24 JULY 2025: SUBMISSION TO THE COMMERCE COMMISSION REGARDING THE GAS DPP4 ISSUES PAPER

Gas price reset needs to ensure investment cost-recovery in face of decreasing demand

Gas demand has declined and its future is becoming increasingly uncertain since the Commerce Commission (Commission) reset gas default price-quality paths in 2022 (DPP3) and completed the Input Methodologies (IMs) review in 2023.

Financeability and cost recovery are serious concerns for Gas Pipeline Businesses (GPBs). The 2026 DPP4 reset is key to addressing the risk that recovering costs will become harder for GPBs, and cost recovery could increasingly burden remaining customers as demand declines.

Submission Summary

- Entrust considers that the Commission should prioritise facilitating recovery of GPBs' prudent and efficient investment costs.

- We agree with the Commission that asset stranding risk needs to be addressed otherwise it "would threaten GPBs' current expectations of financial capital maintenance (FCM)".

- Adoption of accelerated depreciation is a Net Present Value (NPV) neutral, no-regrets option. It allows costs to be recovered over a larger group of customers. We agree with the Commission that delaying asset life shortening would harm future customers as they would pay "disproportionately more."

- Entrust agrees with Vector that the Commission should adopt a much higher rate of accelerated depreciation DPP4. Gas prices would remain much lower than they were 12-years ago even if cost recovery is brought forward.

- If the Commission adopts a 5-year regulatory control period (RCP) this should be accompanied by appropriate mechanisms to address uncertainty/forecasting errors. Entrust agrees with Vector that the Commission should consider a volume re-opener and/or a 'hybrid mechanism' which shares volume risk with consumers.

- We support the Commission re-opening the IMs to help support cost recovery, including adopting a revenue cap and un-indexed Regulated Asset Base (RAB).

- We are also supportive of options such as volume wash-up, alternative re-opener mechanisms, providing a decommissioning allowance, and adjustment to the risk premium in the regulated Weighted Average Cost of Capital (WACC).

- The issue of decommissioning costs should be addressed as part of the reset.

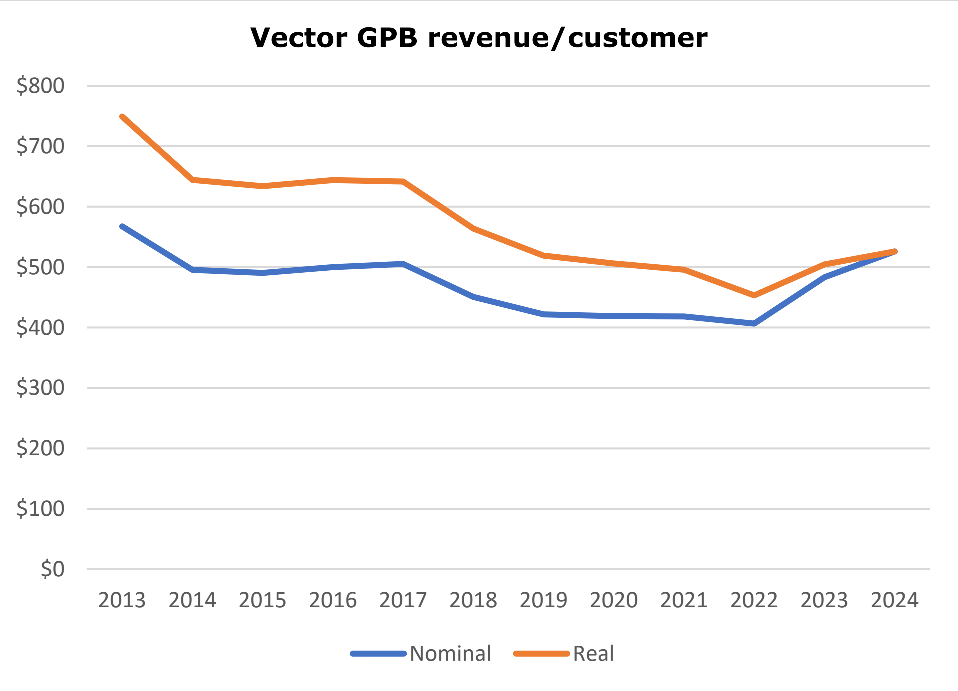
- Reset decisions should be based on the most up-to-date Asset Management Plan (AMP) information. Vector's 2025 AMP was released in June in time to feed into the draft and final DPP4 determinations.

Entrust's Submission

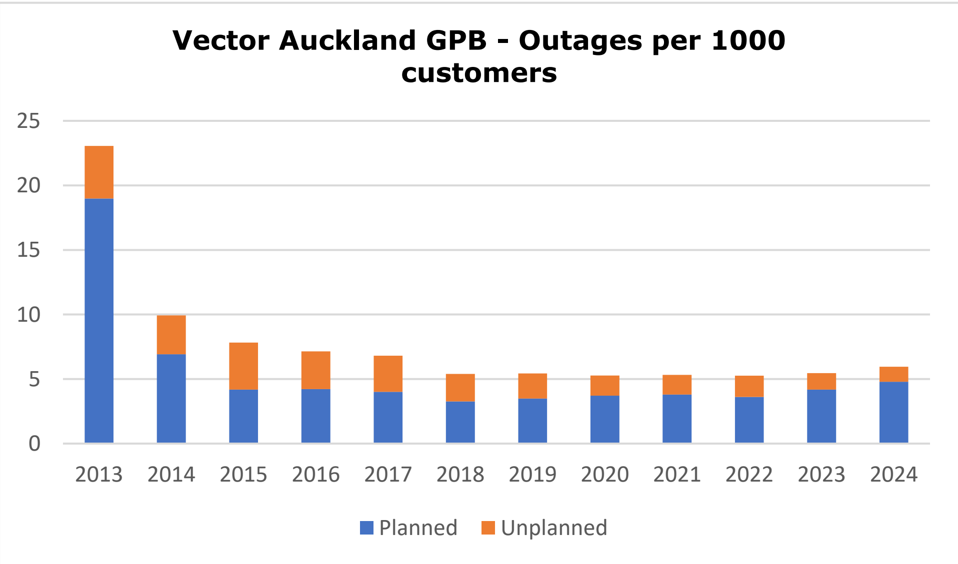
Entrust considers that GPBs have performed well from a consumer perspective over the last decade. This provides a positive foundation for the DPP4 reset.

Gas prices are lower than they were a decade ago and service reliability is better.

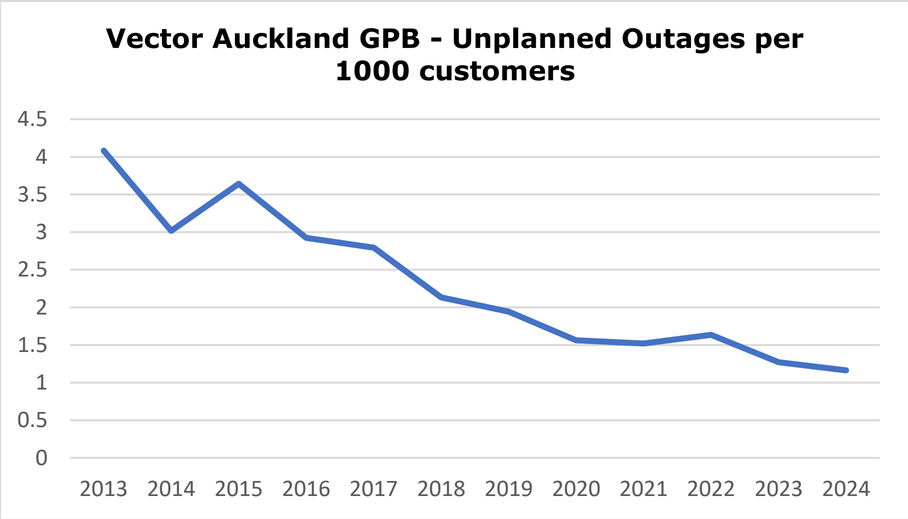
Vector's gas distribution pipeline charges have reduced in both nominal and real terms since 2013; with a reduction of $220 per customer or 30% in real terms.[1]



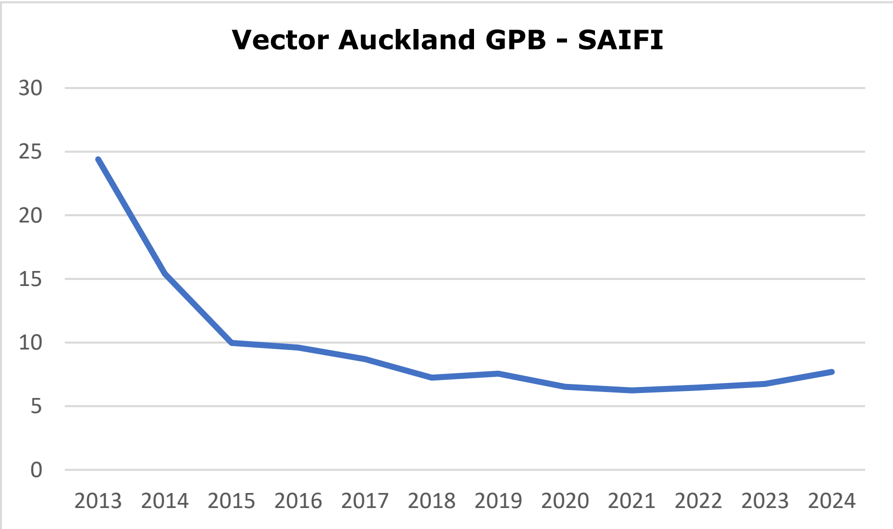
Service reliability has improved, both in terms of planned and unplanned outages, with unplanned outages steadily declining over the last decade. Unplanned outages have decreased from 4.1 to 1.2 per 1,000 customers since 2013.[2]

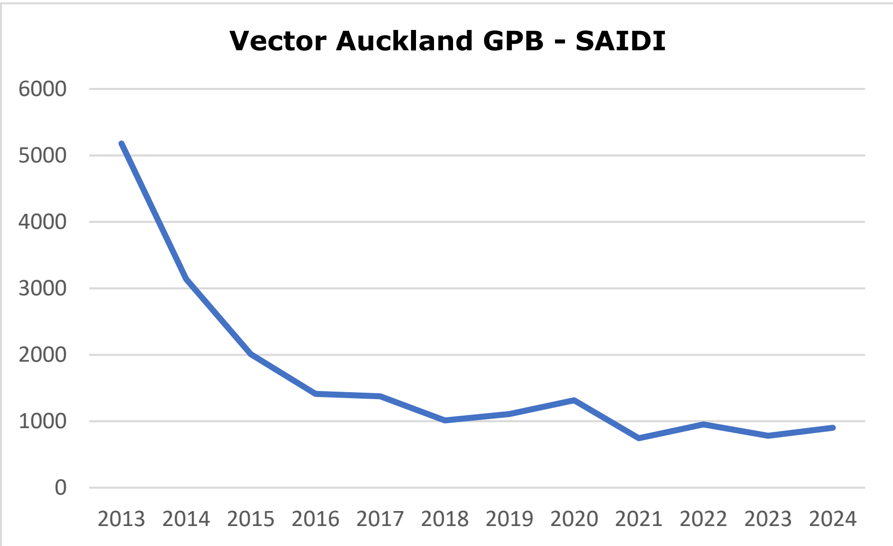


[1] Derived from 7(i), Schedule 7 and Schedule 9(c) disclosures (references based on current schedules): https://www.vector.co.nz/about-us/regulatory/disclosures-gas/gas-financial-and-network-information
[2] https://www.vector.co.nz/about-us/regulatory/disclosures-gas/gas-financial-and-network-information

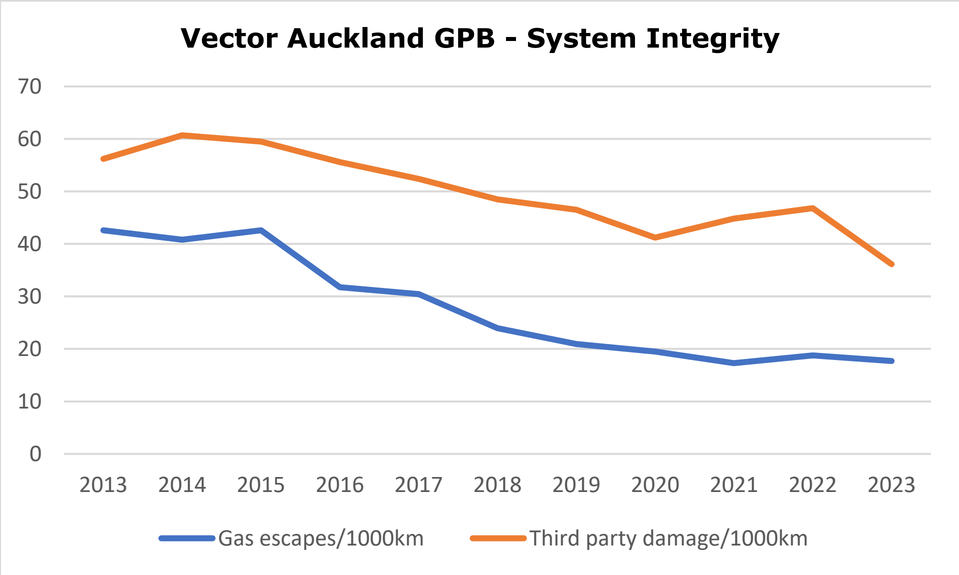


The average number of interruptions experienced across all customers (System Average Interruption Frequency Index (SAIFI)) and the average length of interruptions time across all customers (System Average Interruption Duration Index (SAIDI)) have both reduced over the last decade.





Publicly reported gas escapes and third-party damage events have also declined steadily, over the last decade.[3]



Vector has demonstrated a high degree of reliability and resilience to extreme events such as those observed during the 27 January 2023 Auckland flooding event and Cyclone Gabrielle in February 2023. The average number of complaints has decreased, with Vector now receiving about an average of 0.0008 complaints per customer compared to 0.0013 in 2013.

GPBs face considerable uncertainty and risk

Entrust agrees with the Commission that the key high-level issues for DPP4 include managing uncertainty, asset stranding risk and intergenerational equity, including the impact on tomorrow's consumers as the costs of the network are spread over a declining customer base.

GPBs are operating in an environment with considerable uncertainty over future demand and the wider energy transition.

Entrust welcomes the Commission's recognition that if asset stranding risk is not addressed it "would threaten GPBs' current expectations of financial capital maintenance (FCM)". There is clear consensus amongst GPBs that stranding risk has increased materially since DPP3.

Entrust also welcomes the Commission's acknowledgment that GPBs will continue to need to investment to provide consumers with a safe and reliability gas supply, and that this investment depends on GPBs' expectation they will be able to recover the cost of their investments.

Gas supply will still have an important role in New Zealand's energy supply and security for the foreseeable future.

While there is significant uncertainty about the path to phasing out natural gas and the possibility of repurposing assets, the decline in demand is increasing asset stranding risk. Gas pipeline asset economic lives could end up being shorter than their physical lives.

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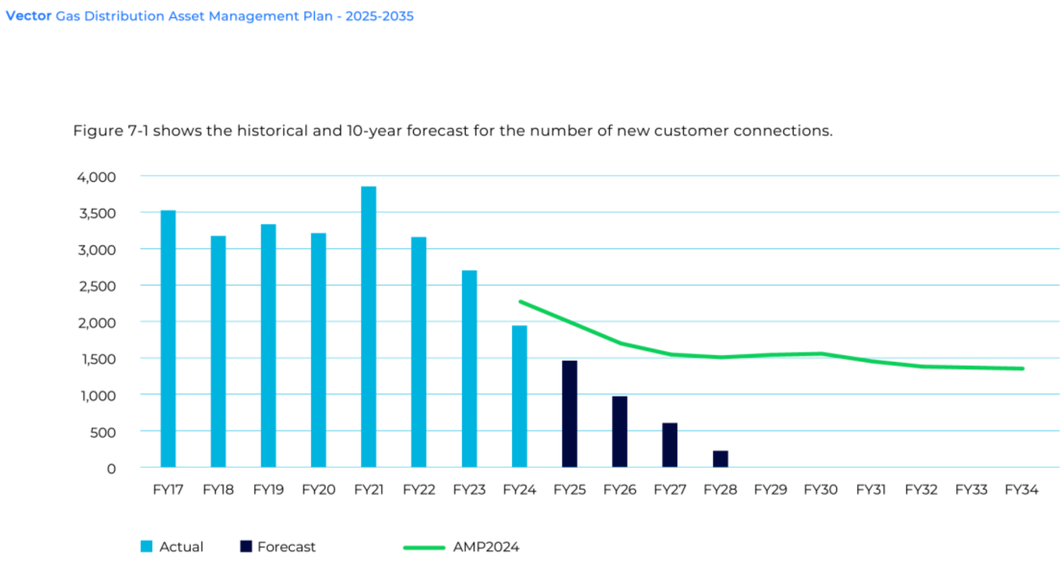
[3] https://www.vector.co.nz/about-us/regulatory/disclosures-gas/gas-financial-and-network-information

Gas demand is declining and becoming increasingly uncertain

GPBs face increasing uncertainty about demand for gas and the rate of connections/disconnections. Gas connections on Vector's Auckland network have been declining since 2021, and gas volumes have been declining since 2018.

Demand for gas is expected to continue to decline but the gas sector faces uncertainty about the rate at which it will decline. GPBs face risk that the actual volume of demand declines at a faster rate than the Commission forecasts for its DPP reset, and connections/disconnections differ from forecast. This is what happened to Vector over DPP3 with the real revenue growth rate lower than the Commission's assumptions used in the price-path. The Commission acknowledged "the pace of decline was quicker than anticipated".[4]

This reflects the uncertainty that the Commission and GPBs are having to grapple with. For example, Vector's forecast of gas connections in 2025[5] is lower than it was in 2024 and the 2024 forecast[6] was lower than 2023.



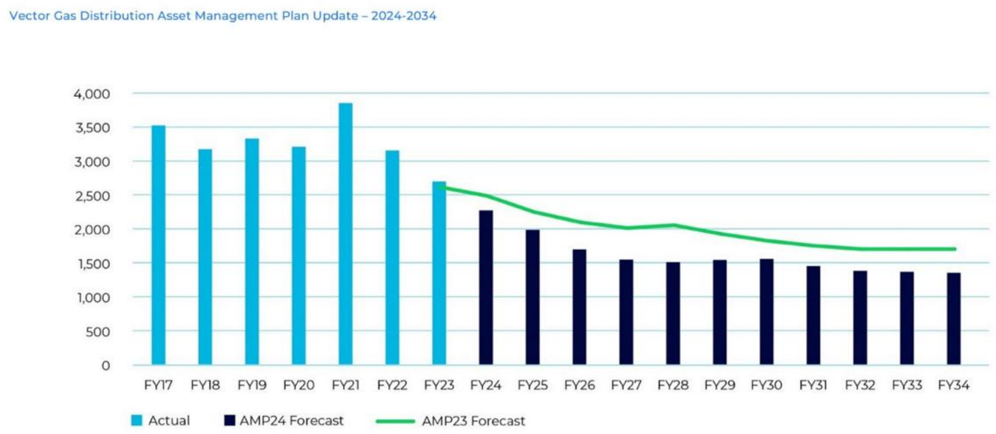
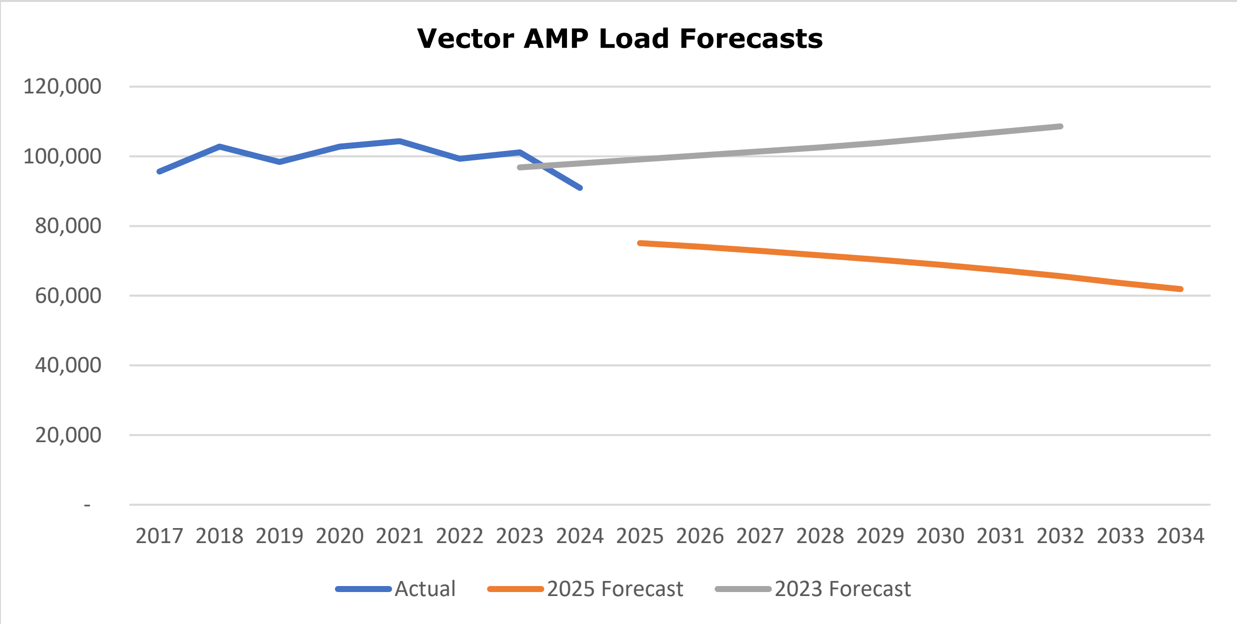


FIGURE 5-1 GAS CONNECTIONS – ACTUAL AND FORECAST

[4] Commerce Commission, Trends in gas pipeline businesses' performance, 18 February 2025.
[5] Vector Gas Distribution Asset Management Plan – 2025-2035.
[6] Vector Gas Distribution Asset Management Plan Update – 2024-2034.

Vector's load forecasts have also changed substantially between its last two full AMP disclosures, with growth forecast in 2023, but in 2025 demand is now expected to substantially decline.



DPP settings should support cost recovery

FirstGas, Powerco and Vector have outlined several matters Entrust agrees the Commission should address, including short-term demand risk, changes in the balance between operating expenditure (opex) and capital expenditure (capex), which may not necessarily reflect historic expenditure, and decommissioning/disconnection costs.

For example, it would be useful to look back at how GPBs' actual expenditure compares to the opex and capex allowances determined for DPP3 period and consider the implications of this for the DPP4 reset.

Entrust welcomes that the Commission is seeking stakeholder input on whether changes should be made to the Weighted Average Price Cap (WAPC). Our previous submissions have detailed our support for accelerated depreciation, adopting an un-indexed RAB and change from a WAPC to a revenue cap.[7]

Chorus has referenced the Commission's reasons why a revenue cap is appropriate for fibre, which also appear relevant to gas:[8]

> A total revenue cap better aligns with the nature of Chorus' fibre business, which is characterised by high fixed costs and demand uncertainty. It also provides Chorus with appropriate incentives to manage demand risk while still protecting end-users.

Matters such as the current approach of RAB indexing and use of a WAPC can impact the cost recovery profile and GPB revenue recovery risk. For example, RAB indexing delays capital cost recovery and could run counter to accelerated depreciation.[9]

[7] Entrust, Submission on the DPP4 Draft Decision, 3 July 2024.
Entrust, Submission on the 2023 Input Methodologies Review Draft Decisions, 19 July 2023.
Entrust, Submission on the Gas DPP3 Reset, 14 March 2022.
[8] Chorus, Submission on Open letter on Fibre Input Methodologies Review, 29 April 2025.
[9] Entrust, Submission on the Gas DPP3 Reset, 14 March 2022.

Cost recovery through depreciation should be further accelerated

Entrust supports increasing the rate of depreciation applied with use of tilted depreciation across all assets. We agree with Vector that the Commission applied a conservative rate of accelerated depreciation in DPP3 and a much higher rate should be adopted for DPP4.

Gas pipeline charges are substantially lower now than they were a decade ago, both in nominal and real terms, which provides considerable leeway to increase gas prices to speed up cost recovery.[10] Vector's GPB charges are $220 lower per customer in real terms than they were in 2013. In comparison, the impact of accelerated depreciation for DPP3 was to raise gas prices for an average gas household in Auckland by $31 per annum.[11]

The High Court dismissal of the Major Gas Users' Group (MGUG) appeals against the Commission's Gas IMs Amendment Determinations 2022 and the DPP3 Determinations supports the use of accelerated depreciation and reinforces the importance of ensuring regulated suppliers have confidence they will be able to earn normal returns over the lifetime of their investments.[12]

The High Court was clear asset stranding risk is real and that in workably competitive markets suppliers would be compensated for carrying this risk. The High Court explained investment incentives would be undermined for both gas pipeline services and other regulated services if GPBs don't receive compensation for bearing stranding risk and this would be detrimental to the long-term interests of consumers.[13]

Entrust agrees with the High Court that the Commission has a window of opportunity for gas pipeline costs to be spread across a larger group of consumers.[14] We also agree with the High Court that if cost recovery is delayed it could create a problem where the cost of stranded assets can't be recovered and/or the cost will fall on a smaller group of customers.[15] That would create a 'lose-lose' situation for GPBs and consumers.

Entrust considers that the High Court commentary lends support to adopting a higher rate of accelerated depreciation for DPP4 than was applied for DPP3. In short, the High Court has highlighted that the decline in demand for gas makes investment cost recovery more urgent as it will get more difficult and potentially result in higher pressure on prices to remaining customers, if current regulatory settings aren't changed.

A 5-year Regulatory Control Period should include mechanisms to address uncertainty

If the Commission adopts a 5-year RCP this should be accompanied by appropriate mechanisms to address uncertainty/forecasting errors. Entrust agrees with Vector that the Commission should consider a volume re-opener and/or a 'hybrid mechanism' which shares volume risk with customers. Both options are supported by Australian regulatory precedent.

We consider that such mechanisms will be needed as the length of the RCP affects the reliability of expenditure forecasts used to set the price-quality path.

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[10] Our submission in response to the 2022 DDP3 reset detailed that there was an opportunity to use low interest rates to help smooth prices beyond a single regulatory period: Entrust, Submission on the Gas DPP3 Reset, 14 March 2022.

[11] Based on Vector calculations the depreciation with normal depreciation rates would have been $12.46 per annum, and it was $43.77 with accelerated depreciation.

[12] MAJOR GAS USERS' GROUP INC v COMMERCE COMMISSION [2024] NZHC 959 [29 April 2024].

[13] iBID at [162].

[14] iBID at [243].

[15] iBID at [243].

FirstGas, Powerco and Vector's submissions and AMPs indicate the Commission should be less confident in their longer-period forecasts which should count against adopting a longer RCP. The Commission has also noted "Different sectors may have different factors that lead to greater or lesser levels of uncertainty".[16]

We agree with the Commission that longer RCPs result in "Greater uncertainty" and greater risk of over or under-forecasting the regulated supplier's revenue allowance.

The Commission should consider re-opening elements of the IMs

Entrust considers that the Commission should revisit its intention not to make amendments to the IMs before the DPP4 reset. While the IMs were reviewed in 2023, there are exceptional circumstances which could justify re-opening elements of the IMs to help support cost recovery, including potential switch from a WAPC to a revenue cap, and adopting an un-indexed RAB.

As noted above, the experience over the course of DPP3 highlights the difficulty in forecasting demand. Vector has detailed that this has heightened questions about whether the regulatory framework, including the IMs, has appropriate mechanisms to mitigate or share short-term demand risk.[17]

We agree with Vector that "[t]he risk of asset stranding is now materially higher than when the Commission made its decisions on DPP3 and the 2023 IM review" and "there is now more evidence about ongoing gas price volatility and its impact".[18] Mechanisms such as accelerated depreciation may need to do more of the 'heavy-lifting' if the IMs aren't changed for DPP4 to help address cost recovery challenges.

Decommissioning costs

We query why the Commission considers that treatment of decommissioning costs may fall outside the scope of the DPP reset. We also query the suggestion that the mechanisms suggested by submitters to address the matter could be described as "novel".

We understand that generally accepted accounting practice (GAAP) allows for decommissioning costs to be part of an asset commissioned value. We support Vector's view that it is appropriate for the GAAP treatment to be followed to ensure GPBs are compensated for those decommissioning costs before they are required to be incurred. The reasoning mirrors the issues with accelerated depreciation. It will be easier to recover the costs/less of a burden on remaining consumers, if this cost can be recovered before the end of the asset's life.

Decisions should be based on up-to-date information

Entrust agrees the Commission should base expenditure allowances on forecasts in AMPs rather than on historic averages.

Vector's latest AMP details that if opex is based on historical spending levels there would be a revenue shortfall compared to its AMP forecast.

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[16] https://comcom.govt.nz/__data/assets/pdf_file/0023/308246/Fibre-Price-Quality-Path-Determination-2024-Duration-of-the-second-regulatory-period-Reasons-paper-28-February-2023.pdf
[17] Vector, Open letter on gas DPP4 2026 price-quality reset, 13 May 2025.
[18] iBID.

The Commission should use the GPBs' most recent AMPs to determine expenditure allowances. Vector's 2025 AMP was released in June in time to feed into the draft and final DPP4 determinations.

A comparison of Vector's 2023, 2024 and 2025 AMPs highlights material year-on-year changes in forecast expenditure and demand.[19] For example, Vector's forecast capex in the 2025 AMP is substantially lower than the 2024 AMP, while forecast opex has increased. This reflects that, as part of a prudent, risk-based approach to asset management, Vector is reducing capex on asset replacement and replacing it with increased annual opex on maintenance.

Other matters

We welcome that the Commission will revisit Part 4 Commerce Act WACC settings as part of its Part 6 Telecommunications Act IMs review. Entrust supports the Commission moving from a rate of the day (ROTD) to a trailing average cost of debt (TACD) WACC.[20]

Concluding remarks

The gas pipeline sector has delivered better consumer outcomes, in terms of investment, price and service quality over the last decade. This provides a strong basis for the DPP4 reset. The reduction in prices over the last three resets provide leeway for bringing forward cost recovery more aggressively while keeping prices under the level they were a decade ago.

The Commission and GPBs face considerable uncertainty in terms of gas demand and the levels of expenditure that will be needed for DPP4. Uncertainty about how quickly demand will fall is a challenge for both the Commission and economic regulators worldwide.

Changes to DPP and IM settings should be made to help ensure financeability and cost recovery, and to provide flexibility in regulatory settings, to help manage this increasing uncertainty and risk.

Accelerating cost recovery would not only help provide regulated suppliers with confidence they will be able to recover the cost of their prudent and efficient investment but also mitigates the risk of future price shocks as network costs are recovered from a smaller number of customers.

The decisions the Commission makes regarding the recovery of prudent and efficient investments by GPBs are important for ensuring regulated suppliers across all industries have confidence to invest and provide services that meet consumer demand.

Kind Regards,

Denise Lee
Chair

[19] Vector Gas Distribution Asset Management Plan – 2025-2035 and Vector Gas Distribution Asset Management Plan Update – 2024-2034.
[20] See, for example, most recently https://www.entrustnz.co.nz/media/ds0k4eta/2024-07-03-submission-to-commerce-commission-regarding-dpp4-draft-decision.pdf and https://www.entrustnz.co.nz/media/xrelbpb1/2023-07-19-submission-ims-decision.pdf.