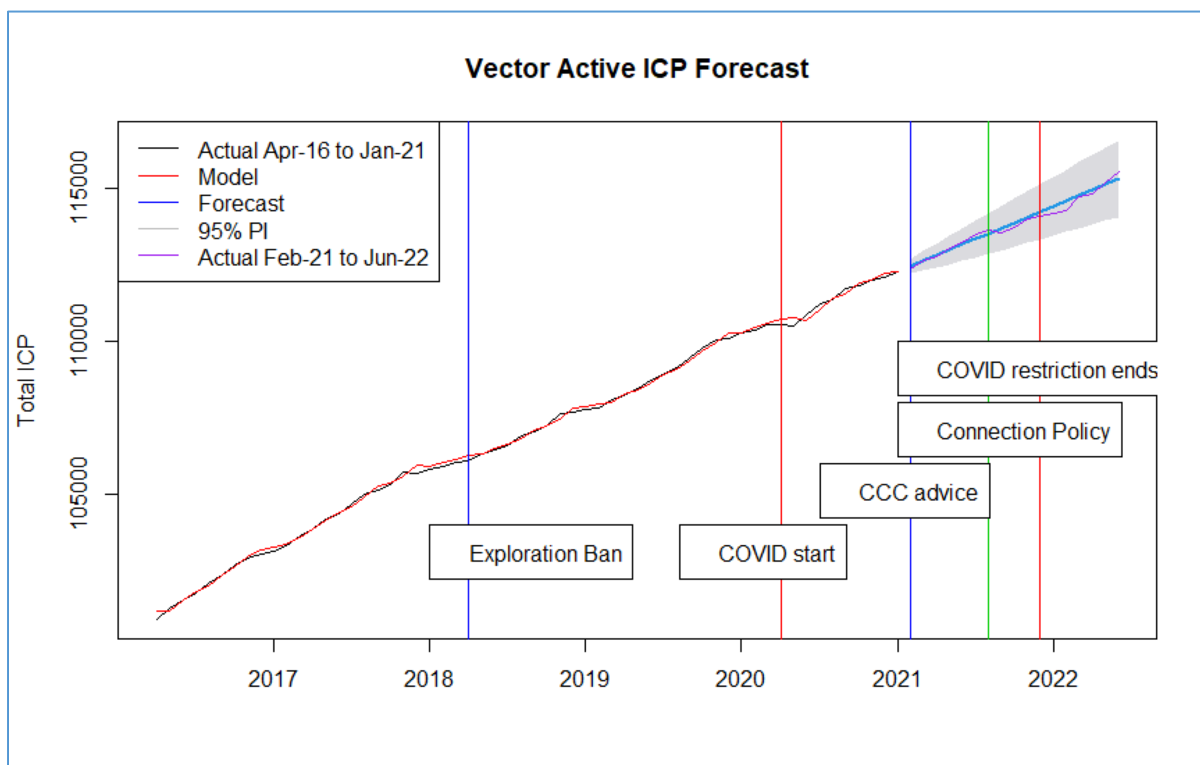

Figure 2: Time Series Forecast from CCC Advice

50. Figure 1 shows that connection growth exceeded the forecast after the exploration ban was announced. It should be noted that the data series used to develop the model was relatively short (25 months). The model picked up a damped trend from this data which it projected forward, whereas the actual connections showed a steadier trend continuing. Whatever the exploration ban did, consumer connections continued to grow steadily. While the model provided a good description of the history of connections it failed to have good predictive power as noted by the actual connections being higher than the expected range.

51. Figure 2 uses the information from Figure 1 that concluded that the exploration ban had little impact on consumers view on the future of gas. The data to develop the model was extended to the end of January 2021, which is when the CCC issued its draft advice, including its view that gas should be phased down/ out with policy prescriptions including banning new gas connections. Overlaying this is the government mobility restrictions due to Covid with a national lockdown in April 2020, and Auckland lockdown in the latter part of 2021. Covid restrictions was expected to impact on Vector's ability to service new connection requests. The Covid restriction period is bounded by the red lines. In addition, Vector introduced a policy from July 2021 to require all new connections to be paid for by the connecting party rather than socialised across the network. In theory this should dampen demand for new connections. The forecast vs actual shows good alignment. The difference with the second model is that instead of picking a damped secular trend response from the data, the longer time series identified a stronger underlying secular trend. This model has both good descriptive, and predictive power. The conclusion inherent in this data driven model is that neither the CCC advice, nor Vector's gas connection policies have affected consumer demand for connection growth.

52. These models argue against a number of Vector's assertions including that there is more forecast uncertainty and that Government policy is affecting consumer response. There is no evidence in the data suggesting consumers are not choosing to connect to gas where they have the option to do so. And furthermore growth forecasts demonstrate remarkable stability.

53. As to Vector's assertions that incentive to grow connections is "not appropriate to net zero", and removing incentive to grow connections would better promote the ERP and net zero target, neither statement agrees with the more recent views of government on gas, nor indeed with Vector's own participation in the Gas Infrastructure Future Working Group seeking to repurpose gas infrastructure.

54. The recently released ERP acknowledges that there may be an ongoing role for gas in a *national* net carbon zero environment and asks that MBIE/ GIC develop a Gas Transition Plan (GTP) based on two pillars: phasing down (not out) of natural gas, and how renewable gas could help replace natural gas[38]. In this context it is a consistent and plausible outcome for gas connections to grow, since this provides the opportunity for households to transition to lower carbon gas in the future.

55. Based on the updated evidence we agree with the Commission's earlier findings that "*changing the current form of control settings is not likely to result in better outcomes for consumers of gas pipeline services or reduce compliance costs, other regulatory costs, or complexity*"[39].

56. In further support for maintaining a WAPC for GDBs we reiterate the point made in our earlier cross submission[40]:

    > The Commission decided on a WAPC form of control for GDBs for reasons outlined in its Input Methodologies Reasons Paper in 2010[41]. *Essentially WAPC form of control was considered appropriate where multiple services are supplied and where demand can be influenced to a reasonable extent by the supplier*.

57. As our above analysis also shows, demand is being influenced to a reasonable extent by the supplier with government policy having less to no influence on consumer willingness to connect.

Asset Management Plan updates need to continue be signed by directors

58. Vector has called for the Commission to amend the ID Determination to remove the requirement for directors to certify AMP updates each year[42]. Vector claims that obtaining annual directors' certification for AMP updates imposes significant workload and time constraint for regulated businesses without "any benefits". We disagree.

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[38] https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwit-vWg4Z_5AhVdzzgGHcKjD2MQFnoECAwQAw&url=https%3A%2F%2Fwww.mbie.govt.nz%2Fdmsdocument%2F20265-terms-of-reference-gas-transition-plan&usg=AOvVaw0Rmbq43_mSL7MXoHWalE4F

[39] DPPs for gas pipeline businesses from 1 October 2022 Final Reasons Paper 31 May 2022 – p59

[40] MGUG Cross Submission on draft decisions IM and DPP3 – para 29-33

[41] 22 December 2010- Input Methodologies (EDBs & GPBs) Reasons Paper – p192, para 8.37, 8.3.8

[42] Vector submission on the Process and Issues paper 11-July 2022 para 145

59. Information Disclosure already supports a light-handed regulatory regime and we see no consumer advantage in weakening what is already a pragmatic concession to balancing consumer interest against monopoly market power.

60. The consumer benefit is implicit in the Schedule 17 certification statement. Directors have duties to act in good faith and have a duty of care under the Companies Act that do-not extend to management. There are considerable repercussions for directors should they breach these duties. When a director certifies an AMP, consumers have at least an assurance that the advice from management has been tested and challenged. In particular, consumers should value the director assurances on prospective financial or non-financial information as well as forecasts have been determined with good faith. We do not see that the same level of assurance can be provided by management.

Taking into account s5ZN into decision making relevant only for Emission Reduction Plans

61. The Commission has indicated it will take into account s5ZN of the Climate Change Response Act 2002 in its decision making. A number of submitters have considered that this should be mandatory, not optional. We support the Commission's optional position to have regard to s5ZN where it considers it relevant and consistent with s52A Purpose of Part 4.

62. S5ZN is a permissive consideration, not an obligation. We don't consider it appropriate for the Commission to go beyond what parliament intended for s5ZN, to create an obligation on itself and impose this on the various sectors.

63. s5ZN considers that a body "may" take into account the 2050 target; or an emission budget; or an emissions reduction plan. These are all defined terms in the legislation and have specific meanings. Crucially the 2050 target and emission budgets refer to *net accounting national* target and budgets. There are no legislated targets or budgets for individual economic sectors. The legislation indicates there can be many pathways to achieving national targets but is agnostic how and where emission reductions are achieved. The principal tool for achieving the most economically efficient pathways is through the ETS scheme. The Commission has no mandate for determining sector targets or budgets and hence we consider that the 2050 target and emission budgets will have little to or no relevance in the Commission's decision making.

64. An ERP however must contain sector specific policies and could be considered to have a bearing on the Commission's decision making. The first ERP to cover the first three emission periods to 2035 was released on 16 May 2022. We consider that Chapter 11 (Energy and Industry) and Chapter 12 (Building and Construction) to speak most directly to matters relevant for the gas sector. In particular we note the actions around supporting renewable energy. This speaks to our concern that Part 4 is not fit for purpose for gas pipeline services where it excludes low carbon gases from consideration in the definition of the regulated service. This reinforces our calls for the Commission to address this[43].

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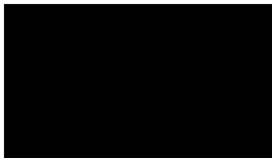
[43] MGUG Submission on 2023 IM review Framework and Process and Issues papers-final para 9, 12, 22-27

65. The ERP requires the development of a gas transition plan and associated terms of reference[44] outlines the two pillars for the plan (transition pathways for the fossil gas sector, and the role of renewable gases). The draft advice to cabinet on the GTP is expected to be delivered in Q1 2023[45]. Notably there are no specific targets or timeframes for either natural gas or renewable gases in the gas system in the terms of reference. We do consider that this two-pillar approach provide a policy signal that while the composition of gas being transported through gas pipelines may change, the need for gas pipeline services will continue.

Yours sincerely



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44 https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwiQ8sK6iqf5AhUExDgGHTHmCP8QFnoECAsQAw&url=https%3A%2F%2Fwww.mbie.govt.nz%2Fdmsdocument%2F20265-terms-of-reference-gas-transition-plan&usg=AOvVaw0Rmbq43_mSL7MXoHWalE4F

45 Indicative milestone communicated by GIC