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12 July 2024

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by email: infrastructure.regulation@comcom.govt.nz
(subject line "Submission on EDB DPP4 draft decision")

**Submission on EDB DPP4 draft decision**

Thank you for the opportunity to provide feedback on the Commerce Commission's (Commission) Default price-quality paths for electricity distribution businesses from 1 April 2025 – Draft decision Reasons paper dated 29 May 2024 (the Draft Decision Paper).

EA Networks has participated in the preparation of an industry response via Electricity Networks Aotearoa (ENA), and we endorse and support the views presented in that submission, subject to the points and emphasis raised in our submission below. The ENA submission is a considered and collaborative effort among the membership, which seeks to provide reasoned and balanced feedback on the Commission's draft decisions. The majority of ENA membership are businesses that are owned by the customers they serve (via one mechanism or another), and members are uniquely placed to objectively comment on the trade-offs between cost impacts on customers and longer-term incentives to invest to meet customers' needs.

EA Networks is a consumer owned cooperative. Our customers are at the heart of every decision that we make. It is important that we maintain a viable business model going forward, and this submission highlights areas of particular importance for our business.

***Balancing pricing impact with service levels***

EA Networks recognises the balance that must be reached between moderating the immediate price impact on customers and the longer-term incentives for electricity distribution businesses (EDBs) to invest in, maintain and innovate to provide services to meet our customers changing needs.

We support the Commission's approach to ensure that costs that relate to this fourth default price path (DPP4) regulatory period are recovered within the DPP4 period. We consider that investment incentives would be eroded if this were not the case. For this cost recovery to work, we acknowledge that an initial step change in price is required, and we support the smoothed (moderated) approach in the Commission's draft decision.

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We note that moderating the initial increase, while insuring that EDBs are able to recover costs within the five-year regulatory period, unavoidably means that revenue (and therefore prices) are "kicked up" in the final years of the regulatory period. For our situation, all other factors remaining unchanged, we will finish the regulatory period with revenue almost 20% above actual costs for that year. At this point we will be moving to a new regulatory period (DPP5) where we envisage that capital and interest costs could be lower, and the kick-up created by the Commission's smoothing will compound the price volatility as we move to the revenue allowance in DPP5.

We have observed that, while our price increases are passed through to customers, price reductions are often not passed through, or not fully reflected in retail pricing. An example of this occurred recently when we were required to pass through settlement residual rebates. These rebates typically accumulated to between $1m and $2m per year, and we observed no recognition of this transfer in retail price adjustments that followed the change.

With the possible price volatility created, and the impact on customers, we submit that the initial step change should not be moderated further than the level proposed in the draft decision. In fact, there may be some benefit in allowing a greater initial step change for those distributors that currently have a higher rate of change (X-factor).

***Undercharging limit***

The Draft Decision Paper recognises that the undercharging limit will allow EDB's, where they are able, to provide additional smoothing (paragraph X16.3). Notwithstanding our comment supporting the importance of allowing full recovery within the regulatory period, we support the flexibility to be able to mitigate impact on customers.

However, the 10% limit is insufficient to address the volatility that we expect the Commission's draft decision will create. If we choose to address the issue then, in order to provide a smooth price path for customers, we would need to defer around half the price increase in years 4 and 5 of the regulatory period and instead recover that revenue in the initial years of the following regulatory period (in the absence of any other changes).

The proposed revenue path defers revenue recovery to the end of the regulatory period, and for our situation we estimate that year 4 will carry close to a 10% loading, and year 5 close to a 20% loading. To realistically mitigate the step change that would follow, we need the ability to defer a significant portion of this recovery.

We understand that the undercharging limit is set to address the price shock that might occur if a distributor builds up a large allowance, and then recovers that through a step change. This concern is instead addressed via the revenue smoothing limit, and in our view, a further restriction is not warranted.

With these factors in mind, we submit that the undercharging limit should be increased to a level where it provides genuine flexibility to address volatility (in the order of 20% for our situation), or should be removed altogether.

***Inefficient focus on Opex***

We observe that the majority of the uplift in prices is driven by external factors, mainly the risk-free rate and inflation. In comparison, the change in our operating expense allowance is a relatively small factor, yet it has a significant impact on services to customers.

The draft decision significantly restricts our proposed operational expenditure which will force us to consider curtailing planned improvements and services.

We also note that price impact on customers is a function of increases in both capex and opex, which to some extent are interchangeable. In this context, EDBs that have lower capex requirements might reasonably expect greater leeway for anticipated operational expenditure (and vice versa).

We support the inclusion of the industry specific 0.3% uplift that the Commission has allowed within the forecast cost escalator. We note that the industry specific metric ("EGWW LCI" in the Draft Decisions Paper) has remained between 1% and 2% above the all-industry LCI over recent years. Setting the uplift at 0.3% (based on a five year average) would appear to allow us to "catch up" on historic higher inflation in the sector, but it is not clear how it might address the continued higher inflation that the Commission expects to persist (paragraph C291). Consistent with the way other cost metrics are set for the regulatory period, this uplift allowance might more reasonably be set based on the difference observed in the base year, which is close to 1%.

Finally, the 5% limit that the Commission has proposed to apply to the combined step changes inefficiently binds those EDBs that face more of the increases than others. An EDB that faces just one of the five approved step changes (excluding CPP specific costs) is allowed a full 5% step change for that increase, whereas an EDB that faces all five cost increases is only allowed an average of 1% for each cost increase.

For perspective, we observe that the highest combined request across the five approved step changes amounts to 9.8% of total opex, which does not appear to us to be out-of-step with the 25% step change that is being allowed for capex.

We acknowledge that it is appropriate to apply some scrutiny to the magnitude of each of the step changes to ensure that the expenditure aligns with the magnitude of the additional cost, and this would suggest that a more granular approach would provide better outcomes.

We submit that the opex restrictions in the draft decision should be reconsidered and eased, recognising the points noted above. We further submit that the step change limits would be more efficiently applied using a limit set for each of the five approved step changes, rather than a combined limit for the total.

***Support 0% partial productivity factor***

We support the Commission's draft decision to apply a 0% partial productivity factor. This factor is intended to reflect sector or economy wide changes in productivity. On this front, our forward-looking view is that we will face increased (rather than reduced) costs across the industry in terms of safety, regulation and compliance obligations. We observe the wider economy is not showing productivity improvement, and we support leaving the factor at 0%.

We also note that the demand for our service is changing, and our focus is naturally drawn to meeting the new customer demands during this period of change. A focus on aligning with economy-wide productivity improvements that might be available will more naturally occur after this period of changing demand.

***Planned outage buffer***

The Commission proposes to halve the planned outage buffer from 200% to 100%. This buffer was put in place to accommodate the additional planned work that EDBs expect to undertake. To an extent, the updated reference period will have captured this change for some EDBs. However, some EDBs are yet to see this transition, and others are still ramping up.

We consider that this change is in conflict with the expectation that EDBs will increase the resilience of their networks and respond to changing customer needs through more planned work. The draft decision may see many distributors falling on the penalty side of the incentive, which is not a desirable outcome when much of this work is for, or in response to, customer demand.

We propose that a reduction to a 150% buffer would provide a better compromise between the need to transition to more planned work and the interests of customers affected by that work.

***Planned outage incentive is not symmetrical***

The draft determination released with the Draft Decision Paper sets out a quality incentive allowance as a recoverable cost. A positive quality incentive adjustment provides an additional revenue allowance, and a negative adjustment would reduce the revenue allowance.

The quality incentive adjustment is calculated as:

The **quality incentive adjustment** is—

(a) for each **non-exempt EDB** the lessor of:

(i) the sum of:

A. $(SAIDI_{unplanned,target} - SAIDI_{unplanned,assessed}) * IR$; and

B. $(SAIDI_{planned,target} - (SAIDI_{B} + (SAIDI_{N} * 0.384615)) * 0.65 * IR$; and

(ii) the **revenue at risk**; and

(b) after calculating the sum in subparagraph (a), as applicable, that sum is adjusted for the time value of money by multiplying the sum in accordance with the following formula:

In relation to this formula, applying the lessor of the calculated incentive or the revenue at risk (which is always a positive number) does not cap the incentive when it is a negative value. This creates a non-symmetrical incentive, where the penalty can significantly exceed the intended 2% revenue at risk intended by the Commission.

We support the decision to cap the revenue at risk at 2%, and to apply the incentive symmetrically above and below the SAIDI target. We request that the mechanism in the determination be adjusted to reflect this intention.

(We also note that the equation part (a)(i)(B) has three opening brackets but only two closing brackets).

***Exclude customer driven Capex from IRIS***

We are facing significant demand for changes to our network to accommodate new and increased loads.

By number, the vast majority of these upgrades will not meet the large connection contract (LCC) mechanism set out in the draft decision. We also face situations where customers seek terms for upgrades or upgrade options in a timeframe that would not allow us to consider the option to apply the LCC provisions, and the service (and revenue) is often not a discrete service that would allow the LCC provisions to be applied. For example, upgrades to provide new capacity often provide capacity that is then shared by existing and future customers, and the discrete "Transpower new investment agreement" approach which the LCC appears to be modelled on is not workable in these situations).

Where we face customer driven capital expenditure that exceeds the allowance in the DPP, we then also face an incremental rolling incentive scheme (IRIS) penalty in relation to that expenditure – this penalty exists regardless of where it manifests as a reduced capex reward, or a greater capex penalty within the IRIS.

We have few options to address this penalty. The more obvious options are either to defer the upgrade until it can be accommodated under future regulatory resets, or to seek a greater capital contribution from the customer initiating the upgrade (thereby reducing our capital expenditure on the upgrade). Both of these options represent a barrier for the customer, which may delay the very decarbonisation transition that we are seeking to support.

More generally, we have little control over the quantum of customer driven capital expenditure, and it is inappropriate to penalise EDBs where there is greater demand for their service (or indeed, to reward EDBs where demand for their service diminishes).

To address this issue, we request that customer driven capital expenditure is carved out of IRIS. We acknowledge that this would not fully address the issue, as we are not provided with a revenue allowance to cover capital or operating costs associated with any upgrade within the regulatory period, but it would go a long way toward facilitating customer driven changes over the next five years.

***Enhanced Innovation and non-traditional solution allowance***

We support the Commission's draft decision to include an Innovation and Non-traditional Solutions Allowance (INTSA), capped at 0.6% of DPP4 allowed revenue, and to allow for collaborative application of that allowance in conjunction with other EDBs (paragraph D65 in the Draft Decision Paper).

We envisage pursuing innovation where success will provide a benefit (in terms of improved service and/or lower cost) to our customers. We would like the proposed policy criteria to be adjusted to capture the uncertainty associated with innovation, rather than requiring the innovation to be "riskier than business as usual".

We also note that, while an INTSA allowance might be provided, the Commission has previously decided that the expenditure associated with that allowance will be taken into account for the assessment of the opex IRIS. We consider that this undermines the very purpose of the INTSA allowance, as the penalty (or reduced reward) under IRIS will diminish the value of that allowance by 33% (the opex retention factor).

***Improving depreciation allowances***

We acknowledge the changes that the Commission has proposed to improve the accuracy of depreciation allowances within the building blocks allowable revenue calculation. One aspect of the previous averaging approach appears to remain – for assets commissioned within the regulatory period, an arbitrary 44 year depreciation life is assumed.

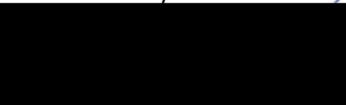
To an extent we are moving away from traditional network capacity solutions, and instead implementing technological solutions that utilise our capacity more efficiently – enhanced protection systems, dynamic control arrangements, and software solutions. While these alternatives are pursued where they have a lower overall cost than the traditional solution, they do tend to come with shorter depreciation lives.

To reflect this change, and to improve the depreciation allowance more generally, we request that the Commission consider using each EDBs forecast average depreciation life for assets that are expected to be commissioned in the regulatory period.

***Concluding remarks***

Thank you again for the opportunity to provide feedback. If you have any queries regarding these comments, please feel free to contact on or at anisbet@eanetworks.co.nz.

Yours sincerely



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