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Commerce Commission
Via email: infrastructure.regulation@comcom.govt.nz

Tēnā koe,

Powerco supports the introduction of a hybrid mechanism

Powerco welcomes the opportunity to respond to the Commission's draft decision to introduce a demand variation revenue adjustment mechanism (the hybrid mechanism) as part of the Gas DPP4 reset. As previously stated in our submissions,¹ we operate in an environment of significant and increasing uncertainty regarding the future of gas supply and demand. Recent global events highlight again, how volatile the sector is, and how quickly it can change.

Summary of our position

Powerco endorses the hybrid mechanism as a proportionate tool to manage the unique forecasting uncertainties of the DPP4 period. However, to effectively mitigate the risk of consumer price shocks and to preserve the incentives for Gas Distribution Businesses (**GDBs**) to provide safe and reliable networks, the threshold must be set at a more realistic level.

To appropriately share risk amongst customers and GDBs, we recommend the Commission lower the threshold that triggers a hybrid mechanism to 5% a level more consistent with international precedents and existing reopener frameworks.

A 15% threshold is disproportionate. This would only achieve the Commission's intent if, the sharing formula is altered to include the full amount of the revenue variation.

Both of these options would ensure the mechanism remains a safeguard for material shocks while remaining accessible enough to actually provide the stability the Commission intends.

More detail on our response is set out below. Our position is supported by the joint submission of Firstgas, Powerco and Vector to this draft decision (**joint submission**), which provides detailed modelling of threshold scenarios and impacts².

¹ [Powerco submission, gas DPP4 issues paper](#), [Powerco submission, gas DPP4 draft decision](#)

² Separate submission made on 21 April 2026 to this consultation, includes modelling

A hybrid mechanism is appropriate

We appreciate the Commission's recognition that existing tools, such as the Customised Price-quality Path (**CPP**) are often resource intensive and slow to address sudden, large scale demand shocks efficiently.

Powerco supports the introduction of a hybrid mechanism as the preferred option because it provides for an automatic adjustment when certain conditions occur. We agree with the Commission that the automatic nature of this mechanism better promotes the Part 4 purpose by supporting the ongoing provision of safe and reliable services while maintaining incentives for efficient investment. In our view an automatic adjustment is superior to discretionary reopeners or the CPP because it:

- **Provides certainty and predictability:** an automatic process provides greater certainty to both consumers and suppliers about how large demand shocks will be treated within the regulatory period.
- **Reduces administrative burden:** a mechanical mechanism is significantly less resource intensive, for both the GDBs and the Commission, than a reopener or CPP.
- **Provides customer protection:** by allowing for in-period sharing of demand risk helps avoid the risk of substantial price corrections and rate shocks at the beginning of the DPP5 period.

While the hybrid mechanism is our preference, a reopener could also be workable, particularly as a secondary option more targeted at a significant event causing a major variance in forecast. However, for this to be an effective complement to the hybrid, the threshold would need to be the same as, or lower than, the existing reopener threshold rather than triggered by the same formula proposed for the hybrid mechanism.

The sharing of risk needs adjustment

While we support the hybrid approach, we believe the proposed +/-15% revenue shock threshold, with 50/50 sharing above that threshold, doesn't work as intended and is too high to address the issues identified by the Commission³. The reasons paper describes the 15% threshold as "reasonably high" to ensure it is only triggered by shocks that neither GDB nor consumers can manage.⁴ The Commission does not provide clear evidence or quantitative analysis to justify 15% as the appropriate tipping point for GDB viability or consumer harm/benefit.

The Commission notes concerns that a lower threshold would trigger the mechanism during normal, manageable demand fluctuations. However, as mentioned in our response to the draft decision, GDBs can only manage these demand fluctuations if we have the appropriate tools to manage that, such as appropriate allowances, uncertainty mechanism, and maintaining flexibility in our approach to capital contributions.⁵ While it is inevitable that some customers may transition from gas during the period, aggregate demand reductions will be reduced if mechanisms exist to support other customers who seek new and expanded connections. For example, by excluding growth

³ Commerce Commission, *Proposed amendments to input methodologies for Gas Distribution Services, Amendments related to the 2026 Gas default price-quality path, draft decision reasons paper*, 2 April 2026, at 2.33 – 2.39.

⁴ Commerce Commission, *Proposed amendments to input methodologies for Gas Distribution Services, Amendments related to the 2026 Gas default price-quality path, draft decision reasons paper*, 2 April 2026, at 2.32.

⁵ Powerco submission, gas DPP4 draft decision, pg 5.

capex in the draft decision, the Commission is removing a key tool that GDBs can use to manage the risk of declining volumes to minimise price rises for remaining customers in future regulatory periods.

In addition to the above, a 15% threshold is disproportionately high when compared to other established uncertainty mechanisms in the sector:

- **Reopener threshold:** standard change event / policy changes thresholds are typically set at 1% of the aggregated allowable revenue (or \$5million for Powerco's electricity business or \$2million for our gas).
- **International precedence:** in our previous submission we referenced the Jemena Gas hybrid mechanism in Australia, where a 5% threshold is applied. The Commission's proposed 15%, is three times higher than this.

Powerco has previously modelled that a demand fall far smaller than 15%, aligned with the Commission's stranding model, could result in \$8 million revenue shortfall over the five years to the end of RY31. This calculated revenue variation is a 6.2% variation in RY31 but less than 5% in the other 4 years, yet triggers significant concerns regarding underservicing and a projected 10% shock at the start of the DPP5 period.⁶

This previous modelling is supplemented by the modelling provided in the joint submission which illustrates that the 15% threshold places an excessive amount of forecasting risk solely on the GDB before any risk-sharing occurs and a lower threshold starts sharing a sustained forecast error earlier, which better protects GDB financeability under sustained under-recovery, and also better protects consumers in a higher revenue scenario.

Practically, a 15% annual threshold means that a GDB could lose a very high portion of its expected revenue over the five year period before receiving any relief, which still might unintentionally shift decision making toward short-term cost minimisation and away from the efficient long-term investment required, and still result in a price shock at the beginning of DPP5. For example, a 14.9% variance per year over the DPP4 period would not trigger the hybrid mechanism but we estimate it could create a 20% price increase for Powerco customers in RY2032.

For simplicity the mechanism applies on an annual basis, but it is the cumulative forecast error risk that is relevant in determining the appropriate threshold to apply. A lower, 5% threshold better recognises the cumulative impact.

The 50/50 sharing of revenue above the threshold as proposed by the Commission, does not share the risk evenly between customers and GDB as intended. For the risk sharing proportion to be truly 50/50, it needs to apply to the entire under recovery, not just the amount above the threshold. This is illustrated in Table 1 below, which shows the proposed commission approach, actually results in GDB bearing 70% of the under recovery risk, because only 20% of the under recovery is shared between GDB and customers.

Should the Commission determine that a 15% threshold is justified, then the sharing formula must be adjusted. This could be a 50/50 sharing of the full amount of the variation, or 70 (customer) / 30 (GDB) above the threshold both which equate to no more than 50% share to the consumer of the overall variance. This approach still avoids the full risk transfer to either party, which is consistent with the Commission's key economic principle of risk allocation.

⁶ Powerco submission, gas DPP4 draft decision, pg 9.

Table 1 Illustrative example of amount of under recover risk borne

| Under recovery amount | Under recovery shared | Threshold | Risk sharing approach | Actual share of revenue under recover risk borne by GDB | Actual share of revenue under recover risk borne by Customer |
|------------------------------|------------------------------|------------------|------------------------------|--|---|
| -35% revenue ⁷ | 20% | 15% | 50/50 | 70% | 30% |
| -35% revenue ⁷ | 35% | 15% | 50/50 | 50% | 50% |
| -35% revenue ⁷ | 20% | 15% | 70/30 | 60% | 40% |
| -35% revenue ⁷ | 30% | 5% | 50/50 | 57% | 43% |

Technical drafting

The proposed amendment to the DPP determination sets out the method of demand variation revenue adjustment in Schedule 7. This calculation uses the term 'assessment period' for the year of the calculation. While this is acceptable for a mechanism wholly contained in the DPP determination (as option 1 is), we note that the Input Methodologies (**IMs**) use 'assessment period' in a different context with a different definition. Should the final change be contained in the IMs (either option 2 or through alternative drafting), this will need to be resolved.

If you have any questions regarding this submission or would like to talk further on the points we have raised, please contact Emma Wilson at Emma.Wilson@powerco.co.nz

Nāku noa, nā,



Emma Wilson

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POWERCO

⁷ We have used -35% under recovery amount to align with the credit metric analysis conducted in the joint submission.