



Key issues in Gas DPP4 Draft Decision



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Contents

1	Introduction	4
1.1	Background and context	4
1.2	Purpose of this report	4
2	Form of control and management of demand risk	5
2.1	Introduction	5
2.2	Commission's position	5
2.3	Frontier Economics' views	6
3	Managing stranded asset risk	13
3.1	Introduction	13
3.2	Commission's position	13
3.3	Frontier Economics' views	13
4	Opex and declining connections	16
4.1	Introduction	16
4.2	Commission's position	16
4.3	Frontier Economics' views	16

Figures

Figure 1: Concept Consulting forecast of gas disconnections	7
Figure 2: Impact on prices from a 2% annual over-forecast under a price cap and a revenue cap	9



1 Introduction

1.1 Background and context

The Commerce Commission (Commission) must set a new default price-quality path (DPP) for gas pipeline businesses to apply over the five years from 1 October 2025 (DPP4). On 27 November 2026 the Commission published its Draft Decision for the gas DPP4 reset.¹

1.2 Purpose of this report

Frontier Economics was engaged by Vector to provide feedback regarding matters addressed in the Commission's Draft Decision. Specifically, in this report we comment on the following aspects of the Draft Decision:

- The form of control that is applied in the context of a within-period risk of decreasing gas use and increasing disconnections.
- The approach to asset lives considering current information about the stranded asset risk that gas distribution businesses (GDBs) face.
- The impact of declining connections on the approach to setting the operating expenditure allowance.

¹ Commerce Commission. (2025). Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026. Draft decision - reasons paper. 27 November 2025.



2 Form of control and management of demand risk

2.1 Introduction

One function of the form of control is to allocate the risk of variations between expected and actual demand and connections between resets to GDBs, customers, or a combination of both. In our response to the Commission's Issues Paper we considered that a weighted average price cap (WAPC) was no longer appropriate for GDBs in New Zealand. The basis for this view was the lack of control that GDBs have over future demand, which is increasingly shaped by government policy, environmental pressures, and tight gas supply, such that demand-linking mechanisms such as a WAPC have lost relevance in New Zealand. We noted also that persisting with a WAPC in this environment would undermine the ability for GDBs to fund necessary service and reliability projects and also expose customers to more material price shocks between regulatory periods.

The Commission has retained a WAPC for its Draft Decision. In this section we summarise the key reasons given by the Commission for retaining a WAPC and provide our response to those reasons.

2.2 Commission's position

The Commission has decided in its Draft Decision for DPP4 to retain a WAPC for GDBs and so not implement a revenue cap form of control or a demand variation mechanism to allocate some of the risk of demand variations within a period to customers.² The reasons given by the Commission for not altering its approach to the form of control are:³

- The demand forecast is a central estimate of forecast demand over the regulatory period. Therefore, there is the potential for both upside improvement as well as downside risk.
- GDBs are able to manage variations to demand under a WAPC through:
 - managing expenditure
 - restructuring prices
 - applying for a customised price path (CPP), and
 - applying for a capacity event reopener

The Commission also considered the option of a new reopener to manage significant changes in demand. It stated it was not convinced there was new evidence showing that the level of risk to customers justifies changing its position from the Input Methodology Review 2023 where a decision was made to not include a demand reopener.⁴

In its Draft Decision, the Commission observed that although some stakeholders pointed out issues with a WAPC because of possible significant changes in demand during the period, it has

² Commerce Commission (2025) Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper. 27 November, para. 3.76, p. 39.

³ Commerce Commission (2025) *Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper*. 27 November, p. 39.

⁴ Commerce Commission (2025) Gas DPP4 reset 2026: Default price quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper. 27 November, para. 3.80, p. 40.



not received any submissions quantifying the risk this within-period demand uncertainty poses to consumers' long-term interests.⁵

2.3 Frontier Economics' views

2.3.1 WAPC with declining demand and increasing disconnections

As mentioned in our reply to the Issues Paper, one of the main reasons for adopting a WAPC for GDBs was to motivate them to promote connections to new pipeline infrastructure on local streets. However, we pointed out that boosting connections in this manner is currently unrealistic, as disconnections have become more common. The Commission's Draft Decision acknowledges that growing numbers of new connections are improbable and that we can expect an ongoing increase in disconnections. In light of the Commission's acceptance of this likely trend, we believe there is little reason to continue with a WAPC; especially considering the additional complications it brings under these circumstances.

Commission views on demand and disconnection

In its Draft Decision the Commission has accepted the GDBs forecasts of demand and disconnection. Relatedly, commentary from the Commission in its Draft Decision suggests that it accepts that disconnection is far more likely than new connection in the future. For instance, the Commission is explicit that it expects an increase in customers disconnecting from the gas network when identifying that this will give rise to new disconnection related issues. Specifically, it stated:⁶

*Given the **expected increase in customers disconnecting from the gas networks**, we expect disconnections to become an emerging focus over DPP4. We have not specifically considered disconnection issues in the past. As the gas networks have been growing, we have not seen large numbers of disconnections and there has been limited focus on the costs and activities related to disconnections.* [emphasis added]

Furthermore, the Commission's advisor on demand forecasts, Concept Consulting, has projected a steeper and deeper decline in ICPs over DPP4 than the GDBs have forecast. A notable observation from Concept's review was that the overall demand projections are generally aligned with the aggregate estimates provided by the GDBs, however, it anticipates a more pronounced decrease in ICP numbers and so disconnections from the network.⁷ Figure 14 from Concept's report, and reproduced in Figure 1 below, highlights this difference.

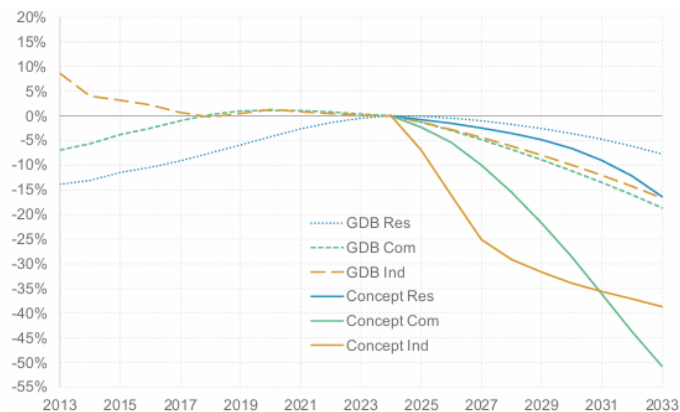
⁵ Commerce Commission (2025) Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper, 27 November, para. 3.77, p. 39.

⁶ Commerce Commission (2025) Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper (Attachments A–H), 27 November, para. E37, p.123

⁷ Concept Consulting (2025), Gas demand projections to feed into the default price-quality path (DPP) regulation of gas distribution businesses, Prepared for the Commerce Commission, August, p.5

Figure 1: Concept Consulting forecast of gas disconnections

Figure 14: ICP numbers movement for all GDBs relative to 2024



Source: Concept consulting - Gas demand projections to feed into the default price-quality path (DPP) regulation of gas distribution, p.9.

Demand and connection reductions are largely outside of a GDBs control

Importantly, the declining demand and increased disconnection forecasts endorsed by the Commission are driven by factors that are outside of the control of the GDBs. The implication being that a WAPC cannot drive behaviour change from GDBs that preserves connections and/or increases demand.

As we identified in our response to the Issues Paper, the external factors driving the declining demand and increased disconnection in New Zealand include:

- the government's climate change policies aim to achieve net zero emissions, which is motivating customers to switch to electric options
- wholesale gas prices are increasing, which is due to a significant shortage of gas, and power plants that are prepared to pay higher prices for gas during dry winter seasons
- reduced gas supply limiting long-term supply options for gas retailers, with evidence some retailers are declining new connections due to this concern, and
- increasing energy costs across New Zealand have caused many large commercial and industrial users to withdraw from the market altogether.

We note in their advice to the Commission on gas demand projections that Concept Consulting also identify a list of factors that might drive reduced gas pipeline demand. Again, each of these things is outside the control of GDBs. Specifically, Concept lists the following 'headwinds' for gas space and water heating:⁸

- growing carbon costs and commodity prices for wholesale gas, with the gas commodity component being significantly uncertain
- increasing cost-reflectivity of electricity tariff structures,
- ongoing cost and performance improvements in electric heat pumps, and
- with reducing gas demand, the 'death-spiral' causing network costs to rise over time.

⁸ Concept Consulting (2025), Gas demand projections to feed into the default price-quality path (DPP) regulation of gas distribution businesses, Prepared for the Commerce Commission, August 2025, pp.14-15.



Symmetry of potential outcomes

The Commission contends that the forecast of demand is a central estimate and so the prospect of demand increases is just as likely as the prospect of demand decreases.⁹ It is not clear to us on what basis this claim is made.

The most likely forecast (i.e. the mode of the forecast distribution) is not necessarily the same as a central estimate of demand. A central estimate is typically defined as the mean or median of the demand distribution, depending on the decision context. In skewed or heavy-tailed distributions, the mean, median and mode will generally differ. As a result, the forecast with the highest probability of occurring can differ from the mean or median demand outcome.

We do not have information about how all of the GDBs have selected their forecast for demand

We note, in addition, that the forecast of the Commission's advisor Concept Consulting do not match those of the GDBs. Given this misalignment, it is not clear how the Commission can have confidence that the forecast that has been adopted has a symmetrical prospect of demand being higher or lower. Indeed, as noted above, Concept's forecast for ICP numbers diverge substantially from those of the GDBs.

Unless the Commission can be confident of symmetry between the prospects of overestimating or underestimating demand forecasts under a WAPC, we think current circumstances indicate a bias towards under-recovery and a failure to achieve FCM. This is a risk that can be avoided entirely by moving away from a WAPC.

2.3.2 Risks from maintaining a WAPC

In response to the Commission's observation that it has not received submissions quantifying the risk to consumers' long-term benefit arising from demand risk, we submit that risks posed by demand volatility under a WAPC framework are both material and multifaceted, with important implications for consumer outcomes and market efficiency over time.

The primary risk to consumers resulting from declining demand under a WAPC is the potential for inefficient investment decisions and exposure to price shocks between regulatory periods. These risks stem from the lack of periodic price adjustment that respond to changing demand over time. With prices fixed during the regulatory period under a WAPC, consumers do not receive pricing signals that reasonably reflect up-to-date information. This means that consumers cannot reliably anticipate how prices may shift at the end of the period, leading to uncertainty when making decisions about investing in new appliances or equipment. This lack of transparency means consumers may inadvertently commit to energy solutions based on outdated price signals, undermining their ability to make informed choices that align with their long-term interests. The key implication being that the trend in prices, rather than the absolute level at any given moment, is what matters most for customer signalling and prudent investment.

We have demonstrated the effect referred to here using a simple version of the New Zealand revenue and pricing model over two regulatory periods. Here, we show the impact of a 2% annual over-forecast of demand (see **Figure 2**). What it shows is that if demand drops faster than forecast in regulatory period one, price outcomes will vary under a revenue cap and a price cap. Under a revenue cap, prices will increase during the regulatory period, reflecting the more up-to-date information on demand and efficient costs. Under a price cap, prices will not increase, continuing to reflect outdated information on demand and efficient costs. At the commencement of the subsequent regulatory period, customers will be exposed to a much

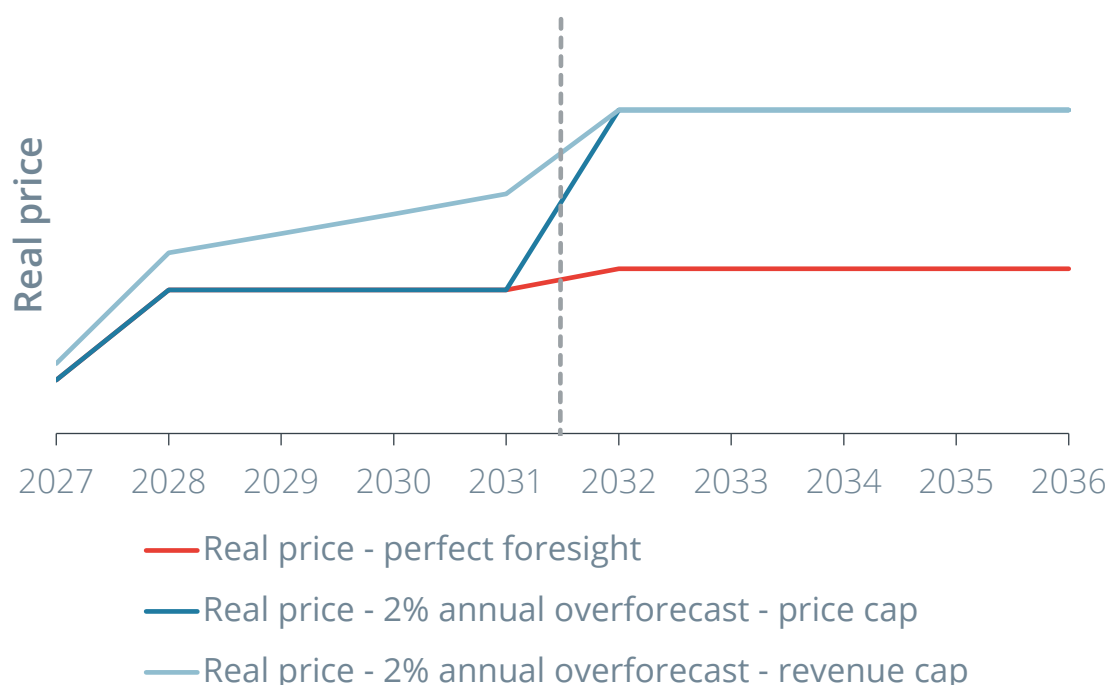
⁹ Commerce Commission (2025) *Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper*. 27 November, para. 3.78, p. 39.



more significant price shock under a price cap than a revenue cap. Specifically, in 2031 customers would be paying over 10% less than what the true cost-reflective price for the pipeline service should be. That is, in 2031 when customers evaluate whether to remain connected to gas or not in light of prevailing costs, their assessments will be inaccurate by at least this margin. The reality being that in the following year customers will incur a significant price increase. This substantially increases the likelihood of customers making decisions about ongoing gas consumption they otherwise might not have made.

Furthermore, the price shock that occurs between regulatory periods under a WAPC may cause some customers to prematurely abandon gas even if remaining connected to the gas network would have remained in their long-term interest. For instance, customers may misinterpret a one-off correction between regulatory periods as part of a persistent and regular trend, prompting them to switch technologies inefficiently.

Figure 2: Impact on prices from a 2% annual over-forecast under a price cap and a revenue cap



Source: Frontier Economics

By contrast, a revenue cap approach offers annual price adjustments that track demand changes, greatly enhancing price transparency for consumers. This form of control enables consumers to make better-informed decisions and reduces the likelihood of being caught off guard by significant price increases at regulatory resets. Because prices are updated each year in response to actual demand, any changes in costs are reflected incrementally rather than in large, abrupt shifts. This annual recalibration ensures that price signals remain current and visible to customers, allowing them to anticipate and respond to changes more effectively. As a result, consumers are better equipped to plan and invest in energy solutions with confidence, having regard to the general trend in prices over time.



2.3.3 Climate impacts

Recognising that WAPCs are designed to motivate GDBs to promote growth in the network, it is arguable whether maintaining this paradigm remains consistent with emission reduction objectives. As the industry faces increasing pressure to decarbonise and align with national climate targets, regulatory frameworks must evolve to support both a managed transition and the long-term interests of consumers. Persisting with incentives that favour network expansion risks undermining broader policy aims, particularly as declining demand and disconnections become more prevalent. This disconnect highlights the need for regulatory approaches that anticipate and respond to the shifting landscape, ensuring that both economic and environmental priorities are met without exposing consumers or businesses to undue risk.

2.3.4 Response to Commission Proposals for Managing Demand Declines under WAPC

As identified above, the Commission identified ways that GDBs are able to manage their business to take account of variations in demand under a WAPC. Here we provide our views on those mechanisms.

In summary, it is our view that the Commission's suggested methods for managing demand declines under a WAPC will either not manage demand declines as hoped by the Commission, will expose consumers to adverse outcomes, or will impose unnecessary costs. As we discuss in the following section, mechanisms that provide timely, transparent, and incremental price adjustments – such as revenue caps or hybrid models that share risk – are better aligned with the realities of demand risk and regulatory objectives.

Expenditure Management

The Commission suggests that businesses may respond to declining demand by managing expenditure. However, as discussed above, this approach is fundamentally constrained by the fixed nature of cost structures in regulated GDBs. Most network costs are sunk or committed to maintaining service levels, meaning that significant reductions in expenditure would directly impact service performance and reliability for customers. Attempting to absorb the loss of revenue from demand risk by cutting expenditure leads to inefficient under-provision of essential services, ultimately harming consumer welfare and contradicting the broader objectives of economic regulation.

Notably, the Commission has acknowledged that under-recovery of costs in the building block model threatens incentives for GPBs to invest and innovate. The outcome being a failure to meet the needs of current and future customers. Specifically, it stated the following in the context the asset stranding issue:¹⁰

If the risk is material, and not compensated for in our building block model (BBM) revenue-setting framework, then it will likely threaten incentives for GPBs to invest and innovate to meet the needs of current and future consumers to the extent that pipelines remain used to satisfy demand for gas.

It is our perspective that the effect of threats to the recovery of costs under the building block approach will have a similar impact, irrespective of whether those threats occur only within the period or over the life of the assets. Recognising again that the expected reductions in demand are not within the control of GDBs, it is our view that the Commission should apply the same

¹⁰ Commerce Commission (2025), Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper (Attachments A–H). 27 November, para. D25.2, p.90



emphasis to FCM in relation to demand risk within a regulatory period as it suggests it does for stranded asset risk.

Restructuring Pricing

The scope for further restructuring of tariffs is limited, especially for residential customers, where substantial reforms have already been undertaken. For instance, in the case of Vector, all residential customers are on fixed tariffs with no variable component.

Furthermore, the Commission's suggestion overlooks the fact that the primary revenue risk for GDBs is increasingly driven by customer disconnections rather than incremental reductions in gas usage among connected customers. Tariff redesign cannot address the loss of entire connections, which is a structural shift rather than a marginal usage decline. Therefore, making further changes to pricing does little to protect against a major source of demand risk and offers little additional benefit to businesses or customers.

Application of a Customised Price-Path (CPP)

The CPP mechanism is designed to allow for bespoke regulatory arrangements in response to exceptional circumstances. However, invoking a CPP to manage within-period demand declines is administratively burdensome and disproportionately costly relative to the problem's scale. The process entails significant regulatory and compliance overheads for both the regulated entity and the Commission, diverting resources from more targeted and efficient solutions. Given that demand declines are increasingly likely and GDBs options to manage risk is decreasing, relying on CPPs as a primary risk management tool is inefficient and fails to offer timely or proportionate relief to affected businesses and consumers.

Capacity Event Reopener

Under current Input Methodologies, the capacity event reopener is designed to address instances of additional capacity requirements for system growth capital expenditure, not reductions in demand.¹¹ Consequently, this mechanism is unsuitable as a means of addressing material falls in demand within a regulatory period and offers no practical utility in the current context.

2.3.5 Alternative Models for Addressing Within-Period Demand Risk

As outlined in our submission to the Commission's Issues Paper, several alternative regulatory models exist to address within-period demand risk for GDBs. These alternatives are particularly relevant as the sector faces accelerating declines in demand and increasing uncertainty regarding future usage and connections. In particular, we note that shifting to a revenue cap or a hybrid form of control better manages the risks to GDBs associated with unanticipated drops in demand. While prices may increase within the period, these rises are necessary to ensure the ongoing viability of the network, maintain FCM, and to avoid the harms that arise from delayed or distorted price signals for customers. The move towards hybrid models in Australia further underscores the need for New Zealand's regulatory framework to evolve in response to changing market dynamics, ensuring that cost recovery and economic efficiency remain at the forefront of regulatory objectives.

The principal models we identified as suitable in the current environment were:

- the adoption of a revenue cap,

¹¹ 4.5.4A of the Gas Pipelines Input Methodologies.



- implementation of a hybrid form of control (such as a cap-and-collar mechanism), and
- the use of demand reopeners.

The revenue cap model fixes total allowable revenue for the regulatory period, thereby insulating GDBs from unpredictable fluctuations in demand that are outside their control. Under this approach, prices may need to increase within the period to ensure cost recovery, but such adjustments reflect the necessity of maintaining FCM; a central tenet of economic regulation in New Zealand. This mechanism also avoids the inefficiencies associated with delayed price signalling for customers discussed above.

A hybrid form of control, exemplified by the cap-and-collar approach recently adopted in Australia, limits GDBs to demand risk within a defined band, with adjustments triggered when demand falls outside this range. This model preserves incentives for managing demand that the Commission perceives are beneficial, even in current circumstances, while safeguarding the ability of GDBs to recover efficient costs should demand materially deviate from forecasts.

Finally, demand reopeners provide a mechanism for the regulatory regime to be revisited when actual demand deviates significantly from forecasts, typically by a pre-specified margin. While the Commission has to date been reluctant to adopt reopeners, citing concerns over asymmetric risk allocation, it remains an option for managing extreme outcomes. In practice, however, both revenue caps and hybrid controls are more robust approaches for addressing within-period demand risk in the present environment.



3 Managing stranded asset risk

3.1 Introduction

It is well accepted that the economic life of gas networks is expected to fall short of the useful life of the assets themselves, driven largely by the transition to a low emissions economy, but in New Zealand also due to supply conditions. In our response to the Issues Paper, we identified that regulators elsewhere were taking increased action to accelerate depreciation in the time since the DPP3 decision. We also presented evidence to show there has been a material change of circumstances since that DPP3 decision was made, suggesting a more pessimistic outlook for gas in New Zealand. Therefore, we recommended that the Commission should consider an additional scenario for DPP4, with decommissioning of the gas networks occurring by 2045, and that each of the three resulting scenarios should be given equal weight.

The Commission has decided in its Draft Decision to not change the scenarios or their weightings adopted in DPP3 for DPP4. The remainder of this section examines the evolving risks of stranded assets for GDBs in New Zealand, considering both the Commission's regulatory response in its Draft Decision and particularly its treatment of recent market developments.

3.2 Commission's position

The Commission states in its Draft Decision that while some factors contributing to network stranding have evolved since DPP3, it considers that the modelled scenarios used for DPP3 remain central in the distribution of risk and are plausible and reasonable scenarios for the DPP4 context.¹² It is the Commission's view that there is an ongoing appetite from households, businesses and power generation for at least the next 20 years.

The approach adopted in DPP3, that it has retained for DPP4 in its Draft Decision, was based on two plausible scenarios for the scaling down and eventual closure of pipeline networks, one in which the closure of the pipeline networks occurs in 2050 (given a one-third weighting), and a second in which the closure of the pipeline networks occurs in 2060 (given a two-thirds weighting).

The Commission considers in its Draft Decision that the approach adopted for DPP3 mitigates the risk that GPBs may not expect to fully recover their investments and that this outcome supports the long-term benefit of consumers.

3.3 Frontier Economics' views

As noted above, in our previous submission, we outlined why the Commission must acknowledge the accelerating risk of asset stranding and why the DPP3 framework for accelerated depreciation is no longer sufficient under current market conditions. It is our view that since the DPP3 review the evidence of heightened and asymmetric stranding risk has only strengthened. Drawing on the same principles we advanced earlier, particularly the need for FCM, efficient intergenerational cost allocation, and regulatory adaptability in the face of unprecedented uncertainty, we provide here additional views in response to the Commission's Draft Decision on this matter.

First, we acknowledge the Commission's intent to recognise stranded asset risk while managing short-term price impacts and that achieving the correct balance is not straightforward. However,

¹² Commerce Commission (2025), Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper. 27 November, para 3.59, p.36.



the assumptions underlying the Commission's earlier scenario weightings no longer reflect the realities of the gas sector. As we highlighted in our prior submission, multiple structural shifts, rapidly declining reserves, rising wholesale gas prices, increasing customer disconnections, and accelerating electrification, have fundamentally altered the likelihood of pipeline networks remaining viable through to 2060. The Commission itself now acknowledges several of these changes. For instance, the Commission has recognised that forecast gas supply is falling faster than expected and this tightening supply is impacting on gas prices and use.¹³ It is our contention that, in combination, these factors unambiguously increase the probability of earlier network closure than was contemplated at DPP3.

Second, while the Commission places weight on "householder stickiness" and the potential for LNG imports, we previously noted, and reiterate here, neither factor provides a durable basis for assuming a long pipeline life. LNG exposure will tie New Zealand's gas prices to international markets, likely **increasing**, not reducing, price pressures faced by domestic consumers. This dynamic strengthens, rather than weakens, the case for accelerated recovery. Importantly, household stickiness does not mitigate the sector-wide structural decline in production and reserves; at most it delays, by a short margin, the timing at which customers exit the network in response to rising delivered gas prices.

Third, it is our view that the Commission's decision at DPP3 to apply heavy weighting to a 2060 scenario would almost certainly have been different had the current supply constraints, reserve declines, and heightened decarbonisation momentum been apparent at that time. The updated evidence base now strongly supports the inclusion of an additional earlier-closure scenario, in our view one concluding in 2045, with equal weighting across the three scenarios. This preserves the Commission's objective of balancing prudence, FCM, and long-term customer benefit across a more realistic set of future states. The effect of this approach, as shown in our earlier indicative assessment of the Commission's modelling, is to lower the adjustment factor and increase the extent of accelerated depreciation. This is an outcome that aligns with the heightened risk profile now facing gas networks.

Fourth, while the Commission understandably expresses concern about short-term price impacts, delaying depreciation does not protect consumers. Instead, it merely shifts the burden onto a shrinking number of future customers who have fewer alternatives, lower ability to switch, and face higher network prices due to a contracting customer base. As we previously argued, this pattern is inequitable and inconsistent with both efficient cost allocation and FCM. Recovering a greater share of depreciation earlier, while customer numbers remain higher, minimises the severity of future price shocks and avoids the risk of unrecoverable sunk cost as demand continues to decline.

Finally, the Commission itself acknowledges that current prices are well below willingness-to-pay and that prices can rise and still remain below the willingness to pay.¹⁴ Combined with the fact that accelerated depreciation is a relatively small contributor to total pipeline prices at a time when the customer base remains relatively broad, there is little evidence to suggest that appropriately paced acceleration now would materially accelerate disconnection. To the contrary, a smoother, more stable long-term price path is likely to provide greater certainty for remaining customers and reduce the price-shock-driven disconnections that occur under back-loaded depreciation profiles.

¹³ Commerce Commission (2025), Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper. 27 November, pp. 15-16

¹⁴ Commerce Commission (2025), Gas DPP4 reset 2026: Default price-quality paths for gas pipeline businesses from 1 October 2026 – Draft decision: reasons paper (Attachments A-H). 27 November, para D41.1, p.71



For these reasons, and consistent with the framework advanced in our first submission, we maintain that the Commission should:

- **introduce a 2045 scenario** alongside the existing 2050 and 2060 scenarios,
- apply **equal weighting** across all three scenarios, and
- **adjust the depreciation path** accordingly to better reflect today's risk environment.

It is our view that this approach best meets the Part 4 purpose by supporting continued investment, maintaining service quality, preserving FCM, and ensuring a fairer sharing of the cost burden between today's and tomorrow's consumers. It also avoids the asymmetric harm associated with insufficient early action. That is, the irreversible loss of the opportunity to recover efficient costs should the network contract faster than expected. Early action can always be moderated later; late action cannot be corrected.



4 Opex and declining connections

4.1 Introduction

This section examines the relationship between operating expenditure (opex) and the ongoing decline in network connections within the gas distribution sector.

4.2 Commission's position

The Commission has acknowledged, with respect to the network scale trend factor, that while GDBs anticipate a reduction in the number of connected ICPs, especially during the latter years of the DPP4 period, historical data does not strongly support the premise that declining ICP numbers will directly result in decreased network length. It observes that disconnections, particularly in the initial stages, are expected to occur in an uncoordinated manner and may not have an immediate impact on the physical extent of the network. Therefore, it is retaining the weightings used for network length, but implementing a floor when forecasting network length so that it does not decline with reductions in ICPs.

Unlike network length, for opex the Commission does not apply a floor of 0% for ICP declines. It assumes that opex should decrease as connections drop, based on a belief that there is a symmetry of costs between adding or losing ICPs. It also considers GDBs operating in a declining context would be actively looking for cost savings, similar to what occurs in a competitive market.

4.3 Frontier Economics' views

In considering the regulatory approach for DPP4, we submit that applying a floor of 0% to the output growth factor is both pragmatic and necessary if the Commission continues with the Base Step Trend (BST) methodology. This safeguard reflects the reality that most operating expenditure does not decrease in proportion to the number of disconnected ICPs. The Commission's current approach to ICP declines assumes a symmetry between the costs associated with increasing and decreasing ICPs, yet this assumption does not withstand scrutiny.

The Commission has not explained why it expects a linear, symmetric relationship between connections and disconnections, nor why opex should decline as connections are lost. In practice, opex does not respond symmetrically to declining connections. While new ICPs can drive incremental costs, such as commissioning, customer onboarding, and possible network augmentation, disconnections do not result in equivalent cost savings.

It is our view there is no compelling justification for the expectation that operating costs will fall in direct proportion to the number of disconnections. Customers rightly expect the same standards of safety and continuity of supply, irrespective of whether the network is serving more or fewer connections. The physical assets of the network remain in place even as customer numbers decline, necessitating continued maintenance, inspection, and compliance activities. These costs are largely fixed or only partially variable, and so the bulk of operating activities, such as public safety, emergency response, leak surveys, statutory compliance, system control, customer service, and incident readiness, must be sustained to uphold network safety and reliability. That is, the operating and maintenance expenses of networks are primarily influenced by the size, complexity, and condition of the assets requiring management, as well as by safety and reliability requirements, rather than by utilisation metrics alone.

While the Commission asserts that GDBs operating in a declining context would be actively seeking cost savings akin to behaviour observed in competitive markets, it is important to acknowledge that the regulatory framework already provides strong incentives for distributors



to pursue efficiencies. Under the current form of incentive regulation, GDBs are continually motivated to minimise their operating costs, as any efficiencies achieved can be retained for a period before being shared with consumers. However, there is a natural and unavoidable floor to these cost reductions, dictated by the need to maintain the service performance standards that customers expect and deserve. Pre-emptively removing anticipated efficiencies from opex allowances is not consistent with the principles underpinning the base step trend approach, nor with the broader philosophy of incentive regulation, which relies on actual outperformance rather than assumed savings. This approach ensures that cost reductions are genuine and sustainable, without compromising safety, reliability, or customer service.

We note, there is the prospect that increasing disconnections may actually impose new costs. For example, network operators must plan for and manage the decommissioning or reconfiguration of assets. This process is complex and may necessitate additional expenditure to ensure that impacts on remaining customers are minimised and that the network continues to operate safely.

Aggressively reducing opex allowances, particularly when capex allowances are also under pressure, risks undermining network investment and maintenance. Such an approach could incentivise under-investment, with adverse consequences for service performance and customer standards. It is therefore essential that the regulatory framework recognises the asymmetric impact of declining connections and ensures that opex allowances remain sufficient to maintain service quality and safety.

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