

18 July 2019

Dane Gunnell
Manager Price-Quality Regulation
Commerce Commission
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Sent via email: regulation.branch@comcom.govt.nz

Dear Dane

EDP default price-quality path reset: draft decision

First Gas welcomes the opportunity to make a submission to the Commerce Commission (the Commission) on its the “*Default price-quality paths for electricity distribution businesses from 1 April 2020 – draft decision*” (the decision paper).

Our submission focusses on our support for the introduction of an innovation fund mechanism. We commend the Commission’s recognition of the need for such funding, as New Zealand moves toward a low-emissions economy. The energy sector is likely to face challenges that will require new approaches to managing networks, including potentially new forms of assets and working with external providers in new ways.

As a matter of principle, we consider that innovation funding for regulated businesses should be tailored specifically to the individual sector, and the opportunities and challenges they are facing. As noted by the Commission,¹ there are many approaches that may be taken, and the key is to ensure the mechanism chosen is the most effective for that industry. To assist this discussion, First Gas engaged Sapere to consider the advantages and disadvantages of various options for funding innovation in energy networks. We have provided the Sapere report in **Attachment 1**.

While the decision paper is directed at electricity distribution businesses, we believe that gas pipeline businesses (GPBs) face similar issues. We would welcome further discussion on this issue in the lead up to our DPP reset in 2022.

Regulation should support the changing environment

We agree with the Commission that substantial changes are occurring in the electricity sector, driven by an increasing focus on decarbonisation and an increasing development and increased affordability of some technologies.² We consider that the commentary around the challenges and opportunities facing EDBs, could in many ways equally apply to the gas sector and gas pipeline businesses (GPBs).

We consider that it is in the long-term benefit of customers that the regulatory framework supports innovation in energy infrastructure. Adapting to meet future needs in the most efficient and effective manner is likely to require collaboration and investment in research and development. There is some risk that the significant cost of research and development may delay investment if benefits are not recognised for some time.

We agree with findings from the Brattle Group and FTI consulting³ report that a basic regulatory regime is insufficient to incentivise innovation and additional regulatory tools are required. We

¹ Appendix F.20, Decision paper.

² Section 4.1, Decision paper.

³ sections 4.59 and 4.60, Decision paper.

support the intent of the Commission's proposed funding mechanism for innovation, but question whether the level of funding proposed, or the mechanism is the most appropriate for the sector.

Funding should be tailored to sector challenges

We believe that to be most effective, the mechanism should be tailored specifically to each sector. The Sapere report observes⁴ that:

There is currently no ideal way of determining what an optimal level of innovation expenditure should be either at a firm or industry sector level. The key consideration will be to ensure that the proposed innovation mechanism for the EDBs provides for flexibility in the optimal level of innovation expenditures (to the benefit of consumers) and most importantly enables the timely adoption of new innovations of benefit to the network and consumers...."

We question whether the proposed mechanism, which allows a limited amount of funding to each non-exempt EDBs, is the most effective way of incentivising innovation in an industry with a relatively large number of participants. As noted by Sapere,⁵ "tenders are more effective in industries with a high number of market participants." This approach would mean more of a "pooling" of the innovation funding and greater regulatory oversight. Compliance costs may therefore increase, but it may result in better outcomes for the industry and importantly consumers.

Whichever mechanism is in the final DPP decision, we recommend the Commission provide clear guidance on the requirements for the application of funding. This guidance should provide some certainty to participants on what is required and any parameters to be considered.

Recommend extending to gas pipeline businesses from 2022

We support the Commission exploring options to encourage innovation across New Zealand's regulated energy businesses. We would welcome a similar mechanism for gas pipeline businesses to support innovative projects and enable the sharing of sector knowledge.

First Gas supports the Government taking action on climate change and committing to a net zero emissions target by 2050. We believe natural gas has a role to play in achieving this target. We are committed to exploring the distribution of alternative fuels such as green hydrogen, biogas and gas blends, that will reduce New Zealand's carbon emissions. While we have already undertaken some research and committed to future trials,⁶ we consider that we are only at the beginning of this journey.

First Gas would welcome the opportunity to further discuss the introduction of a funding mechanism for innovation in the gas infrastructure sector. With only a small number of GPBs, we acknowledge the most appropriate mechanism may be less clear than that for EDBs. We would welcome consultation with the Commission, our customers, and other interested parties to determine the best funding mechanism, as we progress toward our next regulatory control period in 2022.

Contact details

If you have any questions regarding this submission, please contact me on 027 472 7798 or via email at karen.collins@firstgas.co.nz.

Yours faithfully



Karen Collins
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⁴ Page 8, *Analysis of approaches for funding innovation in energy networks*, Sapere, 17 July 2019.

⁵ Pages 4 – 6, Table of advantages and disadvantages of different approaches for funding direct incentives for innovation, Sapere report, 17 July 2019.

⁶ In 2018, First Gas joined with Powerco to commission a report from Vivid Economics that considered possible future uses of gas and gas infrastructure. In 2019, we announced our hydrogen-pipeline trial as one of the first projects likely to start at the National New Energy Development Centre being set up in Taranaki.

Attachment 1: Sapere report - *Analysis of approaches for funding innovation in energy networks*