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Commerce Commission
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To whom that may concern,

A LETTER TO THE COMMERCE COMMISSION ON THE INPUT METHODOLOGIES (IM) REVIEW REGARDING ELECTRICITY DISTRIBUTION BUSINESSES

This letter pertains several considerations about the Commission's review into the input methodologies that underpin the regulation of electricity line companies. These considerations are largely high-level observations. We emphasise that this letter does not comment on the IM review regarding gas pipelines.

The outlook for electricity demand shows that there is significant growth both in the near term and out to 2050. There are countless models across the energy sector which depict the unprecedented need for new electricity generation. BEC's TIMES-NZ model reflects this increase in demand.

TIMES-NZ explores two possible future energy scenarios: Kea, where climate change is prioritised as the most pressing issue, and Tūi, where climate change is one of many pressing issues. According to our modelling, electricity generation is likely to increase substantially as demand for renewable energy for the industrial, commercial, and residential sectors grow. New Zealand's current electricity demand is around 43TWh each year. In our model, Kea shows electricity demand could increase to 271PJ (75TWh) by 2050 and Tui shows electricity demand could increase to 301PJ (83TWh) by 2050.

This large increase in electricity generation requires significant investment in New Zealand's transmission and distribution infrastructure. The need for investment extends to the resilience of network infrastructure, especially in the face of extreme weather arising from climate change. More weather resilient infrastructure requires a coordinated effort between the Crown, local authorities, and regulators. This includes enabling EDBs and Transpower to have the means to fortify the grid and invest in the necessary upgrades to the network, while not forgetting energy affordability. Businesses and households need confidence that they can electrify at pace in their timeframes, not the networks'. To support this, EDB investment must be ahead of the curve, so capacity is available to meet consumers' decisions. This relies on an approach that ensures investments are sensibly timed and where the case of need is robust.

However, the existing input methodologies (IMs) were designed during a more stable and predictable industry environment. In an environment where electrification will be growing predictably but not in a linear trend, it's essential the IMs account for an adequate of possible drivers of uncertainty, including policy settings. It also means the Commission playing its part in processing reopener applications quickly. The draft IMs do not provide consumers that assurance.

We welcome the Commission's review. However, despite the Commission acknowledging the changing circumstances in the sector, the draft decision largely retains the current IM. This may not be prudent in the medium to long-term considering the evolving needs of electrification. Notwithstanding several welcomed changes proposed in the draft decision, we are concerned that necessary adjustments to promote the long-term interests of consumers and adapt to the changing energy landscape is missing.

There are instances where the Commission proposes changes that are retrograde steps, such as reductions to the weighted average cost of capital (WACC) percentiles for EDBs, which seem questionable given the

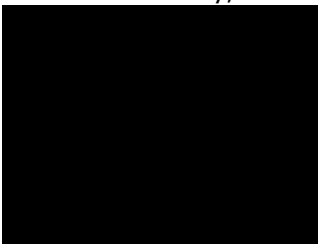
need for investment in decarbonisation and the transition away from being less dependent on thermal generation. The WACC impacts financiability by acting as a building block for the rate of regulated return – the return that a regulated network can earn on investments.

As the sector transitions, the required infrastructure will have cost impacts on consumers. As noted, our TIMES modelling scenarios suggest New Zealand’s demand is expected to grow massively. EDBs must have sufficient capabilities and resources to meet this demand. However, given the capacity and capability of EDBs vary, the Commission needs to be confident that the regulatory settings align with financial viability, including sufficient flexibility to manage cashflows within the regulatory periods.

In relation to the above, we are looking forward to engaging with the Commission’s approach to applying the IMs when assessing EDB asset management plans and expenditure for the next reset which apply to 2030. EDB investment will be responsible for supporting a significant shift towards electrification, such as the adoption of electric vehicles (EVs). The extent of investment is significant. According to the BCG report titled, *the Future is Electric*, New Zealand could require close to \$22 billion in distribution infrastructure by 2030 to support this transition, about 30% more than existing investment levels.

Implementing a steady state or incremental approach, in this context, could possibly slow electrification, and thus jeopardise the country’s energy transition. Insufficient allowances for network companies would likely result in a slower and impeded transition, making it more challenging for the country to meet its international commitments to achieve net-zero emissions within the designated timeframe.

Yours sincerely,



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