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Andy Burgess
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Commerce Commission
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By email: im.review@comcom.govt.nz

Dear Andy

Price-quality path in period adjustment mechanisms workshop

1. This is Vector's submission following the Commerce Commission's (Commission) workshop on in period adjustment mechanisms (re-opener workshop).

2. We enjoyed the workshop and found it helpful to understand the current thinking of the Commission staff.

3. Along with our response to the Commission's guiding questions, we have provided our high-level comments below.

4. No part of this submission (or our response to the guiding questions) is confidential and we are happy for it to be published on the Commission's website.

Thresholds and other in period-adjustment mechanisms

5. We consider there are significant limitations with the re-opener threshold of 1% of forecast net allowable revenue for DPP period.

6. This limit fails to capture expenditure with a relatively low dollar value (i.e. below the 1% threshold) but that could have a high impact and value for consumers so should be encouraged to proceed. Costs related to decarbonisation, cybersecurity, data and resilience are examples.

7. We note the 1% threshold could lead to perverse outcomes. For example, a small EDB may be able to proceed with a re-opener for an investment that is in the long-term interest of consumers that a larger EDB could not due to the 1% threshold. However, the costs and benefits for consumers of the investment would be the same regardless of EDB size.

8. We consider other in-period adjustment mechanisms could be used to support expenditure that has a high impact and value for consumers but is below the threshold. We note Ofgem introduced a net zero 'use it or lose it' funding mechanism in RIIO-2 for projects in the gas sector that have a high net zero impact but would not be captured under other uncertainty mechanisms.

9. Introducing mechanisms to support unforeseen (or uncertain cost and timing) expenditure below the threshold but with high impact and customer value would best promote the long-term benefit of consumers by ensuring this expenditure can proceed without requiring inefficient deferral or re-prioritisation.

10. We recommend the Commission consider the following uncertainty mechanisms:
    - Contingent projects re-openers;
    - Use it or lose it allowances;
    - Wash-ups; and

- Greater use of pass-through and recoverable costs.

11. We consider these mechanisms should be available to all suppliers regardless of size. The benefits provided by these mechanisms will apply equally to all suppliers.

12. In particular, we consider these mechanisms would promote the long-term benefit of consumers by –
    - Providing a mechanism for suppliers to recover costs that are less certain. This avoids the need for these costs to be included in supplier allowances and would ensure consumers only fund these costs if the need actually arises in-period;
    - Avoiding inefficient deferral or re-prioritisation of expenditure where allowances are insufficient to recover unforeseen costs; and
    - Providing lower cost and complexity methods of recovering unforeseen costs, particularly in the case of wash-ups and the greater use of pass-through and recoverable costs.
    - In increasingly uncertain environment the need for easily accessible mechanisms to address uncertainty has grown. Alternative adjustment mechanisms could reduce the workload burden on the Commission and suppliers relative to traditional re-openers.

13. We have provided more detail in our response to the guiding questions on how these in-period adjustment mechanisms should apply.

14. As a general comment, we recommend the benefits of investment are considered at a whole of system level.

New investment contract approach for EDBs

15. New large customer-initiated connections are a key source of expenditure uncertainty for EDBs.

16. We recommend the IMs provide more scope for commercial arrangements to manage these costs in line with the IM approach to Transpower's 'new investment contracts' which are excluded from its price-path.

17. We consider EDBs should have an ability to negotiate 'new investment contract' equivalents with customers where costs and revenue are excluded from the price-path. For example, various data centres have expressed interest in connecting to Vector's network. These are large loads that are not forecastable. The ability to negotiate an equivalent to a 'new investment contract' for these type connections would support EDBs ability to provide greater consumer options.

18. We also note large renewable connections (such as wind and solar farms) could connect at the distribution level. We consider EDBs should have the same tools as Transpower to manage these connections.

19. Introducing the ability for EDBs to negotiate 'new investment contract' equivalents outside the price-path would support the long-term benefit of consumers by –
    - Mitigating forecast uncertainty (and associated negative impacts on incentives and expenditure where allowances are incorrect) by removing these costs from expenditure forecast and allowances; and
    - Allowing EDBs and connecting parties to negotiate contracts on commercial terms that would provide greater consumer options to new large connects; and
    - Avoiding costs attributable to an individual connecting party being recovered from consumers through lines charges.

Project financeability

20. We recommend the Commission introduce a re-opener to support financeability for specific projects (for example, by allowing suppliers to propose a different cashflow profile or rate of return) where current regulatory arrangements do not allow the project to be funded and this would result in sub-optimal outcomes for consumers.

21. In Australia, the experience of Transgrid's Project Energy Connect (PEC) project, provides an example of why this is needed. The PEC project passed the AER's transmission regulatory investment test, however, the returns generated under the regulatory framework were insufficient to fund the project in practice. TransGrid's request to change the project's cashflow timing was denied by the regulator. Ultimately, the Federal Government provided funding for the project through its Clean Energy Finance Corporation.

22. We consider similar situations could arise here. This is a particular concern at the distribution level given cashflow constraints arising from the indexation. We consider amending the cashflow profile by un-indexing the RAB from inflation is a crucial change needed in the IM review.

23. We note suppliers have the ability to propose alternate methodologies as part of a CPP application. However, a full CPP application would not be justifiable for individual smaller scale projects even though they could have significant network and consumer benefits. Introducing a mechanism to support project financing for these projects would support the long-term benefit of consumers by allowing these projects to proceed.

Volume re-opener for GDBs

24. We strongly recommend the GDB move to a revenue cap given the significant difficulty and risk involved in forecasting gas demand in the current uncertain environment.

25. However, if the Commission maintains a weighted average price cap, it is critical the IMs introduce a re-opener or other mechanism to address volume forecast risk.

26. The long-term benefit of consumers will be undermined if the Commission does not address volume risk. GDBs will be disincentivised from efficient expenditure if they do not have confidence they will be able to recover their costs due to uncertainty around volumes.

Cost changes entirely outside the control of suppliers

27. We recommend the Commission introduce a mechanism to wash-up costs that are entirely outside supplier control. In particular, a mechanism to wash-up GAAP changes is needed.

28. The IFRS Interpretation Committees recent decision on software as a service (SaaS) has resulted in Vector recategorizing SaaS expenditure from capex to opex. This will have implications for IRIS where the recategorization will result in an opex increase and capex saving solely due to an accounting change. This undermines the ability of IRIS to promote efficiency where IRIS outcomes are impacted by costs outside supplier control.

29. We note the Commission's decision on Powerco's transition back to the DPP in 2023 included an adjustment for the SaaS change.

30. We also note the Fibre IM contains a re-opener for GAAP changes although this is subject to a 1% threshold. In the context of EDBs and IRIS, we do not consider a threshold appropriate. Lower value cost changes could still result in perverse outcomes under IRIS.

31. Inflation is another significant issue that will impact EDB performance under IRIS, however, we understand the Commission will consider inflation under its risk allocation and incentives workstream.

32. We consider introducing a mechanism to correct for costs outside the control of the EDB, including GAAP changes, would better promote the long-term benefit of consumers by ensuring the incentives provided under IRIS are not undermined. A wash-up would ensure EDBs are not inappropriately penalised (or rewarded) for cost increases (or savings) outside their control.

Yours sincerely

[redacted]

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