

28 May 2021

Andy Burgess
Head of Energy, Airports, and Dairy
Commerce Commission
c/o regulation.branch@comcom.gov.nz

Dear Andy,

Fit for purpose Part 4 regulation.

ON behalf of members, the ENA welcomes the opportunity on behalf of its members to share its views on ensuring that Part 4 of the Commerce Act (1986) remains fit for purpose as New Zealand moves towards a carbon neutral economy.

Electricity Distribution Businesses (EDBs) have a fundamental role in facilitating decarbonisation of the economy. The electricity sector is just at the beginning of this transition phase. The electrification of transport and industrial processes will fundamentally change electricity consumption patterns, and the increased prevalence of distributed energy resources will begin to alter the one-way flow of electricity which has underpinned New Zealand electricity system since its inception.

The distribution sector is laying the foundations for New Zealand's electrified future

The ENA's Network Transformation Roadmap (NTR) sets out to help EDBs in navigate the changes in the way electricity distribution networks will be used in the future. It also provides stakeholders with a coherent vision of the future role of electricity distribution networks in New Zealand.

Our soon-to-be published progress report on the NTR shows that EDBs have been taking a no regrets approach by laying the foundations which will buttress the transition to a carbon zero economy.

Whilst good progress is being made on some of the key enabling actions in the NTR – largely associated with obtaining greater visibility of the low-voltage sections of the distribution networks – it is still not clear that the Part 4 regime will be appropriately responsive and permissive to significant step-changes in deployment of these new technologies and the relatively 'lumpy' nature of some of the necessary investments.

ENA encourages the Commerce Commission (Commission) to carefully consider whether the existing ‘backward looking’ nature of Part 4 price control methodology could accommodate new and significant investments needed in distribution networks, of the sort described above. We and our members would be happy to work with the Commission on more detailed assessments of these sorts of challenges.

Much of the current Part 4 regime is fit for purpose.

The Commission’s regulatory regime and accompanying input methodologies (IMs) must recognise and reflect New Zealand’s determination to become a carbon neutral economy by evolving from a regime in which EDBs aim solely to deliver least-cost distribution services, to one that delivers distribution services that enables a carbon neutral economy at least cost.

The ENA and its members are of the view that much of the current IM regime is fit for purpose and does not need to be reviewed. This includes the following elements:

- the use of a revenue cap (subject to our comments about reopeners and flexibility mechanisms),
- customer consultation and engagement.
- Taxation,
- cost allocation methods, and
- the customised price-quality path mechanism.

A backwards-looking cost regime is no longer an option

The ENA has consistently called for greater recognition of the role innovation can play in delivering efficient distribution services that enable decarbonisation of the economy, and welcomes the recognition of this in the Commission’s open letter.

Facilitating the economy’s transition to a carbon-neutral future will impose new costs on EDBs. The scale, timing and exact nature of these costs are unknown. However, these costs are expected to include:

- customer connection cost as transports and industrial processes electrify,
- cybersecurity and data management costs, and
- low voltage network monitoring and control costs.

EDBs’ past operational and capital expenditures will not be an accurate indicator of prudent and efficient future focused expenditure. The IMs can therefore no longer be solely based on backward looking historical expenditure and must include an allowance for the cost of adaption and innovation.

The Part 4 regime and its incentive schemes must not punish EDBs for facilitating the transition to a carbon-neutral economy. The inclusion of customer connection capital expenditure in the Incremental Rolling Incentive Scheme is the most prominent example of how under the current regime EDBs are made worse off by facilitating growth, the electrification of industry and progress to a carbon neutral economy.

The path to a carbon neutral economy is uncertain

New Zealand's path to carbon zero is in its early stages of development and will only become fully formed over the course of the upcoming 2025-2030 regulatory period. Therefore, the IM regime must be flexible enough to promptly respond to material changes in government policy, legislation, and the regulatory environment within the regulatory period.

This flexibility may be provided via re-openers, pass-throughs, or other flexibility mechanisms. Importantly, this flexibility must be delivered in such a way that it avoids the need for EDBs to go through the time and resource intensive customised price-quality path (CPP) process, or administratively cumbersome application processes. Consideration should be given to the development of contingent allowances that automatically trigger on the occurrence of specific events.

The Part 4 regime does not provide for EDBs or groups to initiate a re-opener or pass through for issues that impact a multiple EDBs (i.e. regulatory change events). This leaves EDBs with a stark choice of individually subjecting themselves to CPP processes to address a sector-wide issue, or suffering materially reduced returns. The ENA's view is that flexibility mechanisms (re-openers or pass through) should be incorporated into the Part 4 regime to allow for collective application. To ensure consumers reap the benefits of EDB investment in innovation facilitated by the additional flexibility mechanisms, they should be symmetric in their application.

Cost of capital in a post COVID environment

In the DPP3 reset the ENA raised significant concerns that the models for estimating cost of capital are unfit for purpose, particularly in the presence of negative real risk-free rates. Those concerns have only heightened in the COVID environment, where the implication of the current approach is that investors would be happy to destroy value in investing in a risk-free asset rather than consume today. Further, EDBs have no faith that they will be adequately compensated for inflation under the CPI forecast IM.

IM review process

ENA and its members are supportive of an IM review process that involves a collaborative approach through targeted workshops that dive deeper into issues, and facilitated concurrent expert evidence sessions ("hot-tubbing") on WACC, and other highly technical issues.

The IM review process must, early on, triage key issues (likely to include cost of capital and flexibility measures) and allow sufficient time and resources for targeted meaningful engagement with EDBs on addressing these issues. The ENA also recommends that a co-design mechanism be adopted to ensure that only practical and fully developed measures are codified into the IMs.

The targeted information disclosure review must be properly resourced and create alignment with the IM

The ENA and its members are supportive of a targeted review of information disclosure (ID) requirements. This review must be adequately resourced, conducted in a timely manner and, importantly, create alignment with DPP3. The ID should be revisited upon the completion of the IM review to ensure alignment is maintained between the two arms of the Commission's regulatory framework.

Closing comment

The Enforcement Guidelines also remain of significant interest to our members, and we encourage the Commission to complete these as a matter of urgency, given the timeframe that has elapsed.

We appreciate the proactive approach being taken by the Commission to identify future priorities.

Please do not hesitate to get in touch with ENA if you would like to discuss this letter. We would be happy to facilitate a meeting or conference call between our members and the Commission to discuss some of these issues in more depth. If you require anything further from ENA or its members, please contact Keith Hutchinson (Keith@electricity.org.nz, 04 555 0074) in the first instance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'GP', written in a cursive style.

Graeme Peters
Chief Executive
Electricity Networks Association