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Electricity Distribution Businesses’ Default Price-Quality Path 4 (DPP4)

Transpower welcomes the opportunity to respond to the Commission’s consultation paper *Default price-quality paths for electricity distribution businesses from 1 April 2025* Issues paper, published 2 November 2023.

We consider that the Commission has captured well the significant changes in the environmental and economic settings facing electricity lines businesses, covering a necessary resilience focus, inflation and interest rate increases, and demand uncertainty.

In the appendix we respond to select questions.

Yours faithfully,

Joel Cook
Head of Regulation.

Appendix – Transpower response to select questions

Ques	Request for comment or responses on initial views	Page	Response
Chapter 2 – Context and challenges			
1	**We are interested in your views on whether we have properly understood the changing industry context as it relates to the DPP4 reset.** Have we properly understood and represented the changing industry context and are there other implications for the DPP4 you believe we should consider?	18	The context is described well, covering a new (and necessary) resilience focus, and inflation and interest rate increases. We agree with the Commission's recognition that "*the size of the investment may need to be larger than we have seen in previous resets*" section 2.11.
Chapter 3 – Forecasting capital expenditure			
3	**We are proposing to apply the capital goods price index to forecast capex allocations.** Is there a more appropriate index which could be applied; and, if so, why?	27	We support the Commission's position of allowing for real price effects. The capital goods price indices and the producer price indices measure slightly different things. A more detailed analysis of the differences between these price indices and their application to the capex forecasts should be undertaken. For our RCP4 forecasts, we have relied more heavily on the PPI and LCI.
4	**We have concerns about the challenges in delivering increased programmes of work given current labour market, supply chain and economic challenges in New Zealand.** How should our capex forecast take into account potential sector-wide deliverability constraints?	27	We agree with the Commission that there is a tight labour market. However, given the significant amount of investment required over the next 20+ years, we need to work to alleviate the deliverability constraints. We are investing in increasing the capability and capacity of our workforce to deliver our workplan. We are working with our service providers to attract and retain skilled workers. These initiatives are set out in our RCP4 proposal. We are also working with other networks and industry on short- and longer-term initiatives to attract workers into the sector.

			As not all of trainees' time can be capitalised to projects, this opex needs to be considered when ramping up a workforce. The tight workforce may also drive-up labour costs, feeding into both capex and opex. The Commission needs to recognise this in the indices it chooses to forecast costs. The indices need to reflect the cost pressures specific to the electricity sector.
Chapter 3 – Forecasting operating expenditure			
9	**We are considering revising our approach to scale growth trend factors, to better reflect EDBs increasing focus on investing to meet growth and renewal needs.** Do you support our emerging view that including forecast capex as a driver of non-network opex could improve opex forecasts, and that this conclusion makes sense in terms of the way EDBs run their businesses? Are there alternative drivers that we should consider, and what evidence is there that they can meaningfully predict EDB scale growth?	34	Yes, we support the Commission's emerging view that that including forecast capex as a driver of non-network opex could improve opex forecasts. We do not support the Commission's view that there is no correlation between capex and network opex. Network opex can both be a substitute to capex (i.e., an opex solution in lieu of a capex solution) or complimentary (i.e., more assets demands more maintenance of said assets). The correlation between capex and network opex is linked to organisations' respective practices around substitution and capitalisation policies.
10	**EDBs have identified that insurance costs have been increasing at a greater rate than other costs they face.** What evidence do you have about how these costs are likely to evolve over time? Is the option of trending insurance opex forward using a separate cost escalator workable? How could incentives on EDBs to make risk management decisions be maintained?	34	We agree with EDBs; Transpower has identified the same in its RCP4 proposal "*Insurance premiums are driven by perception of risk, loss experience, availability of capital, and insured values. This means premium movements vary significantly from inflation. Premium rates respond quickly to catastrophic events such as earthquakes, hurricanes, and flooding. Climate change is leading to more frequent and more severe weather events. These events are driving up premiums.*" We have a material increase in our insurance premiums over RCP3. The increases have been well in excess of our forecast set out in our RCP3 proposal.

Chapter 3 – Quality standards			
12	**Our initial view is to maintain the principle of no material deterioration and set quality standards on a basis consistent with that established in DPP3.** Do you agree with our proposed approach of maintaining the principle of no material deterioration and setting the quality standards on a basis consistent with DPP3? With regard to the quality standards, are the existing reporting obligations appropriate?	38	We agree with the principle. Transpower's RCP4 proposal starts from the position of maintaining current service levels (linked to maintaining a similar risk profile) in RCP4 and beyond (RCP4 proposal page 42).