Major Electricity Users' Group

14 March 2022

Matthew Clark
Manager, Price-Quality Regulation
Commerce Commission
By email to regulation.branch@comcom.govt.z

Dear Matthew

## GPB IM amendments

1. This is a submission from the Major Electricity Users' Group (MEUG) on the Commerce Commission Draft reasons paper "Proposed amendments to input methodologies for gas pipeline businesses related to the 2022 default price-quality paths" dated 10 February 2022 and specifically proposed amendments to the gas pipeline businesses (GPBs) Input Methodologies (IMs) not related to cost of capital.[1]

2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.

3. On the three proposed amendments, MEUG:

   a) Opposes amending the IM for economic network stranding and the option for the Commission to adjust depreciation because we oppose the Commission's draft DPP3 decision to use that mechanism. MEUG's reasons for opposing this are set out in the separate submission on the draft DPP3 proposal. A copy of that submission is attached to this submission.

   b) Have no comment on the treatment of operating leases.

   c) Agree with amendments for capital expenditure capacity and risk event reopeners.

Yours sincerely

Ralph Matthes
Executive Director

[1] Document 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 at 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

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Dear Matthew

## GPB DPP3 reset

1. This is a submission from the Major Electricity Users' Group (MEUG) on the Commerce Commission Draft reasons paper "Default price-quality paths for gas pipeline businesses from 1 October 2022" dated 10 February 2022.[1]

2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.

3. MEUG opposes the proposed single largest change for DDP3 being to accelerate depreciation to mitigate risks of economic network stranding. This will increase GPB line charges in DPP3 by around $41m per year, an increase of around 16%, compared to the DPP2 allowance for 2021-22.[2] As the line charge increases are significant the Commission propose to cap the starting price and annual rate of change increases resulting in not all the accelerated depreciation applicable to DPP3 being recovered. This will lead to a catch-up of carried over accelerated depreciation costs into DPP4.

4. The balance of this submission has three sections that cover:

    - The case for adopting accelerated depreciation for DPP3 is weak.
    - Considering risks and options to address economic stranding should be part of the broader Input Methodologies (IM) review, leaving the option for accelerated depreciation or other solutions for DPP4 starting 1 October 2026.
    - If a final decision is made to apply accelerated depreciation for DPP3, then the justification for a 4-year DPP3 is no longer applicable, and DPP3 should revert to the default 5-years.

1 Document https://comcom.govt.nz/__data/assets/pdf_file/0027/276543/Gas-DPP3-draft-DPPs-for-gas-pipeline-businesses-from-1-October-2022-Draft-reasons-paper-10-February-2022.pdf at 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

2 Draft reasons paper, refer Figure X1 for breakdown of cost changes DPP3 to DPP4 for starting year including $41m for accelerated depreciation.

### The case for adopting accelerated depreciation in DPP3 is weak

5. The Commission has stated fundamental changes to the IM outside the 7-year general IM review are to be avoided. Economic stranding has been considered by the Commission as a systematic risk and therefore part of considerations of the asset beta in estimating WACC.[3] MEUG is concerned the Commission is making a fundamental change to the IM to address economic stranding also as a non-systematic risk without due consideration of:

   a) Any consequential changes to the overall allocation of risk and incentives in the Part 4 regime such as WACC. Weighing such changes should be part of the general review of IM, particularly when the near-term change in charges is material at around $41m per annum (see paragraph 3 above).

   b) Setting aside our primary concern that economic stranding is a non-systematic risk and therefore be-spoke fixes need to be considered carefully, accelerated depreciation is not the only possible solution. The draft DPP3 decision by picking accelerated depreciation as the "winner" now for the gas DPP3 may have biased the consideration of alternatives in the general IM review, e.g., removing asset value indexation could be considered.

   c) The risk of economic stranding in DPP3 is remote and there are existing and new mechanisms proposed by the Commission that mitigate near term risk. The existing mechanisms are to change capital contributions policy or to apply for a CPP. The proposed mechanism is a new reopener to allow GPB that may have a specific concern about continuing investment and maintenance to meet standards because of factors such as stranding risk in the current DPP, to seek a re-opener. The former is already being actively used by GPB and as noted beforehand, the latter is unlikely to be needed in DPP3 though it is useful to have as a backstop just in case.

   Even the Commission recognises fundamental changes to IM's should not be outside the general IM review when it stated,

   > "We do not consider the DPP3 reset is the appropriate time to comprehensively consider the Gas IMs."[4]

6. MEUG has concerns with the quality of the analysis relied on to justify the proposal to apply accelerated depreciation in DPP3. For example, an important theme in the Commission's analysis was summarised in the Briefing to Stakeholders slide titled "Accelerated deprecation to mitigate stranding risk" as:

   > "Net-zero 2050 target suggests shorter time for GPBs to recover capital investment." [5]

   This has been implemented In the Commission's modelled Reference Case by assuming transportation of natural gas through regulated natural gas pipelines ceases by 2050. There are two problems with this:

   a) There is no statutory requirement that transportation of natural gas through regulated natural gas pipelines must cease by 2050.

[3] Draft reasons paper, paragraph [6.18]
[4] Ibid [X63]
[5] Gas DPP3 stakeholder briefing presentation, slide 9, first of four bullet points

b) Concept Consulting discussed the limitations of the assumption in the models that incorporated the Climate Change Commission recommendations for "a prohibition on new gas connections from 2022" and "an assumed prohibition on all distribution-reticulated gas demand by 2050" by noting:

> "It should be noted that these assumed policy interventions are a key driver of the projected demand outcomes. If the government does not follow the Climate Change Commission's recommendations about implementing such policies, it is likely that gas demand will be higher than projected, including for the DPP period out to 2029" [6]

In our view 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.

7. 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. Even the government has hedged a final decision on its aspirational goal of 100% renewable generation by 2030 by confirming in the House in February 2022,

> "This target will be reviewed in 2025 before the second emissions reduction plan is put in place. A review in 2025 allows time to identify additional information on potential solutions to New Zealand's dry year challenge, including through the New Zealand Battery Project." [7]

The government has decided it is important to pause and reflect in 2025, after having decided on the inaugural Emissions Reduction Plan, on the significant political aspirational target of 100% renewable electricity by 2030. MEUG suggests the Commission should adopt the same prudent approach and wait for more information before deciding whether to implement accelerated deprecation for DPP4 from 1 October 2026.

### Better decisions will be likely based on the EPR and IM review, and implementing in DPP4

8. In our view better decisions on how best to mitigate stranding risk should be taken after the following because they will reduce the uncertainty on forecasting gas demand, gas supply and whether accelerated deprecation is the best solution:

   a) The publication of the Emission Reductions Plan due before 31 May 2022.

   b) The completion of the general IM review due before 31 December 2023.

9. Completion of the above allows time to include better quality decisions on policies to mitigate economic stranding for the start of DPP4 on 1 October 2026.

[6] Concept Consulting report for the Commerce Commission, Basis and methodology for producing gas demand projections to feed into the default price-quality path (DPP) regulation of gas distribution businesses, 15 November 2021, p3.

[7] Written Q&A in the House, Stuart Smith to the Minister of Energy and Resources, published 17 February 2022, refer https://www.parliament.nz/en/pb/order-paper-questions/written-questions/document/WQ_02844_2022/2844-2022-stuart-smith-to-the-minister-of-energy-and

### Five rather than four years for DPP3 should apply if accelerated depreciation starts in DPP3

10. If the Commission decides to introduce accelerated depreciation for DPP3, then MEUG believes the rationale for having a four-year period for DPP3 no longer stands, and accordingly the period for DPP3 should revert to the default 5-year term and the ramp up for accelerated depreciation can be moderate by the additional year to reduce the initial price shock and year by year price steps. This would still be a very poor second-best option to deferring consideration of accelerated deprecation to the general review of IM and if appropriate applying in DPP4.

Yours sincerely

Ralph Matthes
Executive Director