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Submission of PowerNet Limited
To the Commerce Commission
On DPP4 reset – Financeability of electricity distribution services in the default price-quality path issues paper

Ben Woodham
Electricity Distribution Manager
Commerce Commission
15 March 2024

Dear Ben,

Introduction

1. PowerNet Limited (PowerNet) appreciates the opportunity to make a submission to the Commerce Commission (the Commission) on the issues paper – Financeability of electricity distribution services in the default price-quality path.

2. PowerNet is an electricity management company with its head office based in Invercargill. It is a joint venture company, owned (50/50) by Electricity Invercargill Limited (EIL) and The Power Company Limited (TPCL). This submission is supported by EIL, TPCL, and OtagoNet Joint Venture (OJV).

3. EIL and TPCL established PowerNet in 1994 to achieve economies of scale through integrated network management across the Southern region's Electricity Distribution Businesses (EDBs). PowerNet manages the non-exempt EDBs of EIL and OJV, the exempt EDB of TPCL, and the non-grid connected Stewart Island Electric Supply Authority (SIESA).

4. PowerNet manages an asset base and investments in excess of NZ$1 billion. The aggregated electricity distribution asset base managed by PowerNet is the fourth largest in New Zealand. It provides services to over 75,000 customers through more than 14,200 circuit kilometres. In addition to EIL operating in Invercargill and Bluff, TPCL operates in Southland and West Otago, OJV in the rural and coastal Otago region that surrounds Dunedin City, Lakeland Network (LNL) in the Frankton, Cromwell and Wānaka regions, and SIESA on Rakiura Stewart Island.

5. PowerNet has long-term management agreements in place with EIL, TPCL, OJV and LNL. With the benefit of integrated business management systems in place, PowerNet has a core purpose and expertise in asset management capability and delivering operating efficiencies and a sustainable network for the future of the EDBs it manages.

6. Alongside our own submission, PowerNet supports the Electricity Networks Aotearoa (ENA) submission in principle. Our submission reinforces some of the key points made in the ENA submission and addresses where the networks PowerNet manage wish to highlight or emphasise issues. This is not intended however to lessen the relevance or emphasis of any of the points in the ENA submission.

7. PowerNet also supports aspirations to reach net zero emissions that are not cost prohibitive. We acknowledge the important role distribution networks will play in supporting New Zealand's transition to a low emissions economy.

Key points

Financeability

8. In simple terms, financeability is about something being able to be financed or receive financing. While the definition is simple, the practical application of this in a regulatory environment is not.

9. Electrification is at the core of NZ's decarbonisation strategy and will need significant investment in transmission and networks in a relatively short period of time. The step-change in investment for the electricity industry is unprecedented and therefore requires an unprecedented approach to ensuring capital can be raised year after year after year to meet this requirement. Operating in the same way as we have always done will not get us there.

10. Regulations need to balance both the costs to consumers of today, and the returns of stakeholders to warrant investment and mitigate the risk of this investment for intergenerational infrastructure.

11. The regulatory allowances need to be sufficient to ensure shareholders/investors are willing to provide the finance that is required to support efficient investment.

12. PowerNet, in light of an understanding that we cannot continue to do what we have always done if we are to have unprecedented investment, is currently working with KPMG and other electricity businesses to look at alternative funding models. One of the key drivers in this work is to consider that costs must be allocated to users in a way that is commensurate with the benefits they receive and when they receive them. Intergenerational equity and affordability are a critical element in the issue of financeability and regulatory constraint.

13. PowerNet accepts the Commissions approach that financing significant new capacity and new investment is the responsibility of the businesses through normal, efficient capital raising and management. However, we would temper this with encouraging the Commission to ensure that where businesses are operating with prudence and efficiency to raise and repay debt and raise equity, that they are not regulated beyond the point of being able to achieve this outcome.

14. We support the ENA submission in that "we do not expect that the Commission, in its regulatory determinations, would consider anything other than the revenues and cashflows determined as part of price-quality determinations in isolation from all other business activities. A firm's actual financial position, including ownership structure, is irrelevant to the DPP determination as it is not a determinant of the revenues/cashflows allowed under the DPP."

    We support the Commissions view in 1.5 that financeability is about the provision of the service, and not the supplier of the service. Other higher returning, higher risk investments made by EDB's should not impact this decision.

15. PowerNet asserts that is it within everybody's best long-term interest to have viable and healthy distribution businesses. We maintain a position that it is the relationship between capital expenditure of our EDB's, the consumer, and our shareholders which holds the formula to this success. This is at the heart of financeability and ensuring intergenerational equity throughout the investment required to meet our goals in electrification and a zero-carbon future.

    The EDB sector is forecast to spend $25 billion to assist in meeting national carbon targets through to 2050. This is a significant investment above the current asset base of $15 billion. We do not believe the Commission view that customised price path applications (CPP's) as expressed in X17 is an appropriate mechanism to deal with what is to come.

Step-changes

16. PowerNet acknowledges that there will be step-changes in DPP4. We have already identified smart meter data access, cyber security, software as a service (capex moving to opex) and insurance as quantifiable examples of step changes that will be faced.

17. The PowerNet managed EDBs have significantly increased expenditure across cyber security and insurance in the last 12 months. In addition, the revaluations of assets, impacted by global pricing and flow-on insurance premiums has seen a significant increase in asset replacement and repair valuations. In short, it will cost more to maintain the network at its current level, and additional costs required for growth and responding to distributed energy resources (DER) consumer demands.

18. While PowerNet is confident in being able to meet these challenges, there is an inherent need for the regulatory environment to support the step-changes needed that will help move New Zealand towards electrification targets. At the current pace of electrification and decarbonisation changes PowerNet is managing, our view is capex and opex allowances for DPP4 and future DPP's must shift and not be wedded to a previous period where decarbonisation was barely on the horizon.

19. PowerNet has previously encouraged the Commission to ensure that barriers to advancing investment at the right time and in the right places are minimised. This stance has not changed.

20. For example, the PowerNet managed EDB's would not invest early in a way that may be inefficient due to perceptions of pace of change risk. We are mindful of lines pricing creating incentives for efficient customer investments, particularly in DER, however we do not expect customers to respond immediately to price changes. Investment decisions in DER (solar, EVs, batteries etc), rely on the customers' ability to secure funding to invest in these non-network solutions. Therefore it is appropriate for PowerNet to signal the value of these energy resources early so customers can see stability and return from their DER investments. This circles back to the very simplistic definition of financeability; the ability for something to be financed or receive financing.

<u>Cashflows</u>

21. PowerNet supports the ENA submission, in that cashflows are an important element of financeability. Throughout the current DPP, high inflation and tightened labour market conditions have all contributed to cashflow exposure and risk.

22. We would encourage the Commission to ensure revenue caps in the regulated scheme are commensurate with both the step-change in expenditure, the changing demands and behaviours of consumers, and the investment required as risk borne by shareholders.

23. While we note the Commissions use of 'patient capital' and 'investors that have long horizons for recouping their investments' (1.8 pg. 8, Issues Paper) to describe the investment in regulated infrastructure, this does not sit comfortably with the purpose of Part 4 (Commerce Act 1986), in that there should also be incentives to innovate and to invest, including in replacement, upgraded, and new assets. If revenue caps are too low, and cashflows become tightened, it is difficult to see how there will be long-term benefits to consumers where there is little intergenerational equity and affordability for the consumers of today and in the future.

24. In short, financeability in the regulated scheme must ensure that there is enough appetite for patient capital, so that the risk of underinvestment or minimization of innovation does not become a more appealing option.

25. The Commission touches on negative cash flows in 3.13. It is in the long-term interest of consumers and investors that there is an appropriate balance from operating cash flows between investment in the network, debt levels and returns to shareholders. DPP3 has seen this balance tip away from the shareholder due to cost increases, delayed CPI revenue adjustments and interest rate increases. EDB's are borrowing to meet capital investments to maintain quality standards. This has led to some shareholders exiting or consulting on exiting their EDB investments. The lack of balance in DPP3 will in part lead to the revenue increases we will see in DPP4.

Other general comments

26. PowerNet acknowledges the Commissions position that their focus is the financeability of the provision of the regulated service, not the supplier of that service whose overall financial position and outlook may be affected by its management choices and non-regulated activities.

27. In acknowledging this, we also encourage the Commission to keep forefront in their thinking the unprecedented nature of the investment required in the DPP4 and those to follow. Without systemic change in the approach and application of financeability, distribution businesses in the current regulated environment will simply will not be able to make the investment required to meet the needs and demands of electrification in New Zealand.

28. PowerNet provides a unique perspective, in that we manage both exempt and non-exempt EDBs. We are able to compare the differences this creates and better understand the challenges and opportunities of the regulatory environment. We have relevant experience of operating within the exempt and non-exempt frameworks, especially with current decarbonisation occurring in our region. It is explicitly clear to us that the settings for exempt EDBs are more conducive to meeting the needs of customers and the goals of decarbonising and electrifying the New Zealand economy. We are of the view that the current regulatory settings for non-except EDBs are inhibiting this transition, which in our view has unfortunately not been efficiently and effectively addressed in the Input Methodology review. It would be disappointing to see this continue by comparing costs and financeability to a DPP period where activity was different.

29. PowerNet agrees with the Commission statements in principle in 2.9 and 2.10 however the Commission should be aware that the significant decarbonisation investment we are experiencing within The Power Company Limited (exempt) EDB area should not see simultaneous efficient planning for the future transfer the burden to those investors or consumers in that area.

30. An alternative to exiting the sector as discussed in 2.10 is to under invest in capex and turn away decarbonisation growth, this could be a barrier to NZ's carbon targets and not in the long-term interest of consumers or the economy of a region.

31. PowerNet does not agree with "secondary" limit approach proposed in 4.17 of the paper. To find such a proposal in a financeability paper at a time when EDB's cash flows are inadequate to meet capital expenditure plans is to say the least disappointing. EDB's charges make up less than 30% of a typical power bill and an initial overall DPP4 increase of say 15%-20% will contribute to a 4.5%-6.0% overall increase. Consider this in the context of local government increases in the region of 10% which have a higher cost base than a household energy bill.

32. As the Commission points out in 2.6 it has the discretion in setting starting prices under sec 53P. It is time the balance between investors in EDBs and consumer pricing is returned to a more balanced position. Continuation of the current low EDB returns will see consumers at the beginning of DPP4 being subsidised by consumers at the end of DPP4 due to the not insignificant time value adjustments of under recoveries in DPP4 returns.

33. The PowerNet managed EDB's cover a vast area of Southern New Zealand. We maintain the second largest pole population in the country and operate under a network management business model managing multiple EDBs. We are committed to diversification and growth and have vision to invest in renewable energy for a sustainable future.

PowerNet contacts for this submission are:

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