Cross-submission on financeability in EDB DPP4

28 March 2024

1 Submission and contact details

Consultation	Cross-submission on financeability in EDB DPP4 reset
Submitted to	Commerce Commission
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2 Confidential information

There is no confidential information provided in this submission. This submission can be publicly disclosed.

3 Financeability cross-submission

Wellington Electricity Lines Limited (**WELL**) welcomes the opportunity to make a cross-submission in response to the Commerce Commission's (**Commission**) '*DPP4 reset – Financeability of electricity distribution issues paper*'. This submission will refer to the consultation paper as '**The Paper'**.

Along with the other five large distribution networks, WELL commissioned Oxera to provide a submission to The Paper. Oxera also provided a submission to the Input Methodologies Issues Paper which also discussed the importance of financeability[1].

The purpose of Part 4 of the Commerce Act 1986 (Part 4) includes a specific requirement to incentivise suppliers to continue to invest in distribution networks. Financeability will be an

[1] https://comcom.govt.nz/__data/assets/pdf_file/0016/323107/27Big-627-EDBs-Oxera_-Response-to-Commission27s-draft-decision-for-IM-Review-2023-on-the-cost-of-capital-Submission-on-IM-Review-2023-19-July-2023.pdf

important regulatory tool for ensuring an EDB has the allowances to fund debt interest costs, maintain financial capital maintenance, and retain investors.

Our submission to The Paper also discussed the importance of 'investability'. The Boston Consulting, 'Future is Electric' forecasts that EDBs will need to invest $22b this decade to meet the expected demand increase from New Zealand's electrification[2]. EDBs will need to find new funding by raising new debt and equity. The Oxera submission highlights the importance of maintaining investability and its impact on retaining and attracting investors.

4 The issue of financeability is real and could be material

We disagree with Fonterra[3] that the DPP process is sufficient for ensuring regulated businesses can generate sufficient shareholder returns from the regulated asset base. We also disagree that the Consumer Advocacy Council[4] that concerns about financeability may be overstated. We think this view is reflected in the Commission's early approach of using a high-level sensibility test rather than using financeability benchmarks for a notional form that would provide an objective assessment.

We provided an analysis of revenue smoothing (using a revenue cap) on cashflows as part of our draft IM submission[5]. The Frontier report "*A review of the limit on EDB price increases and support analysis for the six large distribution networks*" tested different smoothing scenarios. The analysis showed that the revenue cap combined with increasing capex expenditure could result in the washup accounting building to the point that the revenue becomes unrecoverable and/or cashflow shortfalls create financeability issues.

The risk of networks not being able to earn a real return due to financeability issues has also been recognised by both the United Kingdom and Australian electricity distribution service regulators who have introduced and are introducing financeability tests retrospectively.

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[2] Exhibit 3, Boston Consulting, Future is Electric, https://web-assets.bcg.com/b3/79/19665b7f40c8ba52d5b372cf7e6c/the-future-is-electric-full-report-october-2022.pdf

[3] https://comcom.govt.nz/__data/assets/pdf_file/0021/347520/Fonterra-Co-operative-Group-Ltd-15-March-2024.pdf

[4] Para 5, https://comcom.govt.nz/__data/assets/pdf_file/0023/347522/Consumer-Advocacy-Council-15-March-2024.pdf

[5] Section 6.3 https://comcom.govt.nz/__data/assets/pdf_file/0021/323175/Wellington-Electricity-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf

We disagree with MEUG's[6] suggestion that any compensation or amendments from a financeability assessment could create distortions between regulated and exempt EDBs. An exempt EDB isn't subject to regulatory mechanisms like a revenue cap that could create financeability issues, and if they did, they don't have an IRIS mechanism that would penalise a network for increases in its financing costs.

5 Cost savings will not fund the step change in new investment

We agree with Consumer Advocacy Council[7] that strong cost control is important and that it will help reduce the size of the decarbonisation investment needed by distribution networks. However, cost control and non-wire solutions will not fund all of the investment needed to enable our customers to electrify. The $22b[8] in new investment needed this decade to deliver New Zealand net zero targets already includes non-traditional solutions.

The size of the investment is a step change from what EDBs are currently funded to deliver and from what the regulatory model is designed to provide. These investment conditions are unusual and additional measures will be needed to ensure the regulatory model continues to provide the cashflows needed to maintain the notional credit rating (BBB+) or debt allowances are adjusted to reflect any change in the notional credit rating.

6 Managing the impact of financeability

We would agree with MEUG[9] that "We do not consider that any further compensation or amendments are necessary for the DPP regime to deal with this issue," if the cashflows provided by the regulatory model are sufficient for a reasonable firm to fund their financing costs. However, if the regulatory model doesn't provide the cash flows that a notional firm could reasonably expect to meet the debt covenants of BBB+ rated debt, then the debt allowance should be increased to reflect the increased cost of debt. Without this adjustment,

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[6] Para 8, https://comcom.govt.nz/__data/assets/pdf_file/0029/347519/Major-Electricity-Users27-Group-MEUG-15-March-2024.pdf

[7] Para 8, Para 5, https://comcom.govt.nz/__data/assets/pdf_file/0023/347522/Consumer-Advocacy-Council-15-March-2024.pdf

[8] Exhibit 3, Boston Consulting, Future is Electric, https://web-assets.bcg.com/b3/79/19665b7f40c8ba52d5b372cf7e6c/the-future-is-electric-full-report-october-2022.pdf

[9] Para 8, https://comcom.govt.nz/__data/assets/pdf_file/0029/347519/Major-Electricity-Users27-Group-MEUG-15-March-2024.pdf

an EDB could not expect to earn a real return and the purpose of Part 4 would not be met (i.e. Commerce Act 1986, Part 4, 52A(1)(a)), promoting the incentives to invest).

We disagree with MEUG[10] that any specific issues with financeability should be dealt with outside of the DPP framework. MEUG suggested that EDBs now have access to re-openers and a CPP to address any issues. As we presented in our submission to the IM Draft Decision[11], the application of regulatory mechanisms like the revenue cap can create financeability issues for the notional firm which would mean that a reasonable EDB could not fund their cost of debt from the DPP debt allowance. A financeability issue could impact all EDBs on the DPP and it may require an adjustment to the DPP regulatory mechanisms to ensure the notional network is financeable from the allowance provided.

7 Assessing financeability on the notional firm

MEUG[12] said that financeability should focus solely on the provision of regulated services and it's not the Commission's responsibility to regulate non-regulated services. The Consumer Advocacy Council[13] said that "*financeability can be affected by factors outside the regulator's control, such as poor management by the company or decisions regarding dividend payments. Consumers should not be expected to bear the costs of problems caused by an EDB's bad business decisions*". We agree. We think that financeability should be assessed for the notional firm and only consider whether a notional EDB acting reasonably would have financeability issues.

We also think this is consistent with the Commissions view that's it's an EDB responsibility to raise new capital. If it's an EDBs responsibility to raise new capital, then the Commission should also be agnostic about how an EDB chooses to structure it's funding. As long as the regulatory model provides cashflows that a notional firm can reasonably be expected to fund its capital requirements, then an EDB should be free to decide what its best financial structure is. We believe that testing an individual firm's financeability is a regulatory overreach.

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[10] Para 9, https://comcom.govt.nz/__data/assets/pdf_file/0029/347519/Major-Electricity-Users27-Group-MEUG-15-March-2024.pdf

[11] Wellington Electricity, 2023. *IM Review 2023 Draft Decision* Available at https://comcom.govt.nz/__data/assets/pdf_file/0021/323175/Wellington-Electricity-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf

[12] Para 6, https://comcom.govt.nz/__data/assets/pdf_file/0029/347519/Major-Electricity-Users27-Group-MEUG-15-March-2024.pdf

[13] Para10, https://comcom.govt.nz/__data/assets/pdf_file/0023/347522/Consumer-Advocacy-Council-15-March-2024.pdf