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Matthew Clark
Manager, Price-Quality Regulation
Commerce Commission
Wellington

Powerco Limited (Powerco) welcomes the opportunity to provide a cross-submission on the Commerce Commission's Gas Distribution Services Default Price-Quality Path (DPP) Draft Decision.

Submitter concerns with the draft decision are focused on aspects of the decision to accelerate depreciation. While we can understand these concerns, we believe the Commission can have confidence it has made a balanced and pragmatic decision that is in the long-term interests of consumers. To help inform this assessment, Powerco has co-sponsored with Vector and Firstgas two expert reports: Frontier Economics (accelerated depreciation) and Chapman Tripp (the Commission's process to amend the asset valuation IM).

Attachment 1 has our response to concerns raised by submitters. If you have any questions on this submission, please contact Nathan Hill (Nathan.Hill@powerco.co.nz).

Andrew Kerr
Head of Policy, Regulation, and Markets

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Attachment 1: Powerco's response to concerns raised by submitters

Submitter comments/concerns	Our response
The assessment of stranding risk should include the residual network value that may arise from repurposing networks to deliver low-emissions gas. The restrictive interpretation of what constitutes gas pipeline services has led to unreasonable assumptions that RAB of GDBs would be left economically stranded despite RAB having a residual value for repurposing.	Some submitters believe that the risk of economic stranding has been overstated because the Commission hasn't included the residual network value that may arise from repurposing networks to deliver low-emissions gas. We can understand this view; if existing gas networks can deliver low emissions gas cost-effectively, the risk of economic stranding could decline. However, we think it is reasonable for the Commission to exclude any potential residual network value related to network repurposing because: • It is unclear if gas distribution businesses (GDB's) will be able to repurpose their pipelines to deliver low-emissions gas. • Low emissions gas may not be able to compete on price with other low emissions energy sources like electricity • Converting the network may strand assets not suitable for transporting low emissions gas
Delay action on stranding risk to future regulatory periods • 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 consumers	Some submitters think that the Commission can wait to address economic stranding risk and that it is too early to act because the national energy policy for gas is yet to be determined. We can comprehend why some parties hold these views; at first glance, waiting for more certainty on energy policy seems reasonable, and gas demand and customer numbers are not forecast to decline in the upcoming DPP regulatory period.

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• The Commission is acting ahead of yet to be determined energy policy for gas • The argument that accelerating depreciation in DPP3 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.	However, we think it is critical to take a long-term view of economic network stranding risk (beyond the immediate regulatory period) to properly assess the potential consumer impacts. This approach is necessary because of the lengthy profile of GDB capital recovery. A long-term view of gas utilisation and prices shows that there is a window of opportunity for regulators to act, and early action is crucial to mitigating the risk and impacts of economic stranding. The risk involved in the Commission not acting now is that GPB assets become stranded in 2050 or before, and consumers face higher price increases when regulatory action is finally taken. Frontier Economics illustrate the consumer impacts of delaying accelerated depreciation in section 2 of their report. Their analysis suggests that if the Commission wait until DPP4 to accelerate depreciation, the price increases required for 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. We think that the Commission's flexible approach to reviewing the settings and assumptions at each reset is a positive outcome and should comfort all stakeholders because it means the Commission's decision to reduce asset lives is reversible in the future. Finally, bringing forward cash flows (adjusting the recovery profile) is helpful to ensure GDBs have incentives to invest to maintain safety and reliability. Bringing forward cash flows will produce a capital recovery profile aligned with economic stranding risk and New Zealand's climate policy.
The Commission's process to amend the asset valuation IM was imperfect The 4-week submission window didn't give parties a reasonable opportunity to engage effectively on	Some submitters have raised concerns about the Commission's process to amend the asset valuation IM. We agree that it is essential that the required process is followed and that parties should have a reasonable opportunity to engage effectively on proposed amendments.

extensive amendments to the foundational building block of gas IM (as required by s52V(2) of the Commerce Act).	To help inform the assessment of the Commission's IM amendment process, Powerco, Firstgas, and Vector asked Chapman Tripp to comment on the Commission's process and its consistency with the requirements of the Act. Chapman Tripp's view is that the Commission's process meets the requirements and that it provided parties with a reasonable opportunity to engage. Their findings are: • The Commission is entitled to amend an IM at any time. Section 52Y requires periodic comprehensive reviews of the IMs but does not preclude the Commission from amending IMs more frequently under s 52X • The four-week consultation period allowed by the Commission (plus an additional two weeks for submissions) was sufficient to meet the requirements of the Act and the common law standards of consultation • The choice of whether or not to hold a conference or workshop is at the Commission's discretion • The EDB DPP3 reset is an example where the Commission has used s 52X to align the timing of IMs amendments with upcoming regulatory determinations • The concept of "fundamental" IMs is not a rigid category to which the Commission is bound • The Commission is justified in amending the asset valuation IM based on the factors set out in paragraph 3.25 of the Draft Reasons Paper
Other regulations (like WorkSafe) incentivise GDBs to operate and maintain their assets in a safe manner, so GPBs do not need additional incentives to invest in safety and reliability.	Some submitters think accelerated depreciation is unnecessary to incentivise GDBs to invest in safety and reliability because other regulations like WorkSafe provide strong incentives. We agree that other regulations provide incentives. But these incentives are less significant and complement the fundamental incentives that arise from the ex-ante opportunity to earn a normal return on capital (FCM).
Accelerated depreciation is not consistent with outcomes in a competitive market. It is normal in business to have stranded asset risk and GPBs should be no different.	Some submitters have suggested that accelerated depreciation shouldn't be applied to GDBs because it is normal in business to have stranding risk. We acknowledge that both regulated and unregulated businesses face stranding risks. But the price controls imposed on regulated firms mean that the response to stranding risk must be different. Unlike firms in competitive industries, regulated businesses cannot raise prices to compensate for stranding risk; the regulator controls prices.

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	Raising prices for all GDBs is consistent with a probable outcome in competitive markets when the stranding risk affects all firms in the industry. If the stranding risk similarly affected all firms in a competitive sector, they could all raise their prices to accelerate cost recovery without facing any competitive disadvantage.
The WACC already compensates networks for stranding risk, so accelerated depreciation should only apply to incremental capex.	Some submitters have suggested that the WACC already compensates GDB's for stranding risk, so accelerated depreciation should only be applied to new assets. **Has the WACC already compensated networks for stranding risk?** Only for the systematic component. The Commission's WACC allowances only provide compensation for systematic risks. Because the risk of government policy changes and shifts in consumer demand for natural gas is non-systematic, the WACC would not have provided GDBs with any compensation for this risk. Under the Commission's regulatory framework, non-systematic stranding risk should be addressed by methods other than the WACC allowance, such as accelerating depreciation. **Should accelerated depreciation only be applied to new assets?** In our opinion, no. Applying accelerated depreciation only to existing assets would breach the ex-ante FCM principle because regulatory allowances would be set with an expectation that GDBs will not recover the cost of their existing assets. In the immediate term, most stranding risk lies in existing assets, so it is vital to introduce mechanisms like accelerated depreciation that target these assets.
GDBs may extract excessive profits (windfall gains) if alternative gases emerge, or natural gas extends beyond 2050	Some submitters are concerned that accelerating depreciation may result in GDBs extracting excessive profits (windfall gains) if alternative gases emerge or natural gas extends beyond 2050. At face value this appears to be a reasonable concern. However, the Commission's proposed approach does not permit this outcome, alleviating the concern.

	The Commission's proposed approach is a form of risk mitigation, not a form of compensation. As a result, it is NPV neutral, and there is no opportunity for over-recovery. When a dollar of capital is recovered through depreciation, it is removed from the RAB and isn't recoverable again.
DPP3 price increases will accelerate the decline of gas consumption	Some submitters have suggested that accelerating depreciation and increasing prices will accelerate the decline of gas consumption. To reach this conclusion, we assume that submitters have concluded that price increases will exceed some consumers' willingness to pay. So, they will either reduce consumption or disconnect from the gas network. We agree that this could be the outcome for some consumers, but we think this outcome will be limited because of the cost competitiveness of gas. Therefore, we agree with Firstgas' submission that delivered gas prices appear well-placed to accommodate increases without demand destruction. Additionally, the Commission's use of alternative rates of change (annual price change limits) limits the risk that switching away from gas usage is accelerated because of accelerating depreciation in DPP3.
Review the ARR spend associated with pre-1985 pipelines and reflect these expenditure requirements in our GDB's DDP3 allowances	Firstgas' submission echoed our view that the Commission should review its approach to forecasting non-growth capex. Like Powerco, their forecast uplift in expenditure is centred around replacing pre-1985 polyethylene (PE) pipes. We think the Commission should reconsider its non-growth forecasting approach because prudent and efficient investment can justifiably exceed historical levels. The Commission has acknowledged that some situations justify forecast expenditure being uncoupled from historical levels.[1] We believe that GDB expenditure on pre-1985 pipe replacement is one of these.

[1] Paragraph 3.20, Commerce Commission, Targeted information disclosure review for electricity distribution businesses: Process and Issues paper March 2022