13 AUGUST 2025: CROSS-SUBMISSION TO THE COMMERCE COMMISSION REGARDING THE GAS DPP4 ISSUES PAPER

Cost recovery needs to be managed in a fair and equitable manner

Uncertainty about future gas demand means that the Commerce Commission's main challenge in resetting the 2026 default price-quality paths (DPP4), is ensuring Gas Pipeline Businesses (GPBs) can recover the costs of their prudent and efficient investment (known as "reasonable investor expectations").

Entrust agrees with FirstGas that it will be necessary for the Commission to carefully balance cost recovery, ongoing investment requirements and consumer price impacts for consumers, both now and in the future.

Cross-submission Summary

- Entrust agrees with Consumer NZ that regulatory settings should reflect "electricity is a growth industry, while gas is in long-term structural decline." One implication is that the Commission should prioritise facilitating cost recovery.

- The volume and quality of evidence provided by Vector, FirstGas and Powerco reflects the serious and substantial concerns GPBs have about the risk of asset stranding and to cost recovery.

- Some large user submissions have tried to downplay the risks GPBs face. In contrast, Consumer NZ and Rewiring Aotearoa highlight that these risks are significant and real. For example, Rewiring Aotearoa detail why they consider that most homes and many businesses can save money by switching to electric options while investing in natural gas in homes doesn't make sense anymore.

- A big focus of Entrust's submission was that recovering costs could become harder for GPBs, and result in an increasing burden for remaining customers as demand declines. The potential burden on remaining customers could be exacerbated by equity considerations. There can be upfront costs of switching to electricity only. Consumer NZ and Rewiring Aotearoa both point out that it is easier for higher income households to switch to full electric than lower income households. This could mean lower income and vulnerable consumers could disproportionately bear higher future costs if cost recovery isn't adequately addressed now.

- Fonterra's support for a shift from capital-intensive renewals programmes to greater reliance on opex maintenance strategies aligns with the approach Vector is taking to asset management. Entrust also welcomes Fonterra's support for the Commission using up-to-date AMP forecasts rather than historic averages.

- We do not consider MGUG or Methanex's attempts to relitigate the Commission's decision to accelerate asset cost recovery to be well founded or adds anything new. Their submissions ignore the sound evidence and reasoning behind the decision, and that MGUG's merits review appeal on this matter failed.

Entrust's Cross-submission

Entrust is sympathetic to gas user concerns about the importance of managing price changes carefully.

Our submission highlighted that gas pipeline charges are substantially lower now than they were a decade ago, both in nominal and real terms. This provides considerable leeway to increase gas prices to speed up cost recovery.[1] Vector's GPB charges are $220 lower per customer or 30% lower in real terms than they were in 2013.

While it is important to consider shorter-term price impacts, the Commission needs to balance these against the risk that recovering costs could become harder for GPBs, and result in an increasing burden for remaining customers as demand declines. The Commission needs to be careful to make sure that avoiding price shocks now does not just delay the price shocks or make future price shocks larger.

Rewiring Aotearoa details the risks well with its view that most homes and many businesses could save money by changing from gas to electricity only, and "Investing in natural gas in homes doesn't make economic sense". Rewiring Aotearoa commented that in 2025 there has been a decline in residential natural gas connections, some natural gas retailers are no longer taking on new customers and "many large industrial customers already have in place plans to transition away from natural gas over the next five years."

Vector referenced a number of reports which demonstrate the cost competitiveness of electricity over gas. Consumer NZ similarly submitted that "The gas sector now exhibits characteristics of a 'sunset industry'" and "gas is in long-term structural decline".

Risk of an unfair and inequitable transition

Entrust considers that both Consumer NZ and Rewiring Aotearoa present well-founded arguments regarding the importance of managing the risk that cost recovery may increasingly impact a smaller number of remaining customers. Failure to address this risk appropriately could lead to adverse equity outcomes.

Both Consumer NZ and Rewiring Aotearoa point out that higher income households and homeowners find it easier to shift to full electric than lower income households and renters. Not all households can readily afford to switch from dual fuel to electricity only. There are upfront costs from making the transition even if it results in lower energy bills and the customer will be better off overall.

Even if the gas hot water dies and needs replacing, a low income household may not have any other choice than a 'like for like' replacement given the significant capital costs involved even for a simple electric hot water cylinder.

If you don't own your own home you may not have the option of changing. People living in rental properties are stuck with appliances their landlord installs. We share Rewiring Aotearoa's concern that "low income households using natural gas and those in rental accommodation face the biggest barriers to switch away from natural gas." We agree with Rewiring Aotearoa that "[t]his creates a high risk of inequity as New Zealand homes and businesses transition away from natural gas."

Entrust similarly agrees with Consumer NZ that equity risks are growing and the households who remain on dual fuel and left exposed to rising prices could be

[1] 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.

"disproportionately low-income households, renters and older people". Entrust considers the potential impact on different consumer groups is an area that warrants more in-depth attention.

These issues essentially parallel the concerns Entrust raised with the Electricity Authority in relation to the solar and household batteries.[2] Just like with switching from dual fuel to electric, it is higher income households and homeowners that are best placed to invest in solar. The risk is that if they are overcompensated, the financial burden of network cost recovery will disproportionately land on low income and vulnerable households.

Residential customers should not pick up the tab for industrial and large gas users

MGUG has attempted to downplay concerns about cost recovery and asset stranding risk, by arguing "mass market", i.e. residential, customers can be expected to remain connected, allowing GPBs to recover costs from these customers.

The evidence GPBs have provided about changes in gas demand, and the evidence from Consumer NZ and Rewiring Aotearoa, questions the validity of MGUG's assertions.

Even if MGUG was correct, Entrust would be very concerned about the efficiency, equity and distributional impacts of relying on residential customers to recover infrastructure costs that all customers, including industrial and large gas users, benefit from. Our concern is heightened by the prospect that the residential customers could be disproportionately low income and vulnerable households.

Gas pipeline businesses are incentivised to mitigate asset stranding risk

Entrust was surprised by MGUG's claim there are "moral hazard" problems, and GPBs don't have incentives to take adequate precautions to protect their own businesses. We were also surprised by MGUG's suggestion GPBs may be incentivising "degrowth" on their networks, and that GPBs might abandon their customers.

Moral hazard is where one party is insured or protected from the full cost of their actions which is not the position GPBs are in when it comes to investment cost recovery.

It should be self-evident that while Commission's regulatory settings may be designed to help enable recovery of prudent and efficient investment, the Commission has been equally clear it is not responsible for ensuring cost recovery. The Commission has explained that, even with application of the Full Capital Maintenance (FCM) principle, it is not possible to guarantee regulated suppliers will earn normal returns.[3]

GPBs are taking actions to mitigate the risk of asset stranding. We detailed, for example, how Vector is substituting capex for opex as part of a prudent, risk-based approach to asset management.

If GPBs acted in the way MGUG suggest it would undermine shareholder value and increase the risk GPBs will not be able to recover their costs. This would not be rationale behaviour for GPBs.

[2] Entrust, Submission on Electricity Authority Distribution Pricing Consultations, 26 March 2025.
[3] Wellington International Airport Ltd v Commerce Commission [2013] NZHC 3289 at [264].

Regulatory settings should support cost recovery

Entrust agrees with Consumer NZ that regulatory settings need to reflect "electricity is a growth industry, while gas is in long-term structural decline." The Commission should prioritise facilitating recovery of GPBs' prudent and efficient investment costs. Our submission supported adoption of a more aggressive approach to accelerated depreciation, and other options advocated by FirstGas, Powerco and Vector including a volume re-opener and/or a 'hybrid mechanism' which shares volume risk with consumers, adopting a revenue cap, adopting an un-indexed RAB, volume wash-up etc.

We do not consider MGUG's attempt to relitigate the Commission's decision to accelerate asset cost recovery to be well founded or adds anything new. MGUG's repeated suggestion that the decision reflected the Commission's "economic theory belief system" ignores the sound evidence and reasoning behind the decision, and that MGUG's merits review appeal failed. Similar comment can be made in relation to Methanex who simply repeated aspects of their 2022 DPP3 submission on this matter.

In response to what MGUG pejoratively describes as the Commission's "experiment", the High Court found that "A failure to shorten asset lives now [in 2022], when the expected economic life of new investments is shorter than their physical lives, may itself undermine investor expectations of financial capital maintenance and, accordingly, their confidence to make those investments."[4]

Entrust agrees with FirstGas that "Maintaining a consistent philosophy that has been endorsed by the High Court, and an approach to achieving that philosophy that has also been endorsed by the High Court, promotes regulatory certainty in the long-term interests of consumers."

FCM is a core element of Part 4 regulation

MGUG has questioned whether the Commission should strictly adhere to the ex-ante FCM principle. This isn't a principle the Commission can just ignore because it may be convenient to do so.

The FCM principle is central to the Commission's application of price-quality regulation under Part 4 Commerce Act and Part 6 Telecommunications Act. The same can reasonably be expected in relation to regulation of water suppliers under the Local Government (Water Services) Bill 2024.

The High Court has recognised FCM "as an outcome consistent with the making of normal but not excessive profits and is therefore an outcome that will also efficiently promote the purpose of, and outcomes sought by, s 52A(1)."[5]

Our submission also noted that the High Court dismissal of the MGUG appeals reinforces the importance of ensuring regulated suppliers have confidence they will be able to earn normal returns over the lifetime of their investments.[6]

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.[7]

[4] MAJOR GAS USERS' GROUP INC v COMMERCE COMMISSION [2024] NZHC 959 [29 April 2024], at [242].
[5] Wellington International Airport Ltd v Commerce Commission [2013] NZHC 3289 at [263].
[6] MAJOR GAS USERS' GROUP INC v COMMERCE COMMISSION [2024] NZHC 959 [29 April 2024].
[7] iBID at [162].

Concluding remarks

Entrust shares Consumer NZ's concern that "Applying a regulatory model designed for growing or stable markets to a sector in decline risks creating perverse incentives, poor outcomes, and inadequate attention to equity impacts." We similarly acknowledge Rewiring Aotearoa's concern that a business-as-usual approach to gas network price regulation may not be in the best long-term interests of consumers.

The decline in demand for gas justifies departure from some elements of the approach to economic regulation elsewhere.

Entrust also agrees with the FirstGas, Powerco and Vector joint submission that "accelerated depreciation remains a key regulatory action that can help mitigate the adverse consequences of declining gas demand, but it cannot address them entirely" and "it will be important for the Commission to stay the course with accelerated depreciation while considering other actions that could benefit consumers in the longer term".

We also consider that even modest allowances for decommissioning now will reduce the burden on a shrinking customer base later on.

Entrust considers these factors lend support for changes to Default Price-Quality Path and Input Methodology settings that help ensure financeability and cost recovery and provide flexibility to help manage this increasing uncertainty and risk.

Kind regards

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