Major Electricity Users' Group

Promoting a robust electricity market

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Dear Ben

Electricity Distribution Businesses DPP4 – Draft decision

1. This is a submission from the Major Electricity Users' Group (MEUG) on the Commerce Commission's draft decision paper "*Default price-quality paths for electricity distribution businesses from 1 April 2025 – Draft decision*"[1] and supporting material published for consultation on 29 May 2024.

2. MEUG members have been consulted on the approach to this submission. Members may lodge separate submissions. This submission does not contain any confidential information and can be published on the Commission's website unaltered.

Summary of MEUG's points

3. The Commerce Commission's decisions for the 16 regulated electricity distribution businesses (EDBs) for the next regulatory period (DPP4) from 2025 to 2030, alongside decisions for Transpower's RCP4,[2] will have a significant impact on electricity consumers across New Zealand. These draft decisions are being made during a cost-of-living crisis and slowing economy, alongside the need to decarbonise, and increasingly electrify, our economy. The decisions also come at a time when electricity wholesale prices are remaining stubbornly elevated, with no sign of decreasing in the short term, despite the push for greater renewable energy.

4. MEUG has reviewed the draft decision at a high-level, with our comments focused on the areas of greatest impact to our members. We have not provided comments on technical matters, where we expect the Commission will need to balance its view of consumers interests against the detailed analysis and technical matters that will be raised by the regulated EDBs during the consultation period.

[1] https://comcom.govt.nz/__data/assets/pdf_file/0031/353983/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2025-Draft-reasons-paper-29-May-2024.pdf
[2] https://comcom.govt.nz/__data/assets/pdf_file/0025/353860/Draft-Decision-for-Transpowers-IPP-commencing-1-April-2025-29-May-2024.pdf

5. MEUG appreciates the trade-offs that the Commission has had to make during this DPP reset, balancing the need for increased investment in the distribution networks, against the uncertainty facing the energy sector and the price shocks facing all consumers. In summary, MEUG states that:

- The financial impact of this draft decision will put pressure on all electricity consumers, particularly when considered alongside forecast increases in transmission charges and the wholesale electricity spot price. It is essential that government consider the total forecast price consumers are facing, not just the components in isolation, and whether this supports the long-term interests of consumers, as required by the Commerce Act.

- We support the Commission's draft decision to reduce the level of capital expenditure (CAPEX) approved, below that sought by EDBs in their Asset Management Plans (AMPs). However, we do not support the use of the 125% limit for setting CAPEX allowances and believe that the low-cost approach of a DPP regime does not provide sufficient scrutiny of expenditure sought for the next regulatory period. We recognise that many EDBs may seek reopeners to deal with the increased need for investment – it is important that this process is robust and incorporates proper consumer engagement.

- We are reasonably comfortable with the approach taken to forecasting operational expenditure (OPEX), with the use of a 5% limit. However, we still have concerns with the use of the base-step-trend approach, which relies on the assumption that historic expenditure is efficient and prudent.

- We support continuation of a five-year regulatory period and smoothing the revenue across the period. However, as noted in our submission on Transpower's draft decision,[3] we would prefer a smoothing profile that weighted a higher proportion of funding to be recovered in the later years, enabling EDBs to address deliverability concerns and demand uncertainty first, while acknowledging the compounding cost pressures facing electricity consumers.

- We support the introduction of the Innovation and Non-Traditional Solutions Allowance (INTSA) scheme. It is important that EDBs are incentivised to innovate, pursue demand-side management and energy efficiency initiatives. We recommend that the process for INTSA applications is streamlined and does not disincentivise use of these options over Business as Usual (BAU) approaches.

- We support the continuation of the existing measures for quality standards. We recommend that the Commission look at introducing a quality standard or reporting requirement around network capacity. It is important that EDBs are incentivised to optimise use of the existing network, ahead of new investments.

- There are several broader issues, that while out of the exact scope of the DPP4 process, have impacted and will continue to impact on the regulatory framework for EDBs and the magnitude of distribution charges that consumers will face. We outline these concerns and call for greater effort from Government to address issues.

6. To support this submission, MEUG has commissioned NZIER to prepare a short report that considers the suitability of the low-cost light-handed approach to DPP regulation and the combined impact of the DPP decisions on the total cost of energy and how those increases along with wholesale market price pressures and supply constraints could affect the pace of electrification. A copy of NZIER's report is provided in **Attachment 1**.

[3] http://www.meug.co.nz/node/1373

Context facing MEUG members and affordability issues

7. MEUG's members connect to the electricity system in a variety of ways – some businesses connect directly to the transmission system, some directly connect to the distribution network, while other members connect through a retailer, like many consumers across New Zealand. Our members collectively engage with many of New Zealand's 27 electricity distribution businesses (EDBs); therefore, the Commission's decisions for the 16 regulated EDBs are of great interest and relevance.

8. It is important to understand that the financial impact on our members from these decisions will be of a scale much greater than that quoted for the average household – in the order of millions. This will increase the input costs for businesses, impacting profitability, particularly those exposed to international commodity markets – it should not be assumed that these increases can simply be passed through.

9. In addition, the actual customer impact of these increases will only really be understood by seeing how regulated businesses apply their current distribution pricing methodologies, the timing and approach of how retailers pass through these charges in RCP4 (and the rate of increases over the full five years). Consumers are also facing increases across the several other components that factor into electricity pricing for 2025 to 2030:

   - There is expected to be an uplift in transmission charges from Transpower's base expenditure sought through RCP4.
   - There will also be an uplift in transmission charges, resulting from major capex proposals such as NZGP1.
   - Alongside these regulated components, there is also an expected increase in the wholesale electricity price, which has more than doubled in the last six years.

10. As discussed in our submission on the EDBs DPP4 Issues Paper,[4] we recognise that the Commission can only consider the price impact of each regulated component in isolation. However, we repeat our call for Government to consider how it can look at the overall impact of electricity prices and whether the total level of forecast investment into the electricity system results in affordable prices for both consumers and businesses.

Approach to setting CAPEX still needs refinement

11. MEUG supports the Commission's draft decision to reduce the level of capital expenditure (CAPEX) approved, below that sought by EDBs in their Asset Management Plans (AMPs). We:

   - Remain unconvinced that the EDBs will be able to deliver such as substantive uplift in network investment. The Commissions states that EDBs have not been able to provide the necessary reassurance[5] to address this concern and recognise that deliverability is also an issue impacting Transpower. In this case, the Commission is proposing reductions to Transpower's work programme to reflect this deliverability issue for RCP4.
   - Are unconvinced that the demand may grow at the rate predicted by many of the EDBs. There has been a dampening in electricity demand following the change in government energy policy and a slowing economy – signalling that the EDBs estimates may be too optimistic. From our work with NZIER (see **Attachment 1**), there also seems to be inconsistences between demand forecasts outlined by Transpower and those provided by some EDBs.

[4] http://www.meug.co.nz/node/1335
[5] See paragraph 2.18, draft decision paper.

12. MEUG also questions the use of the 125% limit for setting CAPEX allowances. We are not convinced that sufficient justification has been given to move away from the 120% limit applied for DPP3. There may be higher forecast expenditure, but there is also greater uncertainty. We enquire if the Commission has undertaken CAPEX modelling applying the 120% limit and what impact this had on forecast revenue

13. Alongside these points, MEUG also considers that a reduction in CAPEX allowances is justified given the level of scrutiny applied for this reset. We do not believe that sufficient scrutiny is possible through the Commission's low-cost DPP regime, and given the scale of increased investment, consumers cannot be reassured that they may be overpaying for network investment. MEUG notes that:

    - The Commission has indicated that its own review of a selection of AMPs has indicated that "that it would be inconsistent with a relatively low-cost regime to undertake the level of assessment required to obtain assurance from AMPs".[6]
    - The findings of the IAEngg's review and significant variations in EDBs expenditure also raises questions about whether consumers can have confidence in EDBs' projected expenditure.

14. A conservative approach is therefore the best approach, enabling EDBs to seek reopeners or CPPs when greater information is available. We outline in the concluding section of this submission why, in the long-term, we consider that Individual Price-quality Paths (IPPs) may be the best option to oversee investment of the larger EDBs.

<u>Role of capital contributions and large connection contract mechanism</u>

15. MEUG welcomes discussion of how capital contribution will be treated through DPP4, and how these are expected to help support the connection or expansion of many business and industrial loads on the distribution network. We support the Commission reviewing the DPP4 decisions following the Electricity Authority's work on mandating efficient connection pricing (paragraph B147) and the Commission looking at additional reporting around capital contribution policies by EDBs (paragraph B252). The capital contribution process is used by many MEUG members when connecting or increasing capacity to their sites.

16. MEUG supports the introduction of the Large Connection Contract (LCC) mechanism for DPP4. The LCC mechanism seems good in principle, but its usefulness will only be determined through its application by EDBs in coming years. MEUG is happy to provide feedback on this mechanism if it is used with our members.

<u>Reassurance needed of EDBs' deliverability of investment plans</u>

17. Given concerns with deliverability, MEUG strongly support the introduction of an annual deliverability report, or similar mechanism, for DPP4. If designed well, this would provide interested consumers with a clear understanding of how work on the network is progressing, the achievements made, and the reasoning for any delays.

18. We recognise that much of this information will be available via the Information Disclosure schedules completed annually by EDBs. However, we do not believe these documents are the most consumer friendly and require a degree of network knowledge to seek the information that will be of most important to a consumer. Given experience with CPP deliverability reports and proactive customer engagement by some EDBs, we encourage the Commission to look at what is best practice in this area, and what a simple template may look like. Testing this with consumers would also be a valuable step, to ensure its effectiveness.

[6] Paragraph 2.33, draft decision paper.

Use of reopeners

19. The use of re-openers is discussed multiple times in the draft decision paper, as an alternative mechanism available to EDBs if they require more CAPEX or OPEX for investments or projects (rather than a CPP). We are comfortable with the introduction of more re-opener provisions, on the provision that the reopener process is well resourced, is robust and consumers get transparency of both the application and decision. The current two-week consultation period for recent re-openers is considerably short, particularly when decisions are being made during a busy period of consultation. A slightly longer timeframe would be preferred, particularly for any large or complex reopener applications.

20. In addition, we encourage the Commission to require the EDBs to demonstrate how they have consulted with impacted stakeholders as part of the reopener application process. This would go some way in addressing concerns about whether the long-term interest of consumers has been duly considered.

Comfortable with broad approach taken to OPEX allowances

21. MEUG is reasonably comfortable with the approach the Commission has taken to forecasting OPEX, and the resulting OPEX allowances for the regulated EDBs over 2025 – 2030. We support the use of the 5% cap to the level of approved OPEX step changes in DPP4. This recognises the rising costs facing EDBs going forward, while still keeping pressure on efficient costs and ensuring the EDBs have clear rationale for any step changes.

22. We support *Draft decision O1.1*, applying a base-step-trend-approach to forecasting OPEX, as this ensures consistency between regulatory periods, and is an approach that is well understood by EDBs and interested stakeholders such as MEUG. However, we still have concerns with this approach as it relies on the assumption that historic expenditure is both efficient and prudent. We remain unconvinced that this is the case, and reports such as the Cambridge Economic Policy Associates (CEPA) draft report "EDB Productivity Study"[7] prepared for the Commission hints at issues with inefficiency and that New Zealand EDBs may not be performing as well as their international peers. We encourage the Commissions to continue to monitor the performance of EDBs closely, particularly with greater levels of OPEX forecast.

23. MEUG recognises that insurance costs across the country are rising for both businesses and households. However, the cost for regulated monopolies in electricity distribution and transmission sectors seem to be increasing at a much greater rate, primarily due to increases in occurrence and impact of severe weather events. We recommend that the Commission, EDBs and its supporting body, Electricity Network Aotearoa (ENA) investigate other options for insurance for electricity infrastructure to provide more cost-effective cover. This could take the form of a government body such as the Natural Hazards Commission (formerly EQC).

24. We note that only some EDBs have sought additional funding for consumer engagement during DPP4 (as summarised in Table C4). This raises questions about how consistent the approach to consumer engagement is across the 16 regulated EDBs and how EDBs may be performing in this space. We encourage the Commission to continue to monitor the type of customer engagement that is undertaken in DPP4, and what might be considered best practice.

Revenue path

25. We support continuation of a five-year regulatory period for DPP4. We do not believe the benefits of moving to a four-year regulatory period, to address uncertainty, outweigh the administrative burden of having to undertake the DPP reset process more frequently.

[7] https://comcom.govt.nz/__data/assets/pdf_file/0018/348111/CEPA-EDB-productivity-study-draft-report-March-2024.pdf

26. We support the Commission's decision to smooth the revenue recovery across the full DPP4 period. We appreciate consideration of the impact of price shock on consumers, while also considering the needs of regulated EDBs. However, as noted in our submission on Transpower's draft decision,[8] we would prefer a smoothing profile that weighted a higher proportion of funding to be recovered in the later years, enabling EDBs to address deliverability concerns and demand uncertainty first, while acknowledging the compounding cost pressures facing electricity consumers.

Support for new INSTA mechanism but stronger focus is needed

27. MEUG supports the introduction of the Innovation and Non-Traditional Solutions Allowance (INTSA) scheme. It is important that EDBs are incentivised to innovate, pursue demand-side management and energy efficiency initiatives, and much greater progress is needed in this area to support the energy transition. We outlined the importance of this in our submission on the EDB DPP4 Issues Paper.

28. It is encouraging to see that the Commission has reviewed and applied its learnings from the offering of the Innovation Project Allowance (IPA) in DPP3. There was very limited uptake of this allowance, so a different approach is clearly needed. In terms of the INTSA proposed for DPP4, MEUG notes that:

- The proposed INTSA is set at a very low rate (0.6%) and may not be material enough to drive the change that is needed. An INTSA up to a rate of 5% may be needed to drive the change that is needed.
- The INTSA is still described as an additional mechanism for EDBs, with EDBs having to apply for it. This reinforces the status quo practice of EDBs continuing to build more network in line with historic approaches. Innovation should not be seen as an "add on;" rather, it should be considered BAU when operating distribution networks.
- The process for INTSA applications must be streamlined, to incentivise use of this options over Business as Usual (BAU) approaches. There should not be additional regulatory burden for EDBs.
- We support the requirement for EDBs to share learnings from their INTSA projects – this is a positive step in building up sector capacity in new areas or technology.
- We appreciate the Commission including equal IRIS incentives between CAPEX and OPEX (decision I1), but we do not believe this is sufficient to overcome the bias to build and ongoing returns that come from increasing the Regulated Asset Base (RAB).
- We question who will judge if a project is "riskier than BAU" – this seems quite subjective, especially as the Commission note that this could be approached differently amongst EDBs (paragraph D75).
- It is important that the Commission ensure sufficient focus is given to energy efficiency, as this is something that will benefit all consumers in the long-term. We need to avoid the risk of regulated EDBs spending the majority of the INTSA on high-tech devices and systems to aggregate load and control devices such as batteries, EV chargers and hot water cylinders to shift peak load (that don't reduce consumer bills) – rather than on energy efficiency (which does reduce consumer bills). The INTSA needs to be deployed for a range of options.

29. We welcome more engagement with EDBs on how they see this INTSA mechanism working and the types of projects that they may pursue.

[8] http://www.meug.co.nz/node/1373

Support for continued approach to quality

30. As noted in prior submissions,[9] MEUG supports retaining the existing quality standards and incentive schemes from DPP3. The existing quality standards provide sufficient insight and will ensure EDBs remain focused on providing consumers with a reliable and secure supply of electricity.

31. The only area that we consider needs improvement or greater emphasis is around EDBs' network capacity. It is important that EDBs are incentivised to optimise use of the existing network, ahead of new investments, to help drive down the costs facing consumers. As discussed with the Climate Change Commission,[10] MEUG considers that the current system for electricity infrastructure has a strong "bias to build" – EDBs and Transpower have continuously built "poles and wires" infrastructure to meet a relatively steady growth in demand, with assets historically sized to meet a network's peak capacity. The Part 4 regulatory model for both Transpower and EDBs is largely based around the Regulated Asset Base (RAB), which influences the revenue that a regulated entity can earn and the subsequent prices that will be charged onto consumers.

32. Enhanced reporting on network capacity (at a level digestible for consumers) would be a positive step, ahead of investigating capacity standards for future regulatory periods. MEUG would welcome the opportunity to discuss this idea further with both the Commission and EDBs.

Attention must be given to broader regulatory framework for EDBs

33. There are several broader issues, that while out of the exact scope of the DPP4 process, have impacted and will continue to impact on the regulatory framework for EDBs and the magnitude of distribution charges that consumers will face.[11] MEUG strongly recommends that the Commission, alongside the Electricity Authority and the Ministry of Business, Innovation and Employment (MBIE), reviews these issues and looks for ways to ensure that we have a regulatory framework that is future-proof and best considers both the short and long-term benefit of consumers, particularly during the energy transition.

    - **Volatility in WACC over multiple regulatory periods**. Increases in inflation and interest rates have had a significant impact on the proposed WACC for DPP4, and this has been the driver for a large proportion (40%) of uplift revenue forecast for DPP4. However, stakeholders have very little ability to influence the WACC figure through the DPP4 reset, as it is set outside of the price-quality reset process. MEUG strongly recommends that the Commission review the process for setting WACC, looking at the methodology of how it is calculated and how the WACC percentile is applied. We believe that a less volatile and more consistent WACC would be beneficial for both consumers and regulated entities in the long-term.

    - **Shift in balance of risk**: MEUG believes that there has been a shift in the balance of risk between regulated businesses and consumers over recent years. EDBs now have a greater range of re-openers available to them, greatly reducing the risk of underinvestment in the network. As advocated in many submissions, MEUG believes there is an increasingly strong case to move the WACC percentile for EDBs (and Transpower) down from 65 percentile towards the 50th percentile.

[9] https://comcom.govt.nz/__data/assets/pdf_file/0031/339763/Major-Electricity-Users-Group-MEUG-DPP4-issues-paper-submission-19-December-2023.pdf
[10] http://www.meug.co.nz/node/1366
[11] We also raised these issues as part of our submission on the draft decision for Transpower's RCP4.

- **Cross-checking of sector assumptions**: Due to the low-cost approach of the DPP, there does not appear to be any cross checking of the assumptions made by EDBs against Transpower, to ensure that they present a consistent approach to demand forecasting and infrastructure planning. Our report from NZIER provided in **Attachment 1** looks at this and we would welcome further analysis in this space.

- **IPPs for the largest EDBs**: Given the limitations of the low-cost DPP regime and the magnitude of the spending sought by many of the EDBs, MEUG considers that there is a growing case to introduce Individual Price-quality Paths (IPP) for the 6 largest EDBs in New Zealand. This would allow greater scrutiny of expenditure, provide for a more tailored approach and provide the level of assurance that consumers need. This is an idea that we will be advocating to government, as they consider if Part 4 is still fit for purpose through the energy transition.

- **Stronger focus on productivity and the ability to benchmark:** MEUG's submission on the CEPA report highlighted that the Commission is still left with a position where New Zealand EDB productivity has declined over the measurement period while the same measures applied to EDB in the UK and Australia show either long term improvement or stabilisation of productivity. We believe that further work is required in this space to get greater insight and the ability to benchmark EDB performance could assist with this.

- **Use of non-traditional solutions:** MEUG supports the greater use of non-traditional solutions (NTS), across the distribution and transmission network, where it is cost effective. We believe further work is needed in this area to understand what range of NTS are presently available to EDBs, and what is the state / maturity of the NTS market. Ideally, we want to encourage NTS across both transmission and distribution networks, and need to consider if there are any regulatory barriers to this market developing further.

- **Pass-through of charges will be determined by the DPM:** How these costs over DPP4 are passed through to consumers will ultimately be determined by how they are allocated out under the numerous Distribution Pricing Methodologies (DPM) and passed through by retailers. MEUG has several concerns with distribution pricing, including:

    - A lack of transparency around how distribution pricing is established, including how costs are allocated amongst customer groups.

    - Inconsistency in how EDBs operate across regions, including how they consult and share information on distribution pricing and the connection processes for new connections or expansion / reduction in capacity requirements.

    - How EDBs are passing through the new Transmission Pricing Methodologies (TPM) charges to customers.

    We refer the Commission to our submission[12] on the Electricity Authority's targeted reform of distribution pricing, where we expand on these issues. MEUG is seeking greater action in this area, as progress has been slow to date.

34. MEUG welcomed the opportunity to discuss these broader concerns with the Commission and have also discussed them with the Electricity Authority. We strongly recommend that more focus is put on these issues in the short term, to ensure that we have a regulatory and policy framework that supports electrification and decarbonisation, and that meets consumer demand at a fair and justifiable price.

[12] http://www.meug.co.nz/node/1311

Next steps

35. We look forward to engaging with the Commission and stakeholders throughout the cross-submission process. If you have any questions regarding our submission, please contact MEUG on [redacted] or via email at [redacted]

Yours sincerely

[redacted]

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