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Tēnā koe Geoff,

2023 WACC REVIEW

Introduction

1. Unison Networks Ltd (**Unison**) appreciates the Commerce Commission's (**Commission**) 8 December 2022 invitation for submissions on aspects of the cost of capital for the IM Review.

2. Unison supports the Electricity Networks Association (**ENA**) submission, and the rationale and conclusions of the two Oxera reports submitted to the Commission on behalf of the Big 6[1] today.[2]

3. To avoid repeating the arguments made by the ENA and evidence of the Oxera reports, Unison's submission addresses:
   a. the Commission's question about the relevance of increasing electrification and the costs of blackouts;
   b. the role of the network reliability framework as a component of the WACC methodology; and
   c. the need for removing the indexation of Unison's Regulatory Asset Base (**RAB**).

[1] Aurora, Orion, Powerco, Unison, Vector, Wellington Electricity.
[2] Oxera compelling economics (Oxera), Review of the percentile of the WACC distribution that should be targeted by the NZCC, 14 October 2022; and Review of the NZCC's WACC-setting methodology, 10 November 2022.

The appropriate percentile

4. Oxera's evidence includes that:

   a. Electricity distribution businesses (**EDBs**) have earned relatively low returns over the period and have not been "over-compensated".[3]

   b. A decarbonisation framework strengthens arguments for an uplift above the mid-point as the potential cost to consumers of outages increases. This results from the risk of creating investment disincentives owing to a regulatory WACC that is mis-estimated below the true WACC.[4]

   c. 'A WACC percentile somewhere between the 65th and the 85th reflects the highest social benefit when compared to the cost of outages to consumers'.[5]

5. Oxera's acknowledges its NZD $1 billion estimate of the cost of blackouts "…was a conservative, lower bound estimate".[6] Ultimately, CEPA's calculations for the 70th percentile illustrate substantial gains for consumers, in the "range of NZ$180m to NZ$300m while the cost is approximately NZ$100m".[7]

6. Relying on the expert reports referred to in this submission, Unison considers fair compensation for the cost of capital to EDBs in this IM Review is in the range of the 67th to 75th percentiles.

The network reliability framework remains critical

7. CEPA queries the continued role of the network reliability framework as a component of the WACC: *"the Commission may want to consider the qualitative arguments around the importance of network reliability going forward"*.[8]

8. CEPA, however, narrowly address arguments both ways; that is (in summary) the increasing role of electricity in the path to net zero vs. growing DER and self-supply leading

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[3] Oxera, WAAC Methodology report, pg 3: "*Fourth, we note the fact that the NZCC has not found any evidence of over-compensation of energy networks. In fact, the NZCC has published evidence that regulated utilities have been under-compensated (i.e. earned relatively low returns) over the period. This indicates that, despite setting the WACC at the 67th percentile in the previous control, consumers have not faced unduly high electricity costs."*

[4] Oxera, WAAC Percentile report, pgs 2 and 38: *"This asymmetry largely arises from the fact that end-users place much more value on an uninterrupted electricity supply than they do on the additional costs that they pay from a WACC uplift."*

[5] Oxera, WAAC Percentile report, pg 34.

[6] Oxera, WAAC Percentile report, pg 27, Box 4.1.

[7] CEPA, *Review of Cost of Capital 2022/2023* report, pg 46.

[8] Ibid, pg 43.

to less reliance on the network.[9] CEPA rely on the assumption that *"customers are more able to affordably purchase distributed energy resources"*.[10]

9. In contrast, Oxera references the utility of the network reliability framework within the Commission's WACC methodology. It distinguishes New Zealand from the application of some international precedent:[11]

> *"However, this regulatory precedent is of limited direct read-across, as it comes from countries that do not explicitly undertake analysis related to applying the network reliability framework in setting the WACC, as the NZCC has done."*

10. Unison wishes to clarify:

    a. DER (especially to the extent it replaces reliance on the network) is not yet "affordable" to the majority of Unison's residential consumer base.
    b. Unison is not aware of any local or international evidence that DER is causing consumers to be materially less reliant on distribution infrastructure.

11. There is no sound rationale to diminish regulatory tools that respond to the increasing risks facing the industry; an industry that will facilitate decarbonisation (to the long-term benefit of consumers).

Indexation of the RAB

12. The ENA have submitted expert evidence from NERA that addresses financeability including indexation of the RAB.

13. Unison is concerned that the level of investment required over the next decade poses a risk around its ability to efficiently fund future investment levels. Indexation of the RAB suppresses cash flow and hence adds further to this risk.

14. Boston Consulting Group (**BCG**) in *The Future is Electric*[12] quantify the investment needed in the electricity distribution sector as $22 billion in the 2020s (2.7 times greater than the $8.2 billion estimated for Transpower).

[9] Ibid.
[10] Ibid.
[11] Oxera, WAAC Percentile report, pg 40: *"In addition, in many of these countries, aiming straight has tended to be accompanied by measures that have reduced (but not eliminated) the ability for the regulated WACC to deviate from the true WACC, such as the use of indexation of the cost of equity and/or cost of debt allowances"*.
[12] BCG, *The Future is Electric – A Decarbonisation Roadmap for New Zealand's Electricity Sector*, pg 9.

15. Applying the rationale of the approach adopted for Transpower, the necessary investment needs of EDBs justifies adjusting key metrics impacting on financeability by:

    a. removing indexation of the RAB for all EDBs (or by EDB choice); or
    b. implementing a financeablity test (as recommended by NERA with the cost described as “trivial” and appropriately timed as part of the Input Methodology reviews and Default Price Quality Path resets).

Conclusion

16. Unison considers there is ample evidence to support the Commission applying an uplift from the midpoint of the WACC in the range of the 67th – 75th percentiles in the IM Review.

17. International precedent has been distinguished by Oxera. The network reliability framework continues to be an integral component of the WACC methodology in New Zealand, ensuring fair compensation for the cost of capital to EDBs.

18. Unison supports removal of its indexed RAB to ensure its financeablity through a period of significant investment.

19. Please direct any questions about this submission to: rachael.balasingam@unison.co.nz.

Ngā mihi

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