

Letter to the Commerce Commission

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Kia Ora Matt and the Gas Reset Team

Gas DPP4 2026 – Cross-submission on hybrid mechanism and IM amendments

This is a joint cross-submission from Firstgas, Powerco and Vector (**GPBs**) in response to submissions published on the Commission's Revised Draft Decision and Proposed IM amendments introducing a hybrid (demand-variation) mechanism for fourth gas default price-quality path (**DPP4**).

We limit our comments to issues directly relevant to the case for, and design of, the hybrid mechanism. Several submissions raise broader matters regarding accelerated depreciation, Input Methodologies and the regulatory framework more generally. We do not engage with those matters here.

Whether a CPP is a realistic substitute for extreme, intra-period demand loss

Submitters argue that a customised price-quality path (**CPP**) is a sufficient and preferable mechanism to address material deviations from forecast demand during DPP4.¹ We do not agree.

A CPP is a poor operational substitute for a hybrid mechanism where demand outcomes diverge materially from forecast for reasons that are largely exogenous to individual GPBs, and particularly where those outcomes are driven by:

- forecast error inherent in the demand forecasts and scenario assumptions underpinning the DPP4 decision, and
- sector-wide factors affecting multiple networks at the same time (e.g. supply constraints or coordinated consumer defection).

A CPP process is costly, uncertain, and time-consuming for both the applicant and the Commission, and for other stakeholders. Requiring GPBs to pursue CPPs in response to large intra-period forecast error would impose material transaction costs and financial risks, even though the underlying cause of the variance may lie outside the control of any individual GDB.

In these circumstances, it is not reasonable to place the onus, cost and risk of correction solely on suppliers through CPP applications. Doing so would also be administratively inefficient if multiple GDBs were affected concurrently by the same systemic drivers of demand loss.

For gas consumers, a CPP is not symmetric. It is up to the GPB to pursue, so it would likely only be used if actual demand falls below forecasts. It is unlikely to address cases where demand is

¹ See: Major Gas Users Group, 21 April 2026, *Submission on the Revised Draft GDB DPP4 Decision and IM Amendments*, pp.2–3.

higher than expected, underscoring the limits of relying solely on CPPs to fairly share demand risk.

By contrast, a hybrid mechanism provides a pre-specified, symmetric, and low-cost way to address such outcomes, consistent with the Commission's own acknowledgement that uncertainty over demand during DPP4 is genuine and material.

Why WAPC plus smoothing is insufficient under sustained structural decline

Some submitters contend that the existing weighted average price cap (**WAPC**) with revenue smoothing is sufficient to manage demand risk, including under significant demand decline.² This understates the nature of the risk facing the sector.

Other submitters have suggested that a 15% demand reduction could be 'business as usual'.³ However, this appears to conflate the *direction* of demand with forecast error (i.e., differences between actual and forecast demand). The hybrid mechanism addresses forecast error, even where demand is forecast to decline. The suggestion also implies that a 15% decline is immaterial, which we disagree with. By way of illustration, a 15% revenue under-recovery could reduce the realised return on equity by around half based on the draft DPP4 decision⁴ – this is significant and will undermine efficient investment in the gas networks, especially if compounded over the DPP period.

WAPC-based controls can perform adequately where demand variation is temporary, cyclical or reversible. However, where demand reduction is structural and persistent, smoothing mechanisms do not remove the underlying problem – they defer it.

Under sustained demand decline that is faster than forecast:

- under-recoveries can accumulate over multiple years within the regulatory period
- those under-recoveries translate into sharper price resets at the start of the next DPP period, and
- financeability pressures intensify well before the next reset, heightening risks to service continuity and investment incentives.

As the Commission has recognised elsewhere, financeability risk that emerges within a DPP period cannot be costlessly corrected after the event. Where smoothing is used to manage consumer bill impacts, it can also shift more revenue recovery to later years. Absent a sharing mechanism, this increases exposure to demand forecast error within the DPP period and raises the likelihood of sharper price resets heading into the next DPP period.

A hybrid mechanism directly addresses this problem by sharing material forecast error contemporaneously, rather than relying exclusively on future price resets to reconcile historical variance.

This is not about insulating GPBs from all demand risk. It is about recognising that the distribution of risk embedded in a WAPC was not designed for a period characterised by sustained structural contraction, combined with high uncertainty and long asset lives.

² See: Major Gas Users Group, 21 April 2026, *Submission on the Revised Draft GDB DPP4 Decision and IM Amendments*, pp.2–3; and Fonterra Co-operative Group, 21 April 2026, *Submission on the Revised Draft GDB DPP4 Decision*, p.1.

³ See: Greymouth Gas New Zealand Limited, 21 April 2026, *Submission on the Revised Draft GDB DPP4 Decision and IM Amendments*, pp.2.

⁴ The logic is as follows. The return on equity component made up around 18–22% of building block revenue across the GPBs in the draft DPP4 decision. A 15% reduction in revenue will lead to realised returns to equity holders that are around 41–52% of those allowed, assuming no changes to costs except for lower corporate income tax. These values are calculated as $[18\% - 15\% \times (1 - 28\%)] / 18\% = 41\%$ and $[22\% - 15\% \times (1 - 28\%)] / 22\% = 52\%$.

Supporting clear guardrails without over-engineering the mechanism

We support submissions that emphasise the importance of clear, objective safeguards around the operation of a hybrid mechanism, including avoidance of gaming and clarity over trigger conditions.⁵

These concerns are legitimate and should be addressed through design discipline, not abandonment of the mechanism. In a price cap framework (i.e., without a revenue cap), a simple sharing mechanism is needed so smoothing does not leave either consumers or GPBs carrying the full impact of forecast error.

In our view, effective guardrails include:

- objective, transparent trigger definitions tied to forecast revenue or demand
- symmetric sharing of over- and under-recovery beyond the tolerance, and
- avoidance of discretionary reopening tests that re-introduce CPP-like complexity by another name.

We do not support network-specific thresholds or bespoke tests that materially weaken simplicity, predictability or consistency across GDBs. Over-engineering the mechanism would undermine its core purpose: to provide a low-cost, durable way of addressing material forecast error within the regulatory period.

Absent a revenue cap, a simple hybrid mechanism with well-defined parameters is preferable to either:

- reliance on CPPs as a default and asymmetric response to demand shocks, or
- retention of a pure WAPC that leaves both consumers and GPBs exposed to sharper, less predictable price outcomes over time.

Conclusion / Next steps

The core question raised by submissions opposing the hybrid mechanism is whether it is necessary at all. Our view remains that:

- a CPP is not a practical or proportionate response to large, systemic intra-period demand losses
- WAPC plus smoothing is not sufficient where demand decline is structural and sustained, and
- a carefully-designed hybrid mechanism, with clear and limited guardrails, better promotes the long-term benefit of gas consumers under DPP4.

We therefore continue to support the Commission's proposal to introduce a hybrid mechanism, subject to appropriate calibration of its parameters.

Our cross-submission contains no confidential material. We would welcome further discussion if that would assist the Commission's consideration of these issues.

⁵ See: Greymouth Gas New Zealand Limited, 21 April 2026, *Submission on the Revised Draft GDB DPP4 Decision and IM Amendments*, pp.1–3.

Ngā mihi nui,



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