13 March 2025

Gas DPP4 Team
Commerce Commission
By email: infrastructure.regulation@comcom.govt.nz

Tēnā koe,

Gas DPP4 2026 – A customer driven period supported by adaptive regulation

We welcome the opportunity to respond to the Commerce Commission (**Commission**)'s open letter on the gas DPP4 2026 price-quality path reset. The new regulatory settings that the Commission applied in its Gas DPP3 decision have been successful in helping gas pipeline businesses (**GPB**s) mitigate the risk of economic under-recovery due to the Government's policy actions for the domestic target of net zero emissions by 2050, while not materially impacting the real cost to customers.

Maintaining the DPP3 settings and complementing them with uncertainty mechanisms, as the Commission has proposed for electricity distributors in DPP4, will support our ability to maintain pipeline services where there is demand for them without asset stranding. Our summary observations looking towards the DPP4 period are:

Consumer behaviour is driving gas supply and demand but the key theme is uncertainty	• Gas demand is changing, driven by industrial demand response, but demand will consistently underpin energy security throughout the transition and beyond. • Gas supply is changing, including continued development of biogas options. Long-term scenarios are difficult to predict. • With existing pipelines remaining, there will be gas supply for over 300,000 residential and small commercial customers longer than the life of existing appliances. Gas infrastructure needs to support consumer choice during the energy transition.
Tools to manage asset stranding risk are critical to maintaining services to customers	• Asset stranding risk is growing off the back of the security of supply issue last year. • Gas distribution networks will be required to minimise the cost of the transition by avoiding appliance stranding and preserving replacement options. • There is a package of mechanisms available to deal with asset stranding risk, and we are hopeful the right tools will be in place to preserve incentives to invest.

Regulatory settings can deal with uncertainty

- We are encouraged the Commission is looking into the suitability of the form of control, and willingness to consider the need for additional price path adjustments as the sharing of risk is important.
- Forecasting is getting more difficult, therefore it's fundamental that there are mechanisms (e.g. reopeners[1]) in place to deal with uncertainty to ensure GPBs can react accordingly within the DPP4 period.
- Forecasting methods based on historical patterns may not be fit for purpose with the changing environment. AMPs provide a good guide for capex but may also be misaligned with changing investment strategies.

We provide further comments on these observations below and link them to the Commission's questions set out in the open letter.

We are always keen to meet with the Commission to discuss and develop the ideas in our submissions. In the meantime, if you have any questions or would like to talk further on the points we have raised, please contact Emma Wilson (Emma.Wilson@powerco.co.nz).

Nāku noa, nā,

Emma Wilson
Head of Regulatory, Policy and Markets
POWERCO

[1] Similar to the uncertainty mechanisms the Commission has introduced for Electricity Distributors in DPP4

1. While there is uncertainty, there will be gas supply for longer than the life of existing appliances for residential customers

As the Commission notes, delivered volumes of piped natural gas are expected to decline over time, however there is significant uncertainty about the pace of this change and the overall extent of decline of gas volumes and customer numbers.[2]

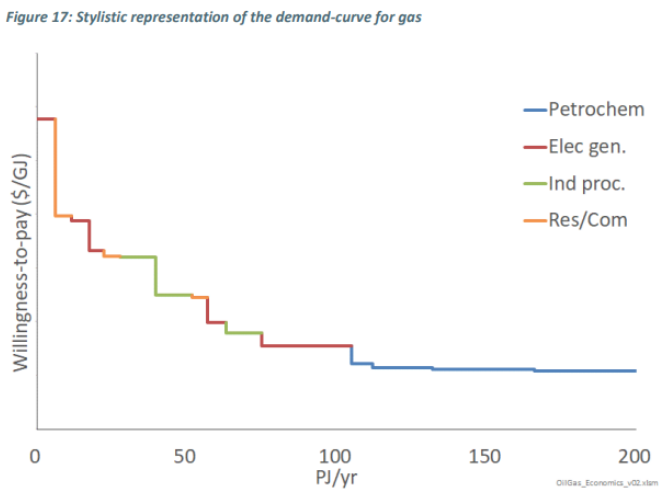
While true in aggregate – and Powerco have already seen a slight decline in gas volumes – the change will be driven by the behaviours of customers and will therefore occur at different rates within the Powerco network, and across the North Island network. This has important implications for the amount we spend on maintaining gas pipeline services and how we price them. In particular:

- Expenditure decisions including capex and opex substitution and how we forecast uncertainty
- How we address stranding risk while at the same time giving customers the certainty they need
- How we maintain incentives to invest and ensure GPBs' flexibility to react to changing market conditions within the DPP4 period.

The Commission's February 2025 analysis of *Trends in gas pipeline businesses' performance*[3] notes a sustained reduction in gas delivered per industrial and non-standard connection since 2014 and a very slight reduction for other customer types. We would expect this trend to continue due to a broad range of factors ranging from global economic conditions, and gas supply (and cost) uncertainty, through to the ETS price and cost of converting to alternative sources of energy.

We are confident that biomethane will increasingly displace natural gas not only in price terms but as a net-zero molecule and as a secure source of domestic supply for certain customers who have a higher willingness to pay. For example, electricity generators and residential and commercial customers have been demonstrated to buy gas at over 4 times the price of the petrochemical industry, as illustrated in Figure 1.[4]

Figure 1 Sector willingness to pay



In the short term, coal and potentially biomass rather than imported LNG[5] is likely to compete with current domestic natural gas production[6] for electricity firming fuel. Commentary following recent developments at Pohokura, Turangi and Kowhari suggests that domestic exploration will continue[7].

[2] Commerce Commission, Open Letter on Gas DPP4 2026 price-quality path reset, pg 1.

[3] Commerce Commission, Commerce Commission - Trends in gas pipeline business performance

[4] *Long term gas supply and demand scenarios*, Concept Consulting for the GIC, September 2019. p. 31

[5] Genesis weathers a tough winter and comes out on top | BusinessDesk

[6] Contact profit down, earnings up as it looks to a calmer future | BusinessDesk

[7] OMV eyes March for new Pohokura supply | Energy News and Greymouth eyes Kaimiro-Ngatoro for gas search | Energy News

Domestic natural gas will continue to be used intermittently for electricity firming in the medium to long term.

We see a strong need for bulk gas supply to support electricity generation and industrial demand in the short to medium term. This supply will flow through to other users and support their (relatively small) demand while biomethane supply is being built up.

Although supply and demand patterns will change over the next 25 years, gas will continue to flow from domestic production on and offshore Taranaki to storage fields in Taranaki, current and future[8] power stations and industrial users. By implication, the gas will continue to flow on Clarus' transmission networks and the distribution networks that are connected to it over this period, and as a result natural gas supply will be available to distribution-connected users while biomethane supply builds up.

Gas supply and demand scenarios are uncertain, but the customers connected to the gas distribution networks represent a very small proportion of gas consumption, with residential customers making up the majority of connections (95%), yet only using 5% of total natural gas demand[9]. We would expect, due to the small total volume, there will be a reliable supply of natural gas for gas network connected customers as they transition to use biomethane as it becomes more widely available or convert to alternative energy sources.

Residential gas-fired appliances (primarily heating, hot water, ovens and cooktops) have a life of 15-20 years[10]. It's important to protect the value in consumer appliances and avoid the cost of unnecessary appliance replacement falling on consumers[11]. In addition, it is important to understand consumer insights about timing of switching, and any potential tension between consumer choice and policy or regulatory settings that could force choice in a certain direction. For example, the Consumer NZ annual energy insights survey[12] found in 2023 that if gas was phased out:

- 55% of respondents will keep using gas for as long as possible
- 38% will switch when existing fittings/appliances need replacement
- 7% have already started moving away from gas.

Further evidence about consumer behaviour is reported in EECA's 2024 report *Electrifying Aotearoa: the consumer perspective*[13] which found that considerations when buying/replacing a gas cooktop included the purchase cost for 75% of respondents, and access to the energy supply for 29% of respondents. And the trigger to replace a gas cooktop would be 'when it breaks down' for 73% of respondents, and 'when the ongoing running cost is too high' for 13% of respondents.

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[8] We note Nova's 2024 statement that *outlook for gas availability is such that achieving an economic return on new gas peakers remains highly uncertain. As such, Nova is not committed to building Peakers at Otorohanga* 2024 RCA and S submission - Nova Energy.pdf

[9] Briefing-to-Incoming-Minister-for-Energy-January-2025-website.pdf

[10] Installations and Replacements - Gas Appliance Specialists and How Long Major Appliances Should Last & When to Replace Them

[11] See strong customer responses about only replacing stoves, heating and cooktops in Q17, 26 and 34 in *Electrifying Aotearoa: The consumer perspective,* TRA/EECA. April 2024. p. 21

[12] Consumer NZ annual energy survey is not available publicly but results are shared with energy sector organisations such as Business Energy Council. The 2023 survey is the latest which asked questions about gas transition.

[13] Electrifying Aotearoa: the consumer perspective, p 23, p 32. The study also looks at heating and hot water but results are less specific to switching from gas to an alternative.

Affordability is critical to maintaining social licence for the transition to a low carbon energy system, and gas networks are fundamental to minimising the cost of the transition by avoiding appliance stranding and preserving replacement options. As highlighted in a recent study by Energy Networks Australia,[14] maintaining gas supply (and investment in gas networks) and distribution services for the life of existing gas appliances will ensure that customers and taxpayers are not forced onto a higher cost transition pathway by the premature need to finance new appliances. Maintaining gas infrastructure through the transition allows expensive investment in both replacing gas appliances and developing electricity networks and generation to meet electricity demand, to be aligned with changes in consumer behaviours and Government policy settings.

Consumer insights will be an important input to the DPP4 process, particularly with the level of gas demand and supply uncertainty. We welcome the opportunity to work with the Commission on focused consumer engagement through 2025 on key areas of uncertainty to inform this reset[15].

2. Sharing of risk is important as forecasting demand is difficult

As the Commission notes in its Open Letter, Gas Distribution Business (**GDBs**) face short-term uncertainty,[16] with gas supply being uncertain and the flow on effects that it has to demand, there is risk in a pricing year that actual gas demand may end up being materially higher or lower than the demand initially forecast when price/revenue allowances for the regulatory period were set. Depending on whether actual demand is higher or lower than forecast, either customers or GDBs will be exposed to the forecasting risk.

This does raise the question of whether a weighted average price cap is still appropriate given forecasting demand is getting increasingly difficult, and the consequences of getting it wrong can have big implications for customers and GDBs incentives to invest. In order to address the risks around demand forecasting, it's clear the status quo is not fit for purpose. Therefore, we believe the Commission has the following options:

- **Revenue cap** – consumers bear the in-period reduced demand risk, and suppliers can change prices during the regulatory period to recover their allowed revenue, incentives to invest are maintained as GDBs have flexibility to respond to any change in market conditions.
- **Maintain price cap, improve forecasting** – in-period demand risk stays with GDBs, but look to improve the forecasting of demand or measures to address changing demand or Government policy within period i.e. demand/quantity wash-up, or ability to update demand forecast within period. However, given forecasting difficulties this might not go far enough.
- **Hybrid price cap** – as we have seen implemented in Australia, an additional price path adjustment to better allocate the in-period gas volume risk between GDBs and consumers in pricing years, where demand is significantly higher/lower than forecast.

In addition to the above, if a price cap form of control is to continue, the Commission will also need to consider whether the rollover of prices or setting prices based on the current and projected profitability of each GDB, is more appropriate given the uncertainty over the future direction of the sector.

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[14] *The Time is Now: Getting smarter with the grid*, LEK for Energy Networks Australia, August 2024. p. 38

[15] In particular through Powerco working with Vector and Clarus, with input from the Commission, on the GIFWG consumer engagement project which includes independently run consumer focus groups and interviews.

[16] Commerce Commission, Open Letter on Gas DPP4 2026 price-quality path reset, pg 5.

We welcome the Commission's willingness to investigate the need for additional price path adjustment mechanisms and look forward to engaging with this further as part of the issues paper.

3. Regulatory mechanisms need to maintain incentives to invest and protect customers

As outlined in section 1 above, we expect to be providing gas services for decades to come, however, as acknowledged by the Commission,[17] with declining demand and potential network closures, gas pipeline assets now have shorter expected economic lives than previously assumed.

Even though we are regulated, GDBs do face market constraints – customers have alternative options (electrification, LPG), increasing our prices more than the market can bear will result in disconnections and will accelerate switching to an alternative fuel. GDBs therefore face the incentive to manage expenditure and prices to ensure that we recover capital before the network is stranded and spend to maintain services for as long as we can provide them at a price customers are prepared to pay – in which case the price/quality path provides the backstop to ensure customers don't pay inefficiently high prices.

3.1 Addressing asset stranding risk

As part of DPP3, the Commission provided new tools to enable GDBs to mitigate the risk of asset stranding, which has been valuable in our ability to maintain services to our customers economically as usage patterns change. This risk is growing, in particular off the back of the security of supply issue last year, which may heighten the stranding risk in some areas. There are a number of mechanisms available to the Commission, which can be used together, in dealing with asset stranding risk:

- **Keeping assets in the RAB until recoupment** – keeping assets in the RAB whether they are used or not allows for the recoupment of the investment through charges to end-users over time. Allowing them to recover a normal return on and off capital. However, this does not protect the GDB from economic network stranding if insufficient end-users remain on the network and are unable to pay enough for the investment to be recouped and also allocates risk to end-users who are not always best placed to manage these risks.
- **Bringing cashflows forward** – either by shortening asset lives, applying a non-standard depreciation profile or not indexing the RAB. Bringing cashflows forward mitigates the risk or the timing of the risk. Each have their benefits / limitations, for example changing the depreciation profile can smooth prices, but can be complex to apply.
- **Ex-ante mechanism** – this can be applied if the above (ex-post) options do not sufficiently compensate regulated providers for the risk of asset stranding. This maintains GDBs exposure to stranding risk by placing financial incentives on them to control it, by promoting uptake. However, the main disadvantage of this, is that if stranding doesn't occur, end-users pay upfront but get no corresponding reduction in revenue in future – compared with shortening asset lives.

When considering the package of tools that could be applied together to address the risk of asset stranding, it's helpful to think about how the risk of stranding is likely to be localised. Analysis can be done to identify geographic

[17] Commerce Commission, Open Letter on Gas DPP4 2026 price-quality path reset, pg 6.

areas that are at most risk of stranding, ensuring that regulatory mechanisms are targeted to those parts of the network at highest risk of stranding and maintain services to customers economically as usage patterns change. Mechanisms will ideally allow flexibility for the GDB to address unique circumstances on their different networks.

As well as regulatory mechanisms, we have commercial mechanisms which we are using to manage our risk to asset stranding such as reducing our investment exposure by increasing customer contributions[18], reviewing parts of the network that are a viability risk, and investigating biomethane options.

The reduction in new customer connections and a steady rate of disconnections has led us to amend our existing Rationalisation Strategy to consider network decommissioning. This approach will assess the viability and profitability of our networks and flag any that are at risk. It also enables us to set clear volume reduction criteria, set triggers for decommissioning assessment (such as a large industrial customer disconnecting on a vulnerable network), and to identify the networks that we expect to have valuable operation into the future, giving confidence to existing and new gas consumers on those networks as well as the business.

By decommissioning small or non-viable networks, we will be better able to avoid stranded assets and reduce cost impacts for remaining consumers. According to our proposed criteria, two networks with a total of eight connected ICPs are considered as non-viable and will be assessed as candidates for decommissioning, with a further 9 networks as potentially vulnerable.

Our analysis is based on commercial risk and benefit only, and does not factor in consumer implications, consumer costs and decommissioning costs.[19] We see value in a collaboration between a gas pipeline business and government to undertake a more detailed assessment (and potentially trial) for at least one decommissioning to provide invaluable learnings across commercial, social and consumer factors. This could also be a good workshop topic for the DPP4 process and we look forward in engaging in more detail as part of the issues paper.

3.2 Forecasting expenditure in DPP4

We are committed to maintaining a safe and reliable network. As mentioned above, as the market changes, we are having to adapt our asset management plans. In our latest AMP update,[20] our forecast mimics the context set out earlier, which highlights a slowdown in system growth (connections). Our Volume-to-Value investment framework guides us towards making the right capex or opex investment decision and we are seeing a shift towards greater balance between capital and maintenance focused work on the network. This is largely driven by:

- A reduction in capital expenditure compared with our 2023 AMP projections, primarily due to a reduction in new connections.
- A reduction in routine and corrective network maintenance costs, offset by a more proactive asset replacement programme to address leakages and losses (which are being detected at higher rates due to new detection methods and modelling), as we focus on emissions reduction.

[18] Powerco, 2024 Gas Asset Management Plan Update, page 4.

[19] This strategy on the Gas Infrastructure Future Working Group (**GIFWG**) 2023 right sizing study, which was carried out by all GPBs as an input into MBIE's Gas Transition Plan consultation. Gas network rightsizing study progress report, August 2023. Page 23-24 discusses cost of estimated appliance replacement and make good work (like repairs for walls and flues).

[20] Powerco, 2024 Gas Asset Management Plan Update, page 26,

- Resilience and adaption, as we continue to assess climate risks and respond with network investment in priority areas.

DPP forecasting relies on the past being a good predictor of the future and forecasting is becoming increasingly hard the more uncertain the market becomes. Current forecasting approaches might not be practical for the DPP4 reset, however with some tweaks to how they are applied, they can better address the changing environment where it differs from historical patterns.

In terms of opex, base-step-trend (**BST**) can only be relied upon for recurring and predictable opex, it is less suitable for unstable operating environments such as the one the energy sector is currently in. For example, due to the supply uncertainty, changing customer behaviour and decarbonisation, which are all unrelated to historical expenditure. If the Commission is to maintain the BST as its **opex** forecasting method, we encourage the Commission to consider:

- **Base year** – the base year is fundamental to ensuring opex allowances are correct. There are two potential options, RY2024 and RY2025. While RY2025 will be the most relevant year of data, the full year of data will not be available until October 2025. On the other hand, RY2024 while not the most up to date, it will be available sooner and an assessment could be done to adjust it up/down to ensure its appropriateness. Alternative, using the latest AMP is also an option however does not reflect the changes in opex for the last 12 – 24 months.
- **Appropriate step changes** – the Commission relaxed its step change criteria for EDBs in the DPP4 reset last year which we welcomed and considered it appropriately balanced the benefits and risks. We encourage the Commission to consider the same approach for GDBs to account for the increases in opex we are expecting.
- **Scale factors –** a capex/opex scale factor could be applied to capture capex/opex substitution.
- **Opex reopeners –** as step changes are unlikely to be known at the time of the reset, mechanisms need to be available in the event things change within the period, this also ensures that expenditure gets proportionate scrutiny to mitigate the risk to customers of funding opex that does not eventuate.

In terms of forecasting **capex**, the same issues apply as for opex, whereby historical expenditure is unlikely to be reflective of future capex needs. However, in the case of capex, the AMP may be a more relevant guide, providing our most up to date view over the period, with the right level of scrutiny applied, and are likely to be more accurate than forecasting capex based on historical patterns.

In addition, we noted above a trend for substitution of capex for opex in relation to asset replacement and renewals occurring. Forecasts need to account for this shift but we also encourage the Commission to consider flexibility options for capex-opex substitutability during the period.

3.3 Maintaining flexibility and uncertainty mechanisms will be key for DPP4

Adding a year to the Commission's regulatory period for DPP4, makes gas supply and demand scenarios even more uncertain as gas supply is difficult to forecast while the exploration landscape continues to evolve, some retailers are still pausing on new gas connections, with unknown impacts of demand. It's impossible for any scenario to accurately predict what's going to happen over the period, but what's important is that there are regulatory mechanisms in place to deal with shocks and changes when they occur within the DPP4 period. This ensures that

customers don't pay for potential situations / scenarios upfront that might not materialise, while also maintaining incentives for GDBs to invest.

Maintaining flexibility will be essential over the DPP4 period, GPBs need to be able to react and adapt if unexpected events occur over the period, in a competitive market businesses have flexibility to respond to changes in the market. We don't want DPP4 to set a path based on inappropriate assumptions or foreclose options that will support the transition. As was the case for the DPP4 reset of electricity, we expect uncertainty mechanisms to play a critical role over the DPP4 period, such as reopeners. Reticulated gas is a discretionary purchase so the way we price and manage it is primarily a response to market demand, rather than regulations so it's important DPP4 doesn't impede GPBs' ability to meet that demand.

In addition, the innovation and non-traditional solution allowance could play a useful role for supporting the transition by encouraging the consideration of options and technology opportunities, or new activities to enable renewable gas injection into the current network in the DPP4 period.

4. Quality information in the context of broader drivers and sector developments

Powerco is committed to maintaining a safe and reliable network but we note that the quality standards set through the DPP do not drive our performance. Rather, our performance is driven by our business objectives, regulations outside the Commerce Act, and our business systems and certifications.

We have quality standards and additional targets that help drive performance improvements and measure our progress in delivering a safe, reliable, resilient, and cost-effective service for our customers and communities. Our key performance indicators are specific goals that align to our Asset Management Objectives, ensuring we operate to a standard that is appropriate in our industry and our environment, and reflect our commitment to further improving service levels to customers. While some targets align to DPP expectations e.g. response time to emergencies (**RTE**), most do not. With RTE we have set our target well above the level required by DPP3 in any case. All targets are set and committed to by the Gas Leadership Team and reported monthly to the Board. Our involvement in Gas NZ provides an opportunity to share industry information and compare our targets with others in the gas sector.

Our commitment to public safety was demonstrated by certifying our Public Safety Management System (PSMS) in 2013. Our PSMS defines the specific steps we take to ensure our assets are designed to be safe and remain safe during operation.

Our reliability is high, which is intrinsic as part of an underground gas network, supplemented by our customer commitments and stringent standards. These standards include those that the whole supply chain must meet (such as NZS 5442 and NZS 5263) as well as our own engineering design / construction standards, business performance targets, and customer service targets. The number of customer supply interruptions due to component failure is low historically, and we expect this to remain consistently low in future years, unrelated to changing demand. We also expect pipe leaks (and any associated interruptions) to consistently track down due to new technology now in operation for leak detection and analysis.

While the DPP4 process is an opportunity to consider the objective of gas quality measures and any appropriate changes, we do not see any gaps in performance measures or any changes to relevance as demand declines. Quality measures are to protect customers and our consistent customer feedback shows high net promoter score results. Figure 2 shows our most recent full year NPS results for our Gas Hub customer delivery team, as well as for natural gas generally. These NPS scores have been reasonably consistent over many years of customer surveys, suggesting there is not the need for new or changed measures. We encourage the Commission to consider the broader drivers of quality including outside of Part 4 regulation, and to avoid introducing additional (or competing) measures unnecessarily.

Figure 1 Powerco Net Promoter Score for gas