



CROSS-SUBMISSION

Default price-quality paths for gas pipelines for 1 October 2022

Draft reasons paper and proposed IMs amendments



Table of Contents

1. Introduction and Summary	3
1.1 Structure of this submission	3
1.2 Supporting material	3
1.3 Contact details	4
2. Process followed to amend Input Methodologies for DPP3.....	5
3. Approach to accelerated depreciation	8
3.1 Is the risk of asset standing real?	8
3.2 Is now the right time to amend IMs?	12
3.3 Are incentives maintained to repurpose the gas networks?	14
3.4 Is the modelling fit for purpose?	16

1. Introduction and Summary

First Gas Limited (Firstgas) welcomes the opportunity to comment on submissions made on the Commerce Commission's (Commission) draft reasons paper "*Default price-quality paths for gas pipelines for 1 October 2022*" and the supporting draft reasons paper "*Proposed amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths*" both released on 10 February 2022.

We are making this cross-submission on behalf of our gas transmission business (GTB) and gas distribution business (GDB). Nothing in this submission is confidential.

1.1 Structure of this submission

This cross-submission is structured as follows:

- **Section 2: Process followed to amend Input Methodologies (IMs).** We address comments made by submitters on the IMs amendment process and why we consider that the process followed to date has been fair and reasonable.
- **Section 3: Approach to accelerated depreciation:** We address submitters comments on whether:
 - The risk of asset stranding is real
 - Now is the right time to amend the IMs to accelerate depreciation
 - Incentives are maintained to repurpose the gas pipeline networks for future fuels (alternative gases)
 - The Commission's modelling around asset stranding is fit for purpose.

We continue to believe that the case for accelerated depreciation is justified, and that a strong case exists to accelerate depreciation at this DPP reset (DPP3). The Commission has proposed a balanced approach that leaves some capital recovery risk with gas pipeline owners and preserves incentives for gas pipeline businesses (GPBs) to repurpose the network for future fuels.

1.2 Supporting material

Together with Vector and Powerco, Firstgas has commissioned two pieces of independent advice to support the points raised in our cross-submission:

- A legal opinion from **Chapman Tripp** on the process followed to amend Input Methodologies (IMs) in preparation for the gas DPP reset. Chapman Tripp reviewed whether the Commission's process was consistent with the requirements of the *Commerce Act 1986*, including whether submitters have had a reasonable opportunity to provide their views on the proposed changes.
- Additional analysis from **Frontier Economics** that responds to points made in submissions on the proposed approach to addressing asset stranding risks. Frontier looks at seven areas including the impact of delaying action to address stranding risk until DPP4 and whether gas pipeline businesses (GPBs) have already been compensated for stranding risks through existing regulatory allowances.

We have also provided updated analysis from the **Gas Infrastructure Futures Working Group** process. This Further Analysis paper assesses the impacts on gas consumers and gas infrastructure owners to reflect the inputs adopted by the Commission in the draft DPP decision, including accelerated depreciation.

We reference these reports where relevant in this cross-submission.

1.3 Contact details

For any questions regarding our submission, please contact:

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2. Process followed to amend Input Methodologies for DPP3

Some stakeholders have raised concerns that the Commission has not followed an appropriate process for proposing IMs amendments as part of a DPP reset. In Table 1, we provide our response to these comments.

Table 1: Submission points made on IMs amendment process

Submitter and submission point(s) ¹	Firstgas response
<p>Major Gas Users Group (MGUG)</p> <p><i>“...We don’t consider this compressed timeframe to give parties a “reasonable opportunity” to engage effectively on extensive amendments to a foundational building block of gas IM” (paragraph X3, page 2).</i></p>	<p>We disagree with this point.</p> <p>As outlined in the legal advice provided by Chapman Tripp, the Commission has:</p> <ul style="list-style-type: none"> a) Provided submitters with a reasonable opportunity to give their views on DPP3 and b) Undertaken a consultation process that is consistent with the provisions set out in the <i>Commerce Act 1986</i>. <p>The legal advice outlines how:</p> <ul style="list-style-type: none"> • The Commission signalled its intention to amend the IMs for this DPP reset, by issuing a notice of intention (4 February 2022).² We note that there is no set timeframe specified in the Act for this requirement. • The four-week consultation period allowed by the Commission (plus an additional two weeks for cross submissions) is sufficient to meet the requirements of the Act and common law standards of consultation. • The Commission is not required to hold conferences or workshops on IMs amendments. • There are examples of approaches in the Commission's past practice to align the timing of IMs amendments with upcoming regulatory determinations. These examples demonstrate that the timing of section 52Y reviews is not rigid and can be flexed (within the seven-year envelope) to align with other aspects of the Commission’s work programme and emerging industry issues. • The concept of “fundamental” (when considering whether the introduction of accelerated depreciation is a “fundamental” IMs amendment) is not a rigid category to which the Commission is bound. <p>The legal advice concludes that the Commission is plainly justified in amending the asset valuation IMs based on the factors set out in paragraph 3.25 of the Draft Reasons Paper for IMs amendments.³</p>

¹ We have referenced the paragraph and page of the relevant submissions, which are all available on the Commission’s website here: <https://comcom.govt.nz/regulated-industries/gas-pipelines/gas-pipelines-price-quality-paths/gas-pipelines-default-price-quality-path/2022-2027-gas-default-price-quality-path?target=documents&root=276273>

² Potential Amendments to the Input Methodologies for Gas Pipeline Services, Commerce Commission, 4 February 2022, https://comcom.govt.nz/_data/assets/pdf_file/0029/276275/Notice-of-Intention-Potential-amendments-to-IMs-for-Gas-Pipeline-Services-4-February.pdf

³ Gas DPP3 draft – Proposed amendments to IMs for gas pipeline businesses, Commerce Commission, 10 February 2022, https://comcom.govt.nz/_data/assets/pdf_file/0028/276544/Gas-DPP3-draft-Proposed-amendments-to-IMs-for-gas-pipeline-businesses-Reasons-paper-10-February-2022.pdf

Submitter and submission point(s) ¹	Firstgas response
<p>Major Electricity Users Group (MEUG) MEUG consider the use of accelerated depreciation is premature before risks have actually materialised, noting for example: “...The proposal to adopt accelerated depreciation can be viewed as the Commission “jumping the start-gun” when key decisions on the Emission Reduction Plan to be tabled in the House by the end of May are not known” (paragraph 7, page 3).</p> <p>Fonterra “...The Commerce Commission should act on the here and now, and not pre-empt potential legislation that could lead to gas pipelines becoming stranded” (page 1).</p>	<p>We disagree with the view that the Commission’s decision to introduce accelerated depreciation is premature. The introduction of the Government’s legislative target to achieve net zero carbon emissions by 2050 provides clear uncertainty for future natural gas demand. We consider that the Commission has considered a range of options to address this risk and presented a compelling case to justify this change. The draft decision represents a balanced approach that addresses some but not all the capital recovery risk. The Commission’s decision is also consistent with how other regulators are thinking about the changes required to gas regulation due to the energy transition. We note that the Australian Energy Regulator (AER) recently released a paper “Regulating gas pipelines under uncertainty”⁴ that looks at the possible options available to address this risk and concludes that adjusting regulatory depreciation is likely to be the best option.</p>
<p>MEUG MEUG has outline that it believes that the DPP is not the appropriate time to review depreciation: “...MEUG has concerns with the quality of the analysis relied on to justify the proposal to apply accelerated depreciation in DPP3” (paragraph 6, page 2).</p> <p>Methanex “We do not believe the scale of change proposed by the Commission is consistent with a DPP reset process” (paragraph 4, page 1).</p> <p>Munro Duignan “.....the analysis in this submission makes the case for not implementing accelerated depreciation in DPP3 and instead giving full consideration to the issue in the IM review” (page 3).</p>	<p>We disagree with the view that DPP3 is an unsuitable time to introduce accelerated depreciation, given the upcoming IMs review. We believe that addressing asset stranding risk through the introduction of accelerated depreciation is the most urgent issue to address in this DPP reset.⁵ The legal advice confirms that the Commission’s process to introduce an IMs amendment is consistent with the requirements under 52X of the Act. We consider that while the Commission has previously stated that it will generally avoid making “fundamental” changes, outside of an IMs review cycle, the Commission has also noted that:</p> <ul style="list-style-type: none"> • That the distinction of what is “fundamental” is not absolute • It has reconsidered fundamental building blocks in isolation in the past where there was a “compelling and urgent rationale for doing so”. For example, in its decision on fibre.⁶

⁴ *Regulating gas pipelines under uncertainty: Information paper*, Australian Energy Regulator, November 2021, <https://www.aer.gov.au/system/files/AER%20Information%20Paper%20-%20Regulating%20gas%20pipelines%20under%20uncertainty%20-%202015%20November%202021.pdf>

⁵ See Firstgas’ submission on the draft DPP3 decision, and our submissions on the Commission’s process and issues paper and the open letter, <https://firstgas.co.nz/about-us/regulatory/submissions/>

⁶ See para 2.18-2.20. *Fibre Input Methodologies Main 2021 Amendments: Final Decisions*, Commerce Commission, 29 November 2021.

Submitter and submission point(s) ¹	Firstgas response
<p>Greymouth Gas</p> <p><i>“.....the Commission should not consider one matter (accelerated depreciation) from the forthcoming IM process early (in DPP3) in the absence of considering interrelated matters” (paragraph 5, page 2)</i></p>	<p>We disagree that the Commission has considered accelerated depreciation in isolation of other elements of the regulatory framework.</p> <p>As noted above, we consider that the Commission has considered how various options might address the risk of asset stranding through its process and issues paper.⁷ The Commission has also set out its decision-making framework to consider IMs amendments, which it notes:</p> <p><i>“...has been consulted on and used as part of prior processes and helps provide consistency and transparency in our decision-making.”⁸</i></p> <p>This framework ensures that the Commission only introduces amendments that overall, better promote the purpose of Part 4.</p> <p>The Frontier memo separately submitted by Firstgas, Vector and Powerco reviews how accelerated depreciation fits with the Commission's current approach to estimating WACC.⁹ The Frontier advice concludes that:</p> <p><i>“To the extent that the WACC allowances received by GPBs historically have provided any compensation for stranding risks, they would have done so only in relation to the systematic component of stranding risk faced by GPBs. No compensation has been provided for the more material non-systematic stranding risk [asset stranding].”¹⁰</i></p>
<p>Munro Duignan</p> <p><i>“... In my submission responding to the Commission's smid-2021 open letter, I suggested the Commission, in conjunction with the Ministry of Business, Innovation and Employment, needed to consider whether Part 4 was fit for purpose, given Parliament's passing of the Climate Change Response Act 2022” (page 1).</i></p>	<p>We consider that the Commission has introduced well considered IMs amendments to address the key material risk facing GPBs during this DPP reset. The Commission have been able to do these within the bounds of the current regulations that guide their work</p> <p>However, as outlined in our submission,¹¹ we do consider that the Commission's mandate should be the subject of future legislation reform when it considers the conveyance of future fuels (alternative gases). We do agree that the legal interpretation of regulated services has constrained the Commission's mandate on this topic and legislation will need to evolve as the emerging markets for alternative fuels also evolve in New Zealand.</p>
<p>Munro Duignan</p> <p><i>“... a one day workshop would be useful, not because my analysis is important enough to warrant that, but because the issue [risk of asset stranding / accelerated depreciation] itself is unprecedented and therefore warrants the full consideration a workshop would provide.” (page 1)</i></p>	<p>We are happy to participate in a workshop, although we consider that the proposed changes have been well-canvassed in a range of forums – the Commission's open letter, the Commission's process and issues paper, the DPP draft decision submissions and through the Gas Industry Futures Working Group (GIFWG).</p> <p>As outlined in the legal advice submitted separately, the Commission may, but is not required to, hold a conference as part of its process for amending the IMs.</p>

⁷ See Appendix D, Resetting default price-quality paths for gas pipeline businesses from 1 October 2022 – Process and Issues paper, Commerce Commission, 4 August 2021, https://comcom.govt.nz/_data/assets/pdf_file/0018/261810/Resetting-default-price-quality-paths-for-gas-pipeline-businesses-from-1-October-2022-Process-and-Issues-paper-4-August-21.pdf

⁸ Paragraph 2.24, page 13, *Proposed amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths Draft reasons paper*, Commerce Commission, 10 February 2022, https://comcom.govt.nz/_data/assets/pdf_file/0028/276544/Gas-DPP3-draft-Proposed-amendments-to-IMs-for-gas-pipeline-businesses-Reasons-paper-10-February-2022.pdf

⁹ Page 1, Nova submission, 14 March 2022.

¹⁰ See section 4, *Response to key submissions made by stakeholders on the Commerce Commission's approach to addressing stranding risks in the Gas Draft DPP3 Decision*, Frontier Economics, 28 March 2022.

¹¹ Table 1, *Default price-quality paths for gas pipelines for 1 October 2022: Draft reasons paper and proposed IMs amendments*, Firstgas submission to the Commerce Commission, 14 March 2022, https://comcom.govt.nz/_data/assets/pdf_file/0041/278987/First-Gas-Submission-on-Gas-DPP3-draft-decision-14-March-2022.pdf

3. Approach to accelerated depreciation

A key topic debated in all submissions was the introduction of accelerated depreciation for gas pipeline businesses (GPBs). Comments were centred around the following questions:

- Is the risk of asset stranding for GPBs real?
- Is now the right time to amend the IMs to introduce accelerated depreciation
- Are incentives maintained to repurpose the gas networks?
- Is the Commission’s modelling fit for purpose?

In Tables 2 – 4, we provide our response to these comments.

3.1 Is the risk of asset standing real?

Table 2: Submission points made on risk of asset stranding

Submitter and submission point(s) ¹	Firstgas response
<p>Fonterra¹² <i>“.....Would place additional unnecessary costs on them [consumers], and risks encouraging abandonment of these assets”</i> (page 1).</p>	<p>We acknowledge that this draft DPP decision will have a material impact on the cost of gas transmission and distribution services charged to shippers and energy retailers, and that this may be passed on to end consumers.</p> <p>However, we consider that the regulatory framework provides flexibility to manage that risk, through the use of GPBs’ pricing methodologies and the pricing approach adopted by energy retailers.</p>
<p>Fonterra² <i>“...Every business in New Zealand faces the issue with stranded assets due to changing regulatory or business conditions”</i> <i>“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?”</i> (paragraph 11, page 2).</p>	<p>We disagree with Fonterra’s statement which questions why the Commission is intervening to address asset stranding risk for GPBs in this instance.</p> <p>It is normal for businesses to face stranding risk. However, it is also normal for businesses to accelerate capital recovery when those risks increase. Regulated GPBs do not have the ability to increase their prices to address this risk, as regulations restrict suppliers’ ability to do this themselves by adjusting the return expectations when asset lives become truncated.</p> <p>Frontier also address this concern and notes the restrictions on regulated businesses from pricing their services to provide compensation for risk. Frontier also outlines how:</p> <ul style="list-style-type: none"> • There remains a very strong incentive for regulated gas businesses to innovate by pursuing a re-purposing of assets • Nothing about the Commission’s approach to accelerating the cost recovery of all the GPBs in response to this common stranding risk is incompatible with the outcomes of a competitive market. It is true that in a competitive market no individual firm facing a growing stranding risk would be able to raise its prices to recoup its costs more quickly – because doing so would make it uncompetitive compared to its rivals. However, if the stranding risk affected all firms in the industry similarly, then all firms could raise their prices to accelerate cost recovery without facing any competitive disadvantage. <p>Section 8 of Frontier’s memo expands on each of these points.</p>

¹² Fonterra – Submission on Gas DDP3 draft decision, https://comcom.govt.nz/_data/assets/pdf_file/0042/278988/Fonterra-Submission-on-Gas-DPP3-draft-decision-10-March-2022.pdf

Submitter and submission point(s) ¹	Firstgas response
<p>Nova</p> <p><i>“....It is incumbent on the Commerce Commission to enable all market participants to achieve a fair economic return from those investments and not favour a single sector of the market [GPBs]” (page 2).</i></p>	<p>We disagree that the Commission should be tasked with ensuring that all market participants in the gas sector achieve a fair return.</p> <p>The Commission’s mandate under Part 4 is “regulation of the price and quality of goods or services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition” (section 52, <i>Commerce Act 1986</i>). Its focus therefore is on gas transmission and gas distribution businesses (who are monopoly providers) and ensuring that the Commission’s regulation promotes outcomes that are “consistent with outcomes produced in competitive markets” (section 52A).</p> <p>Oversight of the broader players in the gas sector is provided by the Gas Industry Company (technical co-regulator), the Ministry of Business, Innovation and Employment (energy policy) and the competition branch of the Commerce Commission (where applicable).</p>
<p>Methanex</p> <p><i>“.... A competitive industry faced with a circumstance equivalent to network stranding has two stark choices; write-down its assets or innovate and seek new markets” (paragraph 12, page 4).</i></p>	<p>We disagree that there are only two choices for competitive businesses when faced with network stranding. We have previously highlighted a third option – increase prices to reflect higher risk (to the extent that consumers are willing to pay)</p>
<p>Methanex</p> <p>Methanex provides a table contrasting the asset life adjustment for EDBs against the proposed asset life adjustment for GPBs (paragraph 18, page 6).</p>	<p>We agree that the Commission has taken a different approach to adjustment factors for GPBs, than it has applied for EDBs. However, we believe the difference in approach reflect the very different contexts the two sectors are facing:</p> <ul style="list-style-type: none"> • EDBs risks are network specific • GPB risks are created by legislation/policy and sector-wide. <p>Given these distinctions, this requires evolving decisions around the use of a particular mechanism for different sectors.</p>
<p>Methanex</p> <p><i>“..... Pipeline owners would also benefit from windfall gains should alternative gases emerge as a future revenue stream, or to the extent that natural gas use extends beyond 2050, and in so doing extract excessive profits from the consumers who over-paid” (paragraph 12, page 4).</i></p>	<p>We disagree that GPBs will benefit from windfall gains. There are no excess profits under the Commission’s approach (NPV = 0) – rather the draft DPP decision only impacts on the timing of revenue and resulting risks. In addition, as GPBs RABs will be lower incoming year, future prices will also be lower.</p> <p>Frontier explores the potential for any future windfall gains for GPBs, in section 3 of its memo. Frontier observes that:</p> <p><i>“...a windfall gain would only accrue to a GPB if it was able to recover (in NPV terms) more than the capital cost of the regulated assets. But the proposed accelerated depreciation mechanism is NPV neutral – it has no effect at all on the NPV of capital recovery.”</i></p> <p>The Commission’s approach provides no opportunity for over-recovery of capital investments, therefore there are no concerns about any windfall gains under the Commission’s proposed approach.</p>

Submitter and submission point(s) ¹	Firstgas response
<p>Methanex</p> <p>“.... We believe that the Commission’s draft decision excessively reduces the risk faced by pipeline owners” (paragraph 12, page 4).</p>	<p>We disagree with this statement.</p> <p>As outlined in our submission, we consider that Commission has taken a balanced approach and left some risk with the pipeline owners. The Commission have retained some RAB value in 2050 (non-depreciating assets), therefor providing only partial mitigation. The Commission has also left some risk with GPBs through the judgements that it has made – we have illustrated this through Table 2¹³ of our submission.</p> <p>Although Methanex does not explain how much risk it believes should remain with pipeline owners, our assessment of the evidence provided in submissions is that remaining risks are material.</p>
<p>Fonterra</p> <p>Sections on Firstgas due diligence showing that:</p> <p>“...FirstGas purchased existing assets with full certainty that:</p> <ul style="list-style-type: none"> a) Climate Change was occurring b) the NZ Government had committed NZ to at first maintaining our GHG emissions to 1990 levels and then subsequently reducing them c) an emissions trading scheme had been implemented which put an additional cost of gas usage” <p>“...FirstGas should not be compensated for purchasing an asset that potentially will face declining usage in the long-term future” (page 2).</p> 	<p>We disagree with the view that the draft DPP decision has the effect of unfairly compensating Firstgas from risks known at the time we acquired the assets.</p> <p>In making this point, Fonterra has not considered whether the regulatory WACC compensate owners for the risks arising from net zero policies and legislation – if it does not, then investors would reasonably expect the type of regulatory change proposed by the Commission in the draft DPP decision to maintain financial capital.</p> <p>Frontier reviewed this issue and draws the link back to assumptions around FCM. Frontier states that:</p> <p>“....There are good reasons for the Commission to maintain its long-held approach to setting prices in way that satisfies the ex ante FCM principle.</p> <p>In that case, the suggestion that owners of the GPBs should have anticipated that the Commission would knowingly set ex-ante allowances without taking any steps to address new / emerging stranding risks has no relevance.”</p> <p>Frontier also notes that much of New Zealand’s gas infrastructure was put in place well before any of the events identified in the Fonterra submission.</p> <p>Many regulators in other countries have also responded to the emergence of asset stranding risk in the same manner as proposed by the Commission. Frontier’s memo sets out several examples from Australia. This demonstrates that the Commission’s proposed approach is consistent with accepted regulatory practice elsewhere and the reasonable expectations of investors in regulated infrastructure.</p>
<p>Electricity Networks Association (ENA)</p> <p>“....ENA is pleased to see the Commission has reaffirmed its commitment to the foundation principle of Part 4 regulation - ex-ante FCM maintenance. This will promote confidence around investment for suppliers in all regulated industries” (page 2).</p>	<p>We agree with ENA and endorse the Commission’s statements about the importance of financial capital maintenance (FCM) to the regulatory framework and investment confidence.</p>

¹³ See page 10 of Firstgas’ submission, https://comcom.govt.nz/_data/assets/pdf_file/0041/278987/First-Gas-Submission-on-Gas-DPP3-draft-decision-14-March-2022.pdf

Submitter and submission point(s) ¹	Firstgas response
<p>Vector</p> <p>“.... Along with accelerated depreciation as proposed by the Commission, we consider it is also necessary to:</p> <ul style="list-style-type: none"> • Implement a revenue cap.... • Un-index the regulated asset base (RAB) from inflation” (paragraph 5, page 2). <p>“...We consider these further actions necessary because otherwise the current back ended cashflow and demand growth forecasting risk could work against the policy intent of bringing cashflows forward to mitigate stranding risk” (paragraph 7, page 2).</p> <p>Powerco</p> <p>“...Removing indexation would have further supported consumer outcomes....especially in times of high inflation” (page 3).</p> 	<p>Firstgas believes that there may be merit at looking at additional IMs amendments for gas pipeline businesses to ensure that the regulation remains “fit for purpose” as the gas sector evolves, customer fuel preferences adjust, and alternative gases emerge.</p> <p>However, we believe that the measures suggested by both Vector and Powerco are best addressed through the 2023 IMs review.¹⁴ We would welcome early engagement on these issues and believe the use of workshops would be an effective tool to flesh out the issues and options during the problem definition phase (signalled for Quarter 3 and 4 of 2022).¹⁵</p>
<p>Nova</p> <p>“.....Nova therefore asks that the Commission apply its depreciation adjustment factor to new investments only.....However, for existing sunk investments there is no justification for an accelerated depreciation rate.”(page 1).</p>	<p>The Frontier memo outlines why it is important and necessary for accelerated depreciation to be applied to both existing and new assets.¹⁶</p> <p>The Commission has reaffirmed its commitment to the FCM principle which ensures that that “investors in regulated assets can expect that they are able to fully recoup their capital costs (i.e., the efficient return on capital and the efficient return of capital)” and adherence to this principle promotes long-term benefits to consumers.</p> <p>Applying accelerated depreciation to only new investments would be a clear breach of the <i>ex-ante</i> FCM principle.</p> <p><i>“The suggestion is that the regulatory allowance on existing assets should be set such that asset owners do not expect to recover the cost of existing assets – because there is nothing the asset owner can do about that, given that the existing assets are already sunk.”</i></p> <p>Such a breach of the <i>ex-ante</i> FCM principle would clearly have broader implications for the Commission, setting a precedent for other regulated businesses.</p>

¹⁴ See section 7.1 of Firstgas’ submission, https://comcom.govt.nz/_data/assets/pdf_file/0041/278987/First-Gas-Submission-on-Gas-DPP3-draft-decision-14-March-2022.pdf

¹⁵ Notice of Intention: Input Methodologies Review 2023, Commerce Commission, 23 February 2022, https://comcom.govt.nz/_data/assets/pdf_file/0034/277387/IM-review-notice-of-intention-to-commence-IM-review-23-February.pdf

¹⁶ See section 6, Response to key submissions made by stakeholders on the Commerce Commission’s approach to addressing stranding risks in the Gas Draft DPP3 Decision, Frontier Economics, 28 March 2022.

3.2 Is now the right time to amend IMs?

Some submitters questioned whether it was the right time (at the DPP3 reset) to amend the IMs to accelerate depreciation. We respond to these comments in Table 3.

Table 3: Submission points made on timing of amending IMs

Submitter and submission point(s) ¹	Firstgas response
<p>MGUG</p> <p>MGUG sets out several points outlining why the Commission’s draft DPP decision doesn’t clearly explain why change is needed now:</p> <p><i>“...Creating certain price shocks now vs speculative price shocks later increases stranding risk. (page 8).</i></p> <p>Methanex</p> <p>Methanex considers that referring changes to DPP4 will <u>reasonably</u> protect FCM and by extension serve the long-term interests of consumers:</p> <p><i>“...We do not believe the scale of change proposed by the Commission is consistent with a DPP reset process.....or that action taken during DPP3, instead of deferring to DPP4, is necessary to reasonably protect the financial capital of pipeline owners, and by extension serve the long-term interests of consumers” (paragraph 4, page 1).</i></p>	<p>We disagree with submitters who suggest that that the introduction of accelerated depreciation should wait until DPP4. As outlined in our submission, and Frontier’s analysis, waiting until 2026 (or later) to accelerate capital recovery would exacerbate the risk:</p> <ul style="list-style-type: none"> • Prior work by Frontier Economics¹⁷ shows that accelerating depreciation now is expected to reduce the maximum price rises facing consumers by almost half • We have evaluated whether affordability concerns warrant a different approach to this DPP and conclude that recent trends in energy prices support accelerated capital recovery risk in DPP3. <p>We commissioned Frontier to specifically explore the implications of delaying the introduction of accelerated depreciation until DPP4.¹⁸ Frontier concludes that:</p> <p><i>“...Under the scenario in which the Commission begins to accelerate depreciation in DPP3, more MAR is recovered earlier when more gas users from whom the costs may be recouped exist. If instead the Commission were to wait until DPP4 to accelerate depreciation, a greater amount of MAR would need to be recovered later, when demand is expected to be declining materially.</i></p> <p><i>Consequently, if the Commission were to wait until DPP4 to accelerate depreciation, the future gas price increases that would, in expectation, be required in order for the GPBs to recoup their full RABs by 2050 would be materially and persistently higher from approximately 2031 onwards than if the Commission were to begin accelerating depreciation in DPP3”</i></p> <p>Frontier has modelled an index of real prices for both scenarios (introduction in DPP3 and DPP4), which clearly the increase in costs facing future customers.¹⁹ If the willingness to pay of those future consumers was lower than the prices required in order to fully recoup GPBs’ costs, then some of those costs may never be recovered.</p> <p>It is therefore appropriate for the Commission to act now, through IMs amendments for DPP3.</p>

¹⁷ Review of Commerce Commission’s Asset Stranding Model, Frontier Economics, 13 March 2022, https://comcom.govt.nz/_data/assets/pdf_file/0035/278990/Frontier-Economics-submitted-by-Vector2C-First-Gas-and-Powerco-on-Gas-DPP3-draft-decision-Review-of-Asset-Stranding-Model-13-March-2022.pdf

¹⁸ See section 2, Response to key submissions made by stakeholders on the Commerce Commission’s approach to addressing stranding risks in the Gas Draft DPP3 Decision, Frontier Economics, 28 March 2022.

¹⁹ See Figure 2, page 5, Response to key submissions made by stakeholders on the Commerce Commission’s approach to addressing stranding risks in the Gas Draft DPP3 Decision, Frontier Economics, 28 March 2022.

Submitter and submission point(s) ¹	Firstgas response
<p>Fonterra²⁰ <i>"We note that this assertion is flawed as there is currently no regulation or proposed regulation before Parliament that will accelerate the decline of gas usage"</i> (page 1).</p> <p><i>"....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....."</i> (paragraph 4, page2)</p> <p>MGUG <i>"....While climate policy is substantially formed, new energy policy has not. Existing energy policy is agnostic towards gas"</i> (paragraph X4c).</p> <p>Greymouth Gas <i>".....The Commission has not fully considered climate change in its Draft DPP decision"</i> (page 1).</p> <p><i>"....There is no evidence in the 2050 target definition to support the Commission's underlying assumption that natural gas will not be piped in New Zealand beyond 2050"</i></p>	<p>We disagree that there is no confirmed or proposed regulation that will confirm the decline of gas use in New Zealand.</p> <p>We consider that the legislative net zero target, and the associated mechanisms such as the setting of ERPs and emission budgets provides this certainty. We note that Fonterra has committed to a "net zero emissions by 2050" for its own manufacturing sites.²¹</p> <p>The ERP and supporting energy policies will evolve over time and there is no clear pathway for the energy transition, as Government monitors and reviews progress. But the legislation target makes it clear that direction for fossil fuel usage in New Zealand is in decline.</p>
<p>Fonterra² <i>"....Fonterra suggests that a Customised Price-Quality Path (CPP) would be a better mechanism to pursue and substantiate the basis for any accelerated depreciation"</i> (page 1).</p>	<p>We disagree that the risk of asset stranding would be better considered through the CPP mechanism.</p> <p>A CPP has been established for when a regulated business does not believe the DPP meets its specific needs. The CPP is tailored to the company's specific plans, including investment plans. The risk of asset stranding is not a business-specific risk; rather it applies to all of the GPBs. Therefore, it is more appropriately dealt with through the use of the DPP mechanism and the specific IMs amendment the Commission has proposed.</p>
<p>Fonterra <i>"....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"</i> (paragraph 15, page 3)..</p>	<p>We do not consider that the proposed Capex re-openers should be subject to the same rigour as a CPP.</p> <p>The Capex re-opener is intended for only a specific project or programme that was not considered and incorporated as part of a GPBs DPP allowances. In contrast, a CPP covers all of the GPBs expenditure for the period and enables considerable tailoring of the price-quality path.</p> <p>Therefore, we consider that applying the same level of CPP scrutiny to a Capex re-opener would not be proportionate to the level of expenditure sought and would be unduly onerous.</p>
<p>Methanex <i>"..... We do not believe that the Commission has a sufficient basis of information or analysis to reasonably form the view that its proposed settings ensure regulated gas businesses have incentives to invest and innovate in their networks, while preventing them from making excessive profits"</i> (paragraph 3, page 1).</p> <p><i>".....It has not justified writing off the regulated asset base ("RAB") by 2050 with the information it has available now"</i> (paragraph 9(i)).</p>	<p>We disagree that the Commission should delay its DPP3 decisions (around asset stranding risk), until it has a sufficient base of information, such as the Government's first Emissions Reduction Plan (ERP) and transition plans for the gas sector.</p> <p>We consider that Commission will never have perfect information – we expect this debate will continue to evolve over the coming decades, as social expectations change, technology emerges and as progress against the 2050 target is monitored and assessed. Therefore, the Commission's approach makes sense – set up an approach that can evolve over time.</p>

²⁰ Fonterra -Submission on GPB IM Amendments, https://comcom.govt.nz/_data/assets/pdf_file/0043/278989/Fonterra-Submission-on-GPB-IM-Amendments-24-February-2022.pdf

²¹ <https://www.fonterra.com/lk/en/embracing-sustainability/our-commitments/climate-change.html>

3.3 Are incentives maintained to repurpose the gas networks?

Some submitters raised concerns that accelerating depreciation could suppress the incentives that gas pipeline businesses would otherwise have to repurpose their assets (e.g., to transport hydrogen or biogas). We respond to these comments in Table 4.

Table 4: Submission points made on repurposing the gas network

Submitter and submission point(s) ¹	Firstgas response
<p>MGUG</p> <p><i>“.....the Commission also hasn’t considered that consumers may have a preference for gas and care less about the narrow distinctions of “natural gas” with blended gases if it continues to deliver wider consumer energy choices for them”</i> (paragraph X10, page 4).</p> <p><i>“....The best long term interests of consumers as well as pipeline companies, other gas market participants, and New Zealand in general comes from gas in its various forms continuing to be an energy choice for households and businesses”</i> (paragraph X14, page 5).</p> <p><i>“.....Part 4 overriding purpose is to address a type of market (little competition). Act is silent on whether repurposed gases could be included, but S52G provides an opener for it to be included within pipeline services”</i> (page 7)</p>	<p>We agree that that primary concern of energy consumers is to ensure access on reasonable terms to energy options that meet their needs. However, the Commission is clearly constrained by the words of the legislation on the scope of the services that it regulates. Section 55A clearly states that the regulated service is the conveyance of natural gas, and we therefore accept that the Commission cannot simply read in other gases to that definition.</p> <p>As submitters note, there are processes available to redefine regulated services or broaden the scope of services that are already regulated. MGUG refers to the s52G process – where the Commission can make a recommendation to the Minister of Commerce. This could be an option worth exploring, although the timeframes for conducting such a review would extend beyond DPP3. A better option is likely to be for MBIE to review section 55A from first principles, considering the factors listed in s52G (competition, market power, and the cost and benefits of regulation).</p> <p>Our general observation is that the pace of the energy transition is placing pressure on the timeframes for regulatory decision making. That is why focusing on the incentives of suppliers is particularly important – since this ensures that good decisions are made within regulatory cycles, rather than waiting for regulatory change to adjust supplier behaviour.</p>
<p>Greymouth Gas</p> <p><i>“.....the Commission should not exclusively consider ‘natural gas’ (which it concedes is not defined in the Commerce Act),⁷ but that consideration should also be given to the possibility that the pipelines will be repurposed for alternative gases”</i> (paragraph 12, page 3).</p>	<p>As mentioned above, we consider that the best way to address this concern is through legislative reform led by MBIE. A significant advantage of taking this approach is that it should ensure a coherent approach with other policy decisions.</p> <p>We understand that the Emissions Reduction Plan due to be released in May 2022 will lead to further policy analysis and decisions, such as developing a National Energy Strategy and a Gas Transition Pathway. This provides a unique opportunity to align policy and regulatory frameworks, which seems preferable to the Commission extending the definition of natural gas in the <i>Commerce Act 1986</i> beyond its plain meaning.</p>
<p>Fonterra²</p> <p><i>“.....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”</i> (paragraph 7, page 2).</p>	<p>We agree with Fonterra that since biomethane is chemically identical to natural gas and meets the existing natural gas specification (NZS5442), it falls within the regulated service definition adopted by the Commission.</p>

Submitter and submission point(s) ¹	Firstgas response
<p>Methanex</p> <p><i>“....the Commission should have given greater consideration to the likely emergence of energy policies that:</i></p> <ul style="list-style-type: none"> <i>(a) promote or make commitments in respect to the future use of alternative gases;</i> <i>(b) implement measures to assure that the use of natural gas does not decline at a rate that places undue stresses on the electricity market and remains sufficient to enable a transition to”</i> (paragraph 16, page 5). 	<p>We actively support the type of policies referred to by Methanex. However, there is no clarity at present as to whether those policies will be adopted, or if they are, whether they will have lasting impact on demand for gas pipeline services. This is because the future use of pipelines to transport alternative gases will be driven by the relative economics of the energy options available to users.</p> <p>Through the work of the Gas Infrastructure Futures Working Group, we have seen very divergent perspectives emerge on the relative merits of different decarbonisation options. This means that all parties (including the Commerce Commission) need to make decisions in the face of considerable uncertainty. We consider that the draft decision has captured this uncertainty well and there is no benefit from placing greater weight on possible policies to support alternative gases.</p>
<p>Methanex</p> <p><i>“....The danger we see is that the draft decision will not only accelerate the wind-down in feasible revenues, it will also forestall the emergence of alternative gases that would otherwise sustain pipeline assets beyond 2050”</i> (paragraph 15, page 5).</p>	<p>We do not see this as a valid concern. As highlighted in our submission, Firstgas has an active programme to ensure that alternative gases are understood as an option worth preserving in New Zealand’s decarbonisation journey.</p> <p>Even with accelerated depreciation, gas pipeline businesses have strong incentives to promote the ongoing use of our assets. This is best illustrated through the updated analysis submitted by the Gas Infrastructure Futures Working Group through its Further Analysis paper, which finds that an optimistic repurposing scenario contains significantly less risk of stranding than any winddown scenario. The difference in value is material at around \$500 million across the industry (\$526 million under a slow winddown scenario and \$79 million under an optimistic repurposing scenario).</p> <p>This aligns with the actions that Firstgas has committed to through our future fuels programme. We have appointed a new executive to lead this programme, are progressing New Zealand’s first renewable gas to grid project at Reporoa, and are proceeding with a trial to blend hydrogen into existing gas networks.</p>
<p>MGUG</p> <p>DPP settings don’t need to encourage investment to ensure reliability and quality – since other regulations deal with this (e.g., AS2885, HSWA etc).</p>	<p>We see the various regulatory regimes that influence our decisions (including Part 4) as a complementary, mutually reinforcing set of arrangements that promote security and reliability. This is consistent with how the Gas Industry Company defined security and reliability in its 2016 review, stating that</p> <p style="text-align: center;"><i>“The primary responsibility for transmission S&R lies with the GTBs, operating within a regulatory framework defined principally by the Health and Safety at Work Act, the Commerce Act, and the Gas Act.”²²</i></p> <p>The GIC review of security and reliability describes the various impacts of Part 4 regulation at section 3.4, and clearly sees this regulation as having a significant impact on investment incentives.</p>

²² See page 4, Gas Transmission Security and Reliability, Gas Industry Company, April 2016, <https://www.gasindustry.co.nz/assets/DMSDocumentsOld/5273~Gas-Transmission-security-and-reliability-report-ID-10808-ID-13598.pdf>

3.4 Is the modelling fit for purpose?

Table 5: Submission points made on modelling

Submitter and submission point(s) ¹	Firstgas response
<p>MGUG <i>“....The counterfactual (applying IM settings from DPP4) hasn’t been adequately addressed in the reasoning. The stranding risk model used by the Commission offers no answer as to why making IM amendments in DPP3 versus in DPP4 is in the long-term interest of consumer”</i> (paragraph X9, page 4” <i>“....Counterfactual argument is not demonstrated by the model. Asset stranding risk model quantifies risk of not acting now. It doesn’t quantify risk of not acting now vs acting in DPP4 (the counterfactual)”</i> (page 8). Methanex <i>“....One of the fundamental sensitivities that appears to be missing is measuring the impact of modelling a counter-factual to the draft decision”</i> (paragraph 24, page 8).</p>	<p>We disagree that the Commission should explicitly model the impact of delaying any accelerated depreciation until DPP4. If the Commission decides that changes in the external environment threaten financial capital maintenance, then it is entitled to adjust regulatory parameters to reflect those changes.</p> <p>In any event, the Frontier Economics report provided in our joint cross-submission with Vector and Powerco does explore this counterfactual. It shows that delaying accelerated depreciation until DPP4 would exacerbate the cost recovery burden facing consumers – leading to higher prices between 2030 – 2050 than taking earlier action.</p>
<p>MGUG <i>“.....The modelling work also falls short in assuming that there is no residual value in the pipelines in addressing ex-ante Financial Capital Maintenance (FCM) risk”</i> (paragraph X10). <i>“...Asset stranding risk model flawed in assuming zero residual value (i.e. RAB is stranded)”</i> (page 9).</p>	<p>We disagree that this is a shortcoming of the modelling. As described in our submission, the modelling does not assume zero residual RAB in 2050 – since non-depreciating assets such as easements are excluded from the model. Furthermore, the other assumptions made in the model mean the practical effect of the draft DPP decision is not to leave a remaining RAB value of zero in 2050. This is shown in the updated analysis provided by the Gas Infrastructure Futures Working Group, which estimates remaining RAB of more than \$500 million in 2050 under a slow winddown scenario using the parameters specified in the draft DPP decision.</p>
<p>MGUG <i>“.....The argument that this avoids “unmanageable” future price shocks (because they are assumed to be shared across a smaller customer base) is countered by the fact that the consumer base, especially for GDBs, is expected to grow through DPP3. The price shocks of DPP3 will fall on a smaller base now than it would in 2026”</i> (paragraph X13a, page4).</p>	<p>We disagree with this statement. We consider that it is wrong to compare the consumer base in 2022 with the consumer base in 2026. When it comes to capital recovery risk; the right comparison is between 2022 and 2040 or 2050. This is when price shocks will become unmanageable based on forecasts of future natural gas demand.</p>
<p>Fonterra² Fonterra suggest that some GDBs do not recover costs over the design life of the assets: <i>“....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”</i> (paragraph 21, page 3)</p>	<p>We disagree with this point. Our reading of the Commission’s analysis is that under current capital contribution policies the full costs of connection assets are recovered through prices over the life of the assets.</p> <p>Firstgas is currently in the process of updating our capital contributions policy for our gas distribution business, as outlined in our submission on the Commission’s process and issues paper.²³ We believe it is appropriate to adjust our policy to fit with the new policy environment – although we agree with the Commission that our current policy does not result in cross-subsidies.</p>

²³ Page 5, *Resetting DPPs for gas pipeline businesses from 1 October 2022: Process and issues paper*, Firstgas submission to the Commerce Commission, 30 August 2021, https://firstgas.co.nz/wp-content/uploads/Firstgas-submission_DPP-reset-issues--process-paper_Aug-2021.pdf.

Submitter and submission point(s) ¹	Firstgas response
<p>MEUG</p> <p><i>“....It is too early to be as definitive as the Commission’s models claim to be, and or, the Commission interprets the analysis. Hence the results of the modelling to date are subject to high levels of uncertainty and little reliance can be used on their findings for such a fundamental change to the IM ahead of the general review of IM...”(paragraph 6, page 3).</i></p>	<p>We agree that you cannot make definitive conclusions from modelling, particularly for the years closer to 2050. However, we consider that the Commission is simply reflecting a reasonable position given current information and uncertainty. We understand that the Commission plans to update its models and regulatory parameters as new information emerges.</p>
<p>Methanex</p> <p><i>“....From the opportunity Methanex has had to consider the asset stranding model it has come away with serious concerns regarding the rigour of the model and the limited degree to which the Commission appears to have modelled important sensitivities before arriving at its conclusions” (paragraph 22, page 7).</i></p>	<p>We do not share Methanex’s concerns with the asset stranding model. We provided an independent review of the modelling (carried out by Frontier Economics) as part of our submission, and the issues identified from that review can be evaluated by the Commission in making the final DPP decision.</p> <p>We consider that the Commission has arrived at a balanced set of assumptions when modelling asset stranding risk and has landed on an approach the balances the impact on consumer prices and level of risk remaining with GPBs.</p> <p>In our submission, we have reviewed the regulatory choices made in the asset stranding model against a set of choices that would provide greater confidence on capital recovery.²⁴ We believe this illustrates the balanced nature of the Commission’s choices.</p>
<p>Methanex</p> <p><i>“....A related element that is also missing from the analysis is the price elasticity of demand in respect to pipeline tariffs within differentiated consumer classes” (paragraph 29, page 9).</i></p>	<p>We disagree with this statement. Analysis of price elasticity of demand is not required for regulatory decisions under Part 4 of the Commerce Act. Rather, consumer responsiveness to price changes should feed into GPB pricing methodologies as part of aligning with the pricing principles specified in the Information Disclosure determination.</p> <p>We intend to review our pricing methodologies for both transmission and distribution in coming years to ensure continued alignment with the Commission’s pricing principles and to consider price elasticity / consumer willingness to pay.</p>

²⁴ See Table 2, page 10 of Firstgas’ submission.