11 July 2022

Via email im.review@comcom.govt.nz

Tēnā koutou,

## The IM review is an opportunity to create an operating environment that supports customer and industry decarbonisation at pace

The input methodologies review sets a pathway for a core part the sector's operating environment. Powerco is one of Aotearoa's largest gas and electricity distributors, supplying around 340,000 (electricity) and 112,000 (gas) urban and rural homes and businesses in the North Island. These energy networks provide essential services and will be core to Aotearoa achieving a net-zero economy in 2050. The IM review forms a key part of the regulatory and policy jigsaw that will enable network companies to deliver these services.

Our summary views on the Commission's papers are:

### Framework

- Incorporating the climate change legislation and associated activities is a must, not a maybe
- Financial capital maintenance is core to incentivising investment - New Zealand's infrastructure sector needs to do some heavy lifting over the coming decades to deliver decarbonisation

### Process and issues

- The Commission's paper captures key issues likely to affect electricity and gas distributors
- The electricity IMs (and their application in the DPP reset process) will need mechanisms that support distributors meeting the long-term individual and collective customer needs from electrification
- The gas IMs (and their application in the DPP reset process) will need mechanisms that support long-term investment and operation required to support a transition off natural gas
- Stakeholder engagement on these issues will support an informed discussion about the opportunities and consequences of IM changes

The Commission's issues paper has picked up on the issues raised in our submission[1] on fit for purpose regulation in May 2021. There we outlined four issues affecting gas and electricity networks that we think are material enough to explore and ensure the IMs can address the issues:

- Enabling customer choice
- Planning to meet customer outcomes
- Innovation
- Incentives that support good investment decisions and long-term outcomes

That submission also provided some solutions and considerations. The reality is that IM changes to address these issues will be a package because the solutions will likely address multiple issues – they won't always be separable. The Commission's approach to reviewing IM changes needs to consider this interaction.

Focusing on the issues that are material and deserving of review now, not later is vital. Key to that will be developing a shared understanding of problems (historical or forecast). For example, since the Commission's open letter the draft and final Emission's Reduction Plan has been issued with long-term implications for the energy sector. To support the shared understanding we are contributing to external advice on topics we think are material – these reports are intended to be an input to the 'emerging views' phase later this year. We see a role for Commission and/or industry-led stakeholder engagement in whichever way is sensible (eg workshops, webinars) to facilitate knowledge-sharing and understanding across all stakeholders.

We have some additional comments on the framework and process/issues papers in the attachments. We support the submission from the Electricity Networks Association and look forward to engaging with the Commission and stakeholders in the next phase of the review. If you have any questions regarding this submission or would like to talk further on the points we have raised above, please contact me.

Nāku noa, nā,

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[1] https://www.powerco.co.nz/-/media/project/powerco/powerco-documents/who-we-are---pricing-and-disclosures/submissions/2021/commerce-commission---response-to-open-letter.pdf

# Attachment 1: Framework paper

Powerco supports the overall direction framework as adopted in the 2016 IM review. There are some changes to the operating environment since that time which are worth considering:

### 1. Financial Capital Maintenance (FCM)

The Commission notes in the Framework and Issues paper [4.26] its position that the economic principals do not amount to a "regulatory compact". Instead, the Commission is required to give effect to the 52A purpose statement. The economic principles are tools which aid the Commission in doing so.

While ex ante FCM is not an explicit requirement in the Act, it is essentially the way to translate of the 52A (1) (a) (investment) and 52A(1) (d) (excess profits) limbs of the 52A purpose to a business context. Specifically, investment will not occur if ex ante FCM doesn't hold. And ex ante FCM ensures firms earn no more than a normal risk adjusted return, ex ante. While we agree with the Commission that there is no absolute guarantee of ex post FCM (eg costs can vary from forecast), we consider it is critical that any actions, or any inactions, by the Commission do not compromise ex ante FCM as this would undermine investment incentives in all sectors the Commission regulates. Given the potential nature and scale of opex and capex required to support decarbonisation, there could be merit in considering financeability tests as considered in Australia[2] to minimise long and short run costs to consumers.

### 2. Materiality

As the Commission notes at 3.12, the IM review must balance the fact that any change it makes may better promote the 52A purpose but simultaneously reduce certainty for regulated suppliers, which is contrary to the 52R purpose of the Input Methodologies. While recognising this trade-off between certainty and better promoting the 52A purpose, the Commission has not outlined a framework for how it will consider this trade-off.

The Part 4 regime has been designed to balance certainty and improving the regime. It would seem contrary to the intent of the regime if every aspect of the IMs was up for grabs every 7 years, as the IMs would not then provide much certainty. We therefore consider a useful framing would be that changes to the IM are only considered where they would result in a "material improvement in the promotion of the 52A purpose". Focusing the IM review on areas where there is either new evidence or a change in circumstances means a change in the IMs would result in a material improvement in promoting the 52A purpose.

Assessment of materiality could involve quantitative and qualitative approaches depending on the issue at hand. For clarity, we are not suggesting that parameters within IMs shouldn't be updated. Rather, the methodology used to calculate those parameters should only be changed if doing so would result in a material improvement in the promotion of the 52A purpose.

### 3. Climate Change

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[2] https://www.energynetworks.com.au/resources/reports/2020-reports-and-publications/nera-report-to-ena-role-of-financeability-in-promoting-the-long-term-interests-of-energy-consumers-december-2020/

The Commission's discussion (2.27 – 2.31) of the permissive considerations under section 5ZN of the Climate Change Response Act (CCRA) suggest the Commission considers climate change and meeting our climate change targets to be secondary to its primary duty to promote the 52A purpose statement. Irrespective of legal arguments about the primacy of the 52A criteria over the 5ZN factors in the CCRA, we consider there is a broader argument about how climate change should be considered in Part 4 regulation.

Addressing climate change is clearly in the long-term benefit of consumers, so network companies taking appropriate action to address it to support Aotearoa meeting the 2050 target and policies that underpin the emission budgets can be considered through the standard 52A lens. That is to say, the Commission should view the 2050 target as part of operationalising what the long-term benefit of consumers is. Specifically, innovation and investment will be required by EDBs for NZ to meet the 2050 target, and the 2050 target is an expression of consumer demands. Climate change and the 2050 target are therefore of direct relevance to operationalising s52 (1) (a) and (d).

# Attachment 2: Process and issues paper

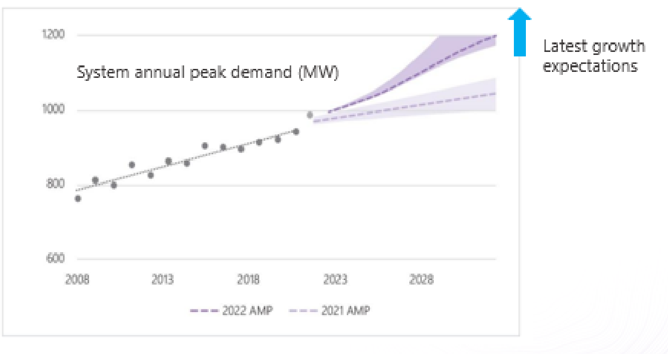
## 1. Electricity distribution

**We all have a role to play to enable customer choices … and they won't follow a linear path.** The issues paper demonstrates the Commission appreciates the challenges facing networks to respond to consumer demand (driven in turn by market and policy drivers). In the near term, this will be dominated by organic growth, electrification of transport and process heat, as well as large- and small-scale generation connections. Powerco is keen to support the Commission's assessment of options, whether it be IMs or DPP reset settings, that ensures there's the 'right' balance between scrutiny on expenditure, incentives to ensure customer needs of this nature are delivered, and the ability for the regime to accommodate the individual characteristics of network and customer requirements.

We expect the next phase of the IM review will involve assessing the materiality of the issues/problems raised by stakeholders. Powerco's operating environment was discussed in a public webinar in early June 2022[3]. Some observations we made which are relevant to the IM review are:

### Demand growth - building for tomorrow, today

The timing and scale of demand is uncertain and the IMs need to anticipate and accommodate the near and long term impacts. For example, the May 2022 announcement by Government on GIDI funding[4] will affect customers on some electricity and gas networks who then need accommodate the network demand and associated requirements.



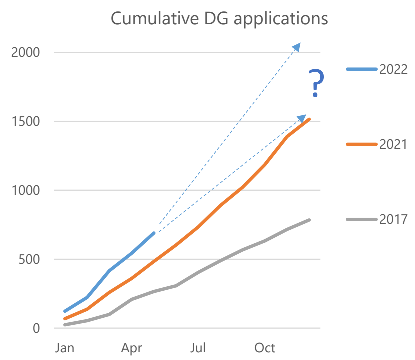

### A step change to distributed generation enquiries

Applications in 2022 for small scale generation connections were <u>more than double</u> those from 2017. Large customer demand is accelerating too, with >100 large connection enquiries compared to ~20. We are working with customers to find optimal solutions that minimise their connection costs and the upstream impacts on growth and security.

**Large-scale**


2MW = Current largest connection

**Small-scale**

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[3] https://vimeo.com/715864739/f54cec7ad2

[4] https://www.beehive.govt.nz/release/supercharging-decarbonisation-transforming-energy-system

The Commission's issues paper has picked up on the issues raised in our submission[5] on fit for purpose regulation in May 2021. There we outlined four themes affecting gas and electricity networks that we think are material enough to explore and ensure the IMs can address the issues:

- Enabling customer choice
- Planning to meet customer outcomes
- Innovation
- Incentives that support good investment decisions and long-term outcomes

Our submission also provided high level solutions and considerations. The reality is that IM changes to address these issues will be a package – issues and solutions will mix. The Commission's approach to reviewing IM changes will benefit from considering this interaction. We look forward to exploring these issues up at the next phase of the review so have not dwelled further on them in this submission (consistent with the Commission's consultation time-frame and approach these papers).

The ENA's submission includes some more detailed topics for prioritisation. They list a range of sub-topics, with the high priority issues comprising:

- Innovation
- IRIS reform
- Operation of the revenue cap
- Finance settings (inflation forecasts, debt compensation, RAB indexation)
- Re-openers
- Contingent allowances
- Forward looking expenditure

We support this categorisation, and anticipate the short-list of material issues will come from this list and look forward to working with the Commission and industry to assess the materiality of these issues.

## 2. Gas distribution

In addition to our 'open letter' submission, our March 2022 submission on the draft gas DPP decision[6] supported a package of proposed changes to IMs and default-price path settings. For IMs, we supported the Commission's proposed IM changes as part of the draft decision:

- A NPV neutral approach to address increased stranding risk (accelerated depreciation) designed to be updated with new assumptions and flexible in its application to inform regulatory settings
- IM changes to allow re-openers to reflect a range of circumstances which affect risk and unforeseen circumstances.

The final decision captured these changes.

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[5] https://www.powerco.co.nz/-/media/project/powerco/powerco-documents/who-we-are---pricing-and-disclosures/submissions/2021/commerce-commission---response-to-open-letter.pdf

[6] https://www.powerco.co.nz/-/media/project/powerco/powerco-documents/who-we-are---pricing-and-disclosures/submissions/2022/commerce-commission----gas-dpp-draft-decision.pdf

We also recognised that some issues could be addressed with IM changes during this process which would apply to the next gas reset in 2025 which would commence in late 2024. This would allow deeper consideration of how the regulatory framework interacts with policy initiatives such as the emissions reduction plan, New Zealand energy strategy and the gas transition plan.

The issues paper (eg 5.62 onwards) recognises demand risk.  There is merit in alternative forms of control, such as a revenue cap. This is because gas demand may be affected by policy decisions within the DPP3 regulatory period which can affect the incentives to invest and alignment with the policy environment. An example of demand risk that can't be managed by a GPB is that affected by policy and Government decisions such as the GIDI funding announced in May 2022. The interaction between policy initiatives like this, and gas network incentives to respond, will be a useful area to explore.