



Submission

Commerce Commission Open Letter – Ensuring our energy and airports regulation is fit for purpose

May 2021

Introduction

Fonterra welcomes the opportunity to provide feedback to the Commerce Commission on the emerging issues for New Zealand's electricity and gas networks. We trust that the commentary we put forward is a constructive contribution in how we collectively ensure the energy networks appropriately support New Zealand's decarbonisation challenge.

Fonterra is a co-operative owned by around 10,000 New Zealand farming families. With the backing of the New Zealand Government, our country has a modern and world-leading dairy industry where our products are desired in markets both here and around the globe.

We are New Zealand's largest exporter and have 27 manufacturing sites spread across the country. Each site is unique in terms of the volume of milk it processes; the products it makes; the energy sources available; and the age of its assets.

Nine of our 27 sites rely on coal as their primary source of energy, including one which co-fires with wood biomass. Seven of these manufacturing sites are in the South Island where there is no reticulated natural gas available.

We use approximately 1,100 GWh per year of electricity which includes the electricity from co-generation facilities. We also use approximately 4.6 PJ of gas annually in our 76 gas boilers and air heaters installed across our manufacturing sites.

We have committed to ending our use of coal by 2037, on the way to net zero emissions by 2050. Coal emits nearly twice as many emissions as gas and we will continue to reduce our emissions by increasing the energy efficiency of our sites and continuing to convert our coal boilers to use renewable energy sources such as wood biomass. As aligned with the Climate Change Commission's draft recommendation, we are transitioning our manufacturing operations off coal, and will then transition our sites off natural gas from 2037 onwards.

Energy is a significant cost input into the manufacturing process and maintaining a cost-effective energy supply is essential for our business to compete in a globally competitive market. We have strongly advocated in recent consultation documents to the Climate Change Commission and the Ministry for Business, Innovation and Employment, that any proposed decarbonisation regulation needs to acknowledge the interdependency of coal and gas, and the impact that the scarcity of gas may have on our ability to reduce and then eliminate dependence on coal and the speed at which organisations can transition.

Our commentary reflects our commitment to assist in meeting New Zealand's overall emissions reduction targets by ensuring the regulatory frameworks for the electricity and gas networks play an enabling role in decarbonisation. As the country moves at speed to decarbonise, it is essential that the cost of complying with regulation, a cost ultimately borne by consumers, is appropriate.

Gas networks

We recommend that some consideration is given to the impact limitations will have on the gas network as current gas users decarbonise. As this occurs existing assets in the gas network become stranded which could significantly impact the ability for the network to be used for alternative low emission energy sources such as biogas or hydrogen.

The current regulatory framework does not appear to adequately accommodate for a significant decrease in the use of gas networks - a regulated asset base. There have been recent examples of gas users ceasing to operate, such as Southdown and Otahuhu, and their share of gas network costs were then allocated to remaining users.

If the regulated asset base continues without impairment or another regulatory mechanism, fewer users will have to pay for higher costs despite no change in the quality of service being provided. It is uncertain at this stage if the utilisation of the gas network will increase or decrease as the country decarbonises, so ensuring there is a mechanism that can adjust for either scenario is vital.

Price-quality path compliance standards

We note that there has already been a reduction in national gas usage, with FirstGas projecting a 10 to 20 per cent reduction in gas transmission volumes. This means that the decision on how to equitably handle the fixed costs of the gas transmission system across remaining customers' needs to be included in either the upcoming gas Default Price-Quality Path (DPP), or if more appropriately set in the Input Methodologies (IM), then a bespoke IM needs to be consulted on ahead of the gas DPP reset.

Electricity networks

We agree with the sentiment in the Commission's open letter that the decarbonisation of fossil fuel use for process heat and increased use of electricity, and the electrification of transport, will likely result in increased use of the electricity networks.

It is essential that the regulatory framework balances the need to build capacity in electricity networks to meet forecast demand growth against the risk of overbuilding the networks, which will result in higher costs to end users and which in turn could delay increased electrification. A similar situation could also occur for the gas networks if demand did not eventuate or decreased.

As our 27 manufacturing sites are located across the country, we have relationships with 16 different electricity distribution businesses. Our scale and spread gives us the ability to offer a somewhat unique perspective on how different approaches to demand growth are occurring across electricity distribution businesses, and how the costs are allocated differently for upgrades to local networks.

In our experience some electricity distribution businesses allocate costs to the user who has increased demand which requires the upgrade to occur, while other businesses allocate the upgrade costs from increased demand across all users. This irregular approach of charging mechanisms means the case for capital investment in electricity distribution upgrades may be economically viable in one region versus another region where the investment case is uneconomic.

For example, at our Clandeboye manufacturing site the costs of network upgrade are apportioned almost entirely to Fonterra where we are the exacerbator. At our Hautapu manufacturing site, we have attracted costs where another party is the exacerbator. In this scenario, we would more likely invest in network upgrades at our Hautapu manufacturing site ahead of our Clandeboye manufacturing site.

We note that the Electricity Authority started tracking the performance of electricity distribution businesses and their pricing structures to align with the Authority's pricing principals in 2019. The most recent report by the Authority in 2020 indicates that progress towards efficient pricing has stalled and that transparency on cost allocation is required to best manage the new and expanding demands of electrification, solar PV and EV charging.

We strongly encourage the Commerce Commission to consider introducing the Default Price-Quality Path (DPP) and Customised Price-quality Path (CPP) process as a way to incentivise progress on cost-reflective pricing reform, aligned to the Electricity Authority's pricing principals.

Transmission Pricing Methodology

The Transmission Pricing Methodology (TPM) is a material proportion of electricity costs and without regulatory certainty of TPM, greater use of electricity is disadvantaged relative to other energy sources. Certainty of future transmission and distribution costs are an important element for potential decarbonisation via electricity.

We are concerned that the new TPM allocates greater costs to additional electrical load. For example, if Fonterra installed a large electrode boiler the TPM costs would likely be materially greater under the new TPM relative to the status quo. As the new TPM charges are uncertain it is extremely difficult to calculate in advance what the new TPM costs will be. Fonterra believes that the new TPM penalizes renewable energy by allocating greater costs to decarbonisation projects than the status quo.

The proposed TPM allocation also has the potential to dissuade investment in energy storage systems that can provide grid support services and enable greater utilisation of South Island generation, by removing the North Island reserves constraints.

We understand that the TPM has evolved, in part, to achieve investment efficiency. As Transpower investments are part of the Commerce Commission's responsibilities, not the Electricity Authority, we believe that the Electricity Authority's inclusion of investment efficiency has skewed the outcome of the new TPM.

The principle performance obligations drive Transpower to build transmission assets to a very high standard which in turn has an associated high capital cost. Often a lower level of reliability is acceptable to some consumers. For Fonterra the cost of decarbonization using electricity is very significant and the inability to trade-off cost against reliability makes decarbonization using electricity even more difficult.

We welcome the opportunity to work with the Commission in your upcoming regulatory processes and would like to meet with you in person to discuss our perspectives in more detail.

ENDS