28 May 2021

Andy Burgess (he/him)

Head of Energy, Airports and Dairy Regulation

Commerce Commission | *Te Komihana Tauhokohoko*

44 The Terrace | PO Box 2351 | Wellington 6140 | New Zealand

Dear Andy

FEEDBACK ON FIT FOR PURPOSE REGULATION

Alpine Energy Limited (Alpine Energy) owns and operates the electricity distribution network in South Canterbury. We welcome the opportunity to share our views on the emerging issues for electricity networks, gas networks, and airports and how the Commerce Commission (the Commission) should prioritise these issues when planning its work programme in the near term, as outlined in your open letter[1]. Nothing in our feedback is confidential or commercially sensitive.

The focus of our feedback is the:

(i) role we will play in supporting South Canterbury to realise decarbonisation goals;
(ii) reopener incentives under the input methodologies (IMs)[2]; and
(iii) start of the consultation for the next default price-quality path (DPP) reset.

Our views on all other matters are expressed in the industry feedback provided by the Electricity Networks Association (ENA).

WE CAN SUPPORT OUR SOUTH CANTERBURY COMMUNITIES TO REALISE THEIR DECARBONISATION GOALS

Over the last decade, we have had significant growth on our network as South Canterbury businesses have expanded and/or re-purposed their operations in pursuit of economic opportunities. Many also use fossils fuels, such as coal and diesel to run their operations, or a combination of multiple fuel sources including electricity. The Climate Change Commission's (CCC) recent draft advice to the government recognised the significant contribution provincial regions make to the New Zealand economy, communities, and culture. This is also significant contribution to New Zealand's emissions. Whether it be from farming, transportation, milk processing or other, our communities will be under enormous pressure to step up and play their role in meeting the government's decarbonisation goals while at the same time continuing to be a major contributor to the health of New Zealand's economy.

We are here to support the multiple sectors across our region to realise their decarbonisation goals by providing secure, reliable, and affordable electricity distribution services in South Canterbury.

[1] Commerce Commission, Open letter—ensuing our energy and airports regulation is fit for purpose, 29 April 2021.

[2] Commerce Commission, Electricity Distribution Services Input Methodologies Determination 2012, Consolidated 20 May 2020.

Decarbonisation will require many to change how they operate. Supporting our region will also require us to change and adapt, letting go of traditional ways of operating our electricity distribution network.

We will support our region by changing the services that we offer and the way we offer them. But change in an industry with assets that last 100 years takes significant planning and investment over time. We can rise to the challenge with a regulatory framework that supports us to innovate and invest today will see New Zealand realise its decarbonised future.

THE REOPENER INCENTIVE IS TOO CONSTRAINED TO SUPPORT A DECARBONISED FUTURE

The Commission foresaw the disruption and uncertainty that decarbonisation would bring to the electricity industry when resetting the DPP in 2019. To address the disruption and uncertainty, the Commission amended the reopener incentive in the IMs.

In the DPP3 Reasons Paper,[3] the Commission recognised that—

> *'There is potential for increases in process heat electrification, connection of new sources of distributed generation, or relocation of assets in response to other infrastructure investment activity. This could have a significant impact on distributor's investment needs Given this, and the difficulties in predicting the timing of these developments, we consider reopeners are the best way to enable distributors to undertake such investments.'*[4]
>
> **[And]**
>
> *'The aim of the reopeners is to ensure, where possible, that distributors are able and incentivised to undertake the investment required to meet one-off sporadic and changing needs of external stakeholders. In particular, this will ensure that distributors can connect and manage significant new demand and low carbon technologies as New Zealand increases its focus on decarbonisation, while maintaining network reliability and meeting the long-term interests of consumers.'*

However the Commission constrained the reopener incentive in several ways, including by—

- Setting a collar so that the additional expenditure must value at least 1% of forecast net allowable revenue or $2 million (whichever is less); and
- Setting a cap of $30 million for the cumulative additional expenditure for all projects applied for in any disclosure year; and
- Requiring that the investment be evidenced as being required to a high degree of certainty.[5]

When the Commission set these constraints as an industry, we had limited understanding of the magnitude of the investment needed to manage the new demand and low carbon technologies to deliver a decarbonised future. Accordingly, most Electricity Distribution Businesses (EDBs) did not include significant expenditure in their 2018-2028 asset management plan (AMP) forecasts. It was only fair that the Commission took a conservative approach to set the reopener constraints and fell back onto the customised price-quality path (CPP) process for those EDBs that needed a step-change in their expenditure allowances.

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[3] Commerce Commission, Default price-quality paths for electricity distribution business from 1 April 2020 – Final decision, Reasons Paper, 27 November 2019.

[4] Supra n3, paragraph X93, on page 34.

[5] Ibid n4, paragraph 4.42 on page 77.

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Because of the work done by the CCC, we now have better indicators of the investment that New Zealander's will need to make in a decarbonised future. The investment needed is staggering and represents a step-change in investment in electricity distribution capacity. Accordingly, the constraints negate any incentive that the reopener intended, as cumulative applications by EDBs will fail to meet the requirements of the reopeners and they will be forced to apply for a CPP.

The collar at 1% of net forecast allowable revenue, or $2 million (whichever is the least), is material. Further, the IRIS imposes a disincentive to risk expending more than what was set under the DPP allowances. When setting DPP3, the Commission recognised the disincentive created by the IRIS to undertake investment in response to new sources of demand and generation on EDBs networks.[6] However, the Commission then constrained the reopener incentive with a collar, which presents a material disincentive negating the incentive to apply for a reopener.'

Decarbonisation projects are likely to be large complex projects undertaken over several years. However, under the IMs, the capitalisation of the project costs will occur in a single disclosure year. Meeting the government's decarbonisation goals is likely to see the industry exceed the $30 million cap placed on reopeners in any given disclosure year. Particularly when several decarbonisation projects (or one very large project) are commissioned in a single disclosure year.

Meeting the government's decarbonisation goals will require more electricity distribution capacity to be built. The conversion of coal-fired plants to electricity will increase demand to a level that requires a step-change in network capacity to support it. Electricity networks are built with spare capacity that can absorb some, if not all, of the increase in demand from a new customer or customer upgrade in the normal course of business. Usually, any customer connection or upgrade cost is minimal. It is recouped directly from the connecting customer and where there is a shared benefit, rolled into the regulated asset base (RAB) and recovered over time from all customers.
However, where a step change in network capacity is needed, it is more efficient to augment early on to cater for and encourage connections and upgrades, whilst maintaining spare capacity in the network. The DPP allowances do not provide for a step-change in investment as they are set on our AMP forecasts and capped at 120% of actual historical spend. It is likely that we will need to apply for a reopener to fund the necessary investment to facilitate decarbonisation on our network. The challenge is that to build efficiently, we will need to do this before we have resolute commitments from most customers.

We may get some customers that are willing to commit, but those customers risk a first-mover disadvantage. Without long-term funding, we will need the customers who first connect or upgrade, to fund a higher proportion of the initial investment in the network than may be the case for those customers who wait and convert after the assets are built. Astute customers will delay their plant conversion until others have moved first, thereby avoiding first-mover disadvantage. This delay in investment constrains our ability to support our region in meeting New Zealand's decarbonisation goals.
When the Commission amended the reopener incentive in 2019, they did so for all the right reasons, and the intentions were sound. However, the Commission failed to appreciate the quantum of the investment

[6] Ibid n5, Table 3.1 on page 69.

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needed by to support the conversion of existing dairy plant power supplies from coal boilers to electrification.

The reopener constraints, though well-intended, represent a significant barrier to an EDB successfully accessing the funding needed to invest in their networks to the level required to support decarbonisation under the DPP. Without appropriate reopener provisions, EDBs will be forced to put a CPP application to the Commission to fund the investment required to meet the government's decarbonisation goals. We urge the Commission to review the reopener incentives as a priority, when considering how it will support the government's decarbonised future.

START CONSULTATION ON DPP4 IN EARLY 2022

Decarbonisation is important, and we must get it right. To get it right, we will need comprehensive engagement with all stakeholders. Leaving the reset to the normal five-year review process (i.e., starting the reset in mid-2023) will not deliver a regulatory framework that supports a decarbonised future.

Accordingly, we ask the Commission to bring forward the EDB DPP4 reset to the start of 2022 so that all stakeholders can engage as soon as is reasonably practicable.

CONCLUDING COMMENTS

We hope the Commission finds our feedback helps identify the emerging issues for electricity networks, gas networks, and airports and how the Commission should prioritise these issues when planning its work programme in the near term.

Yours sincerely

Andrew Tombs
Chief Executive
Alpine Energy