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Dear Dave,

Default price-quality paths for Electricity Distribution Businesses (EDBs) 2020–2025 – Draft decision

Thank you for the opportunity to comment on the Commerce Commission's (Commission) consultation on the default price-quality paths (DPP) for electricity distribution businesses (EDBs) for the third regulatory period beginning 1 April 2020 (DPP3).

General comments

To encourage monopoly distributors to optimise investments, reduce costs and provide a high quality service we believe both competition and regulation have a strong role to play.

The benefits of competition are evidenced in the retail sector. Over recent times electricity demand in New Zealand has remained relatively static and prices in the competitive parts of the sector (generation and retailing) are, in real terms, lower now than they were in 2011. However, in contrast, over the last ten years lines costs per kWh have increased by 24% above inflation, while energy and other non-lines costs per kWh have increased by only 3%. [1, 2, 3] The regulated monopoly lines costs represent around 27% of residential consumer bills so there is considerable scope to improve the efficiency.

The proposed DPP3 changes appear to continue the core components of the current DPP2 framework and the Commission should seek to address some of the challenges we see with the regulated market. We understand a revised weighted average cost of capital (WACC) is not open for consideration at this time but recommend this would provide the greatest incentive to drive competition and innovation across the EDB monopoly market and reduce costs for consumers. We consider the Commission needs to provide the right regulatory settings including revising the input methodologies and use of the 67th percentile WACC determination. As outlined in earlier submissions electricity lines businesses appear to be overcompensated for the level of risk they actually face and the current setting of WACC at the 67th percentile seems high.

Consumer focus

The DPP3 draft decision means the net allowable revenue for monopoly distributors will be 4.6% lower in 2020/21 than in 2019/20. However, during the remainder of the period the total allowed revenue will be approximately 6% higher in DPP3 than in DPP2 and as a consequence beyond 2021 it

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[1] All figures showing price changes over time have been adjusted for CPI inflation.
[2] MBIE: 'Sales-based electricity costs for residential' dataset.
[3] Made up of both transmission (up 33 % since Q1 2009) and distribution (up 22 % since Q1 2009) – breakdown from MBIE Quarterly Survey of Domestic Energy Prices

is anticipated prices may rise to reflect ongoing investments. These increases are likely despite the decrease in WACC from 7.19% to 5.13% - all else being equal. We understand the tension between investment and returning value to customers. The potential size of the pool available to customers if they were to receive all the available reduction would be approximately $400 million per annum.

Innovation allowance

We believe innovative activities are essential to boosting productivity and reducing the cost of network services over the longer term. We consider the existing incentives in the DPP including the Incremental Rolling Incentive Scheme (IRIS) mechanism, the quality incentive scheme and ability to include innovative capital expenditure in the regulated asset base for future return of capital and return on capital are drivers of innovation. However, we acknowledge that these incentives do not appear to be resulting in "innovative" network spend, including:

- Investment in low voltage monitoring;
- Investment in distribution system operator platforms to create third party markets, and
- Programs trialling demand response programs to contract third party resources.

We question whether the low uptake of innovation in the areas above is actually a result of a lack of approved regulated funding. To the contrary, some EDBs appear to have had sufficient regulated funds to invest directly in emerging technologies. However, to date there seems to be limited appetite to invest in innovation which supports the development of competitive network support markets. The majority of EDB's appear to be reluctant to move beyond the build, own, operate model and explore different operating models.

Whilst networks are able to freely invest regulated funds in contestable activities such as solar, batteries, EV chargers and other behind the meter consumer services, the need for an Innovation allowance is not compelling. The Commission must consider the impact the allowance would potentially have on contestable services and emerging third party network support markets, as these will play a critical role to ensure the distribution costs consumers pay are appropriate given technological changes

Accelerated depreciation

The Commission's new discretion under its input methodologies to allow for higher depreciation rates on distributor's network assets needs to be carefully implemented. We support the Commission's recent decision to reject requests by EDB's for accelerated depreciation on network assets.

We support the Electricity Retailers Association of New Zealand (ERANZ) submission.

We would be happy to discuss any details of our submission.

Yours sincerely,

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