COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

# Draft revenue limits and quality standards for electricity lines companies for 2025-2030

## Transpower RCP4 and EDB DPP4 draft decisions

29 May 2024

**Vhari McWha, Commissioner**

# Briefing outline

- Introduction and context
- Draft decisions:
    - Overview
    - Transpower (RCP4)
    - Local lines companies (DPP4)
- Estimated consumer bill impact (RCP4 and DPP4 combined)
- Summary and submissions process

# New settings required

The current price-quality paths for Transpower and 16 local lines companies expire soon, and we must set new ones to take effect from 1 April 2025.

Price-quality paths set the maximum revenues that can be recovered from consumers and the minimum standard of quality consumers receive in return.

Different types of regulation apply to different line companies:

- Transpower is subject to an individual price-quality path (IPP)
- 16 local lines companies are subject to the default price-quality path (DPP), with the option to apply for a customised price-quality path
- The remaining 13 local lines companies are exempt from price-quality regulation and subject to information disclosure regulation only.

Our objective is to help ensure Kiwis continue to receive a safe and reliable supply of electricity that meets their needs now and into the future at a reasonable cost.

# Context for our decisions

Circumstances have changed significantly since when last set revenues in 2019.

- **Underlying macroeconomic conditions** – higher interest rates and inflation
- **Forecast expenditure** - significant step change with numerous drivers (ageing networks, resilience needs, general growth, and increased electrification)
- **Further emergence of new technologies** – growing scope for innovation and non-network solutions
- **Wider cost pressures for consumers** – price increases may be felt more as consumers face higher costs across their budgets

# Draft decisions: overview

Our draft decision is to set higher revenue limits for both Transpower and local lines companies to maintain reliability and support growth. Current quality standards are largely fit for purpose, and we propose only minor refinements.

For Transpower, we propose a revenue allowance increase of:

- 15% for years one and two;
- 5% annual increase for years three to five.

For local lines companies, we propose a revenue allowance increase of:

- 24% for year one (on average);
- Business-specific increases for years two to five

Collectively this represents around an **extra $15 on the average household's monthly bill from 1 April 2025** for affected networks, with variances across different regions and different sized consumers. Smaller increases will follow across the remainder of the regulatory period. To help consumers, we have softened the initial impact by smoothing revenue recovery.

# Draft decisions: key drivers

There are three main drivers behind the increase in revenue:

- An **increase in interest rates** since 2019 – this is reflected in the weighted average cost of capital (WACC).

- An **increase in expenditure** to maintain reliability, meet growing demand, and reconsider resilience needs.

- **Recent higher input costs (inflation)** due to strong international competition for skilled workers and equipment.

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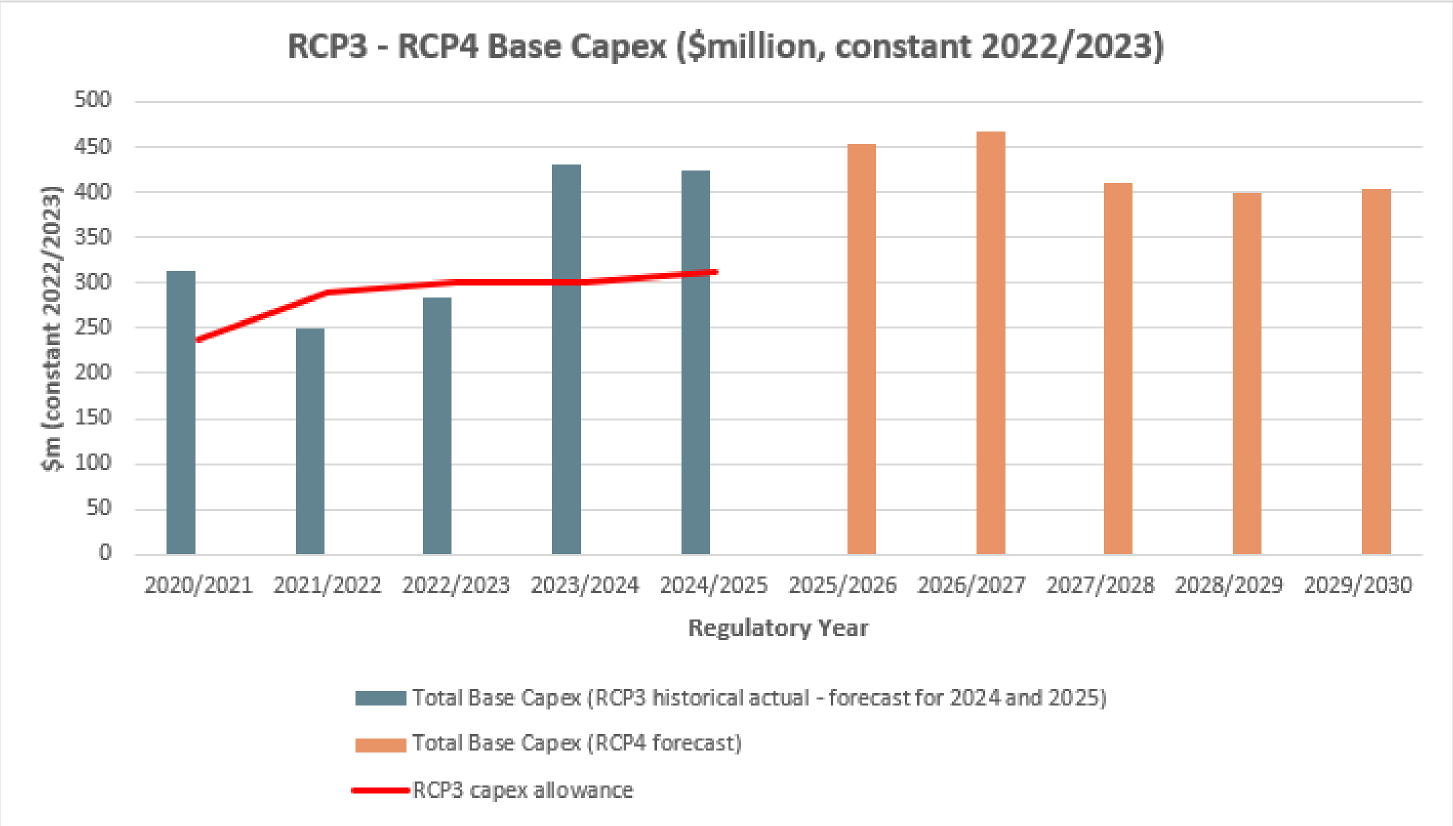
# Transpower (RCP4)

# RCP4: Overview

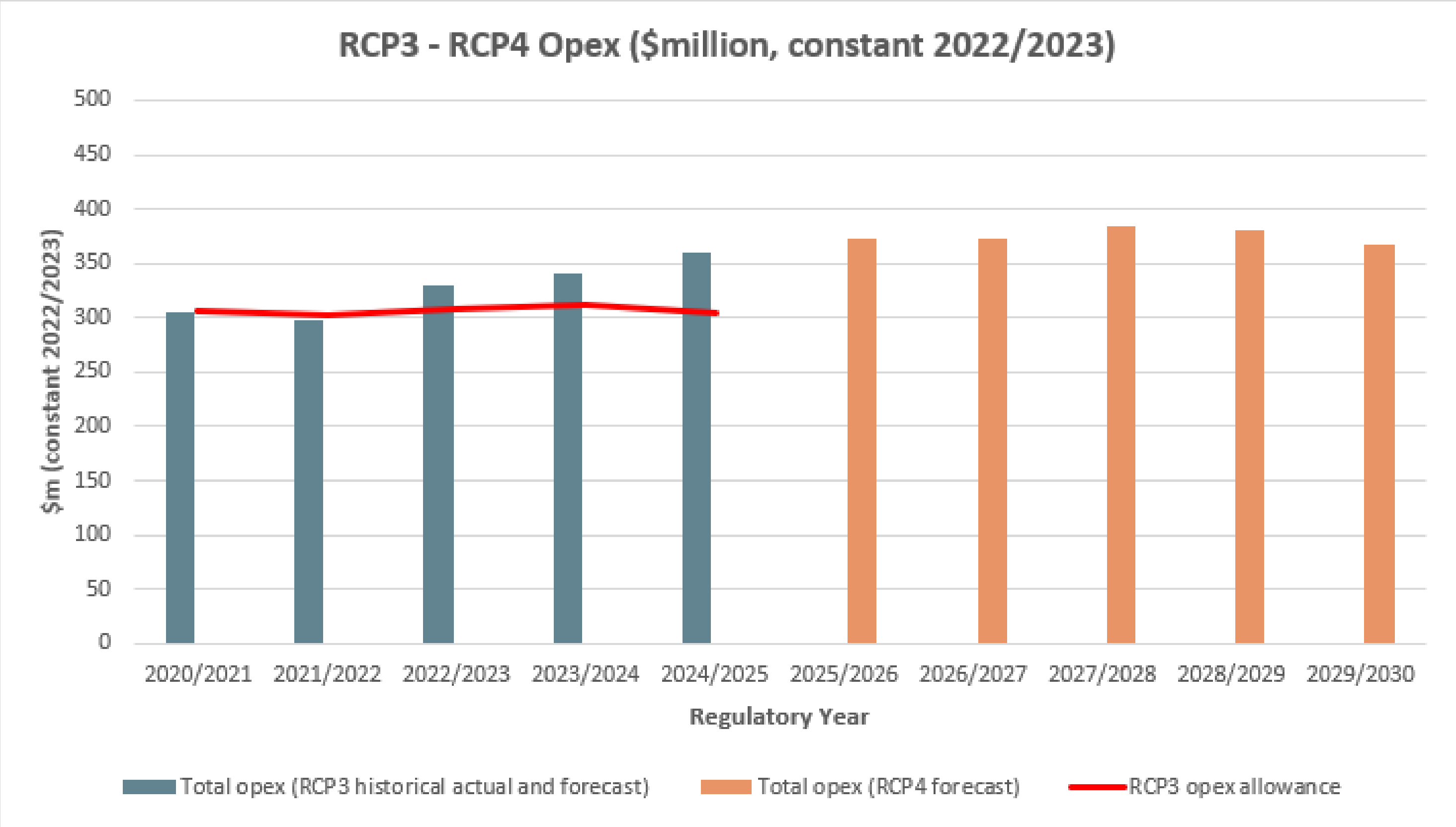
- **Increased replacement and renewal need** - Transpower proposed a substantial work programme to replace and renew assets that were built mid-last century to ensure a safe and reliable supply as New Zealand becomes more reliant on electricity.
- **We are largely satisfied by Transpower's proposal** - we have reviewed Transpower's proposal and the independent verifier's report and propose to allow for the majority of Transpower's proposed expenditure.
- **We propose a downward adjustment to address deliverability concerns** - Transpower's work programme is substantial and recruitment will be challenging. We have decreased upfront expenditure allowances as a result, but Transpower may reapply if recruitment targets are met.
- **We propose revenue smoothing to help mitigate price shocks for consumers** – we propose a smaller initial increase in revenue to soften the impact of price rises for consumers, with the difference spread over the remainder of the regulatory period to keep Transpower whole.
- **Grid output measures remain largely unchanged** - we propose to base Transpower's grid output measures largely on the previous period's with minor refinements.

# RCP4: Capex



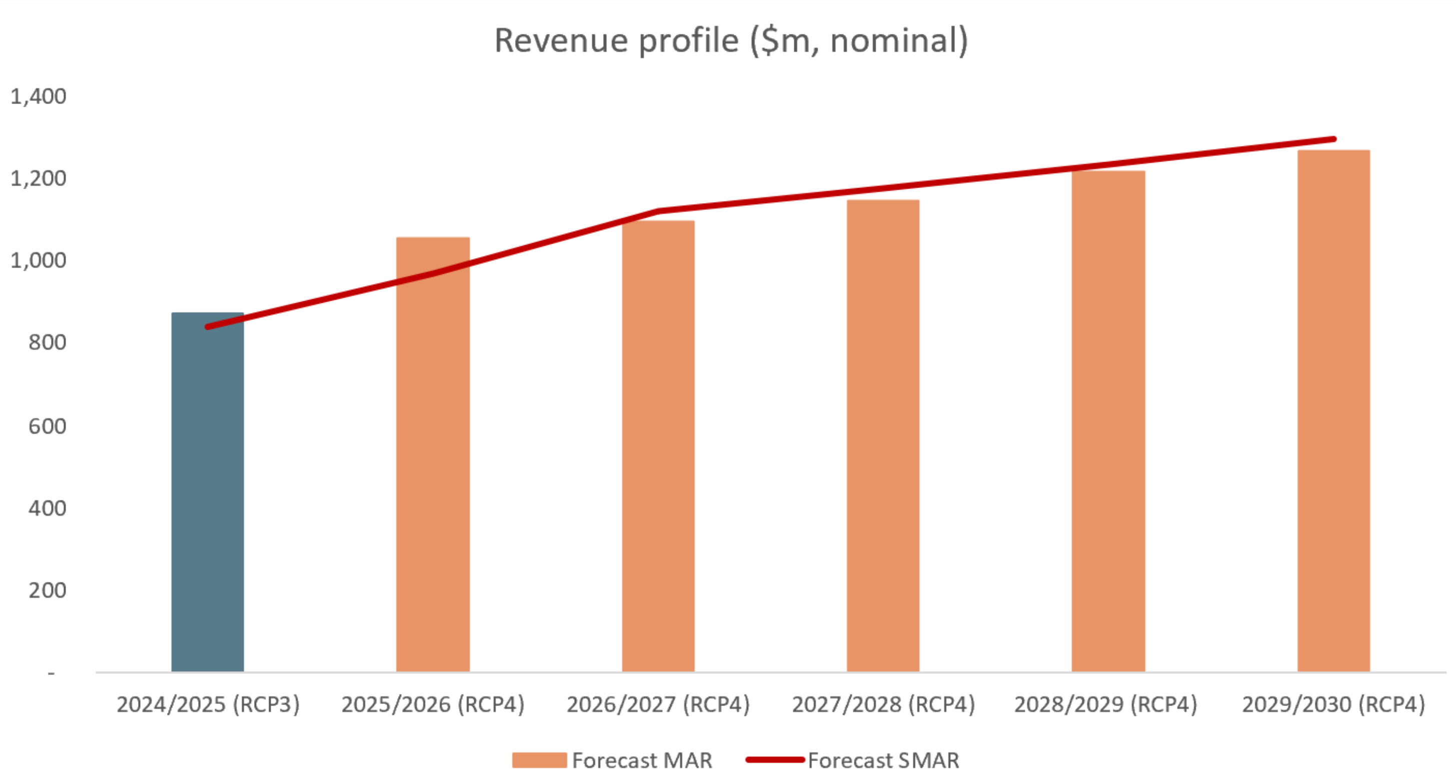

- Mature asset health modelling underpins Transpower forecast
- Providing funding for resilience expenditure
- Reducing capex by $111 million due to deliverability concerns
- Re-openers available for deliverability and other uncertain expenditure

# RCP4: Opex




- Opex is forecast using base-step-trend methodology
- Step change to support delivery of increased work programme
- Increase in maintenance to manage aging asset base
- Reduced opex by $69 million due to deliverability concerns

# RCP4: Revenue path




- Total RCP4 revenue allowance is $5.8 billion, compared with $4.0 billion for RCP3
- Smoothing the price path to soften initial consumer impacts
- 15% annual increase for years one and two
- 5% annual increase for years three to five

# RCP4: Quality and IM amendments

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*Quality*

- Keep Transpower's package of quality measures largely unchanged – to ensure Transpower maintains the current quality of service it is providing to customers.
- Metrics updated to reflect improving performance and take into account Transpower's work programme where relevant

*IM amendments*

- Proposing targeted IM amendments to give effect to our IPP reset including implementation of RAB indexation, deliverability re-opener, impact of reopeners on quality standards, and a transitional adjustment to the EV account.

# Electricity distribution (DPP4)

# DPP4: Overview

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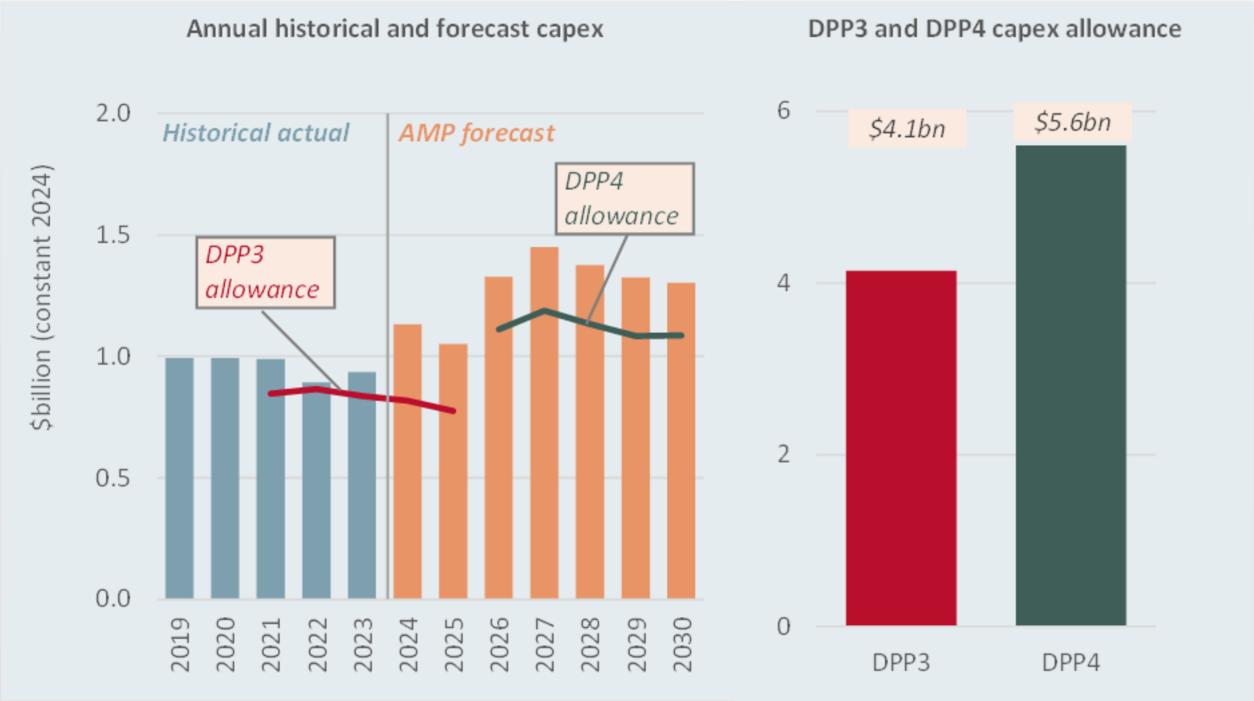
- **Higher overall costs –** uplift in revenues to cover costs and enable investment to maintain reliability and support growth.
- **Flexible regulatory framework enables us to get the best for consumers** – our draft decision does not accept businesses' forecasts in full due to uncertainty and deliverability concerns. Businesses can use the flexibility in the regime where specific projects become justifiable (reopeners) or for specific significant changes (CPP).
- **We have provided for some specific increases in operating costs –** our draft decision allows for some specific costs, such as insurance and low-voltage network monitoring.
- **We are proposing to further incentivise innovation within the regime –** in addition to existing innovation incentives built into the regime, we are proposing a new broader innovation allowance to encourage EDBs to find new solutions for the long-term benefit of consumers.
- **We propose revenue smoothing to help mitigate price increases for consumers** – our draft decision limits initial increases in revenue to soften the impact of price rises for consumers, with business specific increases over the remainder of the regulatory period.

# DPP4: Capex

Lines companies have forecast a significant increase in investment. The draft capex allowance reflects our assessment of what is appropriate in an evolving environment with high levels of uncertainty and likely deliverability challenges.

**Capex profile (constant 2024 dollars)**




In 2024 constant prices, our draft decision is for a DPP4 capex allowance of $5.6 billion.

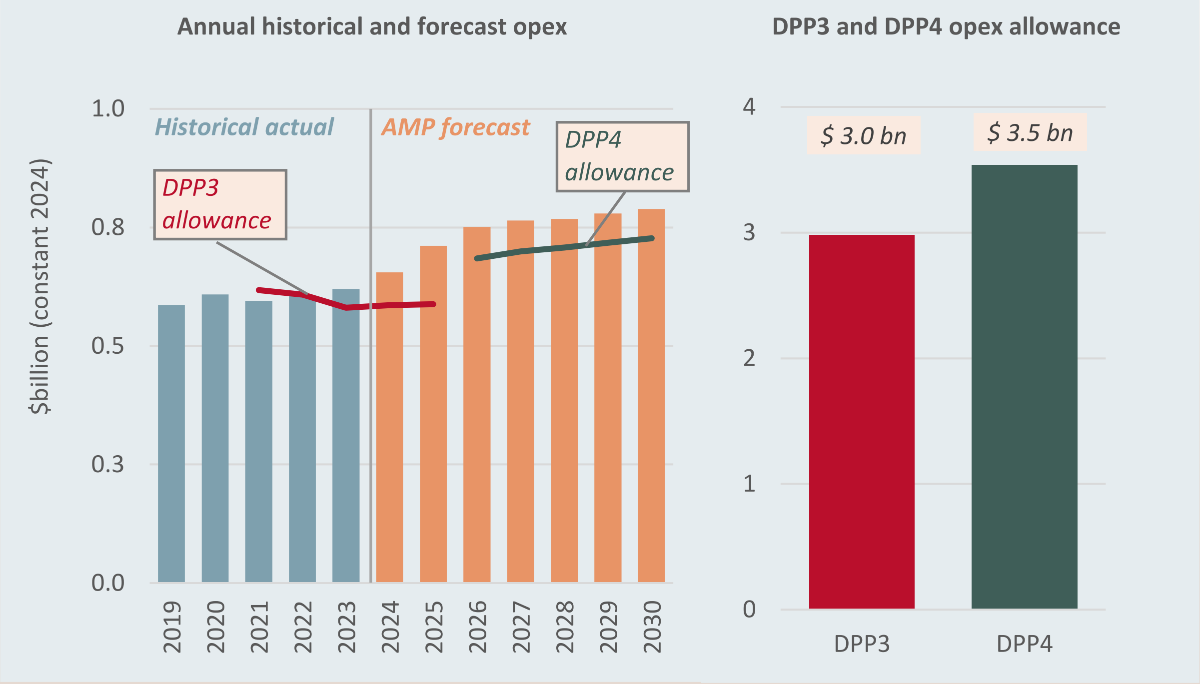
This is $1.5 billion or 35% higher than the DPP3 allowance of $4.1 billion (in 2024 constant prices).

The allowance is 17% less than EDBs' 2024 asset management plan forecast.

# DPP4: Opex

We have set opex allowances to reflect the increases in operating costs faced by the sector since 2020. We have also proposed five step changes in opex to respond to specific economic and business conditions.

**Opex profile (constant 2024 dollars)**




In 2024 constant prices, our draft decision is for a DPP4 opex allowance of $3.5 billion.

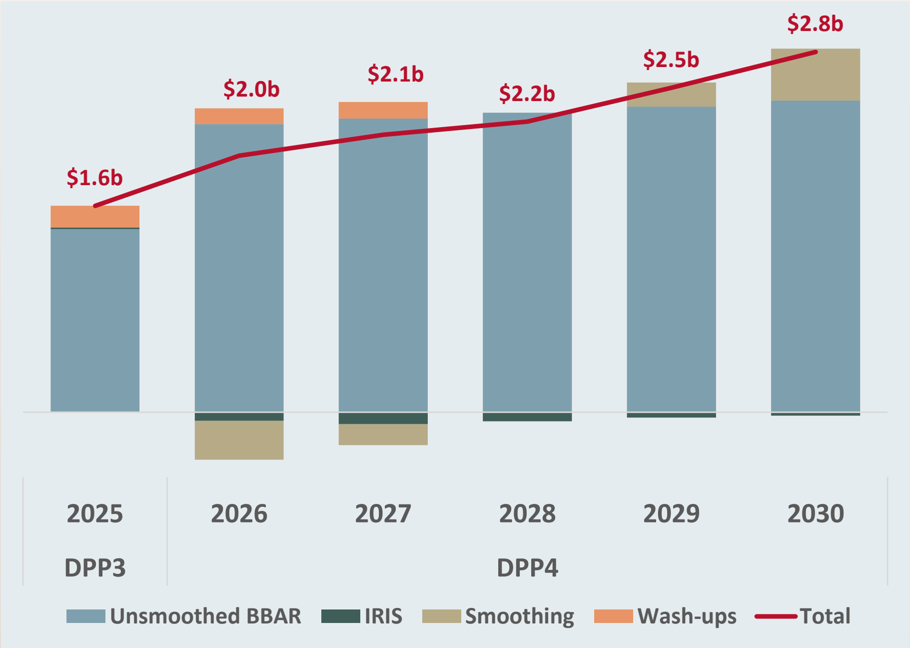
This is $0.5 billion or 19% higher than the DPP3 allowance of $3 billion (in 2024 constant prices).

This includes five step-changes – Insurance, LV monitoring, cybersecurity, Software as a Service and consumer engagement.

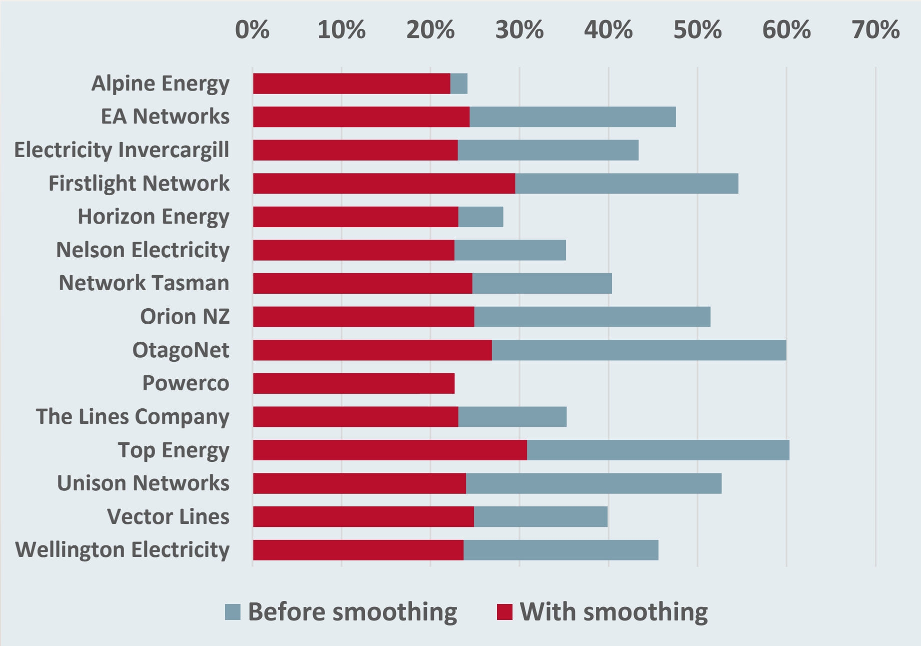
# DPP4: Revenue path smoothing

We have limited initial increases in distribution revenue to soften the impact for consumers of interest rate and inflation changes and spread the remainder over the period in smaller increments.

**Distribution revenue over DPP4 (total, all DPP EDBs)**




**Impacts of our smoothing decisions on initial revenue change**



# DPP4: Innovation and Quality

## *Innovation*

- Maintain equivalence between IRIS incentives for capex and opex, to ensure the regime continues to incentivise EDBs to choose the most efficient solution.
- To introduce an innovation and non-traditional solutions allowance. EDBs will be able to apply for this allowance, capped at 0.6% of their maximum allowance revenue over the DPP4 period.

## *Quality*

- Retain the same quality standards as applied in DPP3, at levels that ensure no material deterioration in quality.

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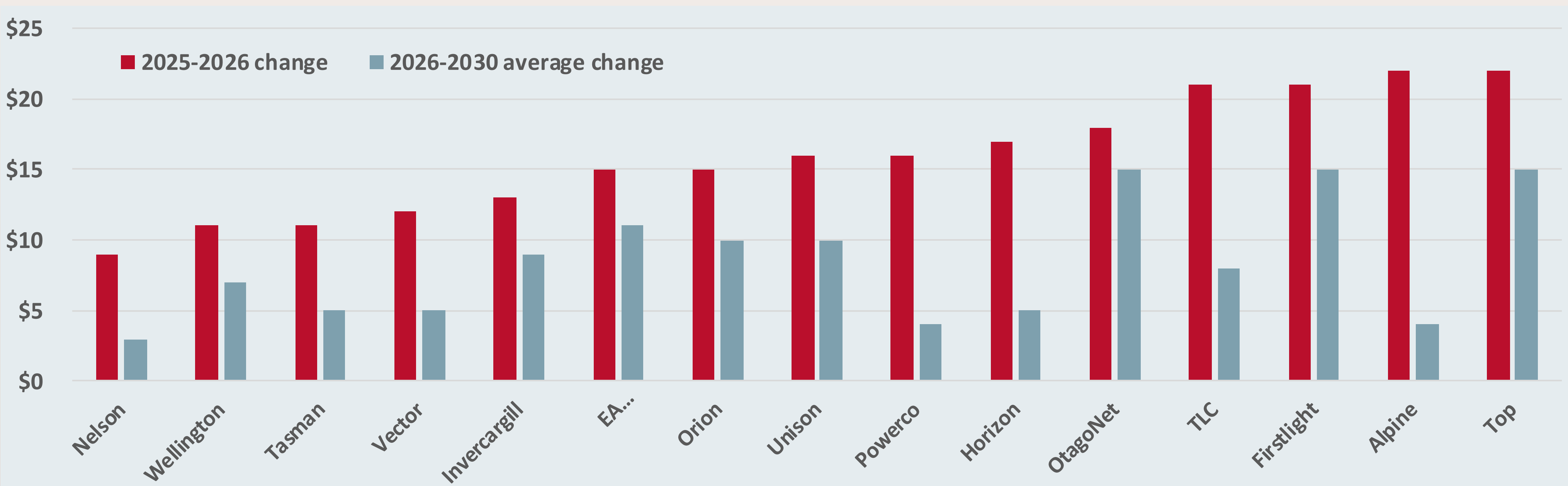
# Consumer bill impacts

# Estimated price impacts

- Delivering the service we need into the future requires investment.
- What this means for consumers is that from 1 April 2025, we estimate that the transmission and distribution component of a household's electricity bill will increase on average, **by $15 per month,** for the affected networks. This represents an **additional $180 per year** on average across most of New Zealand.
- The regional range is for average increases between approximately $10 and $20 per month. There are various drivers for differences between lines companies, but a significant factor is the number of consumers to spread costs over.



# To conclude

- **We are proposing to increase the maximum allowable revenues** for both Transpower and local lines companies to help ensure consumers have a reliable network that meets their needs now and into the future at a reasonable cost.
- The increase is primarily driven by:
  - An increase in **interest rates**
  - An increase in **expenditure**
  - Higher **input costs** (inflation)
- **Balance required** between allowing for revenues upfront and relying on other options for flexibility as there are risks for consumers on both sides.
- **Innovation incentives are heightened** to help improve quality of service and reduce costs over the longer-term.
- **To soften the impact on consumers**, we have smoothed revenue recovery by spreading it over a longer period

# Next steps and draft decision package/ have your say

**RCP4 consultation dates:**

* Submissions by 5pm, on Wednesday 26 June 2024

* Cross-submissions by 5pm, on Monday 15 July 2024

**DPP4 consultation dates:**

* Submissions by 5pm, on Friday 12 July 2024

* Cross-submissions by 5pm, on Friday 2 August 2024

# Questions

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| Email: | infrastructure.regulation@comcom.govt.nz |
| Website: | comcom.govt.nz |