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Commerce Commission

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Cross-submission on the Gas Default Price-Quality Path 4 (DPP4)

Introduction

1. Energy Resources Aotearoa is New Zealand's peak energy sector advocacy organisation. We represent participants from across the energy system, providing a strategic sector perspective on energy issues and their adjacent portfolios. We enable constructive collaboration to bring coherence across the energy sector through and beyond New Zealand's journey to net zero carbon emissions by 2050.
2. We welcome the opportunity to comment on the Commerce Commission's ('the Commission') draft decisions for the Gas Default Price-Quality Path 4 ('DPP4'), and in particular on the proposal to continue the approach with accelerated depreciation of gas distribution assets, or 'pipelines'. Our interest in this proposal lies in the ability of the regulatory system to provide gas consumers with secure and affordable gas into the long-term.

Key messages

3. We acknowledge that some degree of accelerated depreciation can be appropriate in the current context of long-term demand uncertainty. In particular, targeted acceleration may help manage legitimate stranding risk, support prudent investment signals, and avoid placing excessive recovery burdens on future consumers where there is evidence that pipelines are in their final years of use.
4. However, Energy Resources Aotearoa considers it important that accelerated depreciation is applied in a proportionate and targeted manner, rather than as a broad, front-loaded response to uncertainty.
5. We also wish to comment on the approach to capital expenditure ('capex') allowances for growth under DPP4 and what they could signal to developers and new customers. If a capex allowance policy were to be applied broadly and the allowance removed too steeply, it could deter developers or businesses from

choosing to connect to gas, impacting all customers. We recommend a smooth reduction in allowances based on evidence of capex investment.

The risks associated with broad-brush accelerated depreciation

6. The draft decisions aim to provide an element of certainty around decommissioning the gas pipeline network, which is estimated to cost pipeline companies (and by proxy, their customers) \$100-\$200 million at some point in the future. It seeks to allocate asset recovery costs among current and future consumers, with the intent of avoiding a 'death spiral' whereby assets become stranded and future consumers pay unduly high costs because they are the last ones left using the network.
7. However, like most other submitters, we think care must be taken to ensure the final decisions are proportionate and light-touch so that the Commission does not create the very problem it seeks to avoid, namely, *accelerating the exit of gas consumers* and thereby increasing stranding risk.
8. Castalia was commissioned (by Major Gas Users' Group) to provide an evidence-based analysis of the problem and the draft decision. Castalia found that:

"Overall, while the Commission argues that accelerated depreciation is necessary to preserve the incentives for network owners to ensure the necessary re-investment and maintenance of the network, the Commission's approach risks causing the very stranding [of assets] it seeks to address. Significant increases in network prices in the short term, combined with near-term constraints on gas supply, invite a dynamic demand response to accelerate the decline in gas usage instead of bridging the sector to alternative gas supplies."
9. Some have argued that front-loading asset recovery increases short-term network charges, which flow directly into delivered gas prices. If applied too aggressively or uniformly, front-loading of costs risks creating a self-reinforcing dynamic of higher prices and declining volumes. Higher prices will increase incentives to disconnect, even where gas supply remains technically reliable and economically viable. In this way, regulatory price signals risk becoming a driver of demand destruction, rather than a response to it and could potentially instigate decommissioning that is not even needed.
10. However, this argument needs to be nuanced. Other factors have far more impact. In particular, the wholesale price and availability of natural gas.
11. We encourage the Commission to apply accelerated depreciation in a targeted and cautious manner, with opportunities to learn from test cases of network right-sizing during the DPP4 period. This will need to be constantly tested against the real-time market circumstances of the gas market. The LNG announcements will also influence this picture.

Steep reductions in capex allowances and what they signal to developers

12. If capex allowances are removed too steeply, the signal to developers and medium-large businesses looking to connect is not subtle. It effectively says that the gas network may not be there when you need it. Even if that is not the Commission's intent, that is how the signal is likely to be read.
13. Developers and new customers need confidence that connections will be available and that service quality will be maintained over the lifetime of their investment. With tightly constrained allowances (i.e., the developer pays nearly all of the capex, which is not status quo), developers may face higher upfront connection charges or require bespoke funding arrangements. This introduces unquantifiable risk, which is often enough to rule gas out.
14. We recommend a balanced and flexible framework that enables distributors to invest growth capex and connections capex to suit forecast development and types of customer connections in their network area. Flexibility of this kind will help retain consumer options where this is shown to be justified, which should be most of the network in the medium-term at least.

External factors

15. Energy Resources Aotearoa considers the risks above are particularly relevant given that:
 - a gas demand decline is uncertain and varied across regions and customer classes;
 - b some parts of the gas network may remain economic for decades; and
 - c right-sizing and managed network contraction options have not yet been clearly tested or costed.
16. In this context, changing existing depreciation approaches and steeply reducing capex allowances risk pre-empting outcomes. Instead, the Commission should take a balanced approach and decide on a package of decisions informed by evidence of both demand and cost recovery trajectories, network optimisation options (organic right-sizing led by the market), and continue to learn from modelled decommissioning pathways and scenarios.

The importance of keeping options open and the impact on competition

17. Pipelines offer optionality for consumers should they want or need to continue using gas. The proposal from the Commission risks closing off piped gas options to consumers, not just prematurely, but risks increasing their costs and reducing competition in the energy sector.

18. Despite the above market conditions, help is on the way as:
 - a the sector has had an injection of practical support from the Government with the \$200 million Gas Security Fund that has been extended to back not just exploration but drilling and development of existing fields to get more gas to market quickly;
 - b we have procurement for LNG imports underway with significant Government support to provide consumers with long-term security and confidence; and
 - c biogas is a growing market and could support the residential and small commercial gas market to remain viable at the sub-network level. This would contribute to decarbonisation while the renewable gas market grows. Once more, the Government is backing these market developments.
19. The Commission is not the expert in these matters, but it is the competition expert. From a competition perspective, it seems crucial that its regulatory decisions maintain competitive options for the market to determine.
20. For consumers, their concerns will be driven by market confidence. The final decision must not erode market confidence with settings that prematurely indicate that the network is in decline and bring the stranding of assets forward. Consumer choice in energy options is a key component of a competitive market.

Concluding comments

21. Energy Resources Aotearoa encourages the Commission to exercise caution in changing the approach to depreciation settings and steeply removing capex allowances in DPP4.
22. The Commission's focus must be to ensure that any changes are proportionate, balanced, and designed to avoid triggering avoidable, price-driven consumer exit. A more measured approach would help preserve optionality and avoid rapid network exits. In line with the Commission's purpose, this would better promote the long-term benefit of consumers. It would also promote competition by keeping options open and, in turn, economic development.