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### **Default Price-Quality Path from 2025 Draft Decision**

1. This is Vector's submission on the Commerce Commission's (Commission) draft decision on the default price-quality path from 2025 (DPP4).
2. No part of this submission is confidential, and we are happy for it to be published on the Commission's website.
3. We appreciate the Commission's reasons paper recognises the context of the DPP4 reset. As noted in the reasons paper, "*what EDBs do in the next regulatory period will have significant implications for the longer-term capability, capacity, and resilience of their networks.*"<sup>1</sup>
4. We have appreciated the greater level of engagement with Commissioners during the DPP4 reset process. We are also encouraged the Commissioners have listened to stakeholders, introducing new ways of engaging including the workshops on innovation, the capex framework and opex step changes.
5. We agree with the draft decision's characterisation of the three challenges inherent in setting this DPP:
  - a. Enabling electricity distribution businesses (EDBs) to spend and invest to meet forecast consumer demands;
  - b. Incentivising performance and improvement during the energy transition; and
  - c. Managing price shock risks and the ability of EDBs to finance investments.<sup>2</sup>
6. High interest rates, and their impact on the weighted average cost of capital (WACC), are the key driver of price increases in DPP4. The Commission has applied revenue smoothing to mitigate this impact. It is worth noting this is a deviation from what would happen in a competitive market where input costs would be passed on to consumers when they occurred.

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<sup>1</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at X51

<sup>2</sup> Ibid, X53.1 – X53.3

For example, banks have adjusted mortgage rates in line with interest rate movements without smoothing the impact.

7. Our comments on specific aspects of the draft decision, along with an executive summary, are provided below. We have also responded to the Commission’s template in Appendix One.

**Executive summary**

Topic	Vector comments
Revenue path and financeability	<p>We strongly agree with the draft decision to set a revenue path that allows EDBs to recover their building blocks allowable revenue over the period.</p> <p>In our view it is clear any deferral of revenue recovery beyond the period is contrary to the Commerce Act Part 4 (Part 4) purpose as it would undermine the ability of EDBs to invest.</p>
Risks to financeability	<p>We encourage the Commission to remain mindful of potential stressors on financeability that could occur during the regulatory period.</p> <p>In particular, the Electricity Authority (Authority) is currently consulting on distribution regulatory settings including connection pricing. We have significant concerns that any changes to capital contributions arising from this consultation could have a material impact on the price path.</p>
Prices	<p>We acknowledge consumers are facing significant price increases in DPP4 relative to previous DPPs, largely the result of significantly higher interest rate and inflation costs. The Commission has applied a cap on the rate of change to smooth the impact of price increases to avoid price shock.</p> <p>In the next Input Methodologies (IM) review, the Commission should consider regulatory design features previously advocated by stakeholders, such as implementing a trailing average cost of debt, to mitigate against significant volatility in the WACC given this is the key driver of DPP4 price increases.</p>
Length of the period	<p>We support the Commission’s draft decision to maintain the regulatory period for five years. We agree this will better provide regulatory continuity and avoid the need for EDBs to incur the administrative costs of an earlier reset.</p>

Productivity	<p>We strongly support the draft decision to apply a 0% opex partial productivity factor. CEPA's report found that non-exempt EDBs' productivity has declined less in recent years and presented no concrete evidence that a productivity rate needed to be implemented at the reset.</p>
Expenditure	<p>We are encouraged the Commission has recognised EDB costs, for capex and opex, have increased higher than the reference periods.</p> <p>Vector, along with Orion and Wellington Electricity, commissioned a report from Oxford Economics Australia which found strong arguments that the capex inflator should be higher, along with network opex.</p>
Opex step changes	<p>We consider the Commission's new step change criteria is sensible and that the Commission has demonstrated real awareness of the needs of the sector by approving several step changes for EDBs.</p> <p>The Commission's draft decision was to reject Vector's request for a 'reactive maintenance' step change. We have provided more evidence around the need for this step change in our submission (under the more appropriate banner of 'storm response'). We request this step change be reconsidered using our further evidence.</p> <p>Vector agrees that SaaS is an opex step change, but we recommend that the Commission addresses Vector's under-recovery of SaaS costs in DPP4. EDBs who are early adopter of new technologies and digital systems should not be disadvantaged merely due to when expenditure of this nature occurs.</p>
Re-openers	<p>Vector, along with the Big Six EDBs, engaged PwC to draft re-opener guidelines to assist stakeholders with the re-opener process.</p> <p>We recommend that, as a matter of course, the Commission reapply its financeability sense check when considering re-opener applications.</p> <p>We do have significant concerns that relying solely on re-openers to address expenditure required outside the price-path</p>

	<p>may not be workable in practice, given time and workload constraints if the Commission receives multiple applications.</p> <p>We recommend the Commission make further refinements to the re-openers in the IMs to provide confidence to the sector that EDBs will be able to access funding in an efficient and timely way when the need arises. Implementing a fast-track process using an independent verifier would be a way to achieve this in a way consistent with the low cost DPP.</p>
<p>IRIS and efficiency</p>	<p>We recommend the Commission adjust the incremental rolling incentive scheme (IRIS) to remove the impact of:</p> <ul style="list-style-type: none"> <li>• consumer connection expenditure, given EDBs have no control over either the timing or scale of this expenditure; and</li> <li>• leases, as EDBs could be penalised (or rewarded) solely due to forecast error.</li> </ul>
<p>Innovation</p>	<p>We welcome the Commission’s draft decision to implement the innovation and non-traditional solutions allowance (INTSA) as a good step forward.</p> <p>We recommend that more clarity is provided around what is in and out of scope (in particular when it comes to net zero projects) when the Commission issues guidance for the scheme. This needs to be done in consultation with stakeholders.</p>
<p>Quality standards</p>	<p>We support the draft decision to introduce no new quality standards for DPP4.</p> <p>We recommend the Commission adjust the approach to normalisation to ensure outages attributable to the ‘tail’ of major events are normalised. Severe weather events are increasing due to climate change so ‘tail’ events are likely to become a more significant problem.</p> <p>We also recommend the Commission exclude outages implemented by an EDB to reduce fire risk following advice from FENZ and NIWA.</p>
<p>Depreciation</p>	<p>We note the ENA wrote to the Commission expressing concern about the process to amend the depreciation calculation for existing assets in the last IM review. This change had a significant impact on EDBs.</p>

	<p>We encourage the Commission to highlight any changes that could have a material impact to ensure stakeholders have an opportunity to comment.</p> <p>There is regulatory precedence for this in the UK where Ofgem publishes “impact assessments” for their price control decisions, summarising the financial (and other) impact on companies and consumers of their key decisions.</p>
Financial model	<p>Vector has proposed some remediations of certain inputs to the Commission’s modelling, including to asset lives and disposals, which we believe are more consistent with other practices within the process.</p>
Deliverability	<p>Deliverability does not belong in a low cost DPP. The Commission should instead be focusing on ensuring that the regulatory settings support EDBs in delivering their AMPs. EDBs are best placed to manage their business operations.</p>
Additional reporting	<p>If the Commission is seeking to add reporting requirements to the suite of obligations, then it must look to streamline what is already in place. The benefits of new reporting requirements must outweigh the costs of additional regulatory burden.</p>
Connections to other EDB assets	<p>We recommend the Commission amend the IMs to treat the cost of connections to the assets of other EDBs as a pass-through cost.</p> <p>This would be consistent with the treatment of Transpower costs and support EDBs to pursue innovative connection arrangements that could avoid the need for more expensive capex solutions.</p>

### Revenue path and financeability

8. We strongly agree with the Commission’s draft decision to set a revenue path that allows EDBs to recover their building blocks allowable revenue (BBAR) over the regulatory period. This is a key principle to deliver the Part 4 purpose.
9. The draft decision recognises that:

*“Extended and significant revenue deferral could lead to financeability constraints on EDBs, reducing incentives to invest, which would be inconsistent with s 52A(1)(a) of the Act.*

*While deferral of revenue would reduce price shocks for current consumers, it would create the potential for compounding price-shocks leading into DPP5, disadvantaging future*

*consumers. Even though such a deferral would be present value neutral and consistent with the FCM principle (because under the wash-up mechanism EDBs accrue a time-value of money adjustment) consumers would pay more overall in nominal terms.”<sup>3</sup>*

10. In our view, it is clear any deferral of revenue recovery beyond the period is contrary to the Part 4 purpose as it would undermine the ability of EDBs to invest. The Commission’s reasons paper also recognises that this approach could lead to compounding price shocks in later DPPs and that consumers would pay more overall in nominal terms.
11. However, we disagree with the statement that revenue deferral could be consistent with the FCM principal. Oxera’s report for the Big Six EDBs explains that introducing cashflow deferral also introduces a regulatory risk given *“regulators cannot offer binding commitments that their successors will honour in full any pledges that they make today regarding expected future returns.”<sup>4</sup>*
12. Investors are relying on the fact the price-path will provide a return within the DPP period. As the Commission is aware, cashflow is an issue for EDBs and their investors. This is compounded by regulatory settings such as back ending cashflows through regulatory asset base (RAB) indexation, along with significant upfront investment needs. Accordingly, it is important investors have confidence the regulatory settings will deliver sufficient cashflow to cover costs in line with the BBAR derived for that price-path.
13. The Commission’s financeability “sense check” of its draft decision is encouraging. However, we consider a financeability test should be included in the IMs to provide confidence to the sector that the regulatory settings will provide sufficient funding to enable investment going forwards.
14. In terms of the Commission’s approach to the financeability “sense check” we support the Commission’s approach of using a notional firm based on Standard & Poor’s ratios. As a general principle, we consider an allowance for equity issuance costs should also have been included in the test.

### **Risks to financeability**

15. The revenue path in the draft decision reflects a compromise between allowing EDBs to finance their investments and mitigating consumer price shocks. There may be little headroom for EDBs to recover costs if external factors cause a change to the assumptions made when the price path was set.

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<sup>3</sup> Ibid, at F60 – F61

<sup>4</sup> Oxera, *Response to the New Zealand Commerce Commission consultation on the financeability of electricity distribution services in the fourth default price-quality path (DPP4): Prepared for New Zealand Electricity Distribution Businesses* (15 March 2024), page 6

16. Accordingly, it is critical the Commission stays mindful of potential circumstances that could create financeability stress during the regulatory period.
17. In particular, the Authority is consulting on distribution regulatory settings, including on connections pricing that could impact capital contributions received by EDBs.<sup>5</sup> Changes to the regulatory settings in this area could have a material impact on EDB revenue paths. If this requires the price-path to be re-opened, it is critical the Commission re-considers the financeability sense check for the amended price path.
18. Vector's capital contribution policy – to recover 100% of the costs of new connections, along with a portion of additional shared assets resulting from new connections – means Vector's forecast capex for DPP4 is significantly lower than it otherwise would have been. This has had various impacts on the price path for DPP4, including a lower maximum allowable revenue (MAR) than otherwise would be the case.

Impact of capital contributions on the price path

19. Vector has significant concerns about the potential for the Authority to regulate capital contributions since they interact so fundamentally with the price-path. The Part 4 regulatory framework is designed to promote regulatory certainty as a means of supporting the long-term benefit of consumers. However, it is unclear how the next price path will play out given the potential for a material change to EDB funding mechanisms. The Authority's process appears to be clearly undermining one of the fundamental aspects of Part 4 –to promote certainty. This process is occurring right at the time the Commission's task is to provide 5-year certainty on revenues and capex investment envelopes.
20. We note the Commission's draft decision has considered capital contributions in the context of expenditure and re-openers:

*"In setting the [125% capex] cap, we have considered, at a high level, the implications for EDBs of having capped expenditure. EDBs have options available to them which include both managing within and outside their revenue limits. Those options include:*

- a. *operating within their revenue limits by reprioritising and substituting spend, including potential deferral of projects, noting that the price-quality path setting provides a revenue allowance, but not a cap on what can be spent ie, EDBs can substitute between opex and capex*
- b. *utilising flexibility mechanisms ie, LCCs, reopeners where these are available or CPPs (see the 'Role of flexibility mechanisms' section for more information)*
- c. *choosing to incur additional expenditure implicitly beyond that provided for in the price-path, and*

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<sup>5</sup> Electricity Authority, *Targeted Reform of Distribution Pricing: Issues Paper* (5 July 2023)

- d. *increasing the share of cost recovery directly from consumers rather than through regulatory allowances by changing capital contribution policies.*<sup>6</sup>
21. Bullet point d above suggests the Commission is at odds with the Authority by suggesting that increasing capital contributions is an option for increasing capex for EDBs who do not receive their full capex allowances requested at the reset.
22. Another ambiguity when it comes to reopeners interfacing with capital contributions is a specific clause within both the unforeseen and foreseen large project reopener definitions:
- “the amount of capital contributions to be received by the EDB for the project or programme is sufficient in the circumstances, and is in accordance with the EDB’s usual policy on capital contributions”*<sup>7</sup>
20. Therefore, a condition of the large project reopeners is that the EDB must be receiving an amount of capital contribution for the project or programme that is:
- a. “sufficient in the circumstances”; and
- b. in accordance with the EDB’s policy on capital contributions.
23. Capital contributions are received primarily for customer-initiated work, and therefore will be relevant for the consumer connections expenditure category, but also system growth (for certain EDBs) both available under a large project reopener.
24. While the Commission’s IM review reasons papers do not discuss this criterion in detail, it appears that EDBs would not seek additional expenditure through reopeners without first investigating whether connecting customers can or should make a contribution to defray the costs. That could become a concern if the Authority seeks to put forward code amendments to alter EDBs’ capital contribution policies and one of the options to recoup those costs, as outlined by the Authority in their Distribution Pricing paper, is to seek a reopener.

*If the Authority regulates capital contributions the Commission will need to address the impact on the price path*

25. If the Authority regulates EDB capital contribution policy, we expect the appropriate means of addressing the impact on EDB price-paths will be through s54V of the Commerce Act.
26. We note the Commission has recently re-considered Transpower’s price-path using s54V to allow it to recover costs associated with Transmission Pricing Methodology (TPM) development rather than requiring Transpower to apply for a re-opener. The relative scale

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<sup>6</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at B134.1-4

<sup>7</sup> Clauses 4.5.9(1)(h) and 4.5.10(1)(g) of the *Electricity Distribution Services Input Methodologies (IM Review 2023) Amendment Determination 2023*



of this use of s 54V for TPM costs versus what may transpire from the Authority seeking to price regulate connection costs could be of an order of magnitude greater. TPM costs were \$18.5m<sup>8</sup>, whereas the potential price regulation of connection costs has the potential to move the “connection capital” bucket of capex envelopes across all EDBs which will be in hundreds of millions if not billions of dollars.

27. The Authority’s issues paper suggests other means of addressing the impact of their regulation of EDB connections pricing on capital contributions would be for EDBs to seek a re-opener or customised price path (CPP).<sup>9</sup> We do not consider these options would be appropriate if the Authority makes any significant regulatory changes that impact EDB capital contributions. Our understanding is a CPP application on this topic would be a ‘single issue’ CPP which is an approach the Commission rejected in the recent IM review<sup>10</sup> and it is unlikely to be workable if multiple EDBs must apply for re-openers at the same time.
28. If the Authority regulates connections pricing that in turn impacts EDB capital contributions, it would be logical for the Authority to delay any changes from taking effect until the next price path (i.e. until 1 April 2030). Remedying any changes to capital contributions that take effect in DPP4 will involve significant complexity and workload.
29. However, if changes to capital contributions do take effect in DPP4, it will be critical the Commission reapplies its financeability sense check to ensure regulatory change does not undermine EDBs ability to invest. This should include ensuring the amended price-path allows EDBs to recover their building blocks revenue in the period.

### **Price increases**

30. We acknowledge consumers are facing significant price increases in DPP4 relative to previous DPPs, largely the result of significantly higher interest rate and inflation costs. The Commission has applied a cap on the rate of change to smooth the impact of price increases to avoid price shock.
31. As recognised in the draft decision, the DPP4 price increases cannot be deferred without constraining EDB financeability and therefore their ability to undertake necessary investment. This would ultimately lead to negative consumer outcomes in terms of quality and require higher expenditure and prices in the long term. It is right to prioritise dynamic efficiency over short term price impacts.

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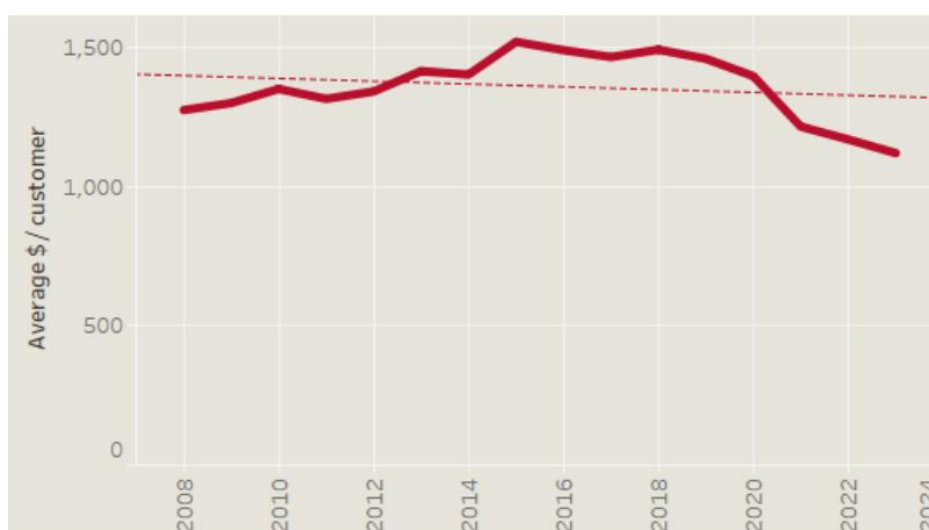
<sup>8</sup> Commerce Commission, *Reconsideration of Transpower’s individual price-quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology: Changes to expenditure allowances for the costs of TPM development and implementation in the 2023 to 2025 disclosure years: Final Decision* (12 October 2023)

<sup>9</sup> Electricity Authority, *Distribution Pricing Reform: Next Steps* (May 2024) at 3.73

<sup>10</sup> Commerce Commission, *CPP and in-period adjustment mechanisms topic paper: Part 4 input methodologies review 2023 – Final decision* (13 December 2023) at 4.32

32. That said, the key driver of price increases in DPP4 is the increased WACC driven by macroeconomic factors, particularly rising interest rates.
33. In the next Input Methodologies (IM) review, the Commission should h consider regulatory design features, as previously advocated by stakeholders, such as implementing a trailing average cost of debt, to mitigate against significant volatility in the WACC. If the current IMs used a trailing average cost of debt, price increases in DPP4 would be less significant, although prices in the last DPP would have been higher. Vector has advocated for a trailing average cost of debt in past consultations and has previously advocated for a starting price IM that, again, could have mitigated against the significant price increases of DPP4.
34. While consumer price increases should never be taken lightly, it is important context to note these increases are relative to very low prices in past DPPs. We note the Commission’s recent report on trends in lines company performance found that lines charges have fallen in real terms per customer.
35. The Commission found that:

*“In real terms (adjusted for inflation), individual customers have paid less for lines companies’ services over the period [2008 – 2024]. This is shown in [the following chart]:”<sup>11</sup>*



36. Similarly, the Commission found that:

*“Since the last Trends Report, the key changes over the last two years were higher inflation which affected the value of EDBs’ assets [and] the impact of severe weather events on the*

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<sup>11</sup> Commerce Commission, *Trends in local lines company performance* (25 June 2024), page 3

*number of outages. These events include Cyclone Gabrielle and the Auckland Anniversary flooding in 2023.*

*On average, we found that the amount of profit that local lines companies receive from each customer had remained roughly the same for the period 2008 to 2020, with a reduced level of profit in 2021. However, over the last two years, the value of local lines companies' assets increased significantly, in line with higher than usual inflation, which is recorded as profits.*

*Overall, when compared to the inflation-adjusted cost of capital, local lines companies made profits in line with expectations set by the regulatory regime. Rising costs meant that customers were paying \$229 more per year in 2023 than in 2008. However, if costs are adjusted for inflation, customers paid \$155 less in 2023 than in 2008. This is equivalent to an increase of 26% in nominal terms, and a reduction of 12% after adjusting for inflation.<sup>12</sup>*

Vector has taken steps to reduce price increases relative to the counterfactual

37. Vector's approach to connections pricing has reduced the impact of price increases for our consumers. Vector's capital contributions policy has resulted in a lower RAB and lower forecast capex in DPP4 than otherwise would be the case.
38. Vector also adopts a prudent approach to its expenditure forecasting which also reduces the impact of price increases on consumers compared to the counterfactual. This is best demonstrated in our recent AMP where we did not include in our forecasts \$196m of capex relating to resilience. The reason for the exclusion is because of the uncertainty as to whether the \$196m capex would need to be incurred during the AMP period.
39. We consider it inappropriate to include expenditure in our forecasts when there is a high degree of uncertainty, otherwise consumers could end up paying for expenditure that is not required.
40. This expenditure is uncertain because:
  - a. It relates to resilience spend to mitigate the impacts of climate change weather events. We have already undertaken weather modelling at a macro level and now need to undertake more granular modelling. This modelling will help determine if the expenditure will be required;
  - b. If it is, then the nature of that expenditure will be dependent on whether the tree regulations have been changed so that an opex solution of tree trimming to achieve the required outcomes is possible at considerably lower cost; and
  - c. If the tree regulations have not been changed then a capex solution will be required.

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<sup>12</sup> Ibid, page 11-12

41. As we noted in the AMP if the expenditure is required in the DPP4 period we will then look to apply for a reopener. The type of reopener will be dictated by the nature of the expenditure required.

### Length of regulatory period

42. We support the Commission's draft decision to maintain the regulatory period for 5 years. We agree this will better provide regulatory continuity and avoid the need for EDBs to incur the administrative costs of an earlier reset.

### Productivity

43. Vector strongly supports the Commission's draft decision to apply an opex partial productivity factor of 0%.

44. We understand the Commission has considered the evidence from:
- the results from CEPA's study of historic productivity changes;
  - comparisons to other similar sectors of the economy and the economy as a whole;
  - recent studies in other jurisdictions; and
  - the potential impact of other DPP4 decisions.

45. Although not explicitly stated, we expect that the Commission also took on board the responses to the CEPA study received on 24 April 2024.

46. We note that in June 2024, CEPA issued a finalised report accounting for responses to their original study.

47. CEPA notes that:

*"However, at an industry level, given the breakdown of operating expenditure in the information disclosures, it is not clear that there is a particular category of operating costs that has increased more than other categories. This could suggest that the EDB industry has experienced a general decline in operating productivity, the changing environment in which EDBs operate has resulted in increases in operating expenditure across the board, or the drivers of the cost increases are not included as an output in our productivity indices.<sup>13</sup>"*

48. It is clear that CEPA has considered the Big Six NERA report<sup>14</sup> in particular the subject of unmeasured outputs.

49. CEPA concedes that:

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<sup>13</sup> CEPA, *EDB Productivity Study June 2024: A report prepared for the Commerce Commission* (24 June 2024), page 69

<sup>14</sup> NERA, *Implications of CEPA's draft findings for the NZCC's decisions on opex productivity for DPP4, Big 6 EDBs* (24 April 2024)

*“If an EDB is incurring costs to provide an output and this output is not captured in the output specification, then this will appear as reduced measured productivity. Similarly, if there are other environmental factors which affect the costs of the EDBs, and those factors are not directly measured and are getting worse over the period, this would show up as reduced measured productivity.”<sup>15</sup>*

50. Vector agrees that a number of the unmeasured outputs would be difficult to incorporate in the Commission’s productivity assessment due to the difficulties to quantify them in any productivity modelling.

51. CEPA explains that:

*“One of the key issues with missing outputs is that they are unmeasured.”<sup>16</sup>*

52. But that does not discount the historical (and projected) impact of those outputs on EDBs’ opex. Vector therefore throws caution to CEPA’s conclusion that:

*“Our analysis also indicates that incorporating proposed unmeasured outputs is unlikely to be sufficient to explain the substantial reduction in measured productivity.”<sup>17</sup>*

53. There must be an emphasis on “*measured*” productivity.

54. CEPA derived this conclusion admitting that all except two of the unmeasured outputs proposed by NERA can be modelled properly:

*“There are two proposed outputs where with some data transformation the requirements for inclusion can be met. These are health and safety and integrating distributed energy resources (DER).”<sup>18</sup>*

55. CEPA also states that it remains entirely possible that there are another set of unmeasured outputs that have decreased over the period<sup>19</sup>, yet while Vector and the other Big Six EDBs thought about this during our work with NERA, none came up.

56. We appreciate the Commission’s attempt to summarise the overall findings from the evidence derived from their analysis in table C14 from the draft decision paper. We have replicated this table below with a few additions in italics/ bold we believe the Commission should have also taken into consideration:

Factors that support a higher opex PFP	Factors that support a lower opex PFP
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<sup>15</sup> Ibid p.71

<sup>16</sup> Ibid p.71

<sup>17</sup> Ibid p.8

<sup>18</sup> Ibid p.73

<sup>19</sup> Ibid p.72

Evidence from trends in Australian EDB performance.	Opex-capex substitution improving capital (and total productivity) at the expense of opex productivity.
Recent (DPP3) trends in PQ-regulated EDB opex productivity	Medium-term (ex 2008) trend in PQ-regulated and ID-only opex productivity.
Accepting step changes in costs that would otherwise present as declines in productivity (SaaS capex replacement, insurance, cybersecurity).	Unaccounted for step changes <b>for DPP4</b> with insufficient evidence (resilience, regulatory costs, digitalisation, (distribution system operator) <b>DSO related costs, flexibility services</b> ).
Accepting step changes that may drive future productivity gains overall (LV monitoring, SaaS system upgrades).	<b>Unaccounted for step changes for DPP3 with insufficient evidence (low voltage (LV) monitoring, data costs, health and safety, traffic management, Auckland growth, decarbonisation).</b>
Using an EDB-specific opex cost escalator	Scale factors (lines, ICPs) that have shown a faster historical decline than broader models. Excluding time as a scale factor.
Incentives to improve efficiency resulting from innovations under the INTSA scheme in DPP4.	<b>Low incentives to improve efficiency resulting from innovations under the IPA scheme in DPP3.</b>
	<b>IRIS mechanism in place penalising/rewarding inefficiencies/ efficiencies</b>

57. We therefore agree that a 0% factor is appropriate for EDBs in DPP4.

## Expenditure

58. We are encouraged the Commission has recognised EDB costs, for capex and opex, have increased higher than the reference periods.

59. In fact, Oxford Economics Australia (OEA) (commissioned by Vector, Wellington Electricity and Orion) found strong arguments that the capex inflator should be higher, along with network opex.

60. The OEA report has been submitted to this consultation. In summary, OEA found that that the Commission's draft decision to utilise All-Groups CGPI + 0.8% to escalate capex allowances should be replaced with a final decision to utilise All-Groups CGPI + 3.1%.

61. Use of an uplift figure of 3.1% would be better to:

- a. reflect long term averages, thereby removing volatility impacts;

- b. reduce reliance on figures generated during the 'covid supply years'. Years where inflationary pressures, which impacted domestic and global economies, have been uniquely far-reaching;
  - c. support the objective of a regulatory certainty that reduces the risk of over or under investment by EDBs over the long run;
  - d. help alleviate the fact that there is generally considered more upside risk to inflation in the years ahead compared to downside risk; and
  - e. ensure the Commission's decision meets its objective to incentivise EDBs to invest and innovate during the decarbonisation transition.
62. In terms of opex, Oxford Economics found that the Commission's decision is appropriate for application to non-network opex.
63. Whilst there is some evidence to increase the uplift factor beyond 0.3%, the evidence to support such an increase is not as compelling as the evidence to support an increase to the capex uplift factor. Therefore, we support the use of application of  $0.6*(LCI+0.3%) + 0.4*(PPI+0.3%)$  for non-network opex.
64. However, we do not support the use of this approach for network opex. Instead, we advocate for an approach that recognises non-labour inputs for network opex are more closely aligned to non-labour inputs used in/for network capex rather than non-labour inputs used in/for non-network opex. We believe the network opex escalator should be:

$0.6*(LCI+0.3%) + 0.4%*$ the capex escalator with the capex escalator being All-Groups CGPI+3.1% (rather than the draft decision of All-Groups CGPI+0.8%).

### **Re-openers**

65. We expect re-openers will become a more significant feature of this DPP given significant uncertainty in the sector along with the large uplift in forecast expenditure.

#### Re-opener guidelines

66. Vector, along with the other large EDBs, have asked PwC to draft re-opener guidelines that the Commission could use to assist stakeholders with the re-opener process. These guidelines have been submitted to this consultation.
67. The draft decision paper notes the Commission is considering information requirements on prioritised projects and programmes for EDBs with capped expenditure to assist with the re-opener process.<sup>20</sup>

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<sup>20</sup> Ibid p.171

68. We would like further information on how this applies to EDBs without capped forecasts. As explained above, Vector excluded a portion of resilience expenditure from our recent AMP due to the uncertainty around the expenditure being required. We may need to rely on a re-opener once we gain further certainty around the need and nature of this expenditure.
69. We recommend the Commission implement PwC's re-opener guidelines. However, if it does not, the Commission should prioritise developing its own guidelines as soon as possible for DPP4.
70. We would welcome more information from the Commission on:
- How EDBs should demonstrate expenditure was not explicitly or implicitly provided in the DPP, for both EDBs with capped and for EDBs with uncapped forecasts;
  - For meeting the materiality threshold required for the large project re-openers, the level of connection between distinct projects that is required to constitute a 'programme'; and
  - How the Commission will assess whether the capital contributions received by the EDB were "sufficient in the circumstances" for the large project re-openers.
71. As a matter of course, the Commission should re-apply its financeability sense check any time it re-opens the price-path.

#### Concerns with re-openers

72. We do have significant concerns that relying solely on re-openers to address expenditure required outside the price-path may not be workable in practice.
73. EDBs have forecast significant expenditure in DPP4 and many EDBs have seen this expenditure capped in the draft decision. In our experience, the re-opener process imposes significant workload on the applicant and on the Commission. If multiple EDBs apply for re-openers in DPP4 this could result in unreasonable delays to necessary expenditure and result in consumer harm.
74. We recommend the Commission make further refinements to the re-openers in the IMs to provide confidence to the sector that EDBs will be able to access additional allowances in an efficient and timely way when the need arises.
75. We consider implementing a fast-track application process using an independent verifier would be an appropriate mechanism to achieve this in a way consistent with the low cost DPP. Using an independent verifier would also provide confidence for consumers that proposed expenditure is appropriate. The PwC re-opener guidelines could be used as criteria for the independent verifier.



76. Alternatively, the Commission could consider implementing alternative flexibility mechanisms such as use-it-or-lose-it allowances. We consider these could be implemented in a way consistent with a low cost DPP, for example, through requiring auditor scrutiny.
77. We also recommend the Commission amends the IMs to make all re-openers opex/capex neutral. It is not clear to us why the resilience re-opener remains limited to capex. This could preclude the pursuit of efficient opex solutions and lock in capex bias.

#### Catastrophic event re-opener

78. Vector is in the process of applying for a catastrophic event allowance and in doing so considered applying for a catastrophic re-opener to recover costs associated with Cyclone Gabrielle.
79. We have appreciated the Commission's constructive engagement with us during this process.
80. We note that interpreting the IM provisions proved to be complex and led to some perverse outcomes. In particular the materiality threshold, requiring an impact on the price path equal to 1% of aggregated forecast net allowable revenue, is overly difficult to meet (although we acknowledge this has been amended in the last IM review).
81. This has increased our concern around re-openers given the potential for unexpected, and potentially unintended, outcomes once the Commission and stakeholders work through the details of a specific re-opener provision in practice.
82. We also note the Commission's view that the "additional net costs" recovered through the catastrophic allowance are restricted to IRIS retention factors. We disagree with this interpretation. In our view the better interpretation is that "additional net costs" comprises at least the difference between the BBAR with and without the costs incurred responding to the catastrophic event.
83. However, if the Commission retains its view that "additional net costs" are restricted to IRIS retention factors, we recommend the Commission amend the IMs to implement an allowance that comprises opex incurred, and forgone depreciation and return on capital building blocks. If an EDB must spend a significant amount responding to a catastrophic event (but below a threshold that a CPP would be reasonable) it could cause financeability constraints if the EDB must wait to recover the expenditure over time, given this expenditure would not have been budgeted ahead of the catastrophic event occurring.
84. We recommend that the Commission allow the revenue related to the additional net capex to be recovered through the revenue washup mechanism rather than the Capex IRIS mechanism to avoid the delay in revenue recovery.

#### Large Connection Contract (LCC)

85. Vector welcomed the IM Review’s final decision to introduce the LCC mechanism. LCCs can address connection forecast uncertainty in situations where the EDB and connecting party agree in writing that the terms and conditions of the contract between them are reasonable.
86. We are however concerned by the Commission’s proposals for:
- a. different approaches for EDBs with capped forecasts and EDBs with uncapped forecasts to determine LCC eligibility for LCCs which arise during DPP4;
  - b. EDBs to provide information for the annual compliance statement in respect of the wash-up so that the Commission can verify the validity of LCCs; and
  - c. collecting information to monitor the uptake and workability of LCCs.
87. In order to ensure that the mechanism works in practice, Vector suggests that guidelines are produced in collaboration with stakeholders on the workings of an LCC. These could include examples of the scenarios that are in and outside of scope, and how EDBs can demonstrate that their LCC projects are eligible in their annual compliance statements.

## Opex step changes

### Changes to the step change criteria

88. The Commission has made sensible changes to the opex step change criteria, particularly through the draft decisions O2.3 And O2.6 described below.
89. Draft decision O2.3 states:
- “Our draft decision is that the second factor is amended to be that a step change should be adequately justified with reasonable evidence in the circumstances. This is intended to be less stringent than ‘robustly verifiable’, with some flexibility included for step changes that are either less significant, or sufficiently satisfy enough of the remaining factors.”<sup>21</sup>*
90. We believe this change makes sense in a low-cost regulatory framework such as the DPP, providing more flexibility for step changes that are either less significant, or sufficiently satisfied through the remaining factors.
91. Meanwhile draft decision O2.6 describes the following amendment:
- “Our draft decision is that this factor is amended to assess whether a step change is widely applicable.”<sup>22</sup>*

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<sup>21</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at C63 and C64

<sup>22</sup> Ibid at C87

92. This change is welcomed because there may be circumstances where:
- a. A step change that clearly satisfies the other factors but only applies to a group of EDBs could efficiently be assessed; and
  - b. A group of EDBs are more seeking to increase an operating spend in an area for which other EDBs do not yet have the capability.

93. We consider this an example of a positive outcome arising from engagement by the Commission. We appreciated that Commission staff attended the ENA's workshop and addressed feedback from EDBs on step changes.

*Approval of step changes in the draft decision*

94. The Commission has demonstrated real awareness of the needs of the sector by approving several step changes for EDBs.
95. The Commission has clearly taken stock of the evidence provided and ascertained that certain categories of opex will see increased levels of expenditure for cyber resilience, LV monitoring, consumer engagement, SaaS and insurance costs.
96. This draft decision by the Commission is aligned to recent decisions made by the Australian Energy Regulator (AER) in particular, the April 2024 5-year revenue determinations for the 6 distribution network service providers (DNSPs) that operate in the New South Wales (NSW), Australian Capital Territory (ACT), Tasmanian (TAS), and Northern Territory (NT).
97. Two key examples have emerged in relation to opex step ups:
- a. Cybersecurity has emerged as another crucial area across the final decisions. This reflects the broader context of cybersecurity threats faced by many Australian industries following several high-profile cyber incidents. In this context, the AER approved the following amounts for opex step ups in cyber security (AUD RY24 prices):
    - i. Ausgrid \$18.1m
    - ii. Endeavour Energy \$4.4m
    - iii. Evoenergy \$14.6m
    - iv. Power and Water \$5m
    - v. TasNetworks \$2.8m
  - b. In the draft decisions, the AER noted that consumer engagement is an important facet of its assessment; together with ensuring it is satisfied that the proposed forecast reasonably reflects prudent and efficient costs and a realistic expectation of future demand and cost inputs.

98. To supplement the cyber resilience step change approval, Vector Technology Solutions (VTS) recently reported<sup>23</sup> the recent trends in cyber security threats:
- a. Ransomware attacks now target both IT and OT environments, driving up cybersecurity insurance demands and regulatory scrutiny.
  - b. Generative AI fuels new security concerns - industries are ramping up efforts to fortify defences and comply with evolving standards;
  - c. State-linked cyber incidents are becoming more sophisticated, exploiting vulnerabilities in both public and private sectors; and
  - d. The digitalisation of electricity systems has expanded cyber-attack surfaces, necessitating robust cybersecurity frameworks.

*Storm response step change*

99. Vector applied for a step change related to 'reactive maintenance' which falls under the 'service interruptions and emergencies' ID category. This relates to activities associated with our response to faults and other unplanned network events. These can be broken down into the following activities:
- a. First response: This is our rapid faults response to unplanned network events. The primary functions here are to make the network safe, initiate and co-ordinate any switching to isolate the fault, restore supply where possible, and to confirm the nature of any remedial work required.
  - b. Fault restoration and repair: This activity primarily focuses on the restoration of supply to all affected customers. These include the installation of generation, temporary repairs, and the restoration of the network to a fully operational state.
100. The Commission did not approve this step change because we failed to provide sufficient evidence that it met the required criteria. Accordingly, we have provided more evidence below. We request the Commission reconsider allowing our step change under the more appropriate banner of 'storm response'.
101. In our 2024 AMP we increased the Service interruptions and Emergencies expenditure in relation to our 2023 AMP. This was largely attributable to \$7.5m provided for in FY27 for a major storm event with the remaining increase each year due to the increased number of sustained adverse weather events<sup>24</sup>. The very recent state of emergency declared on 26 June in Wairoa and Heretaunga as heavy rain and big seas hit Hawke's Bay and Tairāwhiti, demonstrates how these types of events are becoming commonplace.

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<sup>23</sup> Available: [https://www.linkedin.com/posts/vector-technology-solutions-ltd\\_trends-in-cybersecurity-threats-2024-by-activity-7213315154040487936-LMPG](https://www.linkedin.com/posts/vector-technology-solutions-ltd_trends-in-cybersecurity-threats-2024-by-activity-7213315154040487936-LMPG)

<sup>24</sup> Vector, *Electricity Asset Management Plan 2024-2034*, section 15.5.1

102. Vector was disadvantaged through the base step trend approach for this particular category because our base year did not include any storm response related costs. In fact, the costs relating to the impact of the Auckland Anniversary flooding and cyclone Gabrielle on Vector’s storm response were captured in RY23. This required us to apply for an opex step change because our base year costs would have been insufficient to respond to future severe weather events in DPP4. Table 1 below demonstrates this predicament with RY2024 being considerably low in the dataset compared to the previous year (especially given the statistical variance of meteorology).

103. Table 1: Service interruptions and emergencies expenditure 2023-2030<sup>25</sup>.

Service interruptions actuals (RY23) and forecasts (RY24-30) – constant RY24 \$(000)							
2023	2024	2025	2026	2027	2028	2029	2030
21,910	13,693	16,931	17,080	22,833	19,212	17,468	17,599

104. Insurance Council of New Zealand (ICNZ) counts that Aotearoa has experienced more than 150 severe weather events and natural disasters since ICNZ began keeping records in 1968<sup>26</sup>. That equates to exactly 3 of these types of events per year on average (higher than the 2.3 MED expectation in the calculation of boundary values). Vector anticipates significant impacts as extreme weather events increase. The current impacts are expected to continue and worsen.

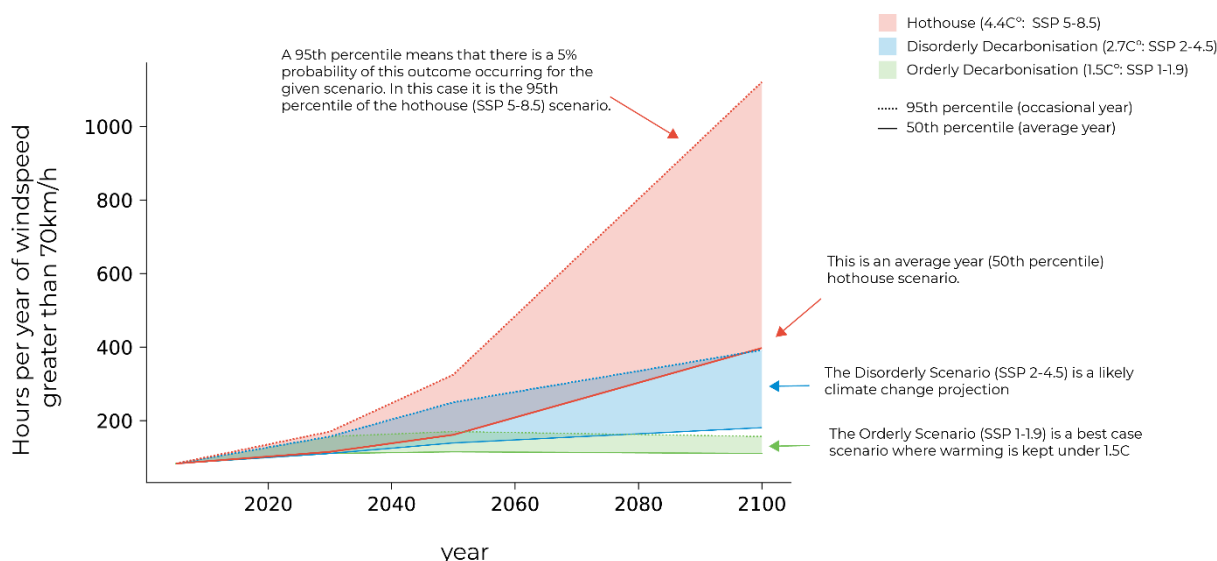
105. In FY2022 Vector began assessing future physical climate scenario analysis based off the IPCC Assessment Report 6 which was published in 2021. It did so by prioritising those risks with the highest expected materiality of impact; those being risks associated with higher wind-speed, flooding risk, landslip risk, fire risk, and risks associated with ground temperature increases.

106. As heavy wind-speeds are responsible for most damage on the Vector network, an increase in wind speed frequency would increase unplanned outages, and additional expenditure for network repair. In FY2022 Vector commissioned ClimSystems to analyse the hours of high wind speeds per year. Figure 1 below highlights hours per year greater than 70km/h.

Figure 1: Hours per year of windspeed greater than 70km/h

<sup>25</sup> Vector, *Electricity Asset Management Plan 2024-2034*, Schedule 11b

<sup>26</sup> ICNZ, available: <https://www.icnz.org.nz/industry/cost-of-natural-disasters/>



107. 70km/h is a windspeed threshold at which point Vector starts noticing network damage, due to wind and therefore more likely to respond to outages on the network . This metric is therefore a good indicator of potential reactive maintenance costs in response to weather events.<sup>27</sup>

108. All future climate scenarios highlight an increase in the hours per year of windspeeds greater than 70km/h. The world is current on trajectory towards the Disorderly Decarbonised scenario (IPCC SSP 2-4.5 Scenario) – highlighted by the blue line. This increase in hours of high windspeed will therefore likely correlate with an increase in reactive maintenance expenditure.

109. Vector has also conducted climate change analysis of coastal inundation, freshwater flooding, landslip susceptibility, and fire risk during hot and dry weather. All results, align to the general IPCC predictions of increasing weather impacts in the coming decade.

110. Vector is currently working towards integrating the latest NIWA data released in July 2024. This will further refine our existing models and understanding of the impacts of climate change.

111. MBIE’s summarised research on the impacts of climate change also aligns with Vector’s findings. This includes<sup>28</sup>:

- a. The Intergovernmental Panel on Climate Change (IPCC) released its Sixth Assessment Report (AR6) in 2021. In it, the global panel of climate scientists projected

<sup>27</sup> Refer to Vector’s FY2023 TCFD for more information <https://blob-static.vector.co.nz/blob/vector/media/vector-2023/vector-2023-tcf-report.pdf>

<sup>28</sup> The science linking extreme weather and climate change: <https://environment.govt.nz/news/the-science-linking-extreme-weather-and-climate-change/>

- that floods across the world will continue to become more frequent between now and 2050;
- b. It is also projected that severe convective storms (thunderstorms) will carry more rain in a warming world;
  - c. Global mean surface air temperature has increased by 1.09°C over the past century. For Aotearoa New Zealand, the atmospheric warming between 1909 and 2016 was 1.1°C;
  - d. One degree of warming in the air translates, on average, to about 7 per cent more water vapour in that air, the IPCC found. While the atmosphere has a higher capacity to “hold” water vapour at higher temperatures, the heavier air masses result in rain bursts that can be 10 to 20 per cent heavier; and
  - e. NIWA produces regional climate projections for New Zealand based on the IPCC’s data. NIWA estimates that in New Zealand, one degree of warming translates to a median 13.5 per cent increase in rainfall per hour in a one-in-50-year event of 1 hour duration (MfE, 2018).
112. Whilst Vector has explained our approach to capex resilience in our 2024 AMP, the Commission must understand that opex investment will also increase due to the above outlined risks brought about by climate change in particular for storm response activities.
113. Vector will not be alone in witnessing increased costs for storm response. Our geography means that all New Zealand EDBs will feel the impact of climate change<sup>29</sup>. This step change is therefore not only significant but widely applicable too.
114. Vector also believes that this step change is in alignment with Action 8.4 from the National Climate Adaptation Plan – which ‘Provide for regulated network revenues to reflect the prudent and efficient cost of resilience’<sup>30</sup>.
115. For these reasons we are re-applying for a step change of \$5.145m which is the average DPP4 expenditure for storm response adjusting for any storm response spend that was in the base year i.e. RY24).

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<sup>29</sup> Aotearoa New Zealand is a small island nation on the Pacific Rim. Our location makes us vulnerable to natural hazards. The island sits on the Ring of Fire subduction zone, where the Earth’s Pacific- and Australian tectonic plates meet, causing increased seismic (earthquake), volcanic and hydrothermal activity. Our large coastline and the lack of other islands between us and the Pacific Ocean increases our tsunami risk. And the fact we’re positioned in the ‘roaring forties’ – an area of the planet exposed to strong, westerly winds – subjects us to frequent extreme weather, including winds, rain and storms. <https://www.icnz.org.nz/industry/about-natural-disasters/>

<sup>30</sup> Available: <https://environment.govt.nz/assets/publications/climate-change/MFE-AoG-20664-GF-National-Adaptation-Plan-2022-WEB.pdf>

116. There are alternative mechanisms the Commission could resort to if these storm response related costs are not seen as adequate for a step change by looking at Ofgem's approach<sup>31</sup>:
- a. At the DPCR4 price control, Ofgem introduced a cost allowance for improvements in restoration times following severe weather events to cover an efficient level of compensation payments and fault costs relating to these events. (Severe Weather 1 in 20 allowance);
  - b. In the current RIIO-ED2 price control Ofgem has determined severe weather costs are pass through items.
117. Vector believes the second option is superior so that EDBs who experience storm related costs can treat the additional expenditure incurred as pass-through costs. The items that are categorised as such would be audited through the annual compliance statement, ensuring costs are incurred efficiently and categorised correctly.

#### *Software as a Service (SaaS)*

118. The Commission has awarded a step change to EDBs which applied for SaaS cost increases where the forecasted costs for DPP4 were higher than the RY24 base year. We support this decision, but consideration must also be given to EDBs who incur increased SaaS expenditure in the last period of DPP3.
119. Over the course of DPP3, due to the IASB's SaaS accounting change and a cloud first strategy for our electricity business, we will spend an additional \$15m of opex not factored into our DPP3 opex allowance. Included in this amount is an expected increase in SaaS costs of approximately \$2.5m between RY24 (the base year) and RY25. This increase was identified after the step change information was provided to the Commission in April. This forecasted increase will result in an extra \$13m of costs not captured in the DPP4 allowance under the current base step and trend approach. We recommend that the Commission addresses this under-recovery of SaaS costs in DPP4 by increasing the DPP4 opex allowance.
120. EDBs who are early adopter of new technologies and digital systems should not be disadvantaged merely due to when expenditure of this nature occurs. Furthermore, we note that there is a wash-up for capex that is incurred in the last period of DPP3 versus the level of capex assumed in that period when DPP4 was set. However there is no such wash-up for opex. There are also no reopeners available for opex driven projects and programmes (for example, to cover digitalisation).

#### **IRIS and efficiency**

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<sup>31</sup> Complete Strategy, *RIIO-ED2 Uncertainty Mechanisms* (March 2023), available here: <https://blob-static.vector.co.nz/blob/vector/media/vector-2023/complete-strategy-uncertainty-mechanisms-in-the-uk.pdf>



121. We support the Commission's draft decision to maintain an equal incentive rate between capex and opex.
122. As raised in the IM review, we are concerned that the intent of the IRIS scheme is undermined where EDBs are penalised (or rewarded) for circumstances entirely out of their control that do not reflect any loss of efficiency (or improvement)
123. For example, the treatment of leases under IRIS is leading to perverse outcomes where EDBs can be penalised for failing to forecast lease opportunities years in advance.
124. The intent of IRIS is to share the burden of overspending and the benefits of underspending with consumers. This is appropriate when EDBs have control over the timing and scale of expenditure. However, it is not appropriate to apply the IRIS to expenditures over which EDBs have no control over either the timing or scale. Consumer Connections capex is a prime example of this type of expenditure.
125. Vector is concerned that the inclusion of consumer connections in the IRIS mechanism may have an impact on customers' incentives to seek decarbonisation solutions through electrification. This is because EDBs may be unwilling to be penalised for connection project costs exceeding the level allowed for in the regulatory settings.
126. Also, as previously mentioned, the Authority has signalled intent to directly regulate connection pricing which will impact EDB capital contributions. This could further loosen EDBs' control of customer connection capex. For these reasons, the Commission must exclude customer connection capex from the IRIS.
127. The higher IRIS retention factors in DPP4 will exacerbate these issues.

## **Innovation**

128. We welcome the Commission's draft decision to implement the innovation and non-traditional solutions allowance (INTSA) as a good step forward. We appreciate that the Commissioners have listened to stakeholder feedback on issues with the innovation project allowance in the current DPP.
129. We recommend the following improvements to the draft INTSA would better support innovation.
130. The INTSA should expressly support net zero innovations, alongside energy efficiency and demand side management especially given the IM Review clarification note that ensures that

the IM review framework give permissive consideration to s 5ZN of the Climate Change Response Act (CCRA)<sup>32</sup>:

*“[the Commission] may take into account the s 5ZN of the Climate Change Response Act 2002 considerations<sup>33</sup> provided they are relevant and that doing so does not compromise our achievement of the s 52A purpose of Part 4”*

131. Given that one of the main criteria of an INTSA project is to promote the Part 4 purpose of the Act, we expect that net zero projects (i.e., projects where the “INTSA outputs” are to reduce carbon emissions) are in scope. The Commission needs to be explicit that this is the case. This would complement draft decisions U2 and U3 which incentivise energy efficiency, demand side management and the reduction of energy losses through the draft INTSA.
132. Greater clarity is needed around how the EDB can demonstrate the eligibility criteria (i.e., that a project is riskier than ‘business as usual’) would better support applications. The Commission has indicated that an EDB could choose to support its case that a project is riskier than BAU by providing a director certificate that confirms this project would not otherwise go ahead without support from the INTSA. It would be beneficial to understand what other ways EDBs could prove this criterion is met.
133. The guidance that the Commission intends to provide around INTSA applications needs to be specific on third party involvement. The Commission has helpfully provided some insights<sup>34</sup> around collaboration on INTSA projects between EDBs but has not been explicit on how the scheme could work when an EDB collaborates with a stakeholder that is not an EDB, nor a consultant. Example could be if Vector wished to undertake an INTSA project with Auckland council who would help with project implementation or a digital company with a new platform for delivery of dynamic operating envelopes. It would be useful if the Commission could outline how the scheme would work with these types of instances.
134. Regarding the guidance the Commission is looking to develop on the INTSA we would encourage the Commission to co-develop that guidance with suppliers and possibly other stakeholders. During the DPP reset process there has been clear benefits derived from working together e.g. the opex step change workshop between ENA members and

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<sup>32</sup> Commerce Commission, *Note of clarification – our part 4 input methodologies review 2023 framework paper* (21 December 2022)

<sup>33</sup> s 5ZN refers to the 2050 target and emissions budget are permissive considerations: if they think fit, a person or body may, in exercising or performing a public function, power, or duty conferred on that person or body by or under law, take into account— (a) the 2050 target; or (b) an emissions budget; or (c) an emissions reduction plan.

<sup>34</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at D63-D67

Commission staff. We therefore encourage the Commission to embrace more of this type of engagement and consider the INTSA guidelines a good candidate for this.

135. Vector welcomes the move to ex-ante approval for the INTSA scheme however the timeliness of the Commission's approval will be crucial for successful innovation. Sometimes ideas and opportunities move quickly and in order to be at the forefront of innovation, the Commission will need to ensure their decision making is fast. We propose that the Commission sets itself a two-month deadline to respond to INTSA proposals.
136. An easy solution to the above suggestions will be for the Commission to include points of clarification in the guidance for how to apply for the INTSA scheme and/ or, its Project Eligibility Assessment (PEA) template. Another consideration which we believe would add value to the guidance are specific examples of projects which fit the criteria and examples of projects which do not, including reasons why. This will remove ambiguity and ensure EDBs are putting effort into project proposals which are meeting the Commission's expectations for the scheme.
137. Vector suggests that when INTSA guidance is issued, that there is an opportunity for stakeholders to feedback and ensure there are not interpretation issues ahead of the guidelines being finalised.
138. One of the positive steps of the INTSA mechanics was the Commission's draft decision to exclude outages directly associated with an INTSA project from the calculation of SAIDI and SAIFI values up to a cap of 0.5% of the respective SAIDI and SAIFI limits. However, it is our view that SAIDI and SAIFI related to flexibility service providers should be entirely carved out, rather than capped. This would otherwise this could act as a disincentive to engage with third parties on innovative projects and services.
139. The Commission states that it has not created a specific carve-out where a third-party fails to comply with a DOE as they consider this should be able to be accommodated within contractual terms. We believe that the regulatory regime should provide safeguards that encourages innovation, as it is unrealistic in developing markets to expect contractual terms to provide all of those safeguards. For example, the potential costs to an EDB of breaching quality standards is very high. If these potential liabilities are part of contractual terms for third parties providing innovative solutions, then we can see these terms detracting from a provider providing such solutions.
140. We were disappointed that in the recent IM review the Commission rejected regulatory sandboxing for INTSA projects, and we consider this needs to be reevaluated by the Commission. A regulatory sandbox can provide exemptions to certain rules in order to promote in delimited scenarios (such as an innovation project) efficiency and/ or innovation.
141. We are pleased to see the INTSA funding increased compared to the innovation project allowance (IPA). The Commission's INTSA is now more in line with the innovation funding allocated in Australia where the AER made clear in all recent decisions that it sees innovation

as a key enabler to customers who can respond to prices and reduce their bills. It sees the accelerated roll-out of smart meters to customers, flagged by the AEMC's metering review – as a critical enabler for the integration of CER (customer energy resources) work programs.

142. In addition, two of the six final decisions explicitly provide for dedicated innovation expenditure – namely, those for Ausgrid and Endeavour Energy. In both decisions, the AER expressed some concern regarding the evidence provided in support of the forecast expenditure amounts. However, it nevertheless approved a level of ex-ante innovation investment for both businesses, acknowledging the need for ex-ante innovation funding to enable the businesses to test new and unproven technologies and ways of managing their networks, before committing these into business-as-usual activities.
143. The AER approved the following amounts:
  - a. Ausgrid \$17m (\$2023–24) (\$15.4m in capex, \$1.5m in opex) for its 'Network Innovation Program', which comprises a range of trials and pilots covering various technologies to support the rapidly evolving electricity sector.
  - b. Endeavour Energy \$20m (\$2023–24) for its own 'Innovation Fund', which is built around four investment themes including orchestration and DSO, EV services, sustainability solutions, and climate resilience.
144. Separate to the dedicated allowances, the AER also provided its demand management innovation allowance (equating to \$8m for Ausgrid, \$5m for Endeavour Energy, \$6m for Essential Energy, \$2m to EvoEnergy, \$3m TasNetworks, and \$2m for Power and Water). Vector believes that depending on the results of the INTSA schemes in DPP4, the Commission should look at a more targeted scheme for DPP5.
145. Finally, we welcome the Commission taking on board Vector and other EDBs' feedback to do more to promote section 54Q of the Act around incentivising energy efficiency, demand side management and the reduction of energy losses. Draft decisions U2 and U3 confirm that those 54Q items are in scope for the INTSA scheme.
146. Investing in energy efficiency and demand side management have the potential to provide significant benefits for consumers from a whole of energy system cost (WESC) perspective (something Vector has long advocated). For example, EDB involvement in energy efficiency of buildings, vehicles and appliances having the effect of maximising energy use, minimising energy loss and reducing customer costs as it pertains to electricity service is beneficial across the energy system.
147. Also, the Commission has alluded to these initiatives having the potential to target energy hardship and/ or vulnerable customers. We welcome the clarification that these types of

projects are in scope for the INTSA “where such projects are within the scope of the role of supplying electricity lines services.”<sup>35</sup>

## Quality standards and incentives

### High level approach for quality standards and EDB operating environment

148. We agree with the draft decision to introduce no new quality standards for DPP4.
149. We also recommend the Commission reconsider its decision to retain the annual assessment of quality standards (rather than replacing it with the two-out-of-three-year rule). We still consider the two-out-of-three-year rule would reduce the risk of false positives.
150. EDBs face a significantly more difficult operating environment relative to the historic reference period with a greater likelihood of severe weather events. NIWA has completed a major project to analyse how New Zealand’s “climate normal” are shifting.<sup>36</sup>
151. Climate Database Scientist Raghav Srinivasan says that climate change is making researchers around the world reconsider how we approach climate normal:

*“Climate change means we are living with rapid shifts in global and regional climate patterns, so we need to better incorporate these variations when we calculate climate normals. Physical processes such as El Niño and La Niña can have significant influence on the year-to-year variance in seasonal rainfall and temperature too, particularly in New Zealand, meaning they must also be integrated into our calculations.”*

### The ‘tail’ of major events and normalisation

152. Post Cyclone Gabrielle and the Auckland Anniversary Storms we have experienced issues with the ‘tail’ of major events which the current approach to normalisation does not account for.
153. The residual impact of extreme weather events results in higher outages and longer restoration times outside the major event reasons. This is for a number of reasons including:
  - a. Limited resources due to widespread faults and high coverage area. In the 2023 storms this required Vector to engage crews from other EDBs including from Australia;

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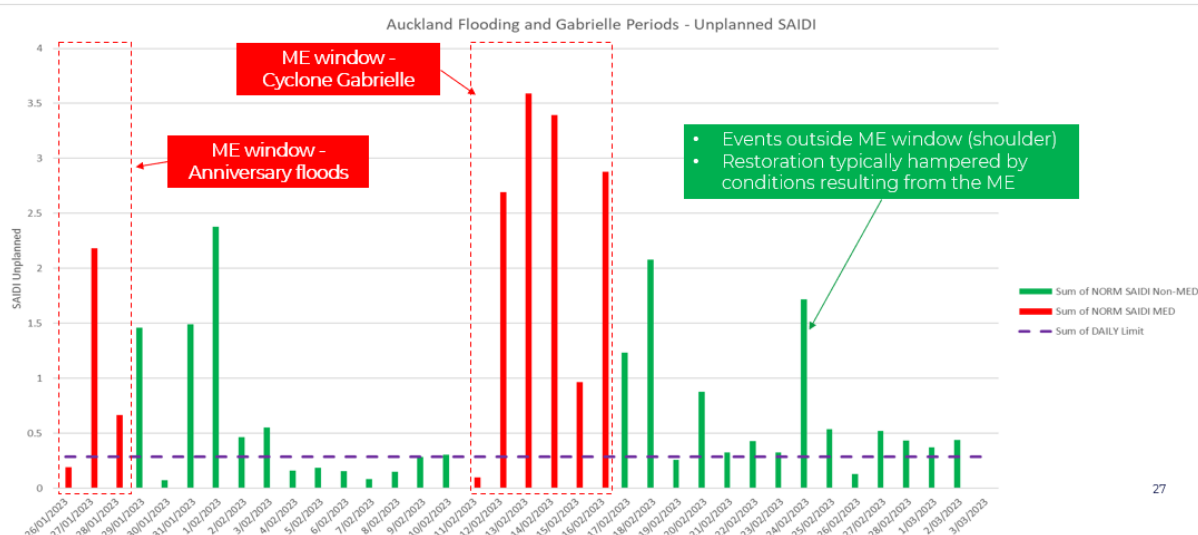
<sup>35</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at D144

<sup>36</sup> Available: <https://niwa.co.nz/news/climate-change-making-scientists-reassess-what-normal>

- b. Complying with health and safety requirements due to unsafe conditions (e.g., flood water, trees falling and ground instability) and fatigue management protocols for crews further lengthens restoration times;
- c. Damage from extreme weather (e.g., flooding, slips and road closures) leading to access issues that lengthen restoration times;
- d. Remote areas become isolated and under the control of emergency services (e.g., Piha and Muriwai during the 2023 storms); and
- e. The compounding effects of multiple severe weather events resulting in ground saturation and instability exacerbates restoration efforts for new faults.

154. The graph below shows the impact of the ‘tail’ of Cyclone Gabrielle and the Auckland storms on our unplanned SAIDI.

Outages outside the ME window for extreme weather events cause significant SAIDI (without triggering another ME)



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- 155. We recommend the Commission adjust the approach to normalisation to ensure outages attributable to the ‘tail’ of major events are normalised. Severe weather events are increasing due to climate change so ‘tail’ events are likely to become a more significant problem.
- 156. Failing to account for ‘tail’ events will result in EDBs being penalised for severe weather events that do not reflect any material deterioration of the network. This would undermine the purpose of the quality standards and could lead to perverse incentives around restoring outages.
- 157. We also note severe weather events can cause a significant ongoing impact on the network that may not be immediately apparent. It is foreseeable that an asset could suffer damage during a major event leading to outages well outside the MED period. Some damage to assets from major events may not be apparent despite EDB monitoring.

FENZ and NIWA advice on fire risk

158. We recommend the Commission exclude outages that result from a direction or advice from FENZ and NIWA around fire risk.
159. Vector has a protocol to de-energise parts of the network for public safety during periods of high fire risk. This is initiated based on advice from FENZ on fire risk and NIWA on windspeeds:
- a. Criteria for a proactive shut down for public safety:
    - i. Extreme fire risk day declared by FENZ; and
    - ii. Forecast sustained wind speed >50km/h.
  - b. Criteria for re-energisation following a public safety shutdown event:
    - i. Extreme fire risk reduces on advice from FENZ; or
    - ii. Re-energisation request from FENZ; or
    - iii. Forecast sustained wind speed < 50km/h; and
    - iv. Following feeder patrol.
160. Vector has not yet had to implement this protocol, so no minutes attributed to fire risk advice are included in our reference period.
161. However, we expect we will incur outages attributed to proactive shutdown for fire risk going forward given changing weather patterns. Higher average temperatures and windspeeds will result in more periods of fire risk so the likelihood of Vector (and other EDBs) incurring outages to reduce bushfire risk has greatly increased in DPP4. This risk will continue to grow as the impact of climate change continues.
162. Outages to reduce fire risk do not reflect any underlying network performance and are only implemented by the EDB on advice from FENZ and NIWA. Accordingly, we consider it would be appropriate to exclude these outages from the calculation of SAIDI and SAIFI. This would be consistent with the treatment of other outages not initiated by the EDB and could otherwise lead to perverse outcomes where EDBs are penalised for following direction to protect public safety.

#### Requests from third parties

163. We have experienced outages where third parties (for example, Transpower) have asked us to reconfigure our network in certain ways to enable them to carry out maintenance. These configurations have left the network more vulnerable (for example, due to reduced security) leading to outages.
164. We recommend outages resulting from these situations be excluded from the calculation of SAIDI and SAIFI.
165. Currently, EDBs face the risk for network configurations requested by third parties. This could lead to perverse incentives, as EDBs could be disincentivised from co-operating with third parties on maintenance.

### Need for enforcement guidelines

166. To better promote regulatory certainty, we recommend the Commission publish enforcement guidelines. The sector has been expecting these guidelines for a number of years.

### Other comments on the draft decisions on quality

167. Vector notes the Commission's draft decision to retain the approach that EDBs must record successive interruptions on the same basis they employed in responding to the s 53ZD notice. Vector has and will provide datasets on both the multi count and non-multi count basis. We are neutral on the method adopted so long as the target setting for SAIFI aligns to the methodology used. However, the Commission needs to have sufficient audited data for the reference period used in order to set targets, which might cause issues with setting targets on the multi-count basis with only one year of audited data requested in the s 53ZD.

168. We support the draft decision to maintain the de-weighting of notified interruptions only being applied to the assessment period and not the reference period dataset.<sup>37</sup> EDBs have major upcoming capex programmes in DPP4 that will result in more planned outages, so it is critical there are appropriate incentives to notify customers.

### **Depreciation**

169. In the last IM review, the Commission changed its approach to calculate depreciation for existing assets to require an asset-by-asset calculation. This change will have a significant impact on Vector's (and other EDBs) revenue in DPP4.

170. We are aware the ENA wrote to the Commission expressing concern that stakeholders did not have sufficient opportunity to comment on this change, and that its impact and implications were not apparent until EDBs began preparing their responses to the s53ZD request issued 20 March 2024.

171. We have submitted the ENA's letter to the Commission on this matter as part of this consultation. We are interested in the outcome of these discussions.

172. Going forward, we strongly encourage the Commission to ensure any regulatory changes that may have a significant impact are appropriately highlighted so stakeholders can provide comment during the consultation process.

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<sup>37</sup> Commerce Commission, *Default price-quality paths for electricity distribution businesses from 1 April 2025 – draft decision: reasons paper* (29 May 2024) at E82



173. There is regulatory precedent for this in the UK where Ofgem publishes “impact assessments” for their price control decisions, summarising the financial (and other) impact on companies and consumers of their key decisions<sup>38</sup>.

### Financial model

174. We have reviewed the Commission’s financial models and note the following issues:

#### Asset Lives

177. The IMs currently require new additions to use a 45-year life. This is inconsistent with treatment of existing asset lives used for depreciation which are determined on an asset-by-asset basis. We recommend the Commission amend the 45-year asset life assumption in the IMs to be consistent with the asset life of additions during DPP3 (RY21 to RY24). During DPP3, a larger proportion of expenditure was on short-life assets related to digital and new technologies than when the 45-year life was set for DPP1. The proportion of short-life assets is likely to increase in DPP4 and into the future.

178. We recommend the Commission calculates the average asset life of DPP4 additions to be used in the financial model by calculating an average asset life based on individual asset additions between RY21 and RY24. The Commission should request each EDB to calculate and provide this information as part of the s 53ZD information request the Commission will issue to gather updated information on depreciation and leases which they will use for their final decision.

179. We suggest the following methodology for calculating the average asset life of additions. This will ensure the average useful life of additions accurately reflects the depreciation profile of the new additions. We note the individual asset values should not be used to weight the useful life, as this will give an inaccurate average life resulting in an incorrect depreciation profile.

$$\text{Average Asset Life} = \text{sum} [\text{Life of Asset}_i * (\text{Year 1 Depreciation of Asset}_i / \text{Year 1 Depreciation of Total New Additions})]$$

For Example:

	A	B	C	D <sup>1</sup>	B*D
Assets	Value	Life	Year 1 Depreciation	Depreciation Proportion	Weighted Life
	\$	Years	\$	%	Years
Asset 1	100	50	2	12.5%	6.3

<sup>38</sup>Ofgem impact assessment for RIIO-ED2, available: [RIIO-ED2 Network Price Control Final Determinations Impact Assessment Annex \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/riio-ed2-network-price-control-final-determinations-impact-assessment-annex)

Asset 2	100	25	4	25.0%	6.3
Asset 3	100	10	10	62.5%	6.3
<b>Total</b>	<b>300</b>		<b>16</b>	<b>100.0%</b>	<b>18.8</b>

$$^1D = Ci / Sum(C)$$

180. The above methodology of calculating average useful life of additions should also be used in the capex IRIS calculation to ensure the correct depreciation profile is used.

Disposals assumption used to calculate MAR

181. The Commission's model for the draft decision uses RY23 disposals increased by an escalation factor. We consider this is incorrect as the Commission should have used the disposals included in our March s 53ZD response, as it includes our best estimate of yearly disposals for the DPP4 period. For the final decision the Commission should use the disposal figures that will be in our s 53ZD response that will be provided to the Commission with updated RY24 information. The reason this must be used is that the s 53ZD response updated for RY24 will be our best forecast of disposals for the DPP4 period and will have been subject to audit, as the s 53ZD response will be required by the Commission to be audited. We consider Vector is better placed to forecast the level disposed assets for the DPP4 period than the Commission, with assurance given by auditors that the approach to determining those disposals is reasonable.

**Deliverability**

175. Our overriding position on deliverability is that it is outside of the Commission's mandate under a low cost DPP model. The Commission needs to provide the regulatory settings to incentivise investment which includes financeability but that does not extend to deliverability. Suppliers are the best placed to make decisions on the "how" and whether investment can be delivered as forecasted. The Commission does not work or operate our businesses and is therefore not well suited to make judgements on whether certain investments are deliverable or not. Direct operational control of suppliers would in our view be very out of step with the Part 4 purpose.

176. That said, Vector has a strong track record of delivering through periods of significant growth. We have witnessed Auckland grow extensively, and ahead of the Commission's forecasts, over the past decade with no signs of easing.

177. Our number of new connections in a year has grown by 40% compared to five years ago; distribution transformer capacity (EDB owned) has increased by 13% since 2018; and our network length by 4% for the same period<sup>39</sup>.
178. This has led Vector to invest and deliver in an efficient manner even during a period where we have witnessed external factors heighten deliverability issues (such as high inflation, Covid-19 on supply chain costs and access to goods and materials).
179. However, there is always a concern that other global events could emerge, infrastructure build across all sectors seems in very high demand, and that inflation remains high in DPP4. To mitigate these concerns, Vector actively engages with our delivery partners around our forecast investments and future resourcing requirements.
180. There is no historical precedent under the DPP for the Commission intervening in an EDBs' operating practices. Given deliverability requires a highly individualised assessment of each EDB's capacity to deliver capex, it is unlikely that an assessment of deliverability as part of capex forecasting would be compatible with the low-cost objective of DPP regulation.
181. If this door is opened it could allow an intrusion which the Commission, an economic regulator, is simply unfit to perform. We would also question how an assessment of deliverability fits with the Part 4 purpose statement s52A(1).
182. We have previously made this assessment in Appendix B of our cross-submission to the DPP4 Issues Paper<sup>40</sup> which in summary concludes that:
- a. an assessment of deliverability is consistent with the s 52A purpose statement; but
  - b. given deliverability requires a highly individualised assessment of each EDB's capacity to deliver capex, it is unlikely that an assessment of deliverability as part of capex forecasting would be compatible with the low-cost objective of DPP regulation; and
  - c. the Commission's Issues Paper discussion of deliverability highlights the risk that consumers are required to fund additional returns to EDBs due to non-delivery, whereas the greater risk to consumers is that prudent and efficient investments are not delivered. That suggests the Commission should instead be focusing on ensuring that the regulatory settings support EDBs in delivering their AMPs.
183. EDBs are best placed to understand these constraints and manage them. EDBs have traditionally delivered their work programmes despite constraints of the past. If the

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<sup>39</sup> All figures derived by comparing our RY2023 EID to the RY2018 EID available on our website here <https://www.vector.co.nz/about-us/regulatory/disclosures-electricity/financial-and-networkinformation>

<sup>40</sup> Available: [https://blob-static.vector.co.nz/blob/vector/media/vector-2024/vector-cross-submission-dpp4-issues-paper-\(1\).pdf](https://blob-static.vector.co.nz/blob/vector/media/vector-2024/vector-cross-submission-dpp4-issues-paper-(1).pdf)

Commission is concerned with awarding allowances and then EDBs being unable to deliver, then they should use other ways such as UIOLI mechanisms or contingent allowances rather than making bold and broad-brush scaling back of allowances due to perceived concerns on deliverability of work programmes. UIOLI schemes provide carved out funds for specific projects or programmes of work, which if not delivered ensure the related funds are returned to consumers.

### **Additional reporting**

184. Along with proposed delivery reporting, the Commission is also considering the following additional reporting requirements:

- a. Re-opener information for EDBs with capped forecasts: As discussed earlier in this submission, we would like further information on how this applies to EDBs with uncapped forecasts.
- b. To provide better visibility of capital contributions: Our initial reaction is this would be unnecessary given EDBs are already subject to disclosure requirements in terms of capital contributions.

185. We do have concerns about the Commission creating additional regulatory burden by introducing new requirements without consideration of removing surplus requirements. We recommend if the Commission adds new reporting requirements it also considers what existing disclosure requirements could be removed. We cannot be in a situation where additional burdens and regulatory compliance costs are forever loaded upon EDBs.

If the Commission is considering additional reporting requirements on EDBs to mitigate deliverability concerns, it must also consider that we operate in a low-cost DPP. EDBs already face a huge regulatory burden through ID. If more disclosures such as an annual delivery report (ADR) are being contemplated by the Commission, then the Commission must provide the additional opex that would be required to set up these reporting mechanisms as a minimum. It is our view that ADR has no place in the low-cost DPP framework. ADR has been used in CPPs, this would seem appropriate as projects and programmes of work have had detailed scrutiny by the Commission and the verifier. This is not the case under the DPP where many of the expenditure categories are “buckets” of spend which are fungible.

186. If the Commission is concerned with forecasts being funded and then programmes of works not being delivered, then mechanisms such as UIOLI should be introduced that eliminate the risk on consumers without burdening them with the unnecessary cost of extensive reporting. We also suggest that the Commission first looks at Schedule 14 of the EID where EDBs are already required to provide explanations of variances of actual against forecast expenditure categories from Schedule 7.

187. The Commission must also consider the cost-benefit analysis of any additional disclosure and ascertain in advance which stakeholders would a. read it and b. benefit from its content.

188. Once again, the Commission is proposing to add to the reporting requirements on EDBs, and has not taken the opportunity to streamline or remove obsolete or unused ID. We propose that the Commission reconsiders the regulatory calendar and removes the requirement for AMP disclosures in years 1, 2 and 5 of the DPP. Instead in those years, EDBs could provide updates on their Year 4 AMP of the previous regulatory period, i.e., the AMP used to inform the reset. Those updates should not require director certification. Full AMPs would remain in place for years 3 and 4 to inform the draft and final decisions of the reset.

#### **Connections to other EDB assets**

189. We recommend the Commission amend the IMs to treat the costs of connections to assets owned by other EDBs as a pass-through cost. This would be analogous to the treatment of costs associated with connections to Transpower's assets.

190. As the country electrifies, there will be more opportunities for EDBs to pursue innovative solutions that avoid the need for more expensive capex solutions such as connecting to other EDB assets. However, there will be barriers to pursuing these solutions if they are not included in the EDBs allowances, in particular, an EDB is unlikely to have opex (for example, for connections charges) in its base year.

191. We consider the regulatory framework should treat connections between EDB assets in the same way as Transpower connections, given all these parties are regulated by the Commission. This would better promote the Part 4 purpose by supporting EDBs to pursue innovative connection arrangements that avoid the need for more expensive capex.

## Appendix one: template on the draft decision from the Commission

Please note that the answers provided in this appendix are supplementary to our submission, and that the bulk of our responses will be found in the main section above.

<b>Request for feedback on DPP4 draft decisions</b>	
<b>Capital expenditure (capex)</b>	
<b>1. Capex</b>	
C1	Use EDB 2024 AMP forecasts as the starting point for setting capex allowances.
C2	Set the capex allowance in constant dollars based on the lower of an EDB's total forecast capex or 125% of its historical reference period capex, with an adjustment for forecast capital contributions.
C3	Use a five-year historical reference period for setting capex allowances [2019 to 2023 for the draft and 2020 to 2024 for the final determination] with an additional cost escalation adjustment.
C4	Include an allowance for the cost of financing, scaled in proportion to the capex allowance.
C5	Include an allowance for the value of considerations for vested assets and spur assets equal to 2024 AMP forecasts.
C6	Use the All-Groups CGPI forecast with an additional adjustment to escalate the constant price capex allowance to a nominal allowance.
Views/Response:	
<p>We are encouraged the Commission has recognised EDB costs, for capex and opex, have increased higher than the reference periods.</p> <p>We recommend the Commission consider the report from Oxford Economics Australia (engaged by Vector, Wellington Electricity and Orion).</p> <p>OAE found strong arguments that the capex inflator should be higher, along with network opex. OEA found that that the Commission's draft decision to utilise All-Groups CGPI + 0.8% to escalate capex allowances should be replaced with a final decision to utilise All-Groups CGPI + 3.1%.</p> <p>Our subsection on expenditure further sets out our views and recommendations on this topic.</p>	
<b>Operating expenditure (opex)</b>	

## Request for feedback on DPP4 draft decisions

### 2. Opex

O1.1	Apply a base-step-trend approach to forecasting opex.
O1.2	Use 2024 as the base year. [2024 AMP forecasts used for the draft decision]

Views/Response:

As a matter of principle, we consider there is scope to make better use of AMP forecasts for opex forecasting.

We support the use of 2024 ID data for the base year.

### 3. Opex step changes

O2.1	Consider proposed step-changes against a defined set of factors, incorporating judgement.
O2.2	Step-changes should be significant.
O2.3	Step-changes should be adequately justified with reasonable evidence in the circumstances.
O2.4	Step-changes must not be included elsewhere in expenditure allowances.
O2.5	Step-changes should have a driver outside the control of a prudent and efficient supplier.
O2.6	Step-changes should be widely applicable.
O3.1	Include a step-change to reflect increasing insurance costs.
O3.2	Include a step-change for greater consumer engagement.
O3.3	Include a step-change for low voltage (LV) monitoring and smart meter data.
O3.4	Include a step-change for increasing cyber-security costs.
O3.5	Include a step-change for the costs of software-as-a-service (SaaS).
O3.6	Include a negative step-change in Aurora's indicative forecasts to capture the end of its CPP spend.
O3.7	Cap aggregate step-changes (in real terms) at 5% of trended opex excluding step-changes.

## Request for feedback on DPP4 draft decisions

Views/Response:

We agree the new step change criteria is sensible and support the step changes included in the draft decision.

We request the Commission reconsider its decision not to include Vector's step change request for reactive maintenance. We have provided further evidence on this step change (under the more appropriate banner of 'storm response') in our submission.

Vector agrees that SaaS is an opex step change, but we recommend that the Commission addresses Vector's under-recovery of SaaS costs in DPP4. EDBs who are early adopter of new technologies and digital systems should not be disadvantaged merely due to when expenditure of this nature occurs.

Our subsection on opex step changes further sets out our views and recommendations on this topic.

### 4. Opex trend factors

O4.1	Escalate all opex costs using the same cost escalator.
O4.2	Escalate opex using the all-industries labour cost (60% weighting) and a producers' price (40%) indices, plus a 0.3% uplift to reflect EDB-specific inflation.
O5.1	Scale growth forecast separately for network and non-network opex.
O5.2	Use 2018-2024 as the reference period for scale elasticities and driver projections [2024 data available post-draft].
O5.3	Forecast network opex scale growth with line length (elasticity 0.52) and ICPs (0.45).
O5.4	Forecast non-network opex scale growth with line length (elasticity 0.35), ICPs (0.22), capex (0.30).
O5.5	Forecast lines length extrapolated using recent growth rate trend, and irregular data adjusted.
O5.6	Forecast ICP count extrapolated using recent growth rate trend, and irregular data adjusted.
O5.7	Forecast capex based on a constant growth.
O6.1	Apply an opex partial productivity factor of 0%.



## Request for feedback on DPP4 draft decisions

### Views/Response

As discussed in our response to 1, we are encouraged the Commission has recognised EDB costs, for capex and opex, have increased higher than the reference periods. We recommend the Commission consider the report from Oxford Economics Australia (engaged by Vector, Wellington Electricity and Orion). OEA found strong arguments that the capex inflator should be higher, along with network opex.

In terms of opex, OEA found the Commission's decision is appropriate for application to non-network opex. However, OEA did not support the approach for network opex. Instead, they advocate for an approach that recognises non-labour inputs for network opex are more closely aligned to non-labour inputs used in/for network capex rather than non-labour inputs used in/for non-network opex.

Our subsection on expenditure further sets out our views and recommendations on this topic.

## Innovation and section 54Q incentives

### 5. Innovation, energy efficiency and demand-side management

U1	Introduce an Innovation and Non-traditional Solutions Allowance (INTSA), capped at 0.6%.
U2	Incentivise energy efficiency and demand-side management incentives through the INTSA.
U3	Do not introduce a reduction of energy losses incentive.

### Views/Response:

We welcome the Commission's draft decision to implement the innovation and non-traditional solutions allowance (INTSA) as a good step forward (U1) and (U2).

We recommend that more clarity is provided around what is in and out of scope (in particular when it comes to net zero projects) when the Commission issues guidance for the scheme. This needs to be done in consultation with stakeholders.

Our subsection on innovation further sets out our views and recommendations on this topic.

## Quality

### 6. Quality standards

QS1	Maintain separate standards for planned and unplanned SAIDI and SAIFI.
QS2	Retain annual unplanned reliability standards for SAIDI and SAIFI.
QS3	Retain the 2.0 standard deviation buffer for setting the unplanned interruptions reliability standards.
QS4	Maintain regulatory period length standard for planned SAIDI and SAIFI.
QS5	Change the planned reliability buffer for the planned interruptions reliability standard to be a 100% uplift on the historic average, capped at a +/- 10% movement from the current standard.
QS6	De-weight the impact of notified planned interruptions by 50% in the assessment of compliance with planned interruption standards.
QS7	Retain SAIDI extreme event standard set at 120 SAIDI minutes or 6,000,000 customer minutes where specified.
QS8	Retain enhanced automatic reporting following a breach of a quality standard.
QS9	No new quality measures are introduced as part of the quality standards applying in DPP4.
QS10	Set interruptions quality standards and incentives for Aurora transitioning from a CPP to the DPP on the same basis as for other EDBs on the DPP.
QS11	Retain the requirement for reasonable reallocation of SAIDI and SAIFI following an asset transfer between EDBs.

#### Views/Response

We don't support the decision to retain annual unplanned reliability standards for SAIDI and SAIFI (QS2). We consider this increases the risk of false positives. We recommend using the two-out-of-three rule to reduce this risk.

We support continuing to de-weight the impact of notified planned interruptions by 50% in the assessment of compliance with planned interruptions (QS6).

We support the draft decision to introduce no new quality standards for DPP4 (QS9).

We recommend the Commission exclude outages implemented by an EDB to reduce fire risk following advice from FENZ and NIWA from quality standards and the quality incentive scheme.

We recommend the Commission exclude outages that occur solely due to network configuration (e.g. less security) implemented on request from a third party (e.g. from Transpower to conduct maintenance).

We also recommend that outages arising from INTSA projects be entirely carved out rather than capped.

Our subsection on quality standards and incentives further sets out our views on this topic.

## 7. Quality incentives

QIS1	Retain the revenue-linked quality incentive scheme for planned and unplanned SAIDI. SAIFI is excluded.
QIS2	Unplanned incentive rates are informed by the value of lost load (VOLL), discounted by (1-IRIS retention factor) to reflect expenditure incentives, and a further 10% to reflect quality standard incentives, with VOLL set at \$35,374r/MWh.
QIS3	Planned incentive rates are reduced by 35% relative to the unplanned incentive rate.
QIS4	Planned 'notified' interruptions are reduced by 75% relative to the unplanned incentive rate to reflect less inconvenience to consumers.
QIS5	Incentives are revenue-neutral at the average of the reference period, also known as the target.
QIS6	The SAIDI caps (which determine maximum losses) are set equal to the SAIDI limits for planned and unplanned SAIDI.
QIS7	The SAIDI collars (which determine maximum gains) are set at 0 for unplanned and planned SAIDI.
QIS8	Cap revenue at risk at 2% of actual net allowable revenue.
QIS9	Do not implement any new incentive schemes.
QIS10	Do not make an explicit adjustment to match the duration of retention benefits between EDBs and consumers.

### Views/Response:

We support the decisions to continue the QIS and not to implement any new incentive schemes.

We recommend the Commission exclude outages implemented by an EDB to reduce fire risk following advice from FENZ and NIWA from quality standards and the quality incentive scheme.

We also recommend the Commission exclude outages that occur solely due to network configuration (e.g. less security) implemented on request from a third party (e.g. from Transpower to conduct maintenance).

We also recommend that outages arising from INTSA projects be entirely carved out rather than capped.

Our subsection on quality standards and incentives further sets out our views and recommendations on this topic.

## 8. Normalisation

N1	Normalisation only applies to unplanned interruptions, which are the only initiators of a major event day.
N2	Retain the normalisation approach used in DPP3, being: <ul style="list-style-type: none"> <li>- define a major event as 24-hour rolling periods (assessed in 30-minute blocks)</li> <li>- the major event boundary value has been identified as the 1104th highest rolling 24-hour period for SAIDI and SAIFI over the 10-year reference period</li> <li>- normalisation is applied on half-hour blocks, within a major event, where the SAIDI figure exceeds 1/48th of the boundary value, and</li> <li>- treat major events by replacing any half-hour that is greater than 1/48th of the boundary value with 1/48th of the boundary value if that half-hour is part of the major event (can exceed 24 hours in duration).</li> </ul>
N3	SAIDI and SAIFI major events are triggered independently.
N4	Set a higher boundary for very small EDBs.
N5	Retain additional reporting by EDBs for each unplanned major event in its compliance statement consistent with DPP3.

### Views/Response:

We recommend the Commission adjust the approach to normalisation to ensure outages attributable to the ‘tail’ of major events are normalised. Severe weather events are increasing due to climate change so ‘tail’ events are likely to become a more significant problem.

Our subsection on quality standards and incentives further sets out our views on this.

## 9. Reference period

RP1	Use a 10-year reference period from 1 April 2013 to 31 March 2023 to inform the parameters for unplanned interruptions reliability standards and incentives, with the period adjusted to 1 April 2014 to 31 March 2024 for the final determination.
RP2	Apply a reference period for planned interruptions of 2017 – 2023 for the draft decision, extended to 2017 – 2024 for the final decision.
RP3	Retain the cap on inter-period movement, $\pm 5\%$ for unplanned interruptions for both the SAIDI and SAIFI unplanned target and also apply this to the SAIDI and SAIFI unplanned limits.
RP4	Make no explicit step changes to reliability targets or incentives.
RP5	Make no explicit adjustments for instances of non-compliance contained within the unplanned interruption reference period dataset.
RP6	EDBs must record successive interruptions on the same basis they employed in responding to the s 53ZD notice.
RP7	Interruptions directly associated with an approved INTSA project are excluded for calculation of SAIDI and SAIFI values up to a cap of 0.5% of the respective SAIDI and SAIFI limit.

**Views/ Response:**

Vector notes the Commission’s draft decision to retain the approach that EDBs must record successive interruptions on the same basis they employed in responding to the s 53ZD notice (RP6). Vector has and will provide datasets on both the multi count and non-multi count basis. We are neutral on the method adopted so long as the target setting for SAIFI aligns to the methodology used. However, the Commission needs to have sufficient audited data for the reference period used in order to set targets, which might cause issues with setting targets on the multi-count basis with only one year of audited data requested in the s 53ZD.

The draft decision to carve out outages directly associated with an approved INTSA project up to a cap of 0.5% (RP7) is a positive step, however, we recommend outages associated with flexibility service providers should be entirely carved out rather than capped.

**Revenue path**

**10. Price path**

P1	Set starting prices based on the current and projected profitability of each supplier using a building blocks allowable revenue (BBAR) model.
P2	Set a default rate of change relative to CPI (X-factor) of 0%.
P3	Set alternative X-factors such that, in most cases, initial price shock is limited to 20% in real per ICP. terms, and the change between years within the regulatory period to 10% (based on the price shock and notional financeability assessments).
P4	Assess price shocks on a real revenue per ICP basis, incorporating wash-ups and IRIS.
P5	Assess notional financeability using FFO/Debt and Debt/EBITDA ratios.

**Views/Response:**

We strongly support the draft decision e that provides a price path that allows EDBs to recover their BBAR over the regulatory period (draft decisions P1, P2 and P3). This is crucial to support the Part 4 purpose by enabling EDBs to invest.

We support the Commissions approach to financeability and the inclusion of a financeability sense check (P5). As a matter of general principle, we recommend that an allowance for equity issuance costs also be included in the test.

We recommend the Commission re-apply the financeability sense check if it re-opens the price-path for any reason.

Our subsections on financeability, risks to financeability and prices provide further comments and recommendations on this topic.

**11. IRIS**

I1	IRIS retention rate for capex is equivalent to the opex rate.
I2	Determine IRIS opex and capex forecasts in real terms (inflated by CPI).

Views/Response:

We support the draft decision to keep the IRIS retention rates for opex and capex equivalent (L1)

We recommend the IRIS calculation exclude consumer connections expenditure and leases.

Our subsection on IRIS and efficiency provides further comments and recommendations on this part.

**12. Revenue Path**

R1.1	Apply a revenue cap with wash-up as the form of control.
R1.2	Forecast CPI based on the four-quarter average change in CPI between the first year of the regulatory period and the current year.
R1.3	Apply a 90% "voluntary undercharging" limit (or an alternative in some cases).
R1.4	Include a large connection contract (LCC) wash-up term in the wash-up accrual formula, to avoid recovery of LCC revenue from other customers.
R1.5	Allow distributors to agree a reasonable reallocation of revenue following an asset transfer.
R2.1	Apply the revenue smoothing limit based on forecast net allowable revenue for the current year and CPI-adjusted recoverable costs from the prior year.
R2.2	Apply a revenue smoothing limit of 10%.
R3.1	Implement the revenue wash-up by specifying a re-run of the DPP4 financial model.
R3.2	Calculate the Y1 inflation wash-up based on the four-quarter average change in inflation between Y0 and Y1.
R3.3	Do not specify base revenue wash-up draw down amounts for DPP4.
R3.4	Calculate the time-value of money of the opening wash-up balance using one year of the DPP3 WACC and one year of a blended DPP3/DPP4 WACC (for a value of 5.25%). [This will be updated for the final decision.]

Views/ Response:

We support retaining the revenue cap as the form of control (R1.1).

On the LCC, we agree in principle that LCC revenue should not be recovered from other customers (R1.4). We recommend the Commission publish guidelines on the LCC to assist stakeholders understand and implement this mechanism.

Our subsections on financeability, risks to financeability and price contain further comments and recommendations in relation to this topic.

**13. Other Matters**

X1	Retain the current five-year regulatory period length.
X2	Include Aurora in the DPP4 expenditure and revenue setting process.
X3	Retain the CPP application timings set for DPP3.

Views/Response:

We support retaining the current five-year regulatory period length (X1).

**14. Other inputs to the financial model**

M1	Weighted average cost of capital (WACC) of 7.37%. [This will be updated for the final decision.]
M2	Include an allowance for disposed assets, based on historical levels.
M3	Forecast depreciation on existing assets based on information provided by each EDB.
M4	Use base year data from 2024 Information Disclosures in our final decisions, and data from 2023 Information Disclosures for our draft decisions.
M5	For CPI forecasts, use the most recently available RBNZ MPS forecasts from when the WACC was determined.

Views/Response:

Our subsection on the financial model contains our comments and recommendations on this topic.

Among other things, we recommend the Commission amend the 45-year asset life assumption in the IMs for additions to be consistent with the average asset life of additions during DPP3 (RY21 to RY24). During DPP3, a larger proportion of expenditure is on short-life assets related to digital and other new technologies than when the 45-year life was set for DPP1. The proportion of short-life assets is likely to increase into the future.