

# Fonterra's submission on the Commerce Commissions "Default price-quality paths for gas pipeline businesses from 1<sup>st</sup> October 2022" consultation paper

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## Introduction

Fonterra welcomes the opportunity to provide feedback to the Commerce Commission on the consultation paper, "Default price-quality paths for gas pipeline businesses from 1<sup>st</sup> October 2022" (Consultation Paper).

Fonterra is a co-operative owned and operated by around 9,000 New Zealand farming families. We are New Zealand's largest exporter and have 27 manufacturing sites spread across New Zealand, in addition to science and innovation centres and distribution facilities which are integral to the business.

Fonterra uses 4.8PJ per annum of gas directly, and also via steam generated by our third-party cogeneration partners which use approximately 7.8PJ per annum to generate steam and electricity. This combined annual gas usage of approximately 12.6PJ is the largest industrial use volume on the gas pipeline network. Due to Fonterra's manufacturing sites being located throughout the regions this represents the largest collective kilometres of pipeline use, from Kauri at the northern end of the gas pipeline to Pahiatua in the south, Edgecumbe in the eastern Bay of Plenty, to Whareroa in the Taranaki region.

As outlined in this submission, Fonterra does not support the draft decision to amend the Gas Distribution Business's (GDB's) and Gas Transmission Business (GTB) Default Price Path 3 (DPP3) to allow for accelerated depreciation via use of asset life adjustment factors. The basis for this proposed change in the upcoming DPP3 is not justified on numerous basis as outlined below and within our submission –

1. There are no current regulations or proposed regulations that would accelerate the decline of gas usage – there are actually initiatives underway to look at repurposing the existing gas pipeline infrastructure with renewable gases and users have entered into long term gas supply agreements which indicates a continued use of gas in the short-medium term and that these assets will not be stranded. The Commerce Commission should act on the here and now, and not pre-empt *potential* legislation that *could* lead to gas pipelines becoming stranded.
2. Fonterra does not support the proposed 4 year DPP3 period, nor the proposed increases above CPI.

Fonterra would like to reinforce several messages we articulated in our submission on the accompanying proposed amendments to the Input Methodologies and refer to the details within that submission –

3. FirstGas purchased the Maui and Vector pipelines when numerous policies and signals were in place that natural gas use would likely decline in the long-term.
4. It is not in the long-term benefits to consumers and would place additional unnecessary costs on them, and risks encouraging abandonment of these assets, placing a risk on energy security for those users that remain connected to the gas pipelines.
5. Fonterra suggests that a Customised Price-Quality Path (CPP) would be a better mechanism to pursue and substantiate the basis for any accelerated depreciation.

If there are any clarifications, or if there is any further information that would be of use to the Commerce Commission, please do not hesitate to contact us.

## Climate Change Policy and Section 52A purpose

1. The Climate Change Response Act (CCRA) does not make it mandatory for the consideration of the 2050 target in the setting of the Gas DPP3 as outlined in point 2.22 of the Consultation Paper. However, the Consultation Paper outlines a perceived asset stranding risk and the proposal then makes it mandatory for gas users to minimise the stranded asset risk to GDB's and GTB.
2. We note that within the Consultation Paper, the Commerce Commission has been selective and inconsistent with the utilisation of the advice from the Climate Change Commission (CCC) to the Government. For example, in section 3.8 and 3.10 of the Consultation Paper, there is acceptance of the view that fossil gas must decrease, yet not accepting the advice that new fossil gas connections should be banned, and that the Government needs to keep options open as far as possible so as to safeguard consumers from the costs of new infrastructure and to allow the transition to renewable gas alternatives.
3. In section 3.12 of the Consultation Paper, it outlines the differing views of the Commerce Commission that there will be no fossil gas use by 2050, which is contrary to the CCC and the Gas Industry Company (GIC) positions that fossil gas is likely to be in use post-2050. Concept Consulting also note that it is unlikely there will be gas use declining over the proposed DPP3 period (section 3.12).
4. It is inappropriate for DPP3 to pre-empt the content and details that could be within the Emissions Reduction Plan as it requires the Commerce Commission to act outside of its expertise by making judgement calls on future gas pipeline use as outline in section 3.3 and 3.4 of the Consultation Paper. There are a range of scenarios and outcomes that could occur, and as we submitted on the proposed IM amendments, a prudent approach would be to await until these details are known, and any decline in demand is actually observed.

## Role of the Commerce Commission to regulate renewable gas conveyance

5. In section 3.30 to 3.32 of the Consultation Paper, the Commerce Commission attempts to lay out a position that they do not have the right to regulate "non-natural gas" conveyance by pipeline as a counter to the view that gas pipelines will not be stranded and instead will be used for the conveyance of renewable gas.
6. Contrary to the position outlined in section 3.30, that Act does not define natural gas anywhere, but it does define how it interfaces with the Gas Act 1992 which clearly defines gas conveyance pipelines to cover any gas type for fuel.
7. This position is also a moot point when it is considered that chemically there is no difference between biogas and natural gas – both are molecules of methane. And as such, there is no requirement to change the operation of any end user's equipment as the percentage of renewable methane (aka "biogas" or "biomethane") increases.
8. Furthermore, under the Gas Act and associated regulations, all gas injected into the gas pipelines must meet the specifications defined.
9. It is our view that the Commerce Commission does have the right to regulate the conveyance of gaseous fuels through the existing gas pipelines and that this is no different than the regulation of Transpower and EDB's as there is no requirement to draw a distinction between electrons generated from fossil fuel or electrons generated from renewable generation sources.

## Discussion on the Draft DPP3 Decision

10. Fonterra does not agree with the Commerce Commission position outlined in section 4.4. We note that all companies must operate and maintain their assets in a safe manner so there is no need to incentivise GPB's (as laid out in 4.4.1.1) to do this as there are other legislations (such as WorkSafe) that enforce this requirement and there is the risk of prosecution for parties that fail to comply.
11. Every business in New Zealand faces the issue with stranded assets due to changing regulatory or business conditions, be it a diesel truck facing increasing fuel costs or a coal boiler facing consent

renewal issues. If this risk of stranding was not particularly due to the 2050 target but instead gas decline was due to changing technology or poor business decisions by GPB's would the Commerce Commission still be recommending ways reduce the stranded asset risk?

12. Table 4.3 outlines the annual rate of price increases that this DPP3 will deliver to the GPB's to cover their perceived risk of asset stranding. This analysis does not factor in the other costs that gas users are facing. For example, there is a reduction in competition in the upstream gas supply due to consolidation, resulting in effectively two main companies offering gas supply to consumers, putting upward pressure on gas pricing. There is also the impact of NZ ETS prices increasing at over 10% per year and the carbon price of \$75/NZU effectively equates to ~\$4/GJ. The net effect of these drivers is that end users could be seeing prices escalating at more than 25% per year.

### Discussion on expenditure

13. Fonterra notes some of the inconsistencies in the logic regarding new connections within the Consultation Paper – for example, in section 5.12 the Commerce Commission is accepting the GDB's forecast for new connections, in light of the points in 3.8.1 banning new connections and then B88 where FirstGas is recommending 0% new connection growth. It appears that there is no justification for the position that connections will continue to grow. Without a ban on new connections, the Commerce Commission should at minimum ensure that the DPP3 mandates that all new connections must cover the full cost of the connection (similar to Transpower or EDB causer pays position) and the capital payback must occur prior to 2050, and not be cross subsidised by other end-users.
14. Fonterra supports the view in section 5.21 that capital expenditure needs to be at or below historic average levels going forward due to declining growth.
15. Fonterra also supports the proposed capex reopener provision, and we note that the rigour of review must be similar to as if a CPP had been applied for.
16. Fonterra agrees that GPB's shareholders should cover the cost for projects to investigate ways to repurpose and decarbonise the existing gas pipelines.

### Addressing Stranded Asset Risk

17. The proposed changes to DPP3 will result in a substantial price increase to end users, and the level of discussion with end users regarding the perceived risk of stranded assets as outlined in section 6.3 has not been matched.
18. As noted in our accompanying submission on the proposed IM amendments, all businesses are facing stranded asset risk from decarbonisation if they cannot be repurposed or modified to use low emission options. There are very few funding support options for businesses as they decarbonise (predominantly the Government Investment in Decarbonizing Industry, GIDI, fund and the Low Emission Vehicle Fund, LEVF), and there is no support for businesses assets that might become stranded, however the Commerce Commission is recommending providing differential treatment to GPB's and GTB.
19. Fonterra notes that there is 27 years between now and 2050. The Consultation Paper outlines the economic stranding in section 6.9, but we question if there really is a risk. Capital expenditure on repairs and maintenance to ensure safe and reliable operation will typically involve equipment that has a design life of less than 25 years and such are depreciated at that rate. This only leaves the pipelines which do have long design lives of 40 to 80 years, but as table 6.1 shows that size of the residual value decreases fast as you approach 2050.
20. In section 6.22 of the Consultation Paper, it is discussed that the GPB's have some role in mitigating the stranding risk themselves, but that's where the discussion ends. The DPP3 does not mandate the elimination of new connection expenditure or alternatively full contribution for connection costs. We do not agree with providing compensation for new connections as that stranding risk should be carried by the new end user.
21. This is also outlined in the discussion in section B63 and B84 with respect to payback periods. This shows that some GPB's recover costs at an appropriate rate matching the design life and charge new connections for full capital recovery, whereas other GPB's do not. The DPP3 should seek to

standardise that cost allocation to ensure that new connections do not generate stranded assets and other end users having to pay accelerated depreciation.

22. In section 6.112 of the Consultation Paper, the risk of residual value is discussed if the pipelines are repurposed. When considering the drivers for an end user to stay connected to the gas system, the following factors should be taken into account:
- Replacement of gas fired equipment if no longer maintainable: a home owner or industrial boiler owner will make the same economic decision of staying with gas or switching to something else if the current gas equipment is no longer maintainable.
  - Does the gas equipment serve some unique function? For example, a gas fireplace for ambience compared to installing a heatpump, or a gas cooktop compared to an induction stovetop due to consumers preference.
  - Counterfactual economic assessments: what the capital cost is to replace an existing asset, compared to the counterfactual of utilising the existing asset with gas and paying a higher operational cost.
23. All of the above factors will drive for repurposing the pipelines and the proposed accelerated depreciation will generate a new risk for the end users that they have overcompensated the GPB's and GTB for an asset that is not actually stranded.

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