Via email to infrastructure.regulation@comcom.govt.nz

21 February 2024

Transpower's individual price-quality path for the next regulatory control period

Mercury welcomes the opportunity to provide feedback to the Commerce Commission (the Commission) on its issues paper *Transpower's individual price-quality path for the next regulatory control period* (Issues Paper), 25 January 2023.

Mercury is committed to ensuring the energy transition is affordable and the energy system is secure, resilient and supports economic development and productivity growth.

Mercury agrees with the Commission's approach for considering how to apply the regulatory tools within Transpower's Regulatory Control Period 4 (RCP4). We agree that Transpower's RCP4 proposal should be consistent with an expenditure outcome that represents the efficient costs of a prudent supplier of electricity transmission services and best promotes the long-term benefit of consumers.

Within the context of these tools, our submission focuses on the Commission's general approach to revenue smoothing over RCP4. Mercury agrees that in implementing revenue smoothing, the Commission should consider:

- Minimising price shock risks to consumers; and
- Not imposing undue financial hardship on Transpower.

Mercury notes that these considerations are in general the same as for the EDB DPP4 and as such we refer the Commission to our prior submission.[1] Our present submission, in turn, expands on the need to minimise price shocks while maintaining Transpower's incentives to invest, that is:

- Customers and industry need a clearer view of the overall impact of changes in input prices on retail prices; and
- We need to continue to have an open conversation about how retail prices may change through the energy transition.

Our submission expands on these points.

Customers and industry need a clearer view of the overall impact of changes in input prices on retail prices

In the issues paper, the Commission sets out 16 scenarios for smoothing Transpower's allowed revenue over RCP4 with a focus on 4 scenarios as illustrated in the following graph.

[1] Mercury-DPP4-issues-paper-submission-19-December-2023.pdf (comcom.govt.nz)

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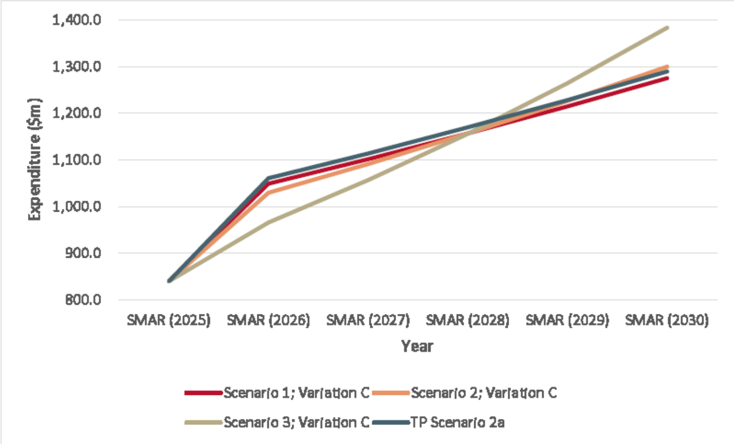
Figure 10.2 Illustration of smoothing scenarios provided by Transpower in response to our section 53ZD notice



Source: Issues Paper Figure 10.2

The Commission's preliminary view is that the main benefits of Scenarios 1 and 2 are the lower annual revenue growth rate and the projected almost neutral closing inter-period smoothing into RCP5. However, both scenarios entail a step change of over 20% between RCP3 to RCP4 in 2025, that is:

- Scenario 1, variation C has the lowest annual growth rate of the scenarios during RCP4 itself with a step change between RCP3 and RCP4 of 24.9%, and an estimated step change between RCP4 and RCP5 of 1.9%; and

- Scenario 2, variation C has a change of 22.6% transitioning into RCP4, and near neutral transition out of RCP4 (0.01%) compared to Scenarios 1 and 3, with a slightly higher growth rate of 6.0% during RCP4.

The Commission notes that the 24.9% step change is largely due to external factors such as cost increases and change in WACC, with a small amount reflecting increased investment. Mercury accepts that changes in the SMAR due to changes in external factors are necessary in order to maintain the integrity of the regulatory regime and therefore maintain the incentives for Transpower to invest. The Commission, however, also states:

> *Although an increase in transmission charges overall of 24.9% might still be considered more than moderate, we expect this would convert to an average consumer electricity bill effect of approximately 3% or less, which we would not consider to be a price shock at the consumer level.*[2]

Mercury requests that the Commission clarify its definition of price shock. It is important that customers and industry have a clearer view of the impact of changes in input prices on retail prices.

We need to have an open conversation about how retail prices may change through the energy transition

Mercury supports the Commission's intent where it states:

> *While our focus will be on the pricing impacts to direct customers of Transpower's electricity transmission services, we are mindful of consumer price shock effects. We will consider whether the potential revenue step change results in a price shock from RCP3 into RCP4, in conjunction with the revenue impacts of our decisions on EDB DPP4.*[3]

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[2] Issues Paper, footnote 208
[3] Issues Paper, paragraph 10.53

Mercury considers that it is crucial for the government more generally to form an ongoing, forward-looking view of the potential effect of changes in the price of input factors on electricity retail prices. The Commission should be involved in this process by providing transparency regarding its decisions and expectations of the impact of RCP4 and EDB DPP4 regulatory settings on retail prices.

As noted above, the Commission has some discretion to determine the rate of change in Transpower's allowed revenue to not impose undue financial hardship on it and to minimise price shock risks on consumers. Exercising this discretion, however, may become increasingly challenging as there are an increasing number of other input factors that may impact on electricity retail prices.

These other input factors may include near term inflation, cost of capital, growth in intermittent generation resulting in increased spot market volatility, the price of NZ ETS units, as well as skilled worker shortages and supply chain issues.

In addition, a larger concern we have is that the full range of factors highlighted above span the Commission, the Electricity Authority, MBIE, and the Ministry for the Environment, which then impact distributors', Transpower's, retailers' and generators' investment and pricing decisions. Presently, there is no single view of how these decisions might come together and impact in total on retail prices.

Even though these changes may be considered individually, it is also important to consider both the cumulative impact of these changes on electricity prices and the fact the impact may be front loaded in the early stage of the energy transition. The cumulative effect of price changes has the potential to also impact affordability of electricity, the rate of electrification, and ultimately support for the energy transition.

In response to the Commission's EDP DPP4 issues paper consultation, Mercury submitted that the Commission hold specific issues-based workshops on its assessment of price shocks to consumers. Mercury reiterates the need for a workshop, particularly when the Commission considers, as noted above, whether the potential revenue step change results in a price shock in the transition between regulatory periods for both Transpower and EDBs.

Mercury looks forward to engaging with the Commission and industry stakeholders further on Transpower's RCP4.

Yours sincerely,

[redacted]

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